SILICON STORAGE TECHNOLOGY INC
Form 10-K
March 15, 2004

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

FORM 10-K

(MARK ONE)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number 0-26944

Silicon Storage Technology, Inc.

(Exact name of Registrant as Specified in its Charter)

California	**77-0225590**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

1171 Sonora Court
Sunnyvale, California 94086
(Address of Principal Executive Offices including Zip Code)

(408) 735-9110
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value.

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 an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. Yes [X] No [ ]

Aggregate market value of the voting stock held by non-affiliates of SST as of June 30, 2003: $341,607,260 based on the closing price of SST's Common Stock as reported on the Nasdaq National Market. Number of shares outstanding of SST's Common Stock, no par value, as of the latest practicable date, February 29, 2004: 95,845,663.

Documents incorporated by reference: Exhibits previously filed as noted on page 41. Part III - A portion of the Registrant's definitive proxy statement for the Registrant's Annual Meeting of Shareholders, to be held on June 4, 2004, which will be filed with the Securities and Exchange Commission.

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PART I

Item 1. Business

Overview

We are a leading supplier of flash memory semiconductor devices for the digital consumer, networking, wireless communications and Internet computing markets.

We offer over 90 products based on our SuperFlash design and manufacturing process technology. Our customers include: 3Com, Apple, Asustek, BenQ, Cisco, Dell, First International Computer, or FIC, Gigabyte, Huawei, Hyundai, Infineon, Intel, IBM, Inventec, Legend, LG Electronics, or LG, Motorola, National Semiconductor, NEC, Nintendo, Nortel, Panasonic, Philips, Quanta, Samsung, Sanyo, Seagate, Siemens, Sony, Sony Ericsson, Texas Instruments and VTech.

We also license our SuperFlash technology to leading semiconductor companies including Analog Devices, Advanced Technology Materials, Inc., or ATMI, IBM, Motorola, National Semiconductor, NEC, Oki, Samsung, Sanyo, Seiko-Epson, Taiwan Semiconductor Manufacturing Co., Ltd., or TSMC, Toshiba and Winbond for applications in semiconductor devices that integrate flash memory with other functions on a single chip.

Our products are manufactured at leading wafer foundries and semiconductor manufacturers including Shanghai Grace Semiconductor Manufacturing Corporation, or Grace, Shanghai Huahong NEC Electronic Company, Limited, or Huahong NEC, Samsung, Sanyo, Seiko-Epson, TSMC and Yasu Semiconductor Corporation, or Yasu. We also work with Grace, Powerchip, Samsung, TSMC and Vanguard to develop new technology for manufacturing our products.

The semiconductor industry has historically been cyclical, characterized by periodic changes in business conditions caused by product supply and demand imbalance. When the industry experiences downturns, they often occur in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. These downturns are characterized by weak product demand, excessive inventory and accelerated declines of selling prices. In some cases, downturns, such as the one we have experienced from late 2000 through 2002, have lasted for more than a year. We began to experience a slow recovery during 2002 through the first half of 2003. During the second half of 2003, demand for our products increased sharply and we began to see improvements in the average selling prices of our products. Our business could be further harmed by industry-wide prolonged downturns in the future.

We derived 90.0% of our net product revenues during 2003 and 88.5% of our net product revenues during 2002 from product shipments to Asia. Additionally, substantially all of our wafer suppliers and packaging and testing subcontractors are located in Asia.

Industry Background

Semiconductor integrated circuits are critical components used in an increasingly wide variety of applications, such as computers and computer systems, communications equipment, consumer products and industrial automation and control systems. As integrated circuit performance has increased and size and cost have decreased, the use of semiconductors in these applications has grown significantly.

Historically, the demand for semiconductors has been driven by the PC market. In recent years, growth in demand for semiconductors relating to PCs has been outpaced by growth in demand for semiconductors that are used in digital electronic devices for communication and consumer applications. Communications applications include digital subscriber line modems, cable modems, networking equipment, wireless local area network, or WLAN, devices, cellular phones and pagers. Consumer-oriented digital electronic devices include digital cameras, DVD players, MP3 players, personal data assistants, or PDAs, set-top boxes, CD-ROM drives and Global Positioning System, or GPS. In order to function correctly, PCs and other digital electronic devices require program code. The program code defines how devices function and affects how they are configured. In PCs, this program code, called BIOS, initiates the loading of the PC's operating system, which is then read from the disk drive. In the case of other digital electronic devices, the program code is stored in its entirety in nonvolatile memory, mostly in flash memory. As a result, virtually all digital electronic systems that use a processor or controller for computing, consumer,

communications, and industrial applications require nonvolatile memory.

System manufacturers generally prefer nonvolatile memory devices that can be reprogrammed efficiently in the system in order to achieve several important advantages. With re-programmable memory, manufacturers can cost effectively change program codes in response to faster product cycles and changing market specifications. This in turn greatly simplifies inventory management and manufacturing processes. Re-programmable memory also allows the manufacturer to reconfigure or update a system either locally or through a network connection. In addition, in-system re-programmable devices can be used for data storage functions, such as storage of phone numbers for speed dialing in a cellular phone or captured images in a digital camera.

Flash memory is the predominant re-programmable nonvolatile memory device used to store program code and data. Flash memory can electrically erase select blocks of data on the device much faster and more simply than with alternative solutions, such as Erasable Programmable Read-Only Memory, or EPROM. Moreover, flash memory is significantly less expensive than other re-programmable solutions, such as Electrically Erasable Programmable Read-Only Memory, or EEPROMs. As a result, the demand for flash memory has grown dramatically. This growth has been fueled by the need for code sharing and other storage functions in a wide array of digital devices. According to a February 2004 Webfeet Research report, worldwide flash memory revenue was $11.7 billion in 2003 and is expected to grow to $15.9 billion in 2004 and $30.0 billion in 2008.

Our Solution

We are a leading supplier of flash memory semiconductor devices addressing the needs of high volume electronic applications. We believe our proprietary flash memory technology, SuperFlash, offers superior performance to other flash memory solutions. In addition, we believe SuperFlash has benefits that include high reliability, fast, fixed erase time, the ability to be scaled to a smaller size and a low-cost manufacturing process. We offer over 90 products based on our proprietary SuperFlash design and manufacturing process technology. These products are produced to meet the needs of a wide range of digital consumer, networking, wireless communications and Internet computing markets. Our product offerings include standard flash products, application specific memory products, embedded controllers and mass data storage products. Our memory devices have densities ranging from 256 Kbit to 32 Mbit and are generally used for the storage of program code. Our flash embedded microcontrollers support concurrent flash read-while-write operations using In-Application Programming, or IAP. Our mass data storage products are used for storing images, music and other data in devices such as digital cameras and MP3 players.

Our Strategy

Our objective is to be the leading worldwide supplier of flash memory devices and intellectual property for program code storage applications. In addition, we intend to leverage our SuperFlash technology to penetrate the high-density mass data storage markets. We intend to achieve our objectives by:

Maintaining a leading position in the program code storage market.

We believe that program code storage is an attractive segment of the flash memory market for a number of reasons. While experiencing continued growth in all densities, solutions for program code storage applications benefit from the increasing number and variety of digital electronic applications, longer product lives and lower density requirements relative to mass data storage applications. We believe that our proprietary SuperFlash technology is a superior product for program code storage applications because we believe it offers superior reliability and performance at a lower cost

of manufacture than competing solutions.

Continuing to enhance our leading flash memory technology.

We believe that our proprietary SuperFlash technology is less complicated, more reliable, more scalable and more cost-effective than competing flash memory technologies. Our ongoing research and development efforts are focused on enhancing our leading flash memory technology by working closely with technology partners who own wafer fabrication facilities with advanced lithographic and other manufacturing equipment.

Introducing new products based on SuperFlash

. We intend to introduce new standard memory and various application specific products. We continue to develop and expand our ComboMemory family. ComboMemory is a new class of devices for wireless and portable applications that combine volatile and nonvolatile memory on a single monolithic device or multiple dies in a common package with optimized performance. We also continue to expand our flash microcontroller family and Advanced Technology Architecture, or ATA, controller products. In 2003, we continued to expand our family of serial flash products which now includes densities of 512kbit, 1Mbit, 2Mbit 4Mbit

and 8Mbit. For PC BIOS applications, we are expanding our LPC Firmware Flash product offering to match all the densities offered in our Firmware Hub, or FWH, products.

Maintaining a leading position in licensing embedded flash technology

. We believe that SuperFlash technology is well-suited for embedded memory applications, which integrate flash memory and other functions onto a monolithic chip. We intend to continue to license SuperFlash technology to semiconductor manufacturers for embedded flash applications, to enhance our technology and to facilitate integration at higher densities and higher levels of complexity.

Penetrating the high-density mass data storage market

. Many digital electronic devices currently being introduced, such as MP3 players, digital cameras and PDAs, require high-density flash memory for storing music, pictures and other data that require mass data storage capacities. We believe that the market for high-density flash memory is attractive based on its potential size and growth. We further believe that SuperFlash technology can readily scale to address this market's needs as they change. We intend to leverage our leading technology and strong manufacturing partnerships to introduce high-density mass data storage flash products and to compete effectively in this market.

Leveraging our leading SuperFlash technology to become a premier provider of wireless memory solutions.

We intend to leverage our leading SuperFlash technology to provide products for wireless memory applications such as cellular phones, GPS, wireless LAN, Bluetooth, data pagers and cordless telephones. We have designed low-density flash products for wireless modems, wireless LANs, data pagers, Bluetooth modules and cordless telephones, and we are currently designing higher density products for the cellular phone market. We intend to continue to develop our products to take advantage of the significant growth opportunities in the wireless memory applications market with specific focus on cellular phone, GPS, wireless LAN and Bluetooth applications.

Our Flash Products

Currently, we offer low and medium density devices (256 Kbit to 32 Mbit) that target a broad range of existing and emerging applications in the digital consumer, networking, wireless communications and Internet computing markets. Our products are segmented largely based upon attributes such as density, voltage, access speed, package and target application. We divide our products into three distinct reportable segments: the Standard Memory Product Group, or SMPG, the Application Specific Product Group, or ASPG, and the Special Product Group, or SPG.

SMPG

. SMPG includes the Multi-Purpose Flash, or MPF, family, the Multi-Purpose Flash Plus, or MPF+, family and the Many-Time Programmable, or MTP, family. These product families allow us to produce products optimized for cost and functionality to support a broad range of mainstream applications that use nonvolatile memory products. Effective January 1, 2003, we transferred certain MTP products from SMPG to SPG. Effective July 1, 2003, we transferred the Small Sector Flash, or SSF, family from SMPG to SPG. Accordingly, our segment revenues and gross profit information have been reclassified for presentation purposes as if transfers occurred as of January 1, 2001.

ASPG

. ASPG includes Concurrent SuperFlash, Serial Flash, Firmware Hub, or FWH and Low Pin Count, or LPC, flash products. These products are designed to address specific applications such as cellular phones, hard disk drives and PCs. ASPG also includes flash embedded controllers such as the ATA flash disk controller. Effective January 1, 2003, we transferred FlashFlex51 microcontroller products from ASPG to SPG. Accordingly, our segment revenues and gross profit information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001.

SPG

. SPG includes ComboMemory, ROM/RAM Combos, SSF, MTP, FlashFlex51 microcontroller and other special flash products. These products are used in applications requiring low power and a small form factor such as cellular phones, wireless modems, MP3 systems, pagers and digital organizers. Effective January 1, 2003, we transferred certain MTP products from SMPG to SPG and certain flash microcontroller products from ASPG to SPG. Effective July 1, 2003, we transferred the SSF family from SMPG to SPG. Accordingly, our segment revenues and gross profit information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001.

Financial information by reportable segment is contained in Note 10 of the Notes to Consolidated Financial Statements and is incorporated herein by reference.

Technology Licensing

We license our SuperFlash technology to semiconductor manufacturers for use in embedded flash applications. We

intend to increase our market share by entering into additional license agreements for our SuperFlash process and memory cell technology with leading wafer foundries and semiconductor manufacturers. We expect to continue to receive licensing fees and royalties from these agreements. We design our products using our patented memory cell technology and fabricate them using our patented process technology. As of December 31, 2003, we held 78 patents in

the United States relating to certain aspects of our products and processes, with expiration dates ranging from 2010 to 2023, and have filed for several more. In addition, we hold several patents in Europe, Japan, Korea, Taiwan and Canada and have filed several foreign patent applications in Europe, Japan, Korea, Taiwan and Canada.

Customers

We provide high-performance flash memory solutions to customers in four major markets: digital consumer, networking, wireless communications and Internet computing. Our customers benefit by obtaining products that we believe are highly reliable, technologically advanced and have attractive cost structures. As a result of these highly desirable benefits, we have developed relationships with many of the industry's leading companies. In digital consumer products, we provide memory components for consumer companies including Bang & Olufsen, BenQ, Creative Technologies, Hitachi, Infineon, JVC, LG, Nintendo, Panasonic, Philips, Samsung, Sanyo, Sharp, Sony, Sony Ericsson, Thomson Multimedia, TiVo and Yamaha. In networking, we provide memory components for 3Com, Cisco, E-tech, Intel and Nortel. In wireless communications, we provide products for companies including Bang & Olufsen, LG, Maxon, RTX, Vtech and Wistron. In Internet computing, we provide a wide array of memory components for companies including Asustek, Compal, Dell, FIC, Gigabyte, HP, IBM, Inventec, LG, Mitac, Quanta, Samsung, Trigem and Wistron.

The following tables illustrate the geographic regions in which our customers or licensees operate based on the country to which the product is shipped by us or the logistics center or license revenue is generated.

	Year ended December 31,		
	2001	2002	2003
United States	$ 28,592	$ 21,871	$ 19,600
Europe	21,332	10,599	9,957
Japan	23,549	28,465	27,575
Korea	22,039	30,321	25,214
Taiwan	110,847	91,219	109,254
China (including Hong Kong)	57,146	70,609	76,107
Other Asian countries	28,157	21,574	27,334
Rest of world	2,368	--	--
	$ 294,030	$ 274,658	$ 295,041

Sales and Distribution

We sell a majority of our products to customers in Asia through our manufacturers' representatives. We distribute a majority of our products through our logistics center. We also sell and distribute our products in North America and Europe through manufacturers' representatives and distributors. Our manufacturer representative and distributor relationships are generally cancelable, with reasonable notice, by the other party or us.

Applications

As the Digital Consumer, Networking, Wireless Communications and Internet Computing industries continue to expand and diversify, new applications are likely to be developed. We believe our products are designed to address this expanding set of applications:

Digital Consumer		Networking	Wireless Communications	In Com
TV Replayer	Set-top Box	VoIP	Cellular Phone	Information A
Digital TV	CD-ROM Drive	DSL Modem	Data Pager	Notebook PC
Digital Camera	CD-RW Drive	Cable Modem	Cordless Telephone	Desktop PC
Digital Camcorder	DVD-ROM Drive	V.90/56K Modem		Hard Disk Dri
DVD Player	DVD-RAM Drive	Wireless LAN	GPS on Cellular Phone	LCD Monitor
DVD Recorder	DVD-RW Drive	Network Interface Card		Palm PC
VCD Player	Web Browser		Bluetooth Applications	X-PC
MP3 Player	Hand-held GPS	Router/Switch		Server
Video Game	Electronic Toys		Wireless Modems	Graphics Card
PDA	Smart Cards			Printer
Electronic Book	Memory Cards			Copier/Scanne
Remote Controller	Electronic Organizer			Bar Code Scan
				Thin Client S

Manufacturing

We purchase wafers and sorted die from semiconductor manufacturing foundries, have this product shipped directly to subcontractors for packaging, testing, and finishing, and then ship the final product to our customers. Virtually all of our subcontractors are located in Asia.

Wafer and Sorted Die

. During 2003, our major wafer fabrication foundries were TSMC, Sanyo, Samsung and Seiko-Epson. In 2003, wafer sort, which is the process of testing individual die on silicon wafer, was performed at Acer Testing, Inc., King Yuan Electronics Company, Limited, or KYE, Lingsen, Samsung, Sanyo, Seiko-Epson and TSMC. Although capacity is not guaranteed, under these arrangements, we generally receive preferential treatment regarding wafer pricing and capacity. In order to obtain, on an ongoing basis, an adequate supply of wafers, we have considered and will continue to consider various possible options, including equity investments in foundries in exchange for guaranteed production volumes, the formation of joint ventures to own and operate foundries and the licensing of our proprietary technology. In the first quarter of 2001, we invested $50.0 million in Grace Semiconductor Manufacturing Corporation, or GSMC, the parent company of Grace. Grace is located in Shanghai, People's Republic of China. GSMC is funded mostly by investors who reside outside of China. Grace began to manufacture some of our products during 2003. In March 2004, we committed to invest an additional $33.2 million in GSMC during 2004.

Packaging, Testing and Finishing

. In the assembly process, the individual dies are separated and assembled into packages. Following assembly, the packaged devices require testing and finishing to segregate conforming from nonconforming devices and to identify devices by performance levels. Currently, all devices are tested and inspected pursuant to our quality assurance program at our domestic or international subcontracted test facilities or at our test facilities in Sunnyvale, California before shipment to customers. Certain facilities currently perform consolidated assembly, packaging, test and finishing operations all at the same location. During 2003, most subcontracted facilities performing the substantial majority of our operations were in Taiwan. The subcontractors with the largest amount of our activity are KYE, Lingsen, and Powertech Technology, Incorporated, or PTI. We hold equity investments in three subcontractors: Apacer Technology, Inc., or Apacer, KYE and PTI. For newly released products, the initial test and finishing activities

are performed at our Sunnyvale facility.

Research and Development

We believe that our future success will depend in part on the development of next generation technologies with reduced feature size. During 2001, 2002 and 2003, we spent $50.4 million, $47.1 million and $43.1 million, respectively, on research and development. Our research efforts are focused on process development and product development. Our research strategy is to collaborate with our partners to advance our technologies. We work

simultaneously with several partners on the development of multiple generations of technologies. In addition, we allocate our resources and personnel into category-specific teams to focus on new product development. From time to time we invest in, jointly develop with, license or acquire technology from other companies in the course of developing products.

Competition

The semiconductor industry is intensely competitive and has been characterized by price erosion, rapid technological change and product obsolescence. We compete with major domestic and international semiconductor companies, many of whom have substantially greater financial, technical, marketing, distribution, manufacturing and other resources than us. Our low to medium density memory products, sales of which presently account for substantially all of our revenues, compete against products offered by Advanced Micro Devices, or AMD, Atmel, Intel, Macronix, STMicroelectronics and Winbond. Our high-density memory products, if developed, may compete with products offered by AMD, Atmel, Fujitsu, Intel, Mitsubishi, Samsung, Sharp Electronics and Toshiba. In addition, competition may come from alternative technologies such as ferroelectric random access memory device, or FRAM, technology.

The competition in the existing markets for some of our product families, such as the FlashFlex51 microcontroller product family and the ADC, ADM, and CompactFlash Card product families, is extremely intense. We compete principally with major companies such as Atmel, Intel, Microchip Technology, Motorola and Philips in the microcontroller market and with Hitachi, M-Systems and SanDisk in the memory card and memory module market. We may, in the future, also experience direct competition from our foundry partners. We have licensed to our foundry partners the right to fabricate certain products based on our proprietary technology and circuit design, and to sell such products worldwide, subject to royalty payments back to us.

We compete principally on price, reliability, functionality and the ability to offer timely delivery to customers. While we believe that our low and medium density products currently compete favorably on the basis of cost, reliability and functionality, it is important to note that our principal competitors have a significant advantage over us in terms of greater financial, technical and marketing resources. Our long-term ability to compete successfully in the evolving flash memory market will depend on factors both within and beyond our control, including access to advanced process technologies at competitive prices, successful and timely product development, wafer supply, product pricing, actions of our competitors and general economic conditions.

Employees

As of December 31, 2003, we employed 488 individuals on a full-time basis, all but 103 of whom reside in the United States. Of these 488 employees, 79 were employed in manufacturing support, 205 in engineering, 93 in sales and marketing and 111 in administration, finance and information technology. Our employees are not represented by a collective bargaining agreement, nor have we ever experienced any work stoppage related to strike activity. We

believe that our relationship with our employees is good.

Executive Officers

The following table lists the names, ages and positions of our executive officers as of December 31, 2003. There are no family relationships between any executive officer of SST. Executive officers serve at the discretion of our board of directors.

Name	Age	Position
Bing Yeh	53	President and Chief Executive Officer and Director
Yaw Wen Hu	54	Senior Vice President, Operations and Process Development and Director
Derek Best	53	Senior Vice President, Sales and Marketing
Michael Briner	56	Senior Vice President, Application Specific Product
Isao Nojima	59	Group
Paul Lui	53	Vice President, Standard Memory Product Group
Jack K. Lai	49	Vice President, Special Product Group Vice President, Finance and Administration and Chief Financial Officer and Secretary

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Bing Yeh, one of our co-founders, has served as our President and Chief Executive Officer and has been a member of our board of directors since our inception in 1989. Prior to that, Mr. Yeh served as a senior research and development manager of Xicor, Inc., a nonvolatile memory semiconductor company. From 1981 to 1984, Mr. Yeh held program manager and other positions at Honeywell Inc. From 1979 to 1981, Mr. Yeh was a senior development engineer of EEPROM technology of Intel Corporation. He was a Ph.D. candidate in Applied Physics and earned an Engineer degree at Stanford University. Mr. Yeh holds a M.S. and a B.S. in Physics from National Taiwan University.

Yaw Wen Hu, Ph.D.,

joined us in July 1993 as Vice President, Technology Development. In 1997, he was given the additional responsibility of wafer manufacturing and, in August 1999, he became Vice President, Operations and Process Development. In January 2000, he was promoted to Senior Vice President, Operations and Process Development. Dr. Hu has been a member of our board of directors since September 1995. From 1990 to 1993, Dr. Hu served as deputy general manager of technology development of Vitelic Taiwan Corporation. From 1988 to 1990, he served as FAB engineering manager of Integrated Device Technology, Inc. From 1985 to 1988, he was the director of technology development at Vitelic Corporation. From 1978 to 1985, he worked as a senior development engineer in Intel Corporation's Technology Development Group. Dr. Hu holds a B.S. in Physics from National Taiwan University and a M.S. in Computer Engineering and a Ph.D. in Applied Physics from Stanford University.

Derek Best

joined us in June 1997 as Vice President of Sales and Marketing. In June 2000 he was promoted to Senior Vice President, Sales & Marketing. Prior to joining SST he worked for Micromodule Systems, a manufacturer of high-density interconnect technology, as vice president marketing and sales world wide from 1992 to 1996. From 1987 to 1992 he was a co-founder and owner of Mosaic Semiconductor, a SRAM and module semiconductor company. Mr. Best holds an Electrical Engineering degree from Portsmouth University in England.

Michael Briner

joined us as Vice President, Design Engineering in November 1997, and became Vice President, Products during 1999. He was promoted to Senior Vice President of Application Specific Product Group in February 2001. From 1993 to 1997, he served as vice president of design engineering for Micron Quantum Devices, Inc., a subsidiary of Micron Technology, Inc., chartered to develop and manufacture flash memory products. From 1986 through 1992, he served as director of design engineering for the Nonvolatile Division of Advanced Micro Devices, Inc. In this position, he was instrumental in helping AMD become a major nonvolatile memory manufacturer. Mr. Briner holds a B.S. in Electrical Engineering from the University of Cincinnati.

Isao Nojima

joined us as Vice President, Memory Design and Product Engineering in March 1993 and became Vice President, Advanced Development in July 1997. He became Vice President of Standard Memory Product Group in July 2000. From 1990 to 1993, Mr. Nojima served as director of design engineering of Pioneer Semiconductor Corporation, now called Pericom, a manufacturer of semiconductors. From 1980 to 1990, he served as design manager of Xicor Inc., a nonvolatile semiconductor company. From 1977 to 1980, he served as a senior design engineer for Intel Corporation. From 1969 to 1976, he was a senior researcher at Toshiba's R&D Center in Japan. Mr. Nojima holds a B.S. and a M.S. in Electrical Engineering from Osaka University in Japan.

Paul Lui

joined us as Vice President and General Manager of the Linvex Product Line in June 1999 and became Vice President, Special Product Group in June 2001. From 1994 to 1999, he was the president and founder of Linvex Technology Corporation. From 1987 to 1994, he was the president and chief executive officer of Macronix, Inc. From 1981 to 1985, he served as group general manager at VLSI Technology, Inc. where he was responsible for transferring that company's technology to Korea. In addition, Mr. Lui has held senior engineering positions at the Synertek Division of Honeywell and McDonnell Douglas. Mr. Lui holds a M.S.E.E. degree from University of California, Berkeley and a B.S. degree in Electrical Engineering and Mathematics from California Polytechnic State University, San Luis Obispo.

Jack Lai

joined us as Chief Financial Officer and Vice President, Finance and Administration and Secretary in November 2003. Before joining SST, he was vice president and chief financial officer of Aplus Flash Technology, a memory design and manufacturing company, from 2001 to 2003. Prior to this, Mr. Lai had served as vice president of operations and finance and chief financial officer at WireX Communications, Inc., a software system developer, from 2000 to 2001 and vice president and chief financial officer at Genoa Electronics Corp., a manufacturer of computer and related systems, from 1998 to 1999. Mr. Lai holds M.B.A.'s from San Jose State University in San Jose, CA and Culture University in Taipei, Taiwan. He also holds a B.A. in Business Administration from Tamkang University in Taipei, Taiwan.

Available Information

We were incorporated in California in 1989. We make available free of charge on or through our Internet website,

http://www.sst.com, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

Item 2. Properties

As of January 31, 2004, we leased six major facilities totaling 188 thousand square feet in Sunnyvale, California in which our executive offices, principal manufacturing engineering, research and development and testing facilities are located. In Sunnyvale we currently occupy five of these facilities totaling 168 thousand square feet. The leases on five facilities expire in 2005 and the lease on one facility expires in 2010. We also have 24 thousand square feet of office space in various international sites with expiration dates ranging from 2004 to 2012. We believe these facilities are adequate to meet our needs for at least the next 12 months.

Item 3. Legal Proceedings

In January 1996, Atmel Corporation filed suit against the SST alleging that we infringed six U.S. patents. We successfully moved for summary judgment on two of the six asserted patents in September 1997. In January 2001, Atmel withdrew its allegation that we infringed another patent. On May 7, 2002, a judgment was entered against us in the amount of $36.5 million. We appealed the judgment on July 16, 2002. On September 12, 2003 the Court of Appeals upheld the jury's verdict. On November 18, 2003 the Court of Appeals denied our request for a rehearing, and in December 2003 we paid Atmel $37.8 million to satisfy the judgment plus statutory interest accrued during the appeals. The payment was recorded as other operating expense in the year ending December 31, 2003.

The other patent remaining in the case, the '903 patent, expired in September 2001. The trial court has held that, if it is found to be valid, certain of our products infringed that patent. Trial to determine whether the '903 patent is invalid began on July 29, 2002. On August 5, 2002 the jury announced that it was unable to reach a verdict on our invalidity defense, and a mistrial was declared. Atmel requested a new trial, but the Court stayed the matter until after our appeal of the earlier judgment is resolved. At Atmel's request, the Court has directed the parties to conduct a settlement conference before a Magistrate Judge. That settlement conference is scheduled for April 14, 2004. If the parties are unable to reach a settlement agreement, the Court may set a date for a new trial. The impact related to the outcome of the remaining patent is undeterminable at this time.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have incurred certain costs while defending these matters. There can be no assurance the remaining Atmel complaint or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring royalty payments in the future which may adversely impact gross margins. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses have been accrued in our financial statements as of December 31, 2003.

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

No matters were submitted during the fourth quarter to a vote of security holders.

PART II

Item 5. Market for Registrant's Common Stock and Related Shareholder Matters

Price Range of Common Stock

The principal U.S. market for our Common Stock is the Nasdaq National Market. The only class of our securities that is traded is our Common Stock. Our Common Stock has traded on the Nasdaq National Market since November 21, 1995, under the symbol SSTI. The following table sets forth the quarterly high and low closing sales prices of the Common Stock for the period indicated as reported by the Nasdaq National Market. These prices do not include retail mark-ups, markdowns, or commissions. The closing sales price of our Common Stock on December 31, 2003, the last trading day in 2003, was $11.00.

2002		High Close	Low Close
First Quarter:	January 1 - March 31, 2002	$ 11.25	$ 6.52
Second Quarter:	April 1 - June 30, 2002	12.51	7.80
Third Quarter:	July 1 - September 30, 2002	7.32	3.91
Fourth Quarter:	October 1 - December 31, 2002	7.50	2.90

2003		High Close	Low Close
First Quarter:	January 1 - March 31, 2003	$ 4.78	$ 2.25
Second Quarter:	April 1 - June 30, 2003	4.80	2.31
Third Quarter:	July 1 - September 30, 2003	10.00	4.19
Fourth Quarter:	October 1 - December 31, 2003	14.11	9.32

2004		High Close	Low Close
First Quarter:	January 1 - February 27, 2004	$13.46	$11.16

Approximate Number of Equity Security Holders

As of December 31, 2003, there were approximately 278 record holders of our Common Stock.

Dividends

We have never paid a cash dividend on our Common Stock and we intend to continue to retain earnings, if any, to finance future growth. Accordingly, we do not anticipate the payment of cash dividends to holders of Common Stock in the foreseeable future.

Equity Compensation Plan Information

Information regarding our equity compensation plans will be contained in our definitive Proxy Statement with respect to our Annual Meeting of Shareholders under the caption "Compensation - Equity Compensation Plan Information," and is incorporated by reference into this report. All of our equity compensation plans have been approved by our shareholders.

Item 6. Selected Consolidated Financial Data

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and the notes thereto included elsewhere in this report. Certain amounts in our prior years' consolidated financial statements have been reclassified to conform to the current year presentation. These reclassifications have no impact on our previously reported net income (loss).

	Year ended December 31,				
	1999	2000	2001	2002	2003
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Net revenues:					
Product revenues - unrelated parties	$ 99,769	$ 408,708	$ 168,593	$ 100,620	$ 86,549
Product revenues - related parties	18,473	66,608	90,025	143,401	169,980
License revenues	6,552	14,945	35,412	30,637	38,512
Total net revenues	124,794	490,261	294,030	274,658	295,041
Cost of revenues	94,652	264,139	248,161	206,246	218,775
Gross profit	30,142	226,122	45,869	68,412	76,266
Operating expenses:					
Research and development	18,199	41,535	50,380	47,069	43,144
Sales and marketing	10,576	27,968	26,794	25,498	22,272
General and administrative	3,800	14,966	17,855	17,097	14,398
Other	2,011	3,911	1,346	--	37,849
Total operating expenses	34,586	88,380	96,375	89,664	117,663
Income (loss) from operations	(4,444)	137,742	(50,506)	(21,252)	(41,397)
Interest and other income	730	10,510	7,350	3,197	2,784
Interest expense	(214)	(691)	(338)	(214)	(138)
Impairment of equity investments	--	--	(3,274)	(7,757)	--
Income (loss) before provision for (benefit from) income taxes	(3,928)	147,561	(46,768)	(26,026)	(38,751)
Provision for (benefit from) income taxes	88	41,813	(17,772)	(10,931)	26,416
Net income (loss)	$ (4,016)	$ 105,748	$ (28,996)	$ (15,095)	$ (65,167)
Net income (loss) per share - basic	$ (0.06)	$ 1.23	$ (0.32)	$ (0.16)	$ (0.69)
Net income (loss) per share - diluted	$ (0.06)	$ 1.13	$ (0.32)	$ (0.16)	$ (0.69)
Consolidated Balance Sheet Data:					
Total assets	$ 88,806	$ 512,590	$ 446,760	$ 440,606	$ 396,361
Long-term obligations	$ 446	$ 279	$ 1,793	$ 1,873	$ 1,423
Shareholders' equity	$ 41,015	$ 416,635	$ 391,411	$ 381,851	$ 331,497

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those discussed. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below under the heading "Business Risks", as well as those discussed elsewhere in this report.

Overview

We are a leading supplier of flash memory semiconductor devices for the digital consumer, networking, wireless communication and Internet computing markets.

The semiconductor industry has historically been cyclical, characterized by periodic changes in business conditions caused by product supply and demand imbalance. When the industry experiences downturns, they often occur in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. These downturns are characterized by weak product demand, excessive inventory and accelerated declines of selling prices. In some cases, downturns, such as the one we experienced from late 2000 through 2002, have lasted for more than a year. We began to experience a slow recovery during 2002 through the first half of 2003. During the second half of 2003, demand for our products increased sharply and we began to see improvements in the average selling prices of our products. Our business could be further harmed by industry-wide prolonged downturns in the future.

Our product sales are made primarily using short-term cancelable purchase orders. The quantities actually purchased by the customer, as well as shipment schedules are frequently revised to reflect changes in the customer's needs and in our supply of product. Accordingly, our backlog of open purchase orders at any given time is not a meaningful indicator of future sales. Changes in the amount of our backlog do not necessarily reflect a corresponding change in the level of actual or potential sales.

We derived 80.7%, 88.5% and 90.0% of our net product revenues during 2001, 2002 and 2003, respectively, from product shipments to Asia. Additionally, substantially all of our wafer suppliers and packaging and testing subcontractors are located in Asia.

Our top ten end customers, which excludes transactions through stocking representatives and distributors, accounted for 19.3%, 31.5% and 37.7% of our net product revenues in 2001, 2002 and 2003, respectively.

No single end customer, which we define as original equipment manufacturers, or OEMs, original design manufacturers, or ODMs, contract electronic manufacturers, or CEMs, or end users, represented 10.0% or more of our net product revenues during 2001, 2002 and 2003.

Since March 2001, we have been increasing our out-sourcing activities for our customer service logistics to support our customers. Silicon Professional Technology Ltd., or SPT, supports our customers in Taiwan, China and other Southeast Asia countries. SPT provides planning, warehousing, delivery, billing, collection and other logistic functions for us in these regions. SPT is a wholly-owned subsidiary of one of our stocking representatives in Taiwan, Professional Computer Technology Limited, or PCT. Please see a description of our relationship with PCT under "Related Party Transactions." Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT. For the years ended December 31, 2001, 2002 and 2003, SPT serviced end customer sales accounting for 29.7%, 57.4% and 64.2% of our net product revenues recognized. As of December 31, 2001, 2002 and 2003, SPT represented 48.8%, 68.5% and 73.4% of our net accounts receivable, respectively.

We ship products to, and have accounts receivable from, OEMs, ODMs, CEMs, stocking representatives, distributors, and our logistics center. Our stocking representatives, distributors and logistics center reship our products to our end customers, including OEMs, ODMs, CEMs and end users. Shipments, by us or our logistic center, to our top three stocking representatives for reshipment accounted for 10.9%, 16.9% and 29.9% of our product shipments in 2001, 2002 and 2003, respectively. In addition, the same three stocking representatives solicited sales, for which they received a commission, for 27.5%, 41.3% and 32.8% of our shipments to end users in 2001, 2002 and 2003, respectively.

Results of Operations: Years Ended December 31, 2001, 2002 and 2003

Net Revenues

Net revenues were $295.0 million in 2003, $274.7 million in 2002 and $294.0 million in 2001. Net revenues for 2003 increased compared to 2002 due to increased unit shipments and increased license and royalty revenues, offset by decreased average selling prices. Net revenues for 2002 decreased compared to 2001 primarily due to decreased average selling prices for our products and decreased license and royalty revenues, partially offset by increased unit shipments. Average selling prices fluctuate due to a number of factors including the overall supply and demand for our products in the marketplace, maturing product cycles and changes in general economic conditions.

Product Revenues.

Product revenues were $256.5 million in 2003, $244.0 million in 2002 and $258.6 million in 2001. Products revenues for 2003 increased compared to 2002 primarily due to increased unit shipments by 23.5%, partially offset by decreased average selling prices by 15.7%. The decrease from 2001 to 2002 was primarily due to decreased average selling prices by 36.5%, partially offset by increased unit shipments of our products by 31.6%. Shipping volumes fluctuate due to overall industry supply and demand.

License Revenues.

Revenues from license fees and royalties were $38.5 million in 2003, $30.6 million in 2002 and $35.4 million in 2001. The increase from 2002 to 2003 related primarily to increased royalty payments from our existing licensees and up-front license fees from our new licensees. During 2000 and 2001, Winbond Electronics of Taiwan paid us $10.4 million and $20.0 million, respectively, under a settlement agreement. No further back royalty payments were

required after 2001 under this legal settlement. Although the settlement payments have ceased, Winbond continues to pay royalties under the license agreement. The decrease from 2001 to 2002 was primarily due to the termination of license fees received as part of our legal settlement with Winbond during 2001, offset by increases in upfront license fees and royalty payments received from our licensees during 2002. We anticipate that license revenues may fluctuate significantly in the future.

Gross Profit

Gross profit was $76.3 million, or 25.8% of net revenues, in 2003, $68.4 million, or 24.9% of net revenues, in 2002, and $45.9 million, or 15.6% of net revenues, in 2001. The increase in gross profit in 2003 when compared to 2002 is primarily due to increased unit shipments of 23.5%, increased technology licensing revenues of $7.9 million and improved manufacturing costs as a result of transitions to more advanced process technologies, offset by decreased average selling prices by 15.7%. The increase in gross profit in 2002 when compared to 2001 is due primarily to a $72.2 million inventory valuation adjustment recorded in 2001, offset by decreased average selling prices of 36.5% and a decrease in technology licensing revenues of $4.8 million. Product gross margin was 14.7% in 2003, compared to 15.5% in 2002 and 4.0% in 2001. The decrease in product gross margin in 2003 when compared to 2002 was primarily due to decreased average selling prices of 15.7%, offset by improved manufacturing costs as a result of transitions to more advanced process technologies. The increase in product gross margin from 2001 to 2002 primarily relates to a $72.2 million inventory valuation adjustment recorded in 2001. Gross margin in 2002 was reduced by decreased average selling prices of our products by 36.5%. For other factors affecting our gross profit, please also see "Business Risks - We incurred significant inventory valuation adjustments in 2001, 2002 and 2003 and we may incur additional significant inventory valuation adjustments in the future."

Operating Expenses

Operating expenses consist of research and development, sales and marketing, general and administrative and other expenses. Operating expenses were $117.7 million, or 39.9% of net revenues, in 2003, $89.7 million or 32.6% of net revenues, in 2002, and $96.4 million, or 32.8% of net revenues, in 2001. The increase in 2003 from 2002 was primarily due to the Atmel judgement of $37.8 million, offset by decreases of $2.8 million in bad debt expense, $1.7 million in mask, wafer and evaluation part expenses, $1.5 million in legal fees, $1.1 million in commission expense and $1.1 million in depreciation expense. The decrease from 2001 to 2002 was primarily due to decreases of $2.3 million in wafer and mask expenses, $2.5 million in non-production engineering material expenses and $1.9 million in commissions expenses. We anticipate that we will continue to devote substantial resources to research and development, sales and marketing and to general and administrative activities, and that these expenses will increase in dollars.

Research and development

. Research and development expenses include costs associated with the development of new products, enhancements to existing products, quality assurance activities and occupancy costs. These costs

consist primarily of employee salaries and benefits and the cost of materials such as wafers and masks. Research and development expenses were $43.1 million, or 14.6% of net revenues, in 2003, $47.1 million, or 17.1% of net revenues, in 2002, and $50.4 million, or 17.1% of net revenues, in 2001. Research and development expenses decreased by 8.3% from 2002 primarily due to decreases in wafer, mask and evaluation part expenses of $1.7 million due to cost reduction measures and the completion of certain technology projects during 2003, headcount related

expenses of $1.4 million due to a reduction in headcount and depreciation expense of $761 thousand. Research and development expenses decreased from 2001 to 2002 by 6.6% primarily due to decreases in wafer and mask expenses of $2.3 million due to cost reduction measures during 2002, non-production engineering material expenses of $2.5 million related to new product testing and outside service expenses of $910 thousand, offset by increased headcount and related costs of $2.1 million due to increased headcount and new building costs. We expect research and development expenses will increase in dollars.

Sales and marketing

. Sales and marketing expenses consist of commissions, headcount and related costs, as well as travel, entertainment and promotional expenses. Sales and marketing expenses were $22.3 million, or 7.5% of net revenues, in 2003, $25.5 million, or 9.3% of net revenues, in 2002, and $26.8 million, or 9.1% of net revenues, in 2001. The decrease in sales and marketing expenses from 2002 to 2003 by 12.7% was primarily due to decreases in headcount related costs of $1.7 million due to the transfer of some sales personnel to Asia and decreased facility and information technology related expenses, a decrease in commission expense of $1.1 million due to reduced commission rates and decreased marketing expenses of $849 thousand, offset by increased logistic center fees of $652 thousand due to increased activity through the logistic center. The decrease in sales and marketing expenses from 2001 to 2002 by 4.8% was primarily due to decreased commissions expenses of $1.9 million as a result of decreased product revenues and decreased marketing expenses of $692 thousand, offset by increased headcount and related costs of $1.2 million due to increased in sales and marketing headcount and a $510 thousand expense recorded for a bonus to our senior vice president of sales and marketing. We expect sales and marketing expenses will increase in dollars as we continue to expand our sales and marketing efforts. In addition, fluctuations in revenues will cause fluctuations in sales and marketing expenses as it impacts our commission expense.

General and administrative

. General and administrative expenses consist of salaries and related costs for administrative, executive and finance personnel, recruiting costs, professional services and legal fees and allowances for doubtful accounts. General and administrative expenses were $14.4 million, or 4.9% of net revenues, in 2003, $17.1 million, or 6.2% of net revenues, in 2002, and $17.9 million, or 6.1% of net revenues, in 2001. The decrease in general and administrative expenses from 2002 to 2003 by 15.8% was primarily due to decreases in bad debt expenses of $2.8 million due to a charge taken in 2002 related to one specific customer, a decrease in legal fees of $1.5 million due to decreased Atmel defense activity, and lower depreciation and amortization expense of $876 thousand, offset by increases in headcount related costs of $2.4 million due to changes in allocations for facility, IT and insurance expenses. The decrease in general and administrative expenses from 2001 to 2002 by 4.2% was primarily due to decreased professional service expenses of $1.0 million and decreased bank fees of $486 thousand, offset by increased bad debt expenses of $795 thousand. We anticipate that general and administrative expenses will increase in dollars as we scale our facilities, infrastructure, and headcount to support our overall expected growth. We may also incur additional expenses in connection with the Atmel litigation. For further information on this litigation see "Legal Proceedings."

Other operating expenses

. In 2003, other operating expenses were $37.8 million, or 12.8% of net revenues, which related entirely to the Atmel litigation settlement. The $37.8 million of settlement fees and interest was paid in December 2003. There were no other operating expenses recorded in 2002. In 2001, other operating expenses of $1.3 million, or 0.5% of net revenues, were comprised of $590 thousand related to an expense for impairment of intangible assets and a $756 thousand period charge related to an operating lease for an abandoned building. This charge represents the estimated difference between the total non-discounted future sublease income and our non-discounted lease commitments relating to this building. The charge is an estimate and may be adjusted if we obtain a sublease for the building and the actual sublease income is significantly different from the estimate. We may be unable to secure subtenants for such space due to the recent decrease in demand for commercial rental space in Silicon Valley.

During the quarter ended December 31, 2001, due to the delays in completing this first flash memory device using the Agate technology, we recorded an expense for impairment of intangible assets of $590 thousand. The assets related to patents acquired as part of the acquisition of Agate Semiconductor Inc. in December 2000. We reviewed the recoverability of the recorded amounts based on expected future cash flows (undiscounted and before interest) from use of these assets and then determined the impairment loss of $590 thousand based on the difference between the net book value of the assets and the estimated fair value of the assets.

Interest and other income

. Interest and other income was $2.8 million, or 0.9% of net revenues, during 2003, $3.2 million, or 1.2% of net revenues, during 2002, and $7.4 million, or 2.5% of net revenues, during 2001. Interest income decreased from 2002 to 2003 primarily due to decreased interest rates on invested cash, offset by realized gains of $649 thousand on the sale of some of our investments. Interest income decreased from 2001 to 2002 primarily due to decreasing interest rates on invested cash.

Interest expense

. Interest expense was $138 thousand during 2003 as compared to $214 thousand during 2002 and $338 thousand during 2001. Interest expense relates to interest and fees under our line of credit and to our notes payable. We terminated our line of credit in July 2002.

Impairment of equity investments.

In 2000, we acquired a 10.0% interest in Apacer, a privately held company located in Taiwan that designs, manufactures and markets memory modules, for $9.9 million in cash. Our investment in Apacer was valued at cost. Bing Yeh, our President and CEO and Board Director, is a member of Apacer's Board of Directors. In 2001, we invested an additional $2.1 million in Apacer. In August 2002, we made an additional investment of $181 thousand. At the end of the third quarter of 2002, we determined that a continued and significant decline in Apacer's price per share was other than temporary, and accordingly, in the third quarter of 2002, we recorded a period charge to impairment of equity investments of $7.8 million to write down our investment in Apacer to $4.4 million which was determined using the price per share paid for the additional investment in August 2002. As of December 31, 2003 the recorded value of our investment in Apacer was $4.4 million.

During 2001, KYE, a company in which we have an investment, completed an initial public offering on the Taiwan Stock Exchange. Since the initial public offering there had been a significant decline in the market value of the investment. We had concluded that the decline in value is "other-than-temporary" and a write down of $3.3 million was necessary as of December 31, 2001. The investment was written down to $1.3 million based on the quoted market price as of December 31, 2001. As of December 31, 2003, the recorded value of our KYE investment was $3.2 million based on the quoted market price as of the balance sheet date.

Provision for (Benefit from) Income Taxes

In 2003, our income tax expense was $26.4 million on a net loss before tax of $38.8 million. Our provision for taxes included a charge recorded during the third quarter of 2003 to establish a full valuation allowance against our deferred tax assets offset by a reduction in income tax payable as a result of a reassessment of expected liabilities for 2003 and certain exposures. During the fourth quarter of 2003, we maintained a full valuation allowance on our net deferred tax assets. The valuation allowance was determined in accordance with the provisions of Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting for Income Taxes," which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. Cumulative losses incurred in the U.S. in recent years represented sufficient negative evidence under SFAS No. 109 and accordingly, a full valuation allowance was recorded against U.S. deferred tax assets. We intend to maintain a full valuation allowance on the U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance. Our income tax benefit of $10.9 million in 2002 consisted of a 42.0% tax rate on our loss before income taxes. In 2001, our income tax benefit of $17.8 million consisted of a 38.0% tax rate on loss before income taxes. In 2003, we implemented an international tax structure, which in conjunction with the full valuation allowance, will mean that going forward we will record a tax expense as a result of foreign tax withholding and alternative minimum tax until

such time that the valuation allowance against the deferred tax asset is no longer required.

Segment Reporting

Our operations involve the design, development, manufacturing, marketing and technical support of our nonvolatile memory technology and products. We offer low and medium density devices that target a broad range of existing and emerging applications in the digital consumer, networking, wireless communications and Internet computing markets. Our products are differentiated based upon attributes such as density, voltage, access speed, package and predicted endurance. We also license our technology for use in non-competing applications. Our reportable segments are: the Standard Memory Product Group, or SMPG, the Application Specific Product Group, or ASPG, the Special Product Group, or SPG, and Technology Licensing. Refer to Note 10 to the Consolidated Financial Statements for revenue and gross profit information by reportable segment. Our analysis of the changes for each segment is discussed below.

SMPG includes our three standard flash memory product families: the MPF family, the MPF+ family and the MTP

family. Effective January 1, 2003, we transferred certain MTP products from SMPG to SPG. Effective July 1, 2003, we transferred the Small Sector Flash, or SSF, family from SMPG to SPG. Accordingly, our segment revenues and gross profit information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001. SMPG revenues were $173.1 million in 2003, $147.0 million in 2002 and $118.8 million in 2001. The increase in revenues in 2003 compared to 2002 was primarily due to increases in unit shipments of our products by 26.1%, offset by decreases in average selling prices of 9.0%. The increase in revenues in 2002 compared to 2001 was primarily due to increases in unit shipments of our products of 39.9% and lower product returns in 2002, offset by decreases in average selling prices of 28.4%. Gross margin was 13.3% in 2003, 4.6% in 2002 and negative 21.1% in 2001. The increase in gross margin in 2003 from 2002 was primarily due to higher inventory valuation adjustments in 2002, the sale of previously reserved inventory in 2003 and product mix. The increase in gross margin from 2001 to 2002 was primarily due to inventory valuation adjustments to cost of sales during 2001, offset by decreased average selling prices in 2002.

ASPG includes Concurrent SuperFlash, Serial Flash, Firmware Hub, or FWH, and Low Pin Count, or LPC flash products. ASPG also includes flash embedded controllers such as the ATA controller. Effective January 1, 2003, we transferred FlashFlex51 microcontroller products from ASPG to SPG. Accordingly, our segment revenues and gross profit information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001. ASPG revenues were $60.5 million in 2003, $67.8 million in 2002 and $89.6 million in 2001. The decrease in revenues in 2003 compared to 2002 was primarily due to decreases in average selling prices of 31.8%, offset by increases in unit shipments of our products of 33.3%. The decrease in revenues in 2002 compared to 2001 was primarily due to decreases in average selling prices of 38.6% offset by increases in unit shipments of our products of 15.0%. Gross margin was 19.4% in 2003, 35.6% in 2002 and 40.1% in 2001. The decrease in gross margin in 2003 from 2002 and from 2001 to 2002 was primarily due to decreases in average selling prices and product mix.

SPG includes ComboMemory, ROM/RAM Combos, SSF, MTP, FlashFlex51 microcontrollers and other special flash products. Effective January 1, 2003, we transferred certain MTP products from SMPG to SPG and FlashFlex51 microcontroller products from ASPG to SPG. Effective July 1, 2003, we transferred the SSF family from SMPG to SPG. Accordingly, our segment revenue and gross margin information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001. SPG revenues were $22.9 million in 2003, $29.2 million in 2002 and $50.1 million in 2001. The decrease in revenues in 2003 compared to 2002 was primarily due to decreases in average selling prices of 17.2% and unit shipments of our products by 5.1%. The decrease in revenues in 2002

compared to 2001 was primarily due to decreases in average selling prices of 49.7%, offset by increased unit shipments of our products by 18.3%. Gross margin was 13.0% in 2003, 23.4% in 2002 and negative 0.8% in 2001. The decrease in gross margin in 2003 from 2002 was primarily due to decreases in average selling prices and product mix. Gross margin increased from 2001 to 2002 due to changes in the product mix and inventory valuation adjustments to cost of sales in 2001.

Revenue and gross profit related to Technology Licensing was $38.5 million for 2003, $30.6 million for 2002 and $35.4 million for 2001. The increase from 2002 to 2003 related primarily to increase royalty payments from our existing licensees and up-front license fees from our new licensees. During 2000 and 2001, Winbond Electronics of Taiwan paid us $10.4 million and $20.0 million, respectively, under a settlement agreement. No further back royalty payments were required after 2001 under this legal settlement. Although the settlement payments have ceased, Winbond continues to pay royalties. The decrease from 2001 to 2002 was primarily due to the termination of license fees received as part of our legal settlement with Winbond during 2001, offset by increases in upfront license fees and royalty payments received from our licensees during 2002. We anticipate that license revenues will fluctuate significantly in the future.

Related Party Transactions

The following table is a summary of our related party revenues and purchases (in thousands):

	Year Ended December 31, 2003	
	Revenues	Purchases
Silicon Technology Co., Ltd.	$ 3,615	$ --
Apacer Technology, Inc and related entities	1,555	2,361
Silicon Professional Technology Ltd.	164,810	--
Grace Semiconductor Manufacturing Corporation	--	12
King Yuan Electronics Company, Limited	--	19,659
Powertech Technology, Incorporated	--	9,280
	$ 169,980	$ 31,312

	Year Ended December 31, 2002	
	Revenues	Purchases
Silicon Technology Co., Ltd.	$ 2,089	$ --
Acer and related entities (1)	269	--
Apacer Technology, Inc and related entities	899	588
Professional Computer Technology Limited	141	--
Silicon Professional Technology Ltd.	140,003	--
King Yuan Electronics Company, Limited	--	18,163
Powertech Technology, Incorporated	--	8,378
	$ 143,401	$ 27,129

	Year Ended December 31, 2001	
	Revenues	Purchases
Silicon Technology Co., Ltd.	$ 3,728	$ --
Acer and related entities (1)	5,129	290
Apacer Technology, Inc and related entities	280	626
Ocean Contract Manufacturing Ltd	4,019	--
Professional Computer Technology Limited	76,869	--
King Yuan Electronics Company, Limited	--	21,827
Powertech Technology, Incorporated	--	9,031
	$ 90,025	$ 31,774

(1) Excludes Apacer Technology, Inc. balances.

The following table is a summary of our related party accounts receivable and accounts payable and accruals (in thousands):

	December 31, 2002		December 31, 2003	
	Accounts Receivable	Accounts Payable and Accruals	Accounts Receivable	Accounts Payable and Accruals
Silicon Technology Co., Ltd.	$ 459	$ --	$ 232	$ --
Ambit Microsystems Corp	--	--	--	4
Apacer Technology, Inc and related entities	141	119	400	736
Professional Computer Technology Limited	--	73	--	15
Silicon Professional Technology Ltd	24,648	432	40,588	550
King Yuan Electronics Company, Limited	--	4,285	--	6,896
Powertech Technology, Incorporated	--	2,253	--	2,533
	$ 25,248	$ 7,162	$ 41,220	$ 10,734

In 1996, we acquired a 14% interest in Silicon Technology Co., Ltd., or Silicon Technology, a privately held Japanese company, for $939 thousand in cash. Bing Yeh, our President, CEO and Board Director, is also a member of Silicon Technology's board of directors. We acquired the interest in Silicon Technology in order to provide a presence for our products in Japan. We now have our own office in Japan, although Silicon Technology continues to sell our products to smaller customers. At December 31, 2003, our investment, which is carried at cost, represented 9% of the outstanding equity of Silicon Technology. Our sales to Silicon Technology were made at prevailing market prices and the payment terms are consistent with the payment terms extended to our other customers. We are not obligated to provide Silicon Technology with any additional financing.

Dr. Ronald Chwang, a member of our Board of Directors, is also a director of Ambit Microsystems Corp., which is a related entity of Acer Incorporated, or Acer.

In 2000, we acquired a 10% interest in Apacer Technology Inc, or Apacer, for $9.9 million in cash. Apacer, a privately held Taiwanese company and a related entity of Acer, is a memory module manufacturer. Bing Yeh, our President, CEO and Board Director, is also a member of Apacer's board of directors. In 2001, we invested an additional $2.1 million in Apacer. In August 2002, we made an additional investment of $181 thousand. The investment was written down to $4.4 million during 2002, please refer to Note 8 of the Notes to the Consolidated Financial Statements. At December 31, 2003, our investment represented 10% of the outstanding equity of Apacer. Our sales to the related Acer entities were made at prevailing market prices and the payment terms are consistent with the payment terms extended to our other customers. Our purchases from Apacer are made pursuant to purchase orders at prevailing market prices. We do not have a long-term contract with Apacer to supply us with products. If Apacer were to terminate its relationship with us, we believe that we would be able to procure the necessary products from other production subcontractors. We are not obligated to provide Apacer with any additional financing.

In 2000, we acquired a 15% interest in Professional Computer Technology Limited, or PCT, a privately held Taiwanese company, for $1.5 million in cash. Bing Yeh, our President, CEO and Board Director, is also a member of PCT's board or directors. PCT is one of our stocking representatives. In May 2002, we made an additional investment of $179 thousand in PCT. During 2003, PCT completed an initial public offering on the Taiwan Stock Exchange and we sold a portion of our holdings. Under Taiwan security regulations, certain numbers of shares must be held in a central custody and are restricted from sale for a period of time. The shares available for sale within one year are carried at the quoted market price and included in long-term available-for-sale investments in the balance sheet as of December 31, 2003. Shares required to be held in custody for greater than a one year period are carried at cost and included in equity investments. As of December 31, 2003, the value of the investment recorded as long-term available-for-sale is valued at $3.8 million and the restricted portion of the investment carried at cost is recorded at $775 thousand. At December 31, 2003 our investment represented 13% of the outstanding equity of PCT. In February 2004, we purchased $1.7 million of PCT's European convertible bonds.

PCT and it subsidiary, Silicon Professional Alliance Corporation, or SPAC, earn commissions for point-of-sales transactions to its customers. Commissions to PCT and SPAC are paid at the same rate as all of our other stocking representatives in Asia. In 2001, 2002 and 2003 we paid sales commissions of $1.7 million, $2.5 million and $1.2 million, respectively, to PCT and SPAC. Shipments, by us or our logistics center, to PCT and SPAC for reshipment accounted for 8.5%, 10.3% and 27.3% of our product shipments in 2001, 2002 and 2003. In addition, PCT and

SPAC solicited sales, for which they earned a commission, for 13.4%, 19.5% and 12.0% of our shipments to end users in 2001, 2002 and 2003, respectively.

In March 2001, PCT established a separate company and wholly-owned subsidiary, Silicon Professional Technology, Ltd., or SPT, to provide planning, warehousing, delivery, billing, collection and other logistic functions for us in Taiwan. SPT now services substantially all of our end customers based in Taiwan, China and other Southeast Asia countries. Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT. We pay SPT a fee based on a percentage of revenue for each product sold through SPT to our end customers. The fee paid to SPT covers the cost of warehousing and insuring inventory and accounts receivable, personnel costs required to maintain logistics and information technology functions and the costs to perform billing and collection of accounts receivable. SPT receives extended payment terms and is obligated to pay us whether or not they have collected the

accounts receivable.

We do not have any long-term contracts with SPT or PCT, and SPT and PCT may cease providing services to us at any time. If SPT or PCT were to terminate their relationship with us we would experience a delay in reestablishing warehousing, logistics and distribution functions which would harm our business. We are not obligated to provide SPT or PCT with any additional financing.

In 2000, we acquired a 1% interest in King Yuan Electronics Company, Limited, or KYE, a publicly held Taiwanese company, which is a production subcontractor, for $4.6 million in cash. A member of our management team holds one supervisor position at KYE. The role and responsibilities of a supervisor are defined and governed by Corporate Law in Taiwan. The investment was made in KYE in order to strengthen the relationship between us and KYE. During 2001, KYE completed an initial public offering on the Taiwan Stock Exchange. Accordingly, the investment has been included in long-term available-for-sale investments in the balance sheet as of December 31, 2002 and 2003. The investment was written down to $1.3 million during 2001 and is valued at $3.2 million as of December 31, 2003 based on the quoted market price. At December 31, 2003, our investment represented 0.5% of the outstanding equity of KYE. Our purchases from KYE are made pursuant to purchase orders at prevailing market prices. We do not have a long-term contract with KYE to supply us with services. If KYE were to terminate its relationship with us we believe that we would be able to procure the necessary services from other production subcontractors. We are not obligated to provide KYE with any additional financing.

In 2000, we acquired a 3% interest in Powertech Technology, Incorporated, or PTI, a privately held Taiwanese company, which is a production subcontractor, for $2.5 million in cash. The investment was made in PTI in order to strengthen the relationship between us and PTI. During 2003, PTI completed an initial public offering on the Taiwan Stock Exchange and we sold a portion of our holdings. Under Taiwan security regulations, certain numbers of shares must be held in a central custody and are restricted from sale for a period of time. The shares available for sale within one year are carried at the quoted market price and included in long-term available-for-sale investments in the balance sheet as of December 31, 2003. Shares required to be held in custody for greater than a one year period are carried at cost and included in equity investments. As of December 31, 2003, the value of the investment recorded as long-term available-for-sale is valued at $5.5 million and the restricted portion of the investment carried at cost is recorded at $1.2 million. At December 31, 2003, our investment represented 3% of the outstanding equity of PTI. Our purchases from PTI are made pursuant to purchase orders at prevailing market prices. We do not have a long-term contract with PTI to supply us with services. If PTI were to terminate its relationship with us we believe that we would be able to procure the necessary services from other production subcontractors. We are not obligated to provide PTI with any additional financing.

In 2001, we acquired a 9% interest in Grace Semiconductor Manufacturing Corporation, or GSMC, a privately held Cayman Islands company for $50.0 million in cash. Bing Yeh, our President, CEO and Board Director, is also a member of GSMC's board of directors. In addition, a member of our management team holds one supervisor position at GSMC. The role and responsibilities of a supervisor are defined and governed by Corporate Law in the Cayman Islands. This investment is carried at cost. GSMC has a wholly owned subsidiary, Shanghai Grace Semiconductor Manufacturing Corporation, or Grace, which is a wafer foundry company with operations in China. Grace began to manufacture some of our products during 2003. We do not have a long-term contract with Grace to supply us with products. At December 31, 2003, our investment represented 7% of the outstanding equity of GSMC. In March 2004, we committed to invest an additional $33.2 million in GSMC during 2004.

Critical Accounting Estimates

Our critical accounting estimates are as follows:

- Revenue recognition;
- Allowance for sales returns;
- Allowance for doubtful accounts;
- Allowance for excess and obsolete inventory and lower of cost or market;
- Warranty accrual;
- Litigation costs;
- Valuation of equity investments; and
- Accounting for income taxes.

Revenue recognition

. Sales to direct customers and foreign stocking representatives are recognized net of an allowance for estimated returns. When product is shipped to direct customers or stocking representatives, or by our distributors or SPT to end users, prior to recognizing revenue, we also require that evidence of the arrangement exists, the price is fixed or determinable and collection is reasonably assured. Our shipping terms are generally freight on board, or FOB, shipping point and payment terms typically range from 30 to 75 days. Sales to distributors are made primarily under arrangements allowing price protection and the right of stock rotation on merchandise unsold. Because of the uncertainty associated with pricing concessions and future returns, we defer recognition of such revenues, related costs of revenues and related gross profit until the merchandise is sold by the distributor. Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT.

Most of our technology licenses provide for the payment of up-front license fees and continuing royalties based on product sales. For license and other arrangements for technology that we are continuing to enhance and refine, and under which we are obligated to provide unspecified enhancements, revenue is recognized over the lesser of the estimated period that we have historically enhanced and developed refinements to the technology, approximately two to three years (the upgrade period), or the remaining portion of the upgrade period from the date of delivery, provided all specified technology and documentation has been delivered, the fee is fixed or determinable and collection of the fee is reasonably assured. From time to time, we reexamine the estimated upgrade period relating to licensed technology to determine if a change in the estimated upgrade period is needed. Revenue from license or other technology arrangements where we are not continuing to enhance and refine technology or are not obligated to provide unspecified enhancements is recognized upon delivery, if the fee is fixed or determinable and collection of the fee is reasonably assured.

Royalties received under these arrangements during the upgrade period are recognized as revenue based on the ratio of the elapsed portion of the upgrade period to the estimated upgrade period. The remaining portions of the royalties are recognized ratably over the remaining portion of the upgrade period. Royalties received after the upgrade period has elapsed are recognized when reported to us.

If we make different judgments or utilize different estimates in relation to the estimated period of technology enhancement and development, the amount and timing of our license and royalty revenues could be materially different.

Allowance for sales returns

. We maintain allowances for sales returns for estimated product returns by our customers. We estimate our allowance for sales returns based on our historical return experience, current economic trends, changes in customer demand, known returns we have not received and other assumptions. The allowance for sales returns was $4.5 million, $1.8 million and $1.3 million as of December 31, 2001, 2002 and 2003, respectively. If we make different judgments or utilize different estimates, the amount and timing of our revenue could be materially different.

Allowance for doubtful accounts

. We maintain allowance for doubtful accounts for estimated losses from the inability of our customers to make required payments. We evaluate our allowance for doubtful accounts based on the aging of our accounts receivable, the financial condition of our customers and their payment history, our historical write-off experience and other assumptions. If we were to make different judgments of the financial condition of our customers or the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The allowance for doubtful accounts was $2.8 million, $4.4 million and $1.1 million as of December 31, 2001, 2002 and 2003, respectively.

Allowance for excess and obsolete inventory and lower of cost or market

. Our inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market value. We typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate substantially. The value of our inventory is dependent on our estimate of future average selling prices, and, if our projected average selling prices are over estimated, we may be required to adjust our inventory value to reflect the lower of cost or market. Our inventories include high technology parts and components that are specialized in nature or subject to rapid technological obsolescence. We maintain allowance for inventory for potentially excess and obsolete inventories and those inventories carried at costs that are higher than their market values. Some of our customers have requested that we ship them product that has a finished goods date of manufacture that is less than one year old. In the event that this becomes a common requirement, it may be necessary for us to provide for an additional allowance for our on hand finished goods inventory with a date of manufacture of greater than one year old, which could result in additional inventory write-downs. Our allowance for excess and obsolete inventories includes an allowance for our on hand finished goods inventory with a date of manufacture of greater than two years old and for certain products with a date of manufacture of greater than one year old. If we determine that market conditions are less favorable than those currently projected by management, such as an unanticipated decline in average selling prices or demand not meeting our expectations, additional inventory write-downs may be required. The allowance for excess and obsolete inventories was $47.7 million, $27.4 million and $11.2 million as of December 31, 2001, 2002 and 2003, respectively.

Warranty accrual.

Our products are generally subject to warranty and we provide for the estimated future costs of repair, replacement or customer accommodation upon shipment of the product in the accompanying statements of operations. Our warranty accrual is estimated based on historical claims compared to historical revenues and assumes that we have to replace products subject to a claim. For new products, we use our historical percentage for the appropriate class of product. Should actual product failure rates differ from our estimates, revisions to the estimated warranty liability would be required.

Litigation costs

. From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have incurred certain costs associated with defending these matters. There can be no assurance the Atmel complaint or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring royalty payments in the future which may adversely impact gross margins. As of December 31, 2003, no estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. If additional information becomes available such that we estimate that there is a possible loss or possible range of loss associated with these contingencies, then we would record the minimum estimated liability, which could materially impact our results of operations and financial position.

Valuation of equity investments.

We hold minority interests in companies having operations in the semiconductor industry. We record an investment impairment charge when we believe an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments, thereby possibly requiring an impairment charge in the future. The recorded value of our equity investments at December 31, 2003 is $71.0 million.

Accounting for income taxes

. During the third quarter of 2003 we recorded a charge to establish a full valuation allowance against our deferred tax assets offset by a reduction in income tax payable as a result of a reassessment of expected liabilities for 2003 and certain exposures. Accordingly, for 2003 we recorded an income tax expense of $26.4 million. During the fourth quarter of 2003, we maintained a full valuation allowance on our net deferred tax assets. The valuation allowance was determined in accordance with the provisions of Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting for Income Taxes," which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. Cumulative losses incurred in the U.S. in recent years represented sufficient negative evidence under SFAS No. 109 and accordingly, a full valuation allowance was recorded against U.S. deferred tax assets. We intend to maintain a full valuation allowance on the U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance. At December 31, 2003, the valuation allowance against our deferred tax asset was $41.1 million.

Liquidity and Capital Resources

Operating activities

. Our operating activities generated cash of $7.6 million in 2003 and $23.4 million in 2002. For

2003, our primary source of operating cash flow was the timing of inventory purchases and payments to our vendors and service providers, offset by the payment of $37.8 million to Atmel. Cash generated from operating activities included a decreases in inventories of $29.5 million due to increased sales , which reduced the amount of inventory held, and other current and non-current assets of $18.3 million, increases in trade accounts payable from related and unrelated parties of $12.4 million due to increased strategic purchasing of certain products, increases in deferred revenue of $1.0 million and non-cash related adjustments of $37.9 million. Non-cash adjustments related to $7.7 million of depreciation and amortization, $6.7 million of inventory valuation adjustments, $22.3 million decrease in net deferred tax assets and $1.3 million of tax benefit from employee stock plans, offset by a $228 thousand charge to expense for provision for doubtful accounts. Working capital uses of cash included a net loss of $65.2 million, increases in trade accounts receivable from related and non-related parties of $19.9 million due to increased revenue at the end of 2003 compared to 2002 and increased activity through our logistic center which has extended payment terms and decreases in accrued expenses and other liabilities of $6.5 million. In 2002, cash provided by operations was $23.4 million and related primarily to non-cash adjustments of $42.4 million, including depreciation and amortization of $9.8 million, provision for doubtful accounts of $3.0 million, provision for sales returns of $2.8 million, inventory valuation adjustments of $10.4 million, changes in deferred income taxes of $7.0 million, impairment of equity investments of $7.8 million and tax benefit from employee stock plans of $1.5 million. Further, cash provided from operations relates to decreases in accounts receivable from unrelated parties of $3.3 million and inventories of $16.0 million and increases in accounts payable to unrelated parties of $4.3 million and accrued expenses and other liabilities of $1.6 million. Cash provided from operating activities was reduced by increases in accounts receivable from related parties of $4.5 million and other current and non-current assets of $21.3 million and decreases in accounts payable to related parties of $564 thousand and deferred revenue of $2.8 million.

Investing activities

. Our investing activities provided cash of $9.0 million during 2003, primarily due to a total of $10.8 million cash from the excess sales and maturities of available-for-sale investments and restricted cash over the purchases of such investments, offset by $1.8 million invested in capital expenditures. Cash used in investing activities was $17.0 million during 2002. Investing activities in 2002 were primarily related to capital expenditures of $4.3 million and net purchases of available-for-sale investments and restricted cash of $11.1 million. In addition, during 2002 we invested $964 thousand in Insyde Software Corporation, a Taiwanese company that completed an initial public offering on the Taiwan Stock Exchange in January 2003, made additional investments of $179 thousand in PCT and $181 thousand in Apacer and $333 thousand in another investment. We plan to continue to invest in capital equipment to be used primarily for test equipment and design engineering tools for research and development, information systems infrastructure, and leasehold improvements.

Financing activities

. Our financing activities provided cash of $4.3 million in 2003 and $3.8 million in 2002. During 2003, cash provided was from $4.5 million of common stock issued under our employee stock purchase plan and the exercise of employee stock options, offset by $250 thousand in loan repayments. During 2002, the cash provided was primarily from $4.1 million of common stock issued under our employee stock purchase plan and the exercise of employee stock options, offset by $316 thousand in loan repayments. We terminated our line of credit on July 12, 2002.

Principal sources of liquidity at December 31, 2003 consisted of $210.2 million of cash, cash equivalents, and short-term and long-term available-for-sale investments.

Purchase Commitments

. As of December 31, 2003, we had outstanding purchase commitments with our foundry vendors of $72.8 million for delivery in 2004. We have recorded a liability of $538 thousand for adverse purchase commitments.

Lease Commitments.

We have long-term, non-cancelable building lease commitments. We are currently seeking subtenants for our unused office space. During the third quarter of 2001, we recorded a period charge to other operating expense of $756 thousand relating to an operating lease for an abandoned building. This charge represents the estimated difference between the total non-discounted future sublease income and our non-discounted lease commitments relating to this building. The charge was an estimate and may be adjusted if we obtain a sublease for the building and the actual sublease income is significantly different from the estimate. We may be unable to secure subtenants for such space due to the recent decrease in demand for commercial rental space in Silicon Valley. At December 31, 2002 and 2003, payments made have reduced the recorded liability to $473 thousand and $270 thousand, respectively.

Future payments due under building lease, purchase commitments and other contractual obligations as of December 31, 2003 (in thousands):

	Total	Less than 1 year	1-3 years	3-5 years
Notes payable	$ 871	$ 393	$ 478	$ --
Operating leases	20,217	5,376	6,165	5,167
Purchase commitments	72,791	72,791	--	--
Other long-term liability	151	--	151	--
Total	$ 94,030	$ 78,560	$ 6,794	$ 5,167

In addition to our commitments in the above table, in March 2004, we committed to an additional $33.2 investment in GSMC during 2004.

Operating Capital Requirements

. We believe that our cash balances, together with funds we expect to generate from operations, will be sufficient to meet our projected working capital and other cash requirements through at least the next twelve months. However, there can be no assurance that future events will not require us to seek additional borrowings or capital and, if so required, that such borrowing or capital will be available on acceptable terms. Factors that could affect our short-term and long-term cash used or generated from operations and as a result, our need to seek additional borrowings or capital include:

- the average selling prices of our products;
- customer demand for our products;
- the need to secure future wafer production capacity from our suppliers;
- the timing of significant orders and of license and royalty revenue;
- unanticipated research and development expenses associated with new product introductions; and
- the outcome of ongoing litigation.

Please also see "Business Risks - Our operating results fluctuate significantly, and an unanticipated decline in revenues may disappoint securities analysts or investors and result in a decline in our stock price."

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board, or FASB, issued FIN No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 was effective immediately for all new variable interest entities created or acquired after January 31, 2003. In December 2003, the FASB issued a revision of FIN No. 46 that delays the implementation date for certain interests created or acquired prior to January 31, 2003 until the first interim or annual period ending after March 15, 2004. Accordingly, we will implement FIN No. 46 during the quarter ended March 31, 2004. We are currently reviewing our equity investments and associated relationships to determine if they are variable interest entities as defined by the revised FIN No. 46. It is reasonably possible that we are the primary beneficiary of or hold a significant variable interest in a variable interest entity. The nature, purpose and activities of the potential variable interest entities are outlined in Note 11 of our Notes to the Consolidated Financial Statements. Our maximum exposure to loss as a result of our involvement with the potential variable interest entities is our investment in each such entity plus amounts receivable from these entities as we are not obligated to provide any entity with any additional financing.

Business Risks

Risks Related to Our Business

Our operating results fluctuate materially, and an unanticipated decline in revenues may disappoint securities analysts or investors and result in a decline in our stock price.

We incurred net losses for 2001, 2002 and 2003. Our operating results have fluctuated significantly and our past financial performance should not be used to predict future operating results. Our recent quarterly and annual operating results have fluctuated, and may continue to fluctuate, due to the following factors, all of which are difficult to forecast and many of which are out of our control:

- the availability, timely delivery and cost of wafers or other manufacturing and assembly services from our suppliers;
- competitive pricing pressures and related changes in selling prices;

- fluctuations in manufacturing yields and significant yield losses;
- new product announcements and introductions of competing products by us or our competitors;
- product obsolescence;
- lower of cost or market, obsolescence or other inventory adjustments;
- changes in demand for, or in the mix of, our products;
- the gain or loss of significant customers;
- market acceptance of products utilizing our SuperFlash® technology;
- changes in the channels through which our products are distributed and the timeliness of receipt of distributor resale information;
- exchange rate fluctuations;
- general economic, political and environmental-related conditions, such as natural disasters;
- increases in allowance for doubtful accounts;
- valuation allowances on deferred tax assets based on changes in estimated future taxable income;
- difficulties in forecasting, planning and management of inventory levels;
- unanticipated research and development expenses associated with new product introductions; and
- the timing of significant orders and of license and royalty revenue.

As recent experience confirms, a downturn in the market for products such as personal computers and cellular telephones that incorporate our products can also harm our operating results.

Our operating expenses are relatively fixed, and we order materials in advance of anticipated customer demand. Therefore, we have limited ability to reduce expenses quickly in response to any revenue shortfalls.

Our operating expenses are relatively fixed, and we therefore have limited ability to reduce expenses quickly in response to any revenue shortfalls. Consequently, our operating results will be harmed if our revenues do not meet our projections. We may experience revenue shortfalls for the following reasons:

- sudden drops in consumer demand which may cause customers to cancel backlog, push out shipment schedules, or reduce new orders, possibly due to a slowing economy or inventory corrections among our customers;
- significant declines in selling prices that occur because of competitive price pressure during an over-supply market environment;
- sudden shortages of raw materials for fabrication, test or assembly capacity constraints that lead our suppliers to allocate available supplies or capacity to other customers which, in turn, harm our ability to meet our sales obligations; and
- the reduction, rescheduling or cancellation of customer orders.

In addition, political or economic events beyond our control can suddenly result in increased operating costs. For example, the terrorist attacks of September 11, 2001 have resulted in a substantial increase to our business insurance costs. In addition, under a current proposed standard, we would be required to record compensation expense on stock

option grants and on shares purchased under our employee stock purchase program, which would substantially increase our operating costs and impact our earnings (loss) per share.

We incurred significant inventory valuation adjustments in 2001, 2002 and 2003 and we may incur additional significant inventory valuation adjustments in the future.

We typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate materially. The value of our inventory is dependent on our estimate of future average selling prices, and, if our projected average selling prices are over estimated, we may be required to adjust our inventory value to reflect the lower of cost or market. As of December 31, 2003, we had $46.1 million of inventory on hand, a decrease of $36.9 million, or 44.5%, from December 31, 2002. Total valuation adjustments to inventory were $72.2 million in 2001, $9.2 million in 2002 and $6.7 million in 2003. Due to the large number of units in our inventory, even a small change in average selling prices could result in a significant adjustment and could harm our financial results. Some of our customers have requested that we ship them product that has a finished goods date of manufacture that is less than one year old. As of December 31, 2003, our allowance for excess and obsolete inventories includes an allowance for our on hand finished goods inventory with a date of manufacture of greater than two years old and for certain products with a date of manufacture of greater than one year old. In the event that this becomes a common requirement, it may be necessary for us to provide for an additional allowance for our on hand finished goods inventory with a date of manufacture of greater than one year old, which could result in a significant adjustment and could harm our financial results.

Cancellations or rescheduling of backlog may result in lower future revenue and harm our business.

Due to possible customer changes in delivery schedules and cancellations of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. A reduction of backlog during any particular period, or the failure of our backlog to result in future revenue, could harm our business in the future. We began to experience a sharp downturn in several of our markets late in the fourth quarter of 2000, as our customers reacted to weakening demand for their products. Although we had improvements in total units shipped in 2003 compared to 2001 and 2002 and our revenues increased in 2003, we experienced decreased average selling prices. Our business could be harmed by industry-wide fluctuations in the future.

Our business may suffer due to risks associated with international sales and operations.

During 2001, 2002 and 2003, our export product and licensing revenues accounted for 90.3%, 92.0% and 92.9% of our net revenues, respectively. Our international business activities are subject to a number of risks, each of which could impose unexpected costs on us that would harm our operating results. These risks include:

- difficulties in complying with regulatory requirements and standards;
- tariffs and other trade barriers;
- costs and risks of localizing products for foreign countries;
- reliance on third parties to distribute our products;
- extended accounts receivable payment cycles;
- potentially adverse tax consequences;
- limits on repatriation of earnings; and
- burdens of complying with a wide variety of foreign laws.

In addition, we have made equity investments in companies with operations in China, Japan and Taiwan. The value of our investments is subject to the economic and political conditions particular to their industry, their countries and to foreign exchange rates and to the global economy. If we determine that a change in the recorded value of an investment is other than temporary, we will adjust the value of the investment. Such an expense could have a negative impact on our operating results.

We derived 80.7%, 88.5% and 90.0% of our net product revenues from Asia during 2001, 2002 and 2003, respectively. Additionally, substantially all of our wafer suppliers and packaging and testing subcontractors are located in Asia. Any kind of economic, political or environmental instability in this region of the world can have a severe negative impact on our operating results due to the large concentration of our production and sales activities in this region. For example, during 1997 and 1998, several Asian countries where we do business, such as Japan, Taiwan

and Korea, experienced severe currency fluctuation and economic deflation, which negatively impacted our

revenues and also negatively impacted our ability to collect payments from customers. During this period, the lack of capital in the financial sectors of these countries made it difficult for our customers to open letters of credit or other financial instruments that are guaranteed by foreign banks. Finally, the economic situation during this period exacerbated a decline in selling prices for our products as our competitors reduced product prices to generate needed cash.

It should also be noted that we are greatly impacted by the political, economic and military conditions in Taiwan. Taiwan and China are continuously engaged in political disputes and both countries have continued to conduct military exercises in or near the other's territorial waters and airspace. Such disputes may continue and even escalate, resulting in an economic embargo, a disruption in shipping or even military hostilities. Any of these events could delay production or shipment of our products. Any kind of activity of this nature or even rumors of such activity could harm our operations, revenues, operating results, and stock price.

Terrorist attacks and threats, and government responses thereto, could harm our business.

Terrorist attacks in the United States or abroad against American interests or citizens, U.S. retaliation for these attacks, threats of additional terrorist activity and the war in Iraq have caused our customer base to become more cautious. Any escalation in these events or similar future events may disrupt our operations or those of our customers, distributors and suppliers, affect the availability of materials needed to manufacture our products, or affect the means to transport those materials to manufacturing facilities and finished products to customers. In addition, these events have had and may continue to have an adverse impact on the U.S. and world economy in general and consumer spending in particular, which could harm our business.

We do not typically enter into long-term contracts with our customers, and the loss of a major customer could harm our business.

We do not typically enter into long-term contracts with our customers. In addition, we cannot be certain as to future order levels from our customers. In the past, when we have entered into a long-term contract, the contract has generally been terminable at the convenience of the customer.

We depend on stocking representatives and distributors to generate a majority of our revenues.

We rely on stocking representatives and distributors to establish and maintain customer relationships and to sell our products. These stocking representatives and distributors could discontinue their relationship with us or discontinue selling our products at any time. The majority of our stocking representatives are located in Asia. The loss of our relationship with any stocking representative or distributor could harm our operating results by impairing our ability to sell our products to our end customers.

We depend on SPT, our logistics center, to support many of our customers in Asia.

Since March 2001, we have been increasing our out-sourcing activities with our customer service logistics to support our customers. Currently SPT supports our customers in Taiwan, China and other Southeast Asia countries. SPT provides planning, warehousing, delivery, billing, collection and other logistic functions for us in these regions. SPT is a wholly owned subsidiary of one of our stocking representatives in Taiwan, PCT. During 2001, 2002 and 2003, SPT

serviced end customer shipments accounted for 29.7%, 57.4% and 64.2% of our net product revenues recognized, respectively. As of December 31, 2001, 2002, and 2003, SPT accounted for 48.8%, 68.5% and 73.4%, respectively, of our net accounts receivable. For further description of our relationships with PCT and SPT, please refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Related Party Transactions."

We do not have any long-term contracts with SPT or PCT, and SPT or PCT may cease providing services to us at any time. If SPT or PCT were to terminate their relationship with us we would experience a delay in reestablishing warehousing, logistics and distribution functions, which could impair our ability to collect accounts receivable from SPT and may harm our business.

We depend on a limited number of foreign foundries to manufacture our products, and these foundries may not be able to satisfy our manufacturing requirements, which could cause our revenues to decline.

We outsource substantially all of our manufacturing and testing activities. We currently buy all of our wafers and sorted die from a limited number of suppliers. Substantially all of our products are manufactured by five foundries, TSMC in Taiwan, Sanyo, Seiko-Epson and Yasu in Japan, and Samsung in Korea. In March 2001, we invested $50.0 million in GSMC, a Cayman Islands company, for a wafer foundry project located in Shanghai, China. In March 2004, we committed to an additional $33.2 million investment in GSMC during 2004. Grace, a wholly owned subsidiary or GSMC, began manufacturing some of our products early in the fourth quarter of 2003. We anticipate that these foundries, together with Shanghai Hua Hong NEC Electronic Company Limited, or HHNEC and Vanguard in Taiwan will manufacture substantially all of our products in 2004. If these suppliers fail to satisfy our requirements on a timely basis at competitive prices we could suffer manufacturing delays, a possible loss of revenues or higher than anticipated costs of revenues, any of which could harm our operating results.

Our revenues may be impacted by our ability to obtain adequate wafer supplies from our foundries. The foundries with which we currently have arrangements, together with any additional foundry at which capacity might be obtained, may not be willing or able to satisfy all of our manufacturing requirements on a timely basis at favorable prices. In addition, we have encountered delays in qualifying new products and in ramping-up new product production and we could experience these delays in the future. We are also subject to the risks of service disruptions, raw material shortages and price increases by our foundries. Such disruptions, shortages and price increases could harm our operating results.

Manufacturing capacity has in the past been difficult to secure and if capacity constraints arise in the future our revenues may decline.

In order to grow, we need to increase our present manufacturing capacity. We currently believe that the existing capacity plus additional future capacity from Grace, HHNEC and Vanguard available to us will be sufficient through 2004. However, events that we have not foreseen could arise which would limit our capacity. Similar to our $50.0 million investment in GSMC, we may determine that it is necessary to invest substantial capital in order to secure appropriate production capacity commitments. If we cannot secure additional manufacturing capacity on acceptable terms, our ability to grow will be impaired and our operating results will be harmed.

If we are not successful in subleasing our unused office space, we may be required to take additional period charges for the difference between the total future sublease income and our lease cost.

We have long-term, non-cancelable building lease commitments. We are currently in the process of locating subtenants for our unused office space. We may be unable to secure subtenants for this space due to the decrease in demand for commercial rental space in Silicon Valley. During the third quarter of 2001, we recorded a period charge to other operating expense of $756 thousand relating to an operating lease for an abandoned building. This charge represents the estimated difference between the total non-discounted future sublease income and our non-discounted lease commitments relating to this building. The charge was an estimate and may be adjusted if we obtain a sublease for the building and the actual sublease income is significantly different from the estimate. If we are unable to secure subtenants, we may be required to take additional period charges for the balance of the future lease cost, and this will harm our operating results.

Our cost of revenues may increase if we are required to purchase manufacturing capacity in the

future.

To obtain additional manufacturing capacity, we may be required to make deposits, equipment purchases, loans, joint ventures, equity investments or technology licenses in or with wafer fabrication companies. These transactions could involve a commitment of substantial amounts of our capital and technology licenses in return for production capacity. We may be required to seek additional debt or equity financing if we need substantial capital in order to secure this capacity and we cannot assure you that we will be able to obtain such financing.

If our foundries fail to achieve acceptable wafer manufacturing yields, we will experience higher costs of revenues and reduced product availability.

The fabrication of our products requires wafers to be produced in a highly controlled and ultra-clean environment. Semiconductor companies that supply our wafers have, from time to time, experienced problems achieving acceptable wafer manufacturing yields. Semiconductor manufacturing yields are a function of both our design

technology and the foundry's manufacturing process technology. Low yields may result from marginal design or manufacturing process drift. Yield problems may not be identified until the wafers are well into the production process, which often makes them difficult, time consuming and costly to correct. Furthermore, we rely on independent foundries for our wafers which increases the effort and time required to identify, communicate and resolve manufacturing yield problems. If our foundries fail to achieve acceptable manufacturing yields, we will experience higher costs of revenues and reduced product availability, which could harm our operating results.

If our foundries discontinue the manufacturing processes needed to meet our demands, or fail to upgrade the technologies needed to manufacture our products, we may face production delays and lower revenues.

Our wafer and product requirements typically represent a small portion of the total production of the foundries that manufacture our products. As a result, we are subject to the risk that a foundry will cease production on an older or lower-volume manufacturing process that it uses to produce our parts. Additionally, we cannot be certain our foundries will continue to devote resources to advance the process technologies on which the manufacturing of our products is based. Either one of these events could increase our costs and harm our ability to deliver our products on time.

Our dependence on third-party subcontractors to assemble and test our products subjects us to a number of risks, including an inadequate supply of products and higher costs of materials.

We depend on independent subcontractors to assemble and test our products. Our reliance on these subcontractors involves the following significant risks:

- reduced control over delivery schedules and quality;
- the potential lack of adequate capacity during periods of strong demand;
- difficulties selecting and integrating new subcontractors;
- limited warranties on products supplied to us;
- potential increases in prices due to capacity shortages and other factors; and
- potential misappropriation of our intellectual property.

These risks may lead to increased costs, delayed product delivery or loss of competitive advantage, which would harm our profitability and customer relationships.

Because our flash memory products typically have lengthy sales cycles, we may experience substantial delays between incurring expenses related to research and development and the generation of revenues.

Due to the flash memory product cycle we usually require more than nine months to realize volume shipments after we first contact a customer. We first work with customers to achieve a design win, which may take three months or longer. Our customers then complete the design, testing and evaluation process and begin to ramp up production, a period which typically lasts an additional six months or longer. As a result, a significant period of time may elapse between our research and development efforts and our realization of revenue, if any, from volume purchasing of our products by our customers.

We face intense competition from companies with significantly greater financial, technical and marketing resources that could harm sales of our products.

We compete with major domestic and international semiconductor companies, many of which have substantially greater financial, technical, marketing, distribution, and other resources than we do. Many of our competitors have their own facilities for the production of semiconductor memory components and have recently added significant capacity for such production. Our memory products, which presently account for substantially all of our revenues, compete principally against products offered by AMD, Atmel, Intel, Macronix, Sanyo, STMicroelectronics and Winbond. If we are successful in developing our high-density products, these products will compete principally with products offered by AMD, Atmel, Fujitsu, Hitachi, Intel, Mitsubishi, Samsung, SanDisk, Sharp Electronics, STMicroelectronics and Toshiba, as well as any new entrants to the market.

In addition, we may in the future experience direct competition from our foundry partners. We have licensed to our foundry partners the right to fabricate products based on our technology and circuit design, and to sell such products worldwide, subject to our receipt of royalty payments.

Competition may also come from alternative technologies such as ferroelectric random access memory devices, or FRAM, or other developing technologies.

Our markets are subject to rapid technological change and, therefore, our success depends on our ability to develop and introduce new products.

The markets for our products are characterized by:

- rapidly changing technologies;
- evolving and competing industry standards;
- changing customer needs;
- frequent new product introductions and enhancements;
- increased integration with other functions; and
- rapid product obsolescence.

To develop new products for our target markets, we must develop, gain access to and use leading technologies in a cost-effective and timely manner and continue to expand our technical and design expertise. In addition, we must have our products designed into our customers' future products and maintain close working relationships with key customers in order to develop new products that meet their changing needs.

In addition, products for communications applications are based on continually evolving industry standards. Our ability to compete will depend on our ability to identify and ensure compliance with these industry standards. As a result, we could be required to invest significant time and effort and incur significant expense to redesign our products and ensure compliance with relevant standards. We believe that products for these applications will encounter intense competition and be highly price sensitive. While we are currently developing and introducing new products for these applications, we cannot assure you that these products will reach the market on time, will satisfactorily address customer needs, will be sold in high volume, or will be sold at profitable margins.

We cannot assure you that we will be able to identify new product opportunities successfully, develop and bring to market new products, achieve design wins or respond effectively to new technological changes or product announcements by our competitors. In addition, we may not be successful in developing or using new technologies or in developing new products or product enhancements that achieve market acceptance. Our pursuit of necessary technological advances may require substantial time and expense. Failure in any of these areas could harm our operating results.

Our future success depends in part on the continued service of our key design engineering, sales, marketing and executive personnel and our ability to identify, recruit and retain additional personnel.

We are highly dependent on Bing Yeh, our President and Chief Executive Officer, as well as the other principal members of our management team and engineering staff. There is intense competition for qualified personnel in the semiconductor industry, in particular the highly skilled design, applications and test engineers involved in the development of flash memory technology. Competition is especially intense in Silicon Valley, where our corporate headquarters is located. We may not be able to continue to attract and retain engineers or other qualified personnel necessary for the development of our business or to replace engineers or other qualified personnel who may leave our employ in the future. Our anticipated growth is expected to place increased demands on our resources and will likely require the addition of new management and engineering personnel and the development of additional expertise by existing management personnel. The failure to recruit and retain key design engineers or other technical and management personnel could harm our business.

Our ability to compete successfully depends, in part, on our ability to protect our intellectual property rights.

We rely on a combination of patent, trade secrets, copyrights, mask work rights, nondisclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. Policing unauthorized use of our products, however, is difficult, especially in foreign countries. Litigation may continue to be necessary in the

future 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 or invalidity. Litigation could result in substantial costs and diversion of resources and could harm our business, operating results and financial condition regardless of the outcome of the litigation. We own 78 patents in the United States relating to our products and processes, with expiration dates ranging from 2010 to 2023, and have filed for several more. In addition, we hold

several patents in Europe and Canada, and have filed several foreign patent applications in Europe, Japan, Korea, Taiwan and Canada. We cannot assure you that any pending patent application will be granted. Our operating results could be harmed by the failure to protect our intellectual property.

If we are accused of infringing the intellectual property rights of other parties we may become subject to time-consuming and costly litigation. If we lose, we could suffer a significant impact on our business and be forced to pay damages.

Third parties may assert that our products infringe their proprietary rights, or may assert claims for indemnification resulting from infringement claims against us. Any such claims may cause us to delay or cancel shipment of our products or pay damages that could harm our business, financial condition and results of operations. In addition, irrespective of the validity or the successful assertion of such claims, we could incur significant costs in defending against such claims.

In the past we were sued both by Atmel Corporation and Intel Corporation regarding patent infringement issues and sued Winbond Electronics Corporation regarding our contractual relationship with them. Significant management time and financial resources have been devoted to defending these lawsuits. We settled with Intel in May 1999, with Winbond in October 2000, and the Atmel litigation is ongoing.

In addition to the Atmel, Intel and Winbond actions, we receive from time to time, letters or communications from other companies stating that such companies have patent rights that involve our products. Since the design of all of our products is based on SuperFlash technology, any legal finding that the use of our SuperFlash technology infringes the patent of another company would have a significantly negative effect on our entire product line and operating results. Furthermore, if such a finding were made, there can be no assurance that we could license the other company's technology on commercially reasonable terms or that we could successfully operate without such technology. Moreover, if we are found to infringe, we could be required to pay damages to the owner of the protected technology and could be prohibited from making, using, selling, or importing into the United States any products that infringe the protected technology. In addition, the management attention consumed by and legal cost associated with any litigation could harm our operating results.

Public announcements may hurt our stock price.

During the course of lawsuits there may be public announcements of the results of hearings, motions, and other interim proceedings or developments in the litigation. If securities analysts or investors perceive these results to be negative, it could harm the market price of our stock.

Our litigation may be expensive, may be protracted and confidential information may be compromised.

On April 8, 2002, a jury found that we willfully infringed Atmel's '811 and '829 patents, and awarded Atmel $20.0 million in actual damages. On May 7, 2002, the court entered judgment in the total amount of $36.5 million, which

includes the original $20.0 million. The '811 and '829 patents expired in February 2002. Therefore, we are not precluded from selling any of our products. On December 12, 2003, we paid Atmel $37.8 million to satisfy the judgement plus statutory interest accrued during the appeal. The '903 patent case still remains open. The court found that we infringed the '903 patent but the jury was unable to unanimously decide whether the '903 is valid and a mistrial was declared. A settlement conference is scheduled for April 14, 2004. If we are not able to reach a settlement agreement, the court may set a date for a new trial. If we are not successful in reaching a settlement, litigation may continue to consume substantial amounts of our financial and managerial resources. We have incurred certain costs associated with defending this matter, and at any time Atmel may file additional claims against us, which could increase the risk, expense and duration of the litigation. Further, because of the substantial amount of discovery required in connection with this type of litigation, there is a risk that some of our confidential information could be compromised by disclosure. For more information with respect to our litigation, please also see "Part I, Item 3 - Legal Proceedings."

If an earthquake or other natural disaster strikes our manufacturing facility or those of our suppliers, we would be unable to manufacture our products for a substantial amount of time and we would experience lost revenues.

Our corporate headquarters are located in California near major earthquake faults. In addition, some of our suppliers are located near fault lines. In the event of a major earthquake or other natural disaster near our headquarters, our operations could be harmed. Similarly, a major earthquake or other natural disaster such as typhoon near one or more of our major suppliers, like the earthquakes in September 1999 and March 2002 or the typhoon in September 2001 that occurred in Taiwan, could potentially disrupt the operations of those suppliers, which could then limit the supply

of our products and harm our business.

A virus or viral outbreak in Asia could harm our business.

We derive substantially all of our revenues from Asia and our logistics center is located in Taiwan. A virus or viral outbreak in Asia, such as the recent SARS outbreak in early 2003, could harm the operations of our suppliers, distributors, logistics center and those of our end customer, which could harm our business.

Prolonged electrical power outages, energy shortages, or increased costs of energy could harm our business.

Our design and process research and development facilities and our corporate offices are located in California, which is susceptible to power outages and shortages as well as increased energy costs. To limit this exposure, all corporate computer systems at our main California facilities are on battery back-up. In addition, all of our engineering and back-up servers and selected corporate servers are on generator back-up. While the majority of our production facilities are not located in California, more extensive power shortages in the state could delay our design and process research and development as well as increase our operating costs.

Our growth has in the past placed a significant strain on our management systems and resources and if we fail to manage our growth, our ability to market or sell our products or develop new products may be harmed.

Our business has in the past experienced rapid growth which strained our internal systems and future growth will require us to continuously develop sophisticated information management systems in order to manage our business effectively. We recently implemented a supply-chain management system and a vendor electronic data interface system. There is no guarantee that these measures, in themselves, will be adequate to address any growth, or that we

will be able to foresee in a timely manner other infrastructure needs before they arise. Our success depends on the ability of our executive officers to effectively manage our growth. If we are unable to manage our growth effectively, our results of operations will be harmed. If we fail to successfully implement new management information systems, our business may suffer severe inefficiencies that may harm the results of our operations.

Risks Related to Our Industry

Our success is dependent on the growth and strength of the flash memory market.

All of our products, as well as all new products currently under design, are stand-alone flash memory devices or devices embedded with flash memory. A memory technology other than SuperFlash may be adopted as an industry standard. Our competitors are generally in a better financial and marketing position than we are from which to influence industry acceptance of a particular memory technology. In particular, a primary source of competition may come from alternative technologies such as FRAM devices if such technology is commercialized for higher density applications. To the extent our competitors are able to promote a technology other than SuperFlash as an industry standard, our business will be seriously harmed.

The selling prices for our products are extremely volatile and have historically declined during periods of over capacity or industry downturns.

The semiconductor industry has historically been cyclical, characterized by periodic changes in business conditions caused by product supply and demand imbalance. When the industry experiences downturns, they often occur in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. These downturns are characterized by weak product demand, excessive inventory and accelerated declines of average selling prices. In some cases, downturns, such as the one we experienced from late 2000 through 2002, have lasted for more than a year. Our business could be further harmed by industry-wide prolonged downturns in the future. The flash memory products portion of the semiconductor industry, from which we derive substantially all of our revenues, suffered from excess capacity in 2001, 2002 and 2003, which resulted in greater than normal declines in our markets, which unfavorably impacted our revenues, gross margins and profitability. While these conditions began to improve during the third quarter of 2003, deteriorating market conditions at the end of 2000 through the first part 2003 have resulted in the decline of our selling prices and harmed our operating results.

There is seasonality in our business and if we fail to continue to introduce new products this seasonality may become more pronounced.

Sales of our products in the consumer electronics applications market are subject to seasonality. As a result, sales of

these products are impacted by seasonal purchasing patterns with higher sales generally occurring in the second half of each year. In the past we have been able to mitigate such seasonality with the introduction of new products throughout the year. If we fail to continue to introduce new products, our business may suffer and the seasonality of a portion of our sales may become more pronounced.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to risks associated with foreign exchange rate fluctuations due to our international manufacturing and sales activities. These exposures may change over time as business practices evolve and could negatively impact our

operating results and financial condition. Currently, we do not hedge these foreign exchange rate exposures. All of our sales are denominated in U.S. dollars. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore reduce the demand for our products. Such a decline in the demand could reduce revenues and/or result in operating losses. In addition, a downturn in the economies of China, Japan or Taiwan could impair the value of our equity investments in companies with operations in these countries. If we consider the value of these companies to be impaired, we will write off, or expense, some or all of our investments. In the fourth quarter of 2001, we wrote down our investment in KYE by $3.3 million to $1.3 million due to an other than temporary decline in its market value. As of December 31, 2003, the recorded value of our KYE investment was $3.2 million based on the quoted market price. In the third quarter of 2002, we wrote down our investment in Apacer, a privately held memory module manufacturer located in Taiwan, by $7.8 million due to an other than temporary decline in its value. As of December 31, 2003, the recorded value of our Apacer investment was $4.4 million. In addition, we have equity investments in companies with operations in China, Japan, Taiwan and United States with recorded values at December 31, 2003 of $50.0 million, $0.9 million, $19.8 million and $0.3 million, respectively.

At any time, fluctuations in interest rates could affect interest earnings on our cash, cash equivalents and short-term investments, or the fair value of our investment portfolio. A 10% move in interest rates as of December 31, 2003 would have an immaterial effect on our financial position, results of operations and cash flows. Currently, we do not hedge these interest rate exposures. As of December 31, 2003, the carrying value of our available-for-sale investments approximated fair value. The table below presents the carrying value and related weighted average interest rates for our unrestricted and restricted cash, cash equivalents and available-for-sale investments as of December 31, 2003 (in thousands):

	Carrying Value	Interes Rate
Short-term available-for-sale investments - fixed rate	$ 60,569	1
Long-term available-for-sale investments (1 to 2 years) - fixed rate	12,046	1
Cash and cash equivalents - variable rate	124,625	0
	$ 197,240	1

Item 8. Consolidated Financial Statements and Supplementary Data

The consolidated financial statements are included in a separate section of this Annual Report.

Supplementary Data: Selected Consolidated Quarterly Data

The following table presents our unaudited consolidated statements of operations data for each of the eight quarters in the period ended December 31, 2003. In our opinion, this information has been presented on the same basis as the audited consolidated financial statements included in a separate section of this report, and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts below to present fairly the unaudited quarterly results when read in conjunction with the audited consolidated financial statements and related

notes. The operating results for any quarter should not be relied upon as necessarily indicative of results for any future period. We expect our quarterly operating results to fluctuate in future periods due to a variety of reasons, including those discussed in "Business Risks."

	Quarter Ended			
	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003
	(in thousands, except per share data)			
Net revenues:				
Product revenues	$ 53,921	$ 54,860	$ 65,397	$ 82,351
License revenues	7,788	9,320	8,538	12,866
Total net revenues	$ 61,709	$ 64,180	$ 73,935	$ 95,217
Gross profit (loss)	$ 9,208	$ 16,247	$ 18,341	$ 32,470
Income (loss) from operations	$ (11,083)	$ (3,739)	$ (37,390)	$ 10,815
Net income (loss)	$ (10,665)	$ (4,589)	$ (59,018)	$ 9,105
Net income (loss) per share-basic	$ (0.11)	$ (0.05)	$ (0.62)	$ 0.10
Net income (loss) per share-diluted	$ (0.11)	$ (0.05)	$ (0.62)	$ 0.09

	Quarter Ended			
	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002
	(in thousands, except per share data)			
Net revenues:				
Product revenues	$ 66,295	$ 61,480	$ 59,445	$ 56,801
License revenues	8,287	7,997	8,311	6,042
Total net revenues	$ 74,582	$ 69,477	$ 67,756	$ 62,843
Gross profit (loss)	$ 24,080	$ 19,242	$ 18,356	$ 6,734
Income (loss) from operations	$ 1,387	$ (7,050)	$ (1,768)	$ (13,821)
Net income (loss)	$ 1,558	$ (4,222)	$ (4,768)	$ (7,663)
Net income (loss) per share-basic	$ 0.02	$ (0.05)	$ (0.05)	$ (0.08)
Net income (loss) per share-diluted	$ 0.02	$ (0.05)	$ (0.05)	$ (0.08)

We recorded impairment of an equity investments of $7.8 million in the third quarter of 2002.

We recorded settlement fees of $36.5 million and interest of $1.3 million related to the Atmel lawsuit in the third and fourth quarter of 2003, respectively. In the third quarter of 2003, we recorded a full valuation of our deferred tax assets and associated adjustments to income tax payable, resulting in a tax expense of $22.9 million.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Based on their evaluation as of December 31, 2003, our chief executive officer and chief financial officer, have concluded that 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) were sufficiently effective to ensure that the information required to be disclosed by us in this annual report on Form 10-K was recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and Form 10-K. There were no changes in our internal control over financial reporting during the quarter ended December 31, 2003 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or our 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, within 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 control. 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, 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 not be detected.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item will be contained in our definitive Proxy Statement with respect to our Annual Meeting of Shareholders under the captions "Election of Directors," "Security Ownership of Certain Beneficial Owners and Management - Compliance with the Reporting Requirement of Section 16(a)," and "Code of Conduct," and are incorporated by reference into this report. The information relating to our executive officers is contained in Part I, Item 1 of this report.

Item 11. Executive Compensation

The information required by this item will be contained in our definitive Proxy Statement with respect to our Annual Meeting of Shareholders under the caption "Compensation - Compensation of Officers," and is incorporated by reference into this report.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The information required by this item will be contained in our definitive Proxy Statement with respect to our Annual Meeting of Shareholders under the captions "Security Ownership of Certain Beneficial Owners and Management" and "Compensation - Equity Compensation Plan Information," and are incorporated by reference into this report.

Item 13. Certain Relationships and Related Transactions

The information required by this item will be contained in our definitive Proxy Statement with respect to our Annual Meeting of Shareholders under the caption "Certain Transactions," and is incorporated by reference into this report. Please also see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Related Party Transactions."

Item 14. Principal Accountant Fees and Services

The information required by this item will be contained in our definitive Proxy Statement with respect to our Annual Meeting of Shareholders under the caption "Ratification of Selection of Independent Accountants" and is incorporated by reference into this report.

PART IV

Item 15. Exhibits, Financial Statement Schedule, and Reports on Form 8-K

(a) (1) Consolidated Financial Statements. The index to the consolidated financial statements is found on page 41 of this Report.

(2) Financial Statement Schedule. Financial statement schedule Number II is included.

(3) Exhibits. See Exhibit Index in part (c), below.

(b) Reports on Form 8-K.

On October 22, 2003, we filed a current report on Form 8-K in connection with the issuance of a press release dated October 22, 2003 announcing our financial results for the third quarter of 2003. The press release was furnished under Item 9.

On December 12, 2003, we filed a current report on Form 8-K in connection with the Federal Circuit Court of Appeals decision upholding the jury verdict of infringement of the '811 and '829 patents in favor of Atmel Corp. The disclosure was filed under Item 5.

(c) Index to Exhibits.

Exhibit Number	Description of Document
3.1 (1)	Bylaws of SST.
3.2 (2)	Restated Articles of Incorporation of SST, dated November 3, 1995.
3.3 (3)	Certificate of Amendment of the Restated Articles of Incorporation of SST, dated June 30, 2000.
3.4 (4)	Certificate of Designation of Series A Junior Participating Preferred Stock.
4.1	Reference is made to Exhibits 3.1 to 3.4.
4.2 (5)	Specimen Stock Certificate of SST.
4.3 (6)	Rights Agreement between SST and American Stock Transfer and Trust Co., dated May 4, 1999.
4.4 (7)	Amendment No. 1 to Rights Agreement between SST and American Stock Transfer and Trust Co., dated October 28, 2000.
10.1 (8)	Equity Incentive Plan and related agreements.
10.2 (9)	Employee Stock Purchase Plan.
10.3 (10)	1995 Non-Employee Director's Stock Option Plan.
10.4 (11)	Profit Sharing Plan.
10.5 (12)	Lease Agreement between SST and Sonora Court Properties, dated May 4, 1993, as amended.
10.6 (13)	Lease Agreement between SST and Coast Properties, dated May 4, 1995, as amended.
10.8 (14)	Lease amendment, dated March 4, 1998, between SST and Sonora Court Properties.
10.9 (15)	Lease Amendment, dated March 4, 1998, between SST and Coast Properties.
10.11 (16)	Second Amendment to Lease, dated September 13, 1999, between SST and Coast Properties.

10.12 (17)	Lease Agreement between SST and Bhupinder S. Lehga and Rupinder K. Lehga, dated November 15, 1999.

10.13 (18)	Lease Agreement between SST and The Irvine Company, dated November 22, 1999.
10.14 (19)	Sunnyvale Industrials Net Lease Agreement, dated June 26, 2000.
21.1	Subsidiaries of SST.
23.1	Consent of PricewaterhouseCoopers LLP, Independent Accountants.
24.1	Power of Attorney is contained on the signature page.
31.1	Certification required by Rule 13a- 14(a).
31.2	Certification required by Rule 13a- 4(a).
32.1	Certification of President and Chief Executive Officer, as required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).*
32.2	Certification of Vice President Finance & Administration, Chief Financial Officer and Secretary, as required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).*

* The certifications attached as Exhibit 32.1 and Exhibit 32.2 accompany the Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-K), irrespective of any general incorporation language contained in such filing.

_____

1. Filed as Exhibit 3.2 to our Registration Statement on Form S-1, as amended, File No. 33-97802, filed on October 5, 1995, and incorporated by reference herein.
2. Filed as Exhibit 3.4 to our Registration Statement on Form S-1, as amended, File No. 33-97802, filed on October 5, 1995, and incorporated by reference herein.
3. Filed as Exhibit 3.5 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, filed on August 7, 2000, and incorporated by reference herein.
4. Filed as Exhibit 99.3 to our Current Report on Form 8-K filed on May 18, 1999, and incorporated by reference herein.
5. Filed as Exhibit 4.2 to our Registration Statement on Form S-1, as amended, File No. 33-97802, filed on November 3, 1995, and incorporated by reference herein.
6. Filed as Exhibit 99.2 to our Current Report on Form 8-K filed on May 18, 1999, and incorporated by reference herein.
7. Filed as Exhibit 3.6 to our Annual Report on Form 10-K for the year ended December 31, 2000, as amended, filed on March 30, 2001, and incorporated by reference herein.
8. Filed as amended as Exhibit 99.1 to our Registration Statement on Form S-8, File No. 333-98135, filed on August 15, 2002, and incorporated by reference herein.
9. Filed as amended as Exhibit 99.2 to our Registration Statement on Form S-8, File No. 33-33130, filed on March 23, 2000, and incorporated by reference herein.
10. Filed as amended as Exhibit 99.2 to our Registration Statement on Form S-8 File No. 33-98135, filed on August 15, 2002, and incorporated by reference herein.

11. Filed as Exhibit 10.5 to our Registration Statement on Form S-1, as amended, File No. 33-97802, filed on October 5, 1995, and incorporated by reference herein.
12. Filed as Exhibit 10.6 to our Registration Statement on Form S-1, as amended, File No. 33-97802, filed on October 5, 1995, and incorporated by reference herein.
13. Filed as Exhibit 10.7 to our Registration Statement on Form S-1, as amended, File No. 33-97802, filed on October 5, 1995, and incorporated by reference herein.
14. Filed as Exhibit 10.17 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 1998, filed on August 14, 1998, and incorporated by reference herein.
15. Filed as Exhibit 10.18 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 1998, filed on August 14, 1998, and incorporated by reference herein.
16. Filed as Exhibit 10.23 to our Annual Report on Form 10-K for the year ended December 31, 1999, as amended, filed on February 24, 2000, and incorporated by reference herein.
17. Filed as Exhibit 10.24 to our Annual Report on Form 10-K for the year ended December 31, 1999, as amended, filed on February 24, 2000, and incorporated by reference herein.
18. Filed as Exhibit 10.25 to our Annual Report on Form 10-K for the year ended December 31, 1999, as amended, filed on February 24, 2000, and incorporated by reference herein.
19. Filed as Exhibit 10.28 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, filed on August 7, 2000, and incorporated by reference herein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Sunnyvale, County of Santa Clara, State of California, on the 15th day of March, 2004.

SILICON STORAGE TECHNOLOGY, INC.

By: /s/ BING YEH
Bing Yeh
President and Chief Executive Officer
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS

, that each person whose signature appears below constitutes and appoints Bing Yeh and Jack K. Lai, and each or any one of them, his true and lawful attorney-in-fact and agent, with full power of substitution and re-substitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitutes or substitute, may lawfully do or cause to be done by virtue hereof.

Signature

Title

Date

/s/ BING YEH

Bing Yeh

President, Chief Executive Officer and Director (Principal Executive Officer)

March 15, 2004

/s/ JACK K. LAI

Jack K. Lai

Vice President Finance & Administration, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)

March 15, 2004

/s/ YAW WEN HU

Yaw Wen Hu

Director

March 15, 2004

/s/ TSUYOSHI TAIRA

Tsuyoshi Taira

Director

March 15, 2004

/s/ RONALD CHWANG

Ronald Chwang

Director

March 15, 2004

/s/ YASUSHI CHIKAGAMI

Yasushi Chikagami

Director

March 15, 2004

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders
Silicon Storage Technology, Inc.

In our opinion, the consolidated statements listed in the accompanying index appearing under Item 15 (a) (1) on page 37 present fairly, in all material respects, the financial position of Silicon Storage Technology, Inc. and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index appearing under Item 15 (a) (2) on page 37 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS LLP

San Jose, California
February 8, 2004, except for Note 11,
which is as of March 8, 2004

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 31,	
	2002	2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 103,751	$ 124,625
Short-term available-for-sale investments	41,252	60,569
Trade accounts receivable-unrelated parties, net of allowance for doubtful accounts of $4,420 as of December 31, 2002 and $1,118 as of December 31, 2003	10,723	14,110

Trade accounts receivable-related parties	25,248	41,220
Inventories, net	83,040	46,120
Deferred tax asset	17,154	--
Other current assets	29,671	13,232
Total current assets	310,839	299,876
Equipment, furniture and fixtures, net	16,989	11,325
Equity investments	60,910	58,077
Long-term available-for-sale investments	5,862	24,969
Restricted cash and cash equivalents	11,976	--
Restricted available-for-sale investments	24,873	--
Deferred tax asset	5,164	--
Other assets	3,993	2,114
Total assets	$ 440,606	$ 396,361
LIABILITIES		
Current liabilities:		
Notes payable, current portion	$ 352	$ 393
Trade accounts payable-unrelated parties	28,408	37,342
Trade accounts payable-related parties	6,689	10,165
Accrued expenses and other liabilities	18,783	11,911
Deferred revenue	2,650	3,630
Total current liabilities	56,882	63,441
Other liabilities	1,873	1,423
Total liabilities	58,755	64,864
Commitments (Note 5) and Contingencies (Note 6).		
SHAREHOLDERS' EQUITY		
Preferred Stock, no par value		
Authorized: 7,000 shares		
Series A Junior Participating Preferred Stock, no par value		
Designated: 450 shares		
Issued and outstanding: none	--	--
Common stock, no par value:		
Authorized: 250,000 shares		
Issued and outstanding: 93,295 shares in 2002 and 95,328 shares in 2003	339,598	345,384
Accumulated other comprehensive income	151	9,178
Retained earnings (accumulated deficit)	42,102	(23,065)
Total shareholders' equity	381,851	331,497
Total liabilities and shareholders' equity	$ 440,606	$ 396,361

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

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,		
	2001	2002	2003
Net revenues:			
Product revenues - unrelated parties	$ 168,593	$ 100,620	$ 86,549
Product revenues - related parties	90,025	143,401	169,980
License revenues	35,412	30,637	38,512
Total net revenues	294,030	274,658	295,041
Cost of revenues	248,161	206,246	218,775
Gross profit	45,869	68,412	76,266
Operating expenses:			
Research and development	50,380	47,069	43,144
Sales and marketing	26,794	25,498	22,272
General and administrative	17,855	17,097	14,398
Other (Note 5 and Note 7)	1,346	--	37,849
Total operating expenses	96,375	89,664	117,663
Loss from operations	(50,506)	(21,252)	(41,397)
Interest and other income	7,350	3,197	2,784
Interest expense	(338)	(214)	(138)
Impairment of equity investments	(3,274)	(7,757)	--
Loss before provision for (benefit from) income taxes	(46,768)	(26,026)	(38,751)
Provision for (benefit from) income taxes	(17,772)	(10,931)	26,416
Net loss	$ (28,996)	$ (15,095)	$ (65,167)
Net loss per share - basic and diluted	$ (0.32)	$ (0.16)	$ (0.69)
Shares used in per share calculation - basic and diluted	91,084	92,667	94,723

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

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE LOSS
(in thousands)

	Retained	Accumulated

	Common Stock		Earnings (Accumulated	Other Comprehensive	
	Shares	Amount	Deficit)	Income	Total
Balances, December 31, 2000.....	90,118	$ 330,310	$ 86,193	$ 132	$ 416,635
Issuance of shares of common stock under employees' stock purchase and option plans.....	1,467	3,679	--	--	3,679
Net loss.....	--	--	(28,996)	--	
Unrealized gain on available for sale securities, net of tax.....	--	--	--	93	
Comprehensive loss.....	--	--	--	--	(28,903)
Balances, December 31, 2001.....	91,585	333,989	57,197	225	391,411
Issuance of shares of common stock under employees' stock purchase and option plans.....	1,710	4,076	--	--	4,076
Tax benefit from exercise of stock options.....	--	1,533	--	--	1,533
Net loss.....	--	--	(15,095)	--	
Unrealized loss on available for sale securities, net of tax.....	--	--	--	(74)	
Comprehensive loss.....	--	--	--	--	(15,169)
Balances, December 31, 2002.....	93,295	339,598	42,102	151	381,851
Issuance of shares of common stock under employees' stock purchase and option plans.....	2,033	4,535	--	--	4,535
Tax benefit from exercise of stock options.....	--	1,251	--	--	1,251
Net loss.....	--	--	(65,167)	--	
Unrealized gain on available for sale securities, net of tax.....	--	--	--	9,027	
Comprehensive loss.....	--	--	--	--	(56,140)
Balances, December 31, 2003.....	95,328	$ 345,384	$ (23,065)	$ 9,178	$ 331,497

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

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2001	2002	2003
Cash flows from operating activities:			
Net loss	$ (28,996)	$ (15,095)	$ (65,16
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	9,799	9,847	7,69
Provision for doubtful accounts receivable	2,251	3,046	22
Provision for sales returns	32,227	2,842	31
Provision for excess and obsolete inventories, write down of inventory to market and adverse purchase commitments	73,932	10,441	6,67
Deferred income taxes	(19,863)	7,036	22,31
(Gain) loss on disposition of equipment	72	(92)	11
Gain on sale of equity investments	--	--	(64
Other expenses	1,346	--	-
Impairment of equity investments	3,274	7,757	-
Tax benefit from employee stock plans	--	1,533	1,25
Changes in operating assets and liabilities:			
Trade accounts receivable from unrelated parties	55,109	3,263	(3,93
Trade accounts receivable from related parties	(3,999)	(4,452)	(15,97
Inventories	(108,866)	16,024	29,50
Other current and noncurrent assets	3,355	(21,269)	18,31
Trade accounts payable to unrelated parties	(15,086)	4,310	8,93
Trade accounts payable to related parties	(86)	(564)	3,47
Accrued expenses and other liabilities	(17,226)	1,588	(6,53
Deferred revenue	(9,775)	(2,849)	98
Net cash provided by (used in) operating activities	(22,532)	23,366	7,55
Cash flows from investing activities:			
Restricted cash	12,490	--	-
Repayment of restricted cash	(12,490)	--	-
Acquisition of equipment, furniture and fixtures	(13,700)	(4,315)	(1,80
Proceeds from sale of equipment	75	118	-
Purchases of available-for-sale investments and restricted cash	(166,538)	(74,272)	(54,95
Sales and maturities of available-for-sale investments	234,928	63,156	65,79
Investment in equity securities	(52,211)	(1,660)	-
Cash used in acquisition	(498)	--	-
Net cash provided by (used in) investing activities	2,056	(16,973)	9,03
Cash flows from financing activities:			
Borrowings	1,800	--	-
Repayments	(261)	(316)	(25
Issuance of shares of common stock	3,679	4,076	4,53
Other	(230)	--	-
Net cash provided by financing activities	4,988	3,760	4,28
Net increase (decrease) in cash and cash equivalents	(15,488)	10,153	20,87
Cash and cash equivalents at beginning of year	109,086	93,598	103,75
Cash and cash equivalents at end of year	$ 93,598	$ 103,751	$ 124,62
Supplemental disclosure of cash flow information:			
Cash received for interest	$ 8,760	$ 3,449	$ 2,81
Cash paid for interest	$ 356	$ 221	$ 12
Net cash paid for (received from) income taxes	$ 12,965	$ (3,189)	$ (8,22

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

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies:

Nature of Operations:

Silicon Storage Technology, Inc. ("SST" or "us" or "we") supplies flash memory semiconductor devices for digital consumer, networking, wireless communications and Internet computing markets. Flash memory is nonvolatile memory that does not lose data when the power source is removed and is capable of electronically erasing selected blocks of data. We license our SuperFlash technology to other companies for non-competing applications. Our products are used in personal computers, personal computer peripheral devices, consumer electronics and communications devices. Our products are sold to manufacturers located primarily in Asia.

Use of Estimates in Preparation of the Financial Statements:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Risks, Uncertainties and Concentrations:

Our sales are concentrated in the nonvolatile memory class of the semiconductor memory industry, which is highly competitive and rapidly changing. Significant technological changes in the industry, changes in customer requirements, changes in product costs and selling prices, or the emergence of competitor products with new capabilities or technologies could affect our operating results adversely. We currently buy all wafers and die, an integral component of our products, from outside suppliers and we are dependent on third party subcontractors to assemble and test our products. Failure by these suppliers to satisfy our requirements on a timely basis at competitive prices could cause us to suffer manufacturing delays, a possible loss of revenues, or higher than anticipated costs of revenues, any of which could severely adversely affect operating results.

Since March 2001, we have been increasing our out-sourcing activities for our end customer service logistics to support our customers. Currently Silicon Professional Technology Ltd., or SPT, supports our customers in Taiwan, China and other Southeast Asia countries. SPT provides planning, warehousing, delivery, billing, collection and other logistic functions for us in these regions. SPT is a wholly-owned subsidiary of one of our stocking representatives in Taiwan, Professional Computer Technology Limited, or PCT. Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT. For the years ended December 31, 2001, 2002 and 2003, SPT serviced end customer sales accounting for 29.7%, 57.4% and 64.2% of our net product revenues recognized. Further description of our relationships with PCT and SPT are in Note 11 of these Notes to the Consolidated Financial

Statements.

We ship products to, and have accounts receivable from, original equipment manufacturers, or OEMs, original design manufacturers, or ODMs, contract electronic manufacturers, or CEMs, stocking representatives, distributors, and our logistics center. Our stocking representatives, distributors and logistics center reship our products to our end customers, including OEMs, ODMs, CEMs and end users. Shipments, by us or our logistic center, to our top three stocking representatives for reshipment accounted for 10.9%, 16.9% and 29.9% of our product shipments in 2001, 2002 and 2003, respectively. In addition, the same three stocking representatives solicited sales, for which they received a commission, for 27.5%, 41.3% and 32.8% of our shipments to end users in 2001, 2002 and 2003, respectively. Our stocking representatives and distributors could discontinue their relationship with us or discontinue selling our products at any time. The loss of our relationship with any of our stocking representatives or distributors could harm our operating results by impairing our ability to sell our products to our end customers. Our logistics center, SPT, may cease providing services to us at any time. If SPT were to terminate their relationship with us we would experience a delay in reestablishing warehousing, logistics and distribution functions, which could impair our ability to collect accounts receivable from SPT and may harm our business.

We derived 80.7%, 88.5% and 90.0% of our net product revenues from Asia during 2001, 2002 and 2003, respectively. In addition, substantially all of our wafer suppliers and packaging and testing subcontractors are located

in Asia. Any kind of economic, political or environmental instability in this region of the world can have a severe negative impact on our operating results due to the large concentration of our production and sales activities in this region.

Our revenues may be impacted by our ability to obtain adequate wafer supplies from our foundries. The foundries with which we currently have arrangements, together with any additional foundry at which capacity might be obtained, may not be willing or able to satisfy all of our manufacturing requirements on a timely basis at favorable prices. In addition, we have encountered delays in qualifying new products and in ramping-up new product production and we could experience these delays in the future. We are also subject to the risks of service disruptions, raw material shortages and price increases by our foundries. Such disruptions, shortages and price increases could harm our operating results.

We depend on independent subcontractors to assemble and test our products. Our reliance on these subcontractors involves the following significant risks:

- reduced control over delivery schedules and quality;
- the potential lack of adequate capacity during periods of strong demand;
- difficulties selecting and integrating new subcontractors;
- limited warranties on products supplied to us;
- potential increases in prices due to capacity shortages and other factors; and
- potential misappropriation of our intellectual property.

These risks may lead to increased costs, delayed product delivery or loss of competitive advantage, which would harm our profitability and customer relationships.

It should be noted that we may be greatly impacted by the political, economic and military conditions in Taiwan. Taiwan and China are continuously engaged in political disputes and both countries continue to conduct military exercises in or near the other's territorial waters and airspace. Such disputes may continue and even escalate, resulting

in an economic embargo, a disruption in shipping or even military hostilities. This could severely harm our business by interrupting or delaying production or shipment of our product. Any kind of activity of this nature or even rumors of such activity could severely and negatively impact our operations, revenues, operating results, and stock price.

Our corporate headquarters are located in California near major earthquake faults. In addition, some of our suppliers are located near fault lines. In the event of a major earthquake or other natural disaster near our headquarters, our operations could be harmed. Similarly, a major earthquake or other natural disaster, such as a typhoon, near one or more of our major suppliers, like the earthquakes in September 1999 and March 2002 or the typhoon in September 2001 that occurred in Taiwan, could potentially disrupt the operations of those suppliers, which could then limit the supply of our products and harm our business.

Basis of Consolidation:

The consolidated financial statements include the accounts of SST and our wholly-owned subsidiaries after elimination of inter-company balances and transactions. The functional currency of SST and its subsidiaries is the United States dollar.

Foreign Currency Transactions:

Monetary accounts maintained in currencies other than the United States dollar are re-measured using the foreign exchange rate at the balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the rate in effect at the date of the transactions. The effects of foreign currency re-measurement are reported in current operations. The effect of foreign currency re-measurement was not significant in fiscal years 2001, 2002 or 2003.

Financial Instruments:

Cash equivalents are highly liquid investments with original or remaining maturities of three months or less as of the dates of purchase. Highly liquid investments included in cash equivalents are classified as available-for-sale and are carried at cost, which approximates fair value. Cash equivalents present insignificant risk of changes in value

because of interest rate changes. We maintain substantially all of our cash balances with three major financial and/or brokerage institutions domiciled in the United States and we have not experienced any material losses relating to these investment instruments.

Short and long-term investments, which are comprised of federal, state and municipal government obligations, foreign and public corporate debt securities and listed equity securities, are classified as available-for-sale and carried at fair value, based on quoted market prices, with the unrealized gains or losses, net of tax, reported in shareholders' equity as other comprehensive income. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, both of which are included in interest income. Realized gains and losses are recorded on the specific identification method. Realized gains in 2003 were $649 thousand. Realized gains and losses were not material in 2001 and 2002.

The carrying amounts reported for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are considered to approximate fair values based upon the short maturities of those financial instruments. The fair value of available-for-sale investments is in Note 2 of these Notes to the Consolidated Financial Statements.

Financial instruments that potentially subject us to concentrations of credit risks comprise, principally, cash, cash equivalents, investments and trade accounts receivable. We invest our excess cash in accordance with our investment policy, which has been approved by our Board of Directors and reviewed periodically. We perform credit evaluations of new customers and require those without positive, established histories to pay in advance, upon delivery or through letters of credit. Otherwise, we do not require collateral of our customers, and maintain allowances for potential credit losses. As of December 31, 2002 and 2003, SPT represented 68.5% and 73.4% of our net accounts receivable, respectively.

We have acquired interests in Japanese and Taiwanese companies and a Cayman Islands company operating in China. See Note 11 of these Notes to the Consolidated Financial Statements. Some of these companies are privately held and it was not practicable to estimate the fair value of the investments in the issued untraded common stock. Investments in privately held companies are included in "Equity investments" in the balance sheet and are carried at their original cost. When a decline in value is other than temporary the securities are reduced to their estimated fair value. Some of the Taiwanese companies are public companies and their stock is traded on the Taiwan Stock Exchange. Three of these companies completed initial public offerings in Taiwan during 2003. Under Taiwan security regulations, a certain number of shares must be held in central custody subsequent to an initial public offering and are restricted from sale for a period of time. Shares required to be held in custody for greater than a one year period are carried at cost and recorded as equity investments. The unrestricted shares and the shares available for sale within one year from the balance sheet date are carried at quoted market price and included in long-term available for sale investments, with unrealized gains and losses reported as a separate component of shareholders' equity. If a loss is other than temporary, it is reported as an "Impairment of equity investments." See Note 8 of these Notes to the Consolidated Financial Statements. Cash dividends and other distributions of earnings from the investees, if any, are included in other income when declared.

Inventories:

Inventories are stated at the lower of cost (determined on a first-first-in, first-out basis) or market value. We typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate substantially. The value of our inventory is dependent on our estimate of future average selling prices, and, if our projected average selling prices are not realized, we may be required to adjust our inventory value to reflect the lower of cost or market. Due to the large number of units in our inventory, even a small change in average selling prices could result in a significant adjustment and have a significant impact on our financial position and results of operations. Our inventories include high technology parts and components that are specialized in nature or subject to rapid technological obsolescence. Some of our customers have requested that we ship them product that has a finished goods date of manufacture that is less than one year old. In the event that this becomes a common requirement, it may be necessary for us to provide for an additional allowance for our on hand finished goods inventory with a date of manufacture of greater than one year old, which could result in a significant adjustment and could harm our financial results. As of December 31, 2003,

our allowance for excess and obsolete inventories includes an allowance for our on hand finished goods inventory with a date of manufacture of greater than two years old and for certain products with a date of manufacture of greater than one year old. While we have programs to minimize the required inventories on hand and we consider technological obsolescence when estimating allowances for potentially excess and obsolete inventories and those required to reduce recorded amounts to market values, it is reasonably possible that such estimates could change in the near term. Such changes in estimates could

have a significant impact on our financial position and results of operations.

Inventory valuation adjustments to cost of sales and adverse purchase commitments amounted to $72.2 million in 2001, $10.4 million in 2002 and $6.7 million in 2003. In 2001, 2002 and 2003, $24.5 million, $5.9 million and $3.3 million, respectively, of the adjustment related to lower of cost or market with the balance due to excess or obsolete inventory.

Equipment, Furniture and Fixtures:

Equipment, furniture and fixtures are stated at cost and depreciated using the straight-line method over estimated useful lives of three to seven years. See Note 3 of these Notes to the Consolidated Financial Statements.

Intangible Assets:

Intangible assets include technology acquired in acquisitions and technology acquired under licensing arrangements. These amounts are included in other assets and amortized over estimated lives of three to five years.

Long-Lived Assets:

Long-lived assets include equipment, furniture and fixtures, equity investments and intangible assets. Whenever events or changes in circumstances indicate that the carrying amounts of long-lived assets may not be recoverable, we estimate the future cash flows, undiscounted and without interest charges, expected to result from the use of those assets and their eventual disposition. If the sum of the expected future cash flows is less than the carrying amount of those assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

Revenue Recognition:

Sales to direct customers and foreign stocking representatives are recognized net of an allowance for estimated returns. When product is shipped to direct customers or stocking representatives, or by our distributors or SPT to end users, prior to recognizing revenue, we require that evidence of the arrangement exists, the price is fixed or determinable and collection is reasonably assured. Sales to distributors are made primarily under arrangements allowing price protection and the right of stock rotation on merchandise unsold. Because of the uncertainty associated with pricing concessions and future returns, we defer recognition of such revenues, related costs of revenues and related gross profit until the merchandise is sold by the distributor. Products shipped to SPT are accounted for as our inventory held at our logistics center and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT.

For license and other arrangements for technology that we are continuing to enhance and refine and under which we are obligated to provide unspecified enhancements, revenue is recognized over the lesser of the estimated period that we have historically enhanced and developed refinements to the technology, approximately two to three years (the upgrade period), or the remaining portion of the upgrade period from the date of delivery, provided all specified technology and documentation has been delivered, the fee is fixed or determinable and collection of the fee is reasonably assured. From time to time, we re-examine the estimated upgrade period relating to licensed technology to determine if a change in the estimated upgrade period is needed. Revenue from license or other technology arrangements where we are not continuing to enhance and refine technology or are not obligated to provide unspecified enhancements is recognized upon delivery, if the fee is fixed or determinable and collection of the fee is reasonably assured.

Royalties received under these arrangements during the upgrade period are recognized as revenue based on the ratio of the elapsed portion of the upgrade period to the estimated upgrade period. The remaining portions of the royalties are recognized ratably over the remaining portion of the upgrade period. Royalties received after the upgrade period has elapsed are recognized when reported to us, which generally coincides with the receipt of payment.

Research and Development:

Research and development expenses are charged to operations as incurred.

Income Taxes:

Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Computation of Net Loss Per Share:

We have computed and presented net loss per share under two methods, basic and diluted. Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Diluted net loss per share is computed by dividing net loss by the sum of the weighted average number of common shares outstanding and potential common shares (when dilutive).

Stock Compensation:

We account for stock-based compensation using the intrinsic value method. No compensation cost has been recognized for the stock option plans or the employee stock purchase plan. Had compensation cost for these plans been determined based on the fair value at the grant date for the awards, our net loss and net loss per share for 2001, 2002 and 2003 would have been increased to the pro forma amounts indicated below (in thousands):

	Year Ended December 31,		
	2001	2002	2003
Net loss, as reported	$ (28,996)	$ (15,095)	$ (65,167)
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(16,677)	(12,112)	(7,601)
Pro forma net loss	$ (45,673)	$ (27,207)	$ (72,768)
Pro forma net loss per share - basic and diluted	$ (0.50)	$ (0.29)	$ (0.77)

The fair value of each option grant for both the stock option plans is estimated on the date of grant using the Black-Scholes multiple options pricing model with the following weighted average assumptions by year:

	Year Ended December 31,

	2001	2002	2003
Risk-free interest rate	3.9-5.0%	2.8-4.9%	2.4-3.1%
Expected term of option	3 years	6 years	5 years
Expected volatility	100%	100%	100%
Expected dividend yield	0%	0%	0%

The weighted average fair value of options granted under the Equity Incentive Plan and the Directors' Plan during 2001, 2002 and 2003 was $4.01, $4.01 and $6.45, respectively, per share.

The fair value of each stock purchase right is estimated using the Black- Scholes model with the following weighted average assumptions by year:

	Year Ended December 31,		
	2001	2002	2003
Risk-free interest rate	3.6-5.3%	2.1-2.3%	1.0-1.4%
Expected term of right	1/2 year	1/2 year	1/2 year
Expected volatility	100%	100%	100%
Expected dividend yield	0%	0%	0%

Option grants and Purchase Plan rights are priced at the date of grant. The risk-free interest rate range represents the low and high end of the range used at different points during the year.

The weighted average valuation of right grants under the Purchase Plan during 2001, 2002 and 2003 was $7.00, $3.81 and $1.82, respectively, per share.

Comprehensive Loss:

Comprehensive loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive loss includes unrealized gains and losses on available-for-sale investments, net of tax. Other comprehensive gain (loss) is presented in the statement of shareholders' equity and comprehensive loss.

Reclassifications:

Certain amounts in our prior years consolidated financial statements have been reclassified to conform to the current year presentation. These reclassifications have no impact on our previously reported net loss.

Recent Accounting Pronouncements:

In January 2003, the Financial Accounting Standards Board, or FASB, issued FIN No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 was effective immediately for all new variable interest entities created or acquired after January 31, 2003. In December 2003, the FASB issued a revision of FIN No. 46 that delays the implementation date for certain interests created or acquired prior to January 31, 2003 until the first interim or annual period ending after March 15, 2004. Accordingly, we will implement FIN No. 46 during the quarter ended March 31, 2004. We are currently reviewing our equity investments and associated relationships to determine if they are variable interest entities as defined by the revised FIN No. 46. It is reasonably possible that we are the primary beneficiary of or hold a significant variable interest in a variable interest entity. The nature, purpose and activities of the potential variable interest entities are outlined in Note 11 of our Notes to the Consolidated Financial Statements. Our maximum exposure to loss as a result of our involvement with the potential variable interest entities is our investment in each such entity plus amounts receivable from these entities as we are not obligated to provide any additional financing.

2. Available-for-Sale Investments:

The fair value of available-for-sale investments, including restricted available-for-sale investments, as of December 31, 2003 were as follows (in thousands):

	Amortized Cost	Unrealized Gain	Unrealiz Loss
Corporate bonds and notes	$ 184	$ --	$
Government bonds and notes	158,382	14	
Foreign listed equity securities	3,759	9,265	(1
Total bonds, notes and equity securities	$ 162,325	$ 9,279	$ (1
Less amounts classified as cash equivalents			
Total short and long-term available-for-sale investments			
Contractual maturity dates for investments in bonds and notes:			
Less than 1 year			
1 to 5 year			

The unrealized gain as of December 31, 2003 is recorded in accumulated other comprehensive income, net of tax of zero amount.

The fair value of available-for-sale investments as of December 31, 2002 were as follows (in thousands):

	Amortized Cost	Unrealized Gain	Unrealiz Loss
Corporate bonds and notes	$ 359	$ --	$
Government bonds and notes	123,763	107	
Foreign listed equity securities	1,299	138	
Total bonds, notes and equity securities	$ 125,421	$ 245	$
Less amounts classified as cash equivalents			
Total short and long-term available-for-sale investments			

The unrealized gain as of December 31, 2002 is recorded in accumulated other comprehensive income, net of tax of $94 thousand. At December 31, 2002, $24.8 million of available-for-sale investments were restricted as security for a bond associated with a legal contingency.

3. Balance Sheet Detail (in thousands):

Accounts receivables comprise:

	December 31,	
	2002	2003
Trade Accounts Receivable	$ 42,178	$ 57,749
Allowance for sales returns	(1,787)	(1,301)
Allowance for doubtful accounts	(4,420)	(1,118)
	$ 35,971	$ 55,330

Inventories comprise:

	December 31,	
	2002	2003
Raw materials	$ 40,036	$ 20,735
Work in process	8,923	11,265
Finished goods	28,608	9,579
Consigned inventory	5,473	4,541

	$ 83,040	$ 46,120

Other current assets comprise:

	December 31,	
	2002	2003
Refundable income tax	$ 22,744	$ 5,533
Other current assets	6,927	7,699
	$ 29,671	$ 13,232

Equipment, furniture and fixtures comprise:

	December 31,		Estimat Useful
	2002	2003	Lives
Equipment	$ 15,142	$ 13,533	Four yea
Computer and design hardware	7,937	11,900	Three ye
Software	8,625	9,768	Three ye
Vehicles	--	12	Five yea
Furniture and fixtures	10,490	9,213	Seven ye
	42,194	44,426	
Less accumulated depreciation	25,762	33,392	
	16,432	11,034	
Construction in progress	557	291	
	$ 16,989	$ 11,325	

Depreciation expense was $8.4 million, $9.3 million and $7.7 million for 2001, 2002 and 2003, respectively.

Accrued liabilities comprise:

	December 31,	
	2002	2003

Accrued compensation and related	$ 5,070	$ 4,911
Accrued income tax payable	6,782	659
Accrued liabilities-related parties	473	569
Accrued warranty	492	187
Other accrued liabilities	5,966	5,585
	$ 18,783	$ 11,911

Accrued warranty:

Balance at December 31, 2001	$ 2,883
Accruals for warranties issued during the period	460
Settlements made	(2,851)
Balance at December 31, 2002	$ 492
Accruals for warranties issued during the period	485
Settlements made	(790)
Balance at December 31, 2003	$ 187

Our products are generally subject to warranty and we provide for the estimated future costs of repair, replacement or customer accommodation upon shipment of the product in the accompanying statements of operations. Our warranty accrual is estimated based on historical claims compared to historical revenues and assumes that we have to replace products subject to a claim. For new products, we use our historical percentage for the appropriate class of product. Warranty expense has decreased from 2002 to 2003 due to lower return rates.

Our technology license agreements generally include an indemnification clause that indemnifies the licensee against liability and damages (including legal defense costs) arising from any claims of patent, copyright, trademark or trade secret infringement by our proprietary technology. The terms of these guarantees approximate the terms of the technology license agreements, which typically range from five to ten years. Our current license agreements expire from 2004 through 2014. The maximum possible amount of future payments we could be required to make, if such indemnifications were required on all of these agreements, is $36.7 million. We have not recorded any liabilities as of December 31, 2003 related to these indemnities as no such claims have been made or asserted.

4. Commitments:

We lease our corporate facilities under non-cancelable operating leases that expire in 2004 through 2012. The leases require escalating monthly payments over their terms and, therefore, periodic rent expense is being recognized on a straight-line basis. Under the terms of the leases, we are responsible for maintenance costs, including real property taxes, utilities and other costs. Rent expense was, $5.3 million, $5.4 million and $5.5 million in 2001, 2002 and 2003, respectively.

During the third quarter of 2001, we recorded a period charge to other operating expense of $756 thousand relating to an operating lease for an abandoned building. This charge represented the estimated difference between the total non-discounted future sublease income and our non-discounted lease commitments relating to this building. The charge was an estimate and may be adjusted if we obtain a sublease for the building and the actual sublease income is significantly different from the estimate. We may be unable to secure subtenants for such space due to the recent decrease in demand for commercial rental space in Silicon Valley. At December 31, 2001, 2002 and 2003, payments made have reduced the recorded liability to $662 thousand, $473 thousand and $270 thousand, respectively.

Future minimum rental payments at December 31, 2003 are as follows (in thousands):

2004	$ 5,376
2005	3,677
2006	2,488
2007	2,546
2008	2,621
Thereafter	3,509
	$ 20,217

Purchase Commitments:

As of December 31, 2003, we had outstanding purchase commitments with our foundry vendors of $72.8 million for delivery in 2004. We have recorded a liability of $538 thousand for adverse purchase commitments.

5. Contingencies:

In January 1996, Atmel Corporation filed suit against SST alleging that we infringed six U.S. patents. We successfully moved for summary judgment on two of the six asserted patents in September 1997. In January 2001, Atmel withdrew its allegation that we infringed another patent. On May 7, 2002, a judgment was entered against the us in the amount of $36.5 million. We appealed the judgment on July 16, 2002. On September 12, 2003 the Court of Appeals upheld the jury's verdict. On November 18, 2003 the Court of Appeals denied our request for a rehearing, and in December 2003 we paid Atmel $37.8 million to satisfy the judgment plus statutory interest accrued during the appeals. The payment was recorded as other operating expense in the year ending December 31, 2003.

The other patent remaining in the case, the '903 patent, expired in September 2001. The trial court has held that, if it is found to be valid, certain of our products infringed that patent. The trial to determine whether the '903 patent is invalid began on July 29, 2002. On August 5, 2002 the jury announced that it was unable to reach a verdict on our invalidity defense, and a mistrial was declared. Atmel requested a new trial, but the Court stayed the matter until after our appeal of the earlier judgment is resolved. At Atmel's request, the Court has directed the parties to conduct a settlement conference before a Magistrate Judge. That settlement conference is scheduled for April 14, 2004. If the parties are unable to reach a settlement agreement, the Court may set a date for a new trial. The impact related to the outcome of the remaining patent is undeterminable at this time.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have accrued certain costs associated with defending these matters. There can be no assurance the remaining Atmel complaint or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring royalty payments in the future which may adversely impact gross margins. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses have been accrued in our financial statements as of

December 31, 2003.

6. Shareholders' Equity:

Authorized Capital Shares:

Our authorized capital shares consist of 250.0 million shares of common stock and 7.0 million shares of preferred stock. Of the preferred stock, 450 thousand shares have been designated as series A junior participating preferred stock. All of our capital shares have no par value.

Share Purchase Rights Plan:

We have a Share Purchase Rights Plan, adopted in May 1999 and subsequently amended, in which preferred stock rights were distributed as a rights dividend at a rate of one right for each share of common stock held as of the close of business on May 27, 1999. Preferred stock rights will also be issued with any new issuance of common shares. Each Right entitles the registered holder under certain circumstances to purchase from us one three-hundredth (one-third of one one-hundredth) of a share of series A junior participating preferred stock. Until the occurrence of certain events the preferred stock rights will be transferable with and only with the Common Shares. The effect will be to discourage acquisitions of more than 15 percent of our common stock without negotiations with our Board of Directors. The rights expire May 3, 2009.

Net Loss Per Share:

A reconciliation of the numerator and the denominator of basic and diluted net loss per share are as follows (in thousands except for per share data):

	Year Ended December 31,		
	2001	2002	2003
Numerator – Basic and diluted			
Net loss	$ (28,996)	$ (15,095)	$ (65,1
Denominator – Basic and diluted			
Weighted average common stock outstanding	91,084	92,667	94,7
Basic and diluted net loss per share	$ (0.32)	$ (0.16)	$ (0.

Stock options to purchase 10.9 million, 10.7 million and 10.1 million shares of common stock with weighted average price of $7.13, $7.46 and $7.79 were outstanding at December 31, 2001, 2002 and 2003, respectively, but were not included in the computation of diluted net loss per share because we had a net loss in 2001, 2002 and 2003, and inclusion of the shares would be anti-dilutive.

Equity Incentive Plan:

Our 1995 Equity Incentive Plan, or the Equity Incentive Plan, as amended, has 31.8 million shares of common stock reserved for issuance upon the exercise of stock options to our employees, directors, consultants and affiliates.

Under the Equity Incentive Plan, the Board of Directors has the authority to determine to whom options will be granted, the number of shares under option, the option term and the exercise price. The options generally are exercisable beginning one year from date of grant and generally thereafter over periods ranging from four to five years from the date of grant. The term of any options issued may not exceed ten years from the date of grant.

Directors' Option Plan:

Our 1995 Non-Employee Directors' Stock Option Plan, or the Directors' Plan, as amended, provides for the automatic initial grant of options to purchase 45 thousand shares of our common stock to our non-employee directors. The Directors' Plan also provides for the grant of options to purchase up to an additional 18 thousand shares annually thereafter. Options under the Directors' Plan become exercisable immediately upon date of grant, and the exercise price of options granted must equal or exceed the fair market value of our common stock on the date of grant. The options expire ten years after the date of grant. As of December 31, 2003, we have reserved 950 thousand shares of common stock for issuance upon the exercise of stock options under the Directors' Plan.

Activity under the Equity Incentive Plan and Directors' Plan are as follows (in thousands, except per share data):

	Available for Grant	Options Outstanding			Weighted Average Price
		Shares	Price Per Share	Amount	
Balances, December 31, 2000...	3,318	10,603	$ 0.05 - $ 29.44	$ 71,428	$ 6.74
Granted.....	(1,878)	1,878	4.46 - 18.56	11,639	6.20
Exercised.....	--	(1,220)	0.05 - 10.29	(1,294)	1.06
Terminated.....	374	(374)	0.68 - 29.44	(4,128)	11.02
Authorized.....	2,000	--	-	--	--
Balances, December 31, 2001...	3,814	10,887	0.05 - 29.44	77,645	7.13
Granted.....	(1,377)	1,377	3.65 - 10.80	7,133	5.16
Exercised.....	--	(1,193)	0.05 - 8.63	(1,227)	1.03
Terminated.....	417	(417)	0.68 - 29.44	(4,038)	9.68
Authorized.....	2,200	--	-	--	--
Balances, December 31, 2002...	5,054	10,654	0.05 - 29.44	79,513	7.46
Granted.....	(1,337)	1,337	2.30 - 13.57	11,460	8.57

Exercised.....	--	(1,102)	0.05 - 10.29	(2,305)	2.09
Terminated.....	741	(741)	0.95 - 26.02	(9,523)	12.98
Authorized.....	1,650	--	-	--	--
Balances, December 31, 2003...	6,108	10,148	$ 0.07 - $ 29.44	$ 79,145	$ 7.79

At December 31, 2001, 2002 and 2003, 5.4 million, 6.6 million and 6.9 million options were exercisable at a weighted-average exercise price per share of $5.06, $6.62 and $7.96, respectively.

Employee Stock Purchase Plan:

Our 1995 Employee Stock Purchase Plan, or the Purchase Plan, as amended, has 6.0 million shares reserved for issuance. The Purchase Plan provides for eligible employees to purchase shares of common stock at a price equal to 85% of the fair market value of our common stock on the date of the option grant, or, if lower, 85% of the fair market value of our common stock six months after the option grant, by withholding up to 10 percent of their annual base earnings. At December 31, 2003, 2.4 million shares were available for purchase under the Purchase Plan. Shares issued under the Purchase Plan in 2001, 2002 and 2003 were 247 thousand, 517 thousand and 931 thousand, respectively.

The options outstanding and currently exercisable by exercise price under the Equity Incentive Plan and the Directors' Plan at December 31, 2003 are as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Outstanding	Weighted-Average Exercise Price
$ 0.07 - $ 1.04	1,691,720	4.04	$ 0.92	1,691,720	$ 0.92
$ 1.08 - $ 2.36	1,109,153	5.14	$ 2.00	1,069,083	$ 2.00
$ 2.54 - $ 4.42	1,212,560	8.10	$ 3.69	311,106	$ 3.80
$ 4.46 - $ 4.96	1,198,525	7.38	$ 4.60	570,576	$ 4.72
$ 5.00 - $ 9.00	1,018,959	7.73	$ 7.67	600,751	$ 7.64
$ 9.28 - $ 9.85	1,153,090	8.31	$ 9.50	398,086	$ 9.83
$ 9.92 - $ 11.82	1,040,044	5.58	$ 11.13	773,359	$ 11.09
$ 11.85 - $ 18.60	1,017,065	6.62	$ 17.51	812,022	$ 17.88
$ 19.96 - $ 28.35	690,353	6.45	$ 24.11	625,308	$ 24.11
$ 29.44 - $ 29.44	17,160	6.50	$ 29.44	14,265	$ 29.44
$ 0.07 - $ 29.44	10,148,629	6.48	$ 7.79	6,866,276	$ 7.96

7. Other Operating Expenses:

Other operating expenses comprised (in thousands):

	Year ended December 31,		
	2001	2002	2003
Operating lease impairment	$ 756	$ --	$ --
Patent impairment	590	--	--
Atmel Settlement	--	--	37,849
	$ 1,346	$ --	$ 37,849

Operating lease impairment.

During the third quarter of 2001, we recorded a period charge to other operating expense of $756 thousand relating to an operating lease for an abandoned building. This charge represents the estimated difference between the total non-discounted future sublease income and our non-discounted lease commitments relating to this building. The charge was an estimate and may be adjusted if we obtain a sublease for the building and the actual sublease income is significantly different from the estimate. We may be unable to secure subtenants for such space due to the recent decrease in demand for commercial rental space in Silicon Valley. At December 31, 2001, 2002 and 2003, payments made have reduced the recorded liability to $662 thousand, $473 thousand and $270 thousand, respectively.

Patent impairment.

During the quarter ended December 31, 2001, due to the delays in completing the first flash memory device using the Agate technology, we recorded an expense for impairment of intangible assets of $590 thousand. The assets related to patents acquired as part of the acquisition of Agate Semiconductor Inc. in December 2000. We reviewed the recoverability of the recorded amounts based on expected future cash flows (undiscounted and before interest) from use of these assets and then determined the impairment loss of $590 thousand based on the difference between the net book value of the assets and the estimated fair value of the assets.

Atmel Settlement.

In September 2003, the Federal Circuit Court issued a decision upholding the trial court verdict that we infringed on the '811 and '829 patents in our lawsuit with Atmel. As a result of that decision, we accured the judgement of $36.5 million. In October 2003, the court denied our petition to reconsider its decision. In December 2003, we recorded an additional $1.3 million in settlement fees related to the interest on the judgement from the time the judgement was entered in May 2002 to the payment date of the judgement in December 2003. The total judgement and interest of $37.8 million was paid to Atmel in December 2003.

8. Impairment of Equity Investments:

In 2000, we acquired a 10.0% interest in Apacer Technology, Inc., or Apacer, a privately held company located in Taiwan that designs, manufactures and markets memory modules, for $9.9 million in cash. Our investment in Apacer was valued at cost. Bing Yeh, our President and CEO and a member of our Board of Directors, is also a member of Apacer's Board of Directors. In 2001, we invested an additional $2.1 million in Apacer. In August 2002, we made an additional investment of $181 thousand. At the end of the third quarter of 2002, we determined that a continued and significant decline in Apacer's price per share was other than temporary, and accordingly, in the third quarter of 2002, we recorded a period charge to other expense of $7.8 million to write down our investment in Apacer to $4.4 million which was determined using the price per share paid for the additional investment in August 2002.

During 2001, KYE, a company in which we have an investment, completed an initial public offering on the Taiwan Stock Exchange. Since the initial public offering there had been a significant decline in the market value of the investment. We had concluded that the decline in value is "other-than-temporary" and a write down of $3.3 million

was necessary as of December 31, 2001. The investment was written down to $1.3 million based on the quoted market price as of December 31, 2001. The recorded value of our KYE investment was $3.2 million based on the quoted market price as of December 31, 2003.

9. Income Taxes:

The provision for income taxes reflected in the statements of operations for the years ended December 31, 2001, 2002 and 2003 are as follows (in thousands):

	Year Ended December 31,		
	2001	2002	2003
Current:			
Federal	$ 2,078	$ (3,912)	$ 2,516
State	1	1	2
Foreign	12	16	1,580
	2,091	(3,895)	4,098
Deferred:			
Federal	(16,518)	(5,874)	16,818
State	(3,345)	(1,162)	5,500
	(19,863)	(7,036)	22,318
	$ (17,772)	$ (10,931)	$ 26,416

Our effective tax rate (benefit)/provision differs from the statutory federal income tax rate as shown in the following schedule:

	Year Ended December 31,		
	2001	2002	2003
United States statutory rate	(35.0)%	(35.0)%	(35.0)%
State taxes, net of federal benefit	(3.0)	(4.5)	--
Foreign taxes, net	0.2	--	4.0
Research and development credit	(3.0)	(5.9)	(4.8)
Tax exempt interest	--	(2.5)	(2.0)
Capital loss carried forward and not benefitted	--	10.4	--
Change in estimated tax contingency	--	(4.3)	--
Change in valuation allowance	--	--	106.1
Other	2.8	(0.2)	(0.1)

(38.0)%	(42.0)%	68.2 %

As of December 31, 2002 and 2003 our deferred tax assets and liabilities consisted of (in thousands):

	December 31,	
	2002	2003
Allowance for excess and obsolete inventory	$ 6,096	$ 2,552
Allowance for sales returns	691	457
Allowance for doubtful accounts	1,709	419
Deferred revenue	1,546	--
Other	803	2,803
Capitalized research and development	--	2,052
Net operating loss carry-forwards	1,731	10,516
Depreciation	648	803
Tax credits	9,094	21,512
Total deferred tax asset	$ 22,318	$ 41,114
Valuation allowance	--	(41,114)
Net deferred tax asset	$ 22,318	$ --
Current portion	$ 17,154	$ --
Long-term portion	5,164	--
	$ 22,318	$ --

Our provision for taxes included a charge recorded during the third quarter of 2003 to establish a full valuation allowance against our deferred tax assets offset by a reduction in income tax payable as a result of a reassessment of expected liabilities for 2003 and certain exposures. Accordingly, for 2003 we recorded a net charge of $26.4 million. During the fourth quarter of 2003, we maintained a full valuation allowance on our net deferred tax assets. The valuation allowance was determined in accordance with the provisions of Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting for Income Taxes," which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. Cumulative losses incurred in the U.S. in recent years represented sufficient negative evidence under SFAS No. 109 and accordingly, a full valuation allowance was recorded against U.S. deferred tax assets. We intend to maintain a full valuation allowance on the U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance.

At December 31, 2003, we had available $27.5 million for federal and $35.8 million for state net operating loss carry-forwards. These net operating losses, if not utilized, expire in 2023 and 2024. $2.0 million of net operating

losses relates to stock options, which when realized will be credited to equity. At December 31, 2003 we also had available research and development credit carry-forwards for federal and state income tax purposes of $10.6 million and $5.5 million, respectively. The federal carry-forwards expire between 2017 and 2024. In addition, we have $4.6 million of foreign tax credit carry-forwards which will expire in 2009.

10. Segment Reporting:

Our operations involve the design, development, manufacturing, marketing and technical support of our nonvolatile memory products. We offer low and medium density devices that target a broad range of existing and emerging applications in the digital consumer, networking, wireless communications and Internet computing markets. Our products are differentiated based upon attributes such as density, voltage, access speed, package and predicted endurance. We also license our technology for use in non-competing applications.

We manage our business in four reportable segments: the Standard Memory Product Group, or SMPG, the Application Specific Product Group, or ASPG, the Special Product Group, or SPG, and Technology Licensing. We do not allocate operating expenses, interest and other income, interest expense, impairment of equity investments and provision for or benefit from income taxes to any of these segments for internal reporting purposes, as we do not believe that allocating these expenses are material in evaluating a business unit's performance.

SMPG includes our three standard flash memory product families: the Multi-Purpose Flash, or MPF, family, the Multi-Purpose Flash Plus, or MPF+, family and the Many-Time Programmable, or MTP, family. These families allow us to produce products optimized for cost, functionality and quality to support a broad range of mainstream applications that use nonvolatile memory products. Effective January 1, 2003, we transferred certain MTP products

from SMPG to SPG. Effective July 1, 2003, we transferred the Small Sector Flash, or SSF, family from SMPG to SPG. Accordingly, our segment revenues and gross profit information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001.

ASPG includes Concurrent SuperFlash, Serial Flash, Firmware Hub, or FWH, and Low Pin Count, or LPC, flash products. These products are designed to address specific applications such as cellular phones, hard disk drives and PCs. ASPG also includes flash embedded controllers such the ATA flash disk controller to consumer, industrial and mass data storage applications. Effective January 1, 2003, we transferred FlashFlex51 microcontroller products from ASPG to SPG. Accordingly, our segment revenue and gross margin information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001.

SPG includes ComboMemory, ROM/RAM Combos, the Small Sector Flash, or SSF, family, certain Multi-Time Programmable, or MTP, family, FlashFlex51 microcontrollers and other special flash products. These products are used in applications requiring low power and a small form factor such as cellular phones, wireless modems, MP3 players, pagers and digital organizers. Effective January 1, 2003, we transferred certain MTP products from SMPG to SPG and FlashFlex51 microcontroller products from ASPG to SPG. Effective July 1, 2003, we transferred the SSF family from SMPG to SPG. Accordingly, our segment revenue and gross margin information have been reclassified for presentation purposes as if the transfer occurred as of January 1, 2001.

Technology licensing includes both up front license fees and royalties.

The following table shows our product revenues and gross profit (loss) for each segment (in thousands):

	Year Ended December 31, 2003	
	Revenues	Gross Profit (Loss)
SMPG	$ 173,126	$ 23,047
ASPG	60,481	11,723
SPG	22,922	2,984
Technology Licensing	38,512	38,512
	$ 295,041	$ 76,266

	Year Ended December 31, 2002	
	Revenues	Gross Profit (Loss)
SMPG	$ 147,037	$ 6,803
ASPG	67,792	24,138
SPG	29,192	6,834
Technology Licensing	30,637	30,637
	$ 274,658	$ 68,412

	Year Ended December 31, 2001	
	Revenues	Gross Profit (Loss)
SMPG	$ 118,831	$ (25,101)
ASPG	89,643	35,953
SPG	50,144	(395)
Technology Licensing	35,412	35,412
	$ 294,030	$ 45,869

Our net revenues are all denominated in U.S. dollars and are summarized as follows (in thousands):

	Year ended December 31,		
	2001	2002	2003
United States	$ 28,592	$ 21,871	$ 19,600
Europe	21,332	10,599	9,957
Japan	23,549	28,465	27,575
Korea	22,039	30,321	25,214

Taiwan	110,847	91,219	109,254
China (including Hong Kong)	57,146	70,609	76,107
Other Asian countries	28,157	21,574	27,334
Rest of world	2,368	--	--
	$ 294,030	$ 274,658	$ 295,041

Foreign revenue is based on the country to which the product is shipped by us or our logistics center.

The locations and net book value of long-lived assets follows:

	December 31,	
	2002	2003
United States	$ 15,747	$ 10,052
China	752	855
Taiwan	378	299
Other	112	119
	$ 16,989	$ 11,325

11. Equity Investments and Related Party Reporting:

Equity investments comprise (in thousands):

	December 31, 2003		
	Equity Investments at Cost	Available for Sale Investments at Fair Market Value	Total Equity Investment
Apacer Technology, Inc	$ 4,358	$ --	$ 4,358
Grace Semiconductor Manufacturing Corporation	50,000	--	50,000
Insyde Software Corporation	466	397	863
King Yuan Electronics Company, Limited	--	3,218	3,218
Powertech Technology, Incorporated	1,206	5,498	6,704
Professional Computer Technology Limited	775	3,810	4,585
Silicon Technology Co., Ltd	939	--	939
Other	333	--	333
	$ 58,077	$ 12,923	$ 71,000

	December 31, 2002		
	Equity	Available for Sale	Total

	Investments at Cost	Investments at Fair Market Value	Equity Investment
Apacer Technology, Inc.	$ 4,358	$ --	$ 4,358
Grace Semiconductor Manufacturing Corporation...	50,000	--	50,000
Insyde Software Corporation	964	--	964
King Yuan Electronics Company, Limited	--	1,437	1,437
Powertech Technology, Incorporated	2,532	--	2,532
Professional Computer Technology Limited	1,784	--	1,784
Silicon Technology Co., Ltd	939	--	939
Other	333	--	333
	$ 60,910	$ 1,437	$ 62,347

The following table is a summary of our related party revenues and purchases (in thousands):

	Year Ended December 31, 2003	
	Revenues	Purchases
Silicon Technology Co., Ltd	$ 3,615	$ --
Apacer Technology, Inc and related entities	1,555	2,361
Silicon Professional Technology Ltd	164,810	--
Grace Semiconductor Manufacturing Corporation...	--	12
King Yuan Electronics Company, Limited	--	19,659
Powertech Technology, Incorporated	--	9,280
	$ 169,980	$ 31,312

	Year Ended December 31, 2002	
	Revenues	Purchases
Silicon Technology Co., Ltd	$ 2,089	$ --
Acer and related entities (1)	269	--
Apacer Technology, Inc and related entities	899	588
Professional Computer Technology Limited	141	--
Silicon Professional Technology Ltd	140,003	--
King Yuan Electronics Company, Limited	--	18,163
Powertech Technology, Incorporated	--	8,378
	$ 143,401	$ 27,129

	Year Ended December 31, 2001	
	Revenues	Purchases
Silicon Technology Co., Ltd	$ 3,728	$ --
Acer and related entities (1)	5,129	290

Apacer Technology, Inc and related entities.....	280	626
Ocean Contract Manufacturing Ltd.....	4,019	--
Professional Computer Technology Limited.....	76,869	--
King Yuan Electronics Company, Limited.....	--	21,827
Powertech Technology, Incorporated.....	--	9,031
	$ 90,025	$ 31,774

(1) Excludes Apacer Technology, Inc. balances.

The following table is a summary of our related party accounts receivable and accounts payable and accruals (in thousands):

	December 31, 2002		December 31, 2003	
	Accounts Receivable	Accounts Payable and Accruals	Accounts Receivable	Accounts Payable an Accruals
Silicon Technology Co., Ltd.....	$ 459	$ --	$ 232	$ --
Ambit Microsystems Corp.....	--	--	--	4
Apacer Technology, Inc and related entities.	141	119	400	736
Professional Computer Technology Limited....	--	73	--	15
Silicon Professional Technology Ltd.....	24,648	432	40,588	550
King Yuan Electronics Company, Limited.....	--	4,285	--	6,896
Powertech Technology, Incorporated.....	--	2,253	--	2,533
	$ 25,248	$ 7,162	$ 41,220	$ 10,734

In 1996, we acquired a 14% interest in Silicon Technology Co., Ltd., or Silicon Technology, a privately held Japanese company, for $939 thousand in cash. Bing Yeh, our president, CEO and Board Director, is also a member of Silicon Technology's board of directors. We acquired the interest in Silicon Technology in order to provide a presence for our products in Japan. We now have our own office in Japan, although Silicon Technology continues to sell our products to smaller customers. At December 31, 2003, our investment, which is carried at cost, represented 9% of the outstanding equity of Silicon Technology. Our sales to Silicon Technology were made at prevailing market prices and the payment terms are consistent with the payment terms extended to our other customers. We are not obligated to provide Silicon Technology with any additional financing.

Dr. Ronald Chwang, a member of our Board of Directors, is also a director of Ambit Microsystems Corp., which is a related entity of Acer Incorporated, or Acer.

In 2000, we acquired a 10% interest in Apacer Technology, Inc, or Apacer, for $9.9 million in cash. Apacer, a privately held Taiwanese company and a related entity of Acer, is a memory module manufacturer. Bing Yeh, our president, CEO and Board Director, is also a member of Apacer's board of directors. In 2001, we invested an

additional $2.1 million in Apacer. In August 2002, we made an additional investment of $181 thousand. The investment was written down to $4.4 million during 2002, refer to Note 8 of these Notes to the Consolidated Financial Statements. At December 31, 2003, our investment represented 10% of the outstanding equity of Apacer.

In 2000, we acquired a 15% interest in Professional Computer Technology Limited, or PCT, a privately held Taiwanese company, for $1.5 million in cash. Bing Yeh, our president, CEO and Board Director, is also a member of PCT's board of directors. PCT is one of our stocking representatives. In May 2002, we made an additional investment of $179 thousand in PCT. During 2003, PCT completed an initial public offering on the Taiwan Stock Exchange and we sold a portion of our holdings. Under Taiwan security regulations, certain numbers of shares must be held in a central custody and are restricted from sale for a period of time. The shares available for sale within one year are carried at the quoted market price and included in long-term available-for-sale investments in the balance sheet as of December 31, 2003. Shares required to be held in custody for greater than a one year period are carried at cost and included in equity investments. At December 31, 2003 our investment represented 13% of the outstanding equity of PCT. February 2004, we purchased $1.7 million of PCT's European convertible bonds.

PCT and its subsidiary, Silicon Professional Alliance Corporation, or SPAC, earn commissions for point-of-sales transactions to its customers. Commissions to PCT and SPAC are paid at the same rate as all of our other stocking representatives in Asia. In 2001, 2002 and 2003 we paid sales commissions of $1.7 million, $2.5 million and $1.2 million, respectively, to PCT and SPAC. Shipments, by us or our logistics center, to PCT and SPAC for reshipment accounted for 8.5%, 10.3% and 27.3% of our product shipments in 2001, 2002 and 2003. In addition, PCT and SPAC solicited sales, for which they earned a commission, for 13.4%, 19.5% and 12.0% of our shipments to end users in 2001, 2002 and 2003, respectively.

In March 2001, PCT established a separate company and wholly-owned subsidiary, Silicon Professional Technology Ltd., or SPT, to provide planning, warehousing, delivery, billing, collection and other logistic functions for us in Taiwan. SPT now services substantially all of our end customers based in Taiwan, China and other Southeast Asia

countries. Product shipped to SPT is accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT. We pay SPT a fee based on a percentage of revenue for each product sold through SPT to our end customers. The fee paid to SPT covers the cost of warehousing and insuring inventory and accounts receivable, personnel costs required to maintain logistics and information technology functions and the costs to perform billing and collection of accounts receivable. SPT receives extended payment terms and must pay us whether or not they have collected the accounts receivable.

In 2000, we acquired a 1% interest in King Yuan Electronics Company Limited, or KYE, a publicly held Taiwanese company, which is a production subcontractor, for $4.6 million in cash. A member of our management team holds one supervisor position at KYE. The role and responsibilities of a supervisor are defined and governed by Corporate Law in Taiwan. The investment was made in KYE in order to strengthen the relationship between us and KYE. During 2001, KYE completed an initial public offering on the Taiwan Stock Exchange. Accordingly, the investment has been included in long-term available-for-sale investments in the balance sheet as of December 31, 2002 and 2003. The investment was written down to $1.3 million during 2001, refer to Note 8 of these Notes to the Consolidated Financial Statements, and is valued at $3.2 as of December 31, 2003 based on the quoted market price. At December 31, 2003, our investment represented 0.5% of the outstanding equity of KYE.

In 2000, we acquired a 3% interest in Powertech Technology, Inc., or PTI, a privately held Taiwanese company, which is a production subcontractor, for $2.5 million in cash. During 2003, PTI completed an initial public offering on the Taiwan Stock Exchange and we sold a portion of our holdings. Under Taiwan security regulations, certain numbers of shares must be held in a central custody and are restricted from sale for a period of time. The shares available for sale within one year are carried at the quoted market price and included in long-term available-for-sale investments in the balance sheet as of December 31, 2003. Shares required to be held in custody for greater than a one year period are carried at cost and included in equity investments. At December 31, 2003, our investment represented 3% of the outstanding equity of PTI.

In 2001, we acquired a 9% interest in Grace Semiconductor Manufacturing Corporation, or GSMC, a privately held Cayman Islands company for $50.0 million cash. Bing Yeh, our president, CEO and Board Director, is also a member of GSMC's board of directors. In addition, a member of our management team holds one supervisor position at GSMC. The role and responsibilities of a supervisor are defined and governed by Corporate Law in the Cayman Islands. This investment is carried at cost. GSMC has a wholly owned subsidiary, Shanghai Grace Semiconductor Manufacturing Corporation, or Grace, which is a wafer foundry company with operations in China. At December 31, 2003, our investment represented 7% of the outstanding equity of GSMC. In March 2004, we committed to invest an additional $33.2 million in GSMC.

In 2002, we acquired a 6% interest in Insyde Software Corporation, or Insyde, a privately held Taiwanese company, for $964 thousand in cash. Bing Yeh, our president, CEO and Board Director, is also a member of Insyde's board of directors. During 2003, Insyde completed an initial public offering on the Taiwan Stock Exchange. Under Taiwan security regulations, certain numbers of shares must be held in a central custody and are restricted from sale for a period of time. The shares available for sale within one year are carried at the quoted market price and included in long-term available-for-sale investments in the balance sheet as of December 31, 2003. Shares required to be held in custody for greater than a one year period are carried at cost and included in equity investments. At December 31, 2003, our investment represented 6% of the outstanding equity of Insyde.

12. Employee Benefit Plans:

Profit Sharing Plan:

We have a Profit Sharing Plan under which employees may collectively earn up to 10% of our operating profit, provided that both net earnings before interest income (expense), net provision for (benefit from) income taxes and operating profit are greater than 10% of sales. For purposes of the Profit Sharing Plan, "operating profit" is net revenues less cost of revenues and less operating expenses. The sum paid to any particular employee as profit sharing is a function of the employee's length of service, performance and salary. We plan to pay profit sharing sums, when available, to employees twice a year. No profit sharing was paid in relation to 2001, 2002 or 2003.

401(k) Plan:

We have adopted the SST 401(k) Tax Sheltered Savings Plan and Trust, or the Plan, as amended, which is intended to qualify under Section 401 of the Internal Revenue Code of 1986. The Plan covers essentially all employees. Each

eligible employee may elect to contribute to the Plan, through payroll deductions, up to 15% of their compensation, subject to certain limitations. At our discretion, we may make additional contributions on behalf of employees. All employee contributions are 100% vested. During 2001, 2002 and 2003, we matched the first $1,000 of each employees' contribution, for a total of $436 thousand, $405 thousand and $384 thousand, respectively.

SCHEDULE II

SILICON STORAGE TECHNOLOGY, INC.
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Write-off of Accounts /Other	Balance at End of Period
Year ended December 31, 2001				
Allowance for doubtful accounts	$ 783	$ 2,251	$ 220	$ 2,814
Allowance for sales returns	$ 8,207	$ 32,227	$ 35,936	$ 4,498
Allowance for excess and obsolete inventories	$ 2,516	$ 73,932	$ 28,701	$ 47,747
Valuation allowance on deferred tax assets	$ --	$ --	$ --	$ --
Year ended December 31, 2002				
Allowance for doubtful accounts	$ 2,814	$ 3,046	$ 1,440	$ 4,420
Allowance for sales returns	$ 4,498	$ 2,842	$ 5,553	$ 1,787
Allowance for excess and obsolete inventories	$ 47,747	$ 9,160	$ 29,466	$ 27,441
Valuation allowance on deferred tax assets	$ --	$ --	$ --	$ --
Year ended December 31, 2003				
Allowance for doubtful accounts	$ 4,420	$ 228	$ 3,530	$ 1,118
Allowance for sales returns	$ 1,787	$ 316	$ 802	$ 1,301
Allowance for excess and obsolete inventories	$ 27,441	$ 6,670	$ 22,894	$ 11,217
Valuation allowance on deferred tax assets	$ --	$ 41,114	$ --	$ 41,114