ALTERA CORP
Form 10-K/A
October 24, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(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 30, 2005

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: 0-16617

ALTERA CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware	77-0016691

(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
101 Innovation Drive, San Jose, California (Address of Principal Executive Offices)	95134 (Zip Code)

(408) 544-7000

(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, $0.001 par value per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 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/A or any amendment to this Form 10-K/A. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

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

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant was approximately $5,903,001,809 as of July 1, 2005, based upon the closing sale price on the NASDAQ National Market for that date. For purposes of this disclosure, shares of common stock held by persons who hold more than 5% of the outstanding shares of common stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed affiliates. This determination is not necessarily conclusive.

There were 359,297,200 shares of the registrant s common stock, $0.001 par value per share, issued and outstanding as of February 15, 2006.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10, 11, 12, 13, and 14 of Part III incorporate information by reference from the Proxy Statement for the Annual Meeting of Stockholders held on May 9, 2006 and filed with the Securities and Exchange Commission on April 3, 2006 except as to the information updated as a result of this restatement (see Item 11 Executive Compensation).

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EXPLANATORY NOTE

Restatement of Consolidated Financial Statements

We are amending our annual report on Form 10-K for the fiscal year ended December 30, 2005 (the Original Filing) to reflect the restatement of our consolidated financial statements and the related disclosures, for the fiscal years ended 2005, 2004 and 2003 and for each of the quarters in fiscal year 2004. The effects of this restatement on the fiscal year ended December 30, 2005 were negligible and therefore we did not restate any fiscal 2005 consolidated financial statements, except to reflect the cumulative restatement adjustments made to the consolidated balance sheet as of December 30, 2005 as well as a negligible change to fully diluted shares outstanding. We also are restating the pro forma disclosures for stock-based compensation expense required under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, (SFAS 123) included in Note 2 to the consolidated financial statements. This Form 10-K/A also reflects the restatement of Selected Consolidated Financial Data for the fiscal years ended 2005, 2004, 2003, 2002, and 2001 in Item 6 of this Form 10-K/A. The Original Filing was filed with the Securities and Exchange Commission (SEC) on March 14, 2006.

Our decision to restate our consolidated financial statements was based on facts obtained by management and the results of an independent investigation into our stock option accounting that was conducted under the direction of a special committee of the board of directors. On May 3, 2006, our Chief Executive Officer and General Counsel, on their own initiative, commenced a review of the company s historical stock option practices. On May 6, 2006, the board of directors formed a special committee composed solely of independent directors and tasked the committee with the responsibility to conduct a review of the company s historical stock option practices and related accounting. The special committee, with the assistance of its independent legal counsel and forensic accountants, undertook a comprehensive internal review of the facts giving rise to the restatement described below. The investigation included an extensive review of our accounting policies, accounting records, supporting documentation, and e-mail communications, as well as interviews with numerous current and former employees and current and former members of our board of directors.

On June 21, 2006, we announced that our audit committee, after consultation with management and the special committee, determined that our prior consolidated financial statements and any related reports of our independent registered public accounting firm should no longer be relied upon and would be restated. Although we do not believe that the effects of the restatement are material to the results of operations for our fiscal years ended 2005, 2004, or 2003, we are restating prior financial statements because the alternative method of correcting the error, which is to record the cumulative impact of the corrections in the quarter ended March 31, 2006, would result in a material charge to that period and such a charge would likely have a material impact on our fiscal year ended December 29, 2006.

Management concurs with the special committee s conclusion that from December 1996 through February 2001 there were seven occasions on which the recorded grant dates for certain employee stock option grants differed from the actual grant dates. None of these employee stock option grants was made to our current CEO. The price of Altera s stock on the recorded grant dates was lower than the price on the actual grant date thus permitting recipients to exercise these options at a lower strike price. On six occasions, the grants had intrinsic value at the time of grant; that is, they were issued in-the-money . On the seventh occasion, the grants were repriced shortly after the grant date and did not result in a material charge. Under these circumstances, we should have amortized the in-the-money portion of the options over their vesting periods in our previously issued financial statements. To correct this error, we are recording $17.8 million of additional pre-tax, non-cash stock-based compensation expense in the restatement for the periods 1996 to 2004.

The special committee also concurred with management s conclusion that from 1996 to 2002, certain employees stock option agreements were modified in connection with the termination of their employment. Generally these modifications were made in the context of separation agreements that permitted additional vesting and/or additional time to exercise options after the employee had ceased performing services and beyond the periods originally specified in the stock option grant agreements. At the time these agreements were entered into, the Company, did not have sufficient controls in place to ensure that the accounting consequences of these transactions were properly identified, accounted for and reported in the proper period.

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As a result, we should have recorded additional stock-based compensation expense related to the modifications in our previously issued financial statements. To correct this error, we are recording $24.3 million of additional pre-tax, non-cash stock-based compensation expense in the restatement for the periods 1996 to 2002. The majority of this expense relates to only a limited number of modifications that provided an extension of the exercise period for options that were already vested at the time of the modification and approximately 75 percent of this additional expense is attributable to years 1996 and 1997. For more information regarding the investigation and findings relating to stock option practices and the restatement, please refer to Item 7, Management s Discussion and Analysis of Financial Condition and Results Restatement of Consolidated Financial Statements and Related Proceedings , and Note 3 Restatement of Previously Issued Consolidated Financial Statements in Item 8. For more information regarding the investigation and findings relating to stock option practices and the restatement and our remedial measures, see Item 9A, Controls and Procedures.

We have not amended any of our other previously filed annual reports on Form 10-K for the periods affected by the restatement or adjustments other than this amended Annual Report on Form 10-K/A. For this reason, the consolidated financial statements and related financial information contained in such previously filed reports should no longer be relied upon. Except for the sections of this Form 10-K/A listed below, all of the information in this amended Annual Report on Form 10-K/A is as of December 30, 2005 and does not reflect events occurring after the Original Filing. In addition, in accordance with applicable SEC rules, this amended Annual Report on Form 10-K/A includes updated certifications from our Chief Executive Officer (CEO) and acting Chief Financial Officer as Exhibits 31.1, 31.2, 32.1 and 32.2.

For the convenience of the reader, this amended Annual Report on Form 10-K/A sets forth the Original Filing in its entirety, as modified and superseded where necessary to reflect the restatement. The following items have been amended principally as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby as a result of the restatement:

Part I Item 1A: Risk Factors;

Part I Item 3: Legal Proceedings;

Part II Item 6: Selected Consolidated Financial Data;

Part II Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations;

Part II Item 8: Financial Statements and Supplementary Data;

Part II Item 9A: Controls and Procedures;

Part III Item 11: Executive Compensation; and

Part IV Item 15: Exhibits and Financial Statement Schedules.

FORWARD-LOOKING STATEMENTS

This report and certain information incorporated herein by reference contains forward-looking statements, which are provided under the safe harbor protection of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally written in the future tense and/or are preceded by words such as will, may, should, could, expect, suggest, believe, anticipate, intend, plan, or other similar words. Forward-looking statements include statements regarding:

our gross margins and factors that affect gross margins (see Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview and Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Gross Margin);

the commercial success of our new products (see Item 1: Business and Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview);

our research and development expenditures and efforts (see Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Research and Development Expenses);

our capital expenditures (see Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition, Liquidity, and Capital Resources);

the growth prospects of the semiconductor industry and PLD market, including the FPGA and CPLD product sub-segments (see Item 1: Business Strategy and Competition and Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview);

trends in our future sales, including our opportunities for growth by displacing ASICs, ASSPs and other fixed chip alternatives and our belief that maintaining or increasing market share in the FPGA product sub-segment is important to our success (see Item 1: Business Strategy and Competition and Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview);

the impact of new accounting pronouncements, including Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, on our expenses (see Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations);

potential Section 409A remedial actions and additional expenses associated with our stock option investigation, litigation defense and financial restatement (see Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements and Related Proceedings Restatement of Consolidated Financials);

changes to improve our controls relating to the process of granting stock option awards (see Item 9A: Controls and Procedures Management s Consideration of the Restatement Stock Option Grant Measurement Date Errors); and

efforts to improve internal control over financial reporting and progress towards remediation of the company s material weakness and mitigation of control deficiencies (see Item 9A: Controls and Procedures Changes in Internal Control Over Financial Reporting).

Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. The forward-looking statements contained in this report are based on information currently available to us and expectations and assumptions that we deem reasonable at the time the statements were made. We do not undertake any obligation to update any forward-looking statements in this report or in any of our other communications, except as required by law. All such forward-looking statements should be read as of the time the statements were made in the Original Filing, unless modified and superseded in this report, and with the recognition that these forward-looking statements may not be complete or accurate at a later date.

Many factors may cause actual results to differ materially from those expressed or implied by the forward-looking statements contained in this report. These factors include, but are not limited to, those risks set forth in Item 1A: Risk Factors.

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PART I

ITEM 1. BUSINESS.

Founded in 1983, Altera Corporation designs, manufactures, and markets: (1) programmable logic devices, or PLDs; (2) our HardCopy® structured application-specific integrated circuit, or ASIC, devices; (3) pre-defined design building blocks known as intellectual property, or IP cores; and (4) associated development tools. Our headquarters facility is located at 101 Innovation Drive, San Jose, California 95134, and our web-site is www.altera.com. Our common stock trades on the NASDAQ National Market under the symbol ALTR.

Our PLDs, which consist of field-programmable gate arrays, or FPGAs, and complex programmable logic devices, or CPLDs, are semiconductor integrated circuits that are manufactured as standard chips that our customers program to perform desired logic functions within their electronic systems. Our HardCopy devices enable our customers to transition from a high-density FPGA to a low-cost non-programmable implementation of their designs for volume production. Our customers can license IP cores from us for implementation of standard functions in their PLD designs. Customers develop, compile, and verify their PLD designs, and then program their designs into our PLDs using our proprietary development software, which operates on personal computers and engineering workstations.

We were one of the first suppliers of complementary metal oxide semiconductor, or CMOS, PLDs and are currently a global leader in this market. Today, we offer a broad range of PLDs that offer unique features as well as differing densities and performance specifications. Our products serve a wide range of customers within the communications, computer and storage, consumer, and industrial market segments. An overview of typical PLD applications within these markets is shown in the table below.

MARKET SEGMENT	MARKET SUB-SEGMENT	APPLICATION/PRODUCT
COMMUNICATIONS	NETWORKING	Routers
		Switches
	WIRELINE	Access Systems
		Metropolitan Area Networks
		Optical Networks
	WIRELESS	Cellular Base Stations
		Wireless Local Area Networks
COMPUTER AND STORAGE	COMPUTER	Mainframes
		Servers

	Office Automation	Copiers
		Multi-Function Peripherals
		Printers
	Storage	Redundant Array of Inexpensive Disks (RAID) Systems
		Storage Area Networks
Consumer	Broadcast	Studio Editing
		Satellite Equipment
		Broadcasting Equipment
	Entertainment	Audio/Video Systems
		Video Displays, Cable Set Top Boxes
Industrial	Automotive	Car Entertainment Systems
		Navigation Systems
	Instrumentation	Manufacturing Systems
		Medical Diagnostic Systems
		Test Equipment
	Military	Guidance and Control
		Radar Systems
		Secure Communications
	Security /Energy Management	Automatic Teller Machines (ATMs)
		Card Readers
		Energy Management Systems

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Digital Logic Overview

Three principal types of digital integrated circuits are used in most electronic systems: (1) processors, (2) memory, and (3) logic.

Processors, which include microprocessors, microcontrollers, and digital signal processors, are typically used for control, central computing tasks, and signal processing;

Memory is used to store programming instructions and data; and

Logic is typically used to manage the interchange and manipulation of digital signals within a system.

While system designers employ a relatively small number of standard architectures to meet their processor and memory needs, they require a wide variety of logic circuits to differentiate their end products.

The majority of the digital logic market is made up of three product sub-segments: (1) ASICs; (2) application-specific standard products, or ASSPs; and (3) PLDs. In a broad sense, all of these products are competitive with each other as they generally may be used in the same types of applications in electronic systems. However, differences in cost, performance, density, flexibility, ease-of-use, and time-to-market dictate the extent to which they may be directly competitive for particular applications. The table below summarizes key characteristics of ASIC, ASSP, and PLD products from the perspective of the end customer.

	ASIC	**ASSP**	**PLD**
Customizable	Yes, by chip fabrication facility	No	Yes, by end user
Erasability/ Re-programmability	No	No	Yes
Relative Time-to-Market	Slow	Immediate	Fast
Relative Unit Cost	Low	Moderate	Moderate to High
Customer s Development Cost	High	Low	Moderate

ASICs, also referred to as standard cells, are defined by the end customer and customized during manufacturing at the chip fabrication facility. As a result, a given ASIC has a fixed function for use by a single customer in a single application. ASSPs are defined by the ASSP supplier and sold as standard devices that cannot be customized by the end user. Rather than being built for a single customer as in the case of an ASIC, an ASSP is built for a specific type of application and is typically targeted and sold to a limited number of customers. For simplicity, an ASSP may be viewed as an ASIC developed for more than one customer. In contrast to the fixed nature of both ASICs and ASSPs, PLDs are customized by the end customer and hence can be used in a wide range of applications. As a result, a given PLD is typically sold to hundreds or thousands of customers.

The inherent flexibility of PLDs provides significant advantages over ASICs, including design change simplicity, shorter design cycles, and lower development cost. In contrast to ASIC users, PLD users program their design directly into the PLD and can have custom chips that are fully functioning and verified at the time the design is completed, thereby bypassing the lengthy and complex cycles involved in the verification and fabrication of ASICs. As a result of user programmability, PLD customers may experiment with and revise their designs in a relatively short amount of time and with minimum development cost. The ease-of- use and time-to-market advantages of PLDs are complemented by the added benefit of field upgradeability, which generally enables PLD users to modify the PLD design after the electronic system has been shipped.

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Due to their programmability, however, PLDs generally have a larger die size and associated higher per-unit cost when compared to ASICs. While the customized manufacturing of ASICs can result in more optimized chip performance and lower per-unit cost than PLDs, ASICs require higher up-front costs and longer manufacturing lead times.

Historically, due to their lower per-unit costs, ASICs have been viewed as more cost effective than PLDs for large-volume, low-cost applications such as consumer electronics. Consequently, the unit volume of a PLD implementation is typically lower than that for an ASIC implementation. Additionally, some customers may choose to prototype with PLDs for initial engineering development and then re-design to an ASIC in volume production for lower per-unit cost. While such re-designs have always been an aspect of the PLD business, we believe that the following factors are driving electronic systems manufacturers to use PLDs for their systems entire life cycle: (1) the continual reduction in the price premium of programmable logic; (2) the ever-shortening product life cycle of many electronic systems; and (3) the use of more advanced chip manufacturing technology, which heightens the failure risk of ASICs and the up-front costs of design, verification and mask development, known as non-recurring engineering costs, or NREs.

ASSPs have been used in applications where specific fixed functions are needed and where little differentiation is required, such as in implementing certain electronic industry standards. However, the fixed functionality of ASSPs limits the range of applications they can address. In contrast to ASSPs, the flexibility found in PLDs allows users to define circuitry to suit their value-added and differentiated system architecture, rather than restrict their system architecture based upon the ASSP manufacturer s device specification. Furthermore, the emergence of IP design blocks in PLDs has allowed the implementation of standardized functions otherwise performed by ASSPs.

We believe that the adoption of more advanced chip manufacturing technology, which is increasing the total cost of chip development, is reducing the cost advantage of ASICs and ASSPs. The cost and time for us to develop a PLD is comparable to the cost and time for others to develop an ASIC or ASSP. Since each of our PLDs is sold to hundreds or thousands of customers, we generally spread development costs and generate revenue across a wide customer base. In contrast, ASIC and ASSP suppliers build fixed, custom chips for a single customer or for a single application. Because it is increasingly difficult for ASIC and ASSP suppliers to identify opportunities that generate enough revenue to compensate for the high development costs, we believe that ASIC suppliers are imposing ever-higher up-front costs and minimum order quantities on customers, and ASSP manufacturers may be developing fewer products.

Strategy and Competition

We believe that the increasing cost associated with the use of advanced chip manufacturing technology is driving the development and use of standard, programmable digital integrated circuits. As in microprocessors and memory, PLDs provide the flexibility for the end user to change and define circuits without incurring the cost, risk and delays of custom chip fabrication. Consequently, we believe that customers will increasingly use PLDs for both prototyping and production rather than ASICs or ASSPs, despite the higher per-unit cost of PLDs.

In order to capture a larger percentage share of the semiconductors purchased by our customers, we are focused on providing the most advanced programmable solutions. To accomplish this goal, we strive to offer our customers:

- PLDs with the speed, density, functionality, and package types to meet their specific needs;

PLDs optimized for low-cost and high-volume applications;

HardCopy devices that enable our customers to easily move from our largest PLDs to a low-cost structured ASIC implementation of their designs;

Optimized, pre-verified system-level IP cores to speed their design process;

State-of-the-art development tools that offer low cost and ease-of-use and compatibility with other industry-standard electronic design automation, or EDA, tools; and

A complete customer support system.

We believe that the greatest opportunity for our growth is displacing ASICs and ASSPs. We compete with other PLD vendors to realize this opportunity and for market share within the PLD market. The programmable logic market is highly concentrated with two vendors accounting for a majority of the total market: ourselves and Xilinx, Inc. Using publicly available data and

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information obtained from Gartner Dataquest, we estimate that the smaller vendors, including Lattice Semiconductor Corporation and Actel Corporation, together comprise approximately 16% of the PLD market. Within the PLD market, sales of FPGAs and CPLDs constitute the majority of revenues. CPLDs and FPGAs are often viewed as two distinct sub-segments of the PLD market and, due to product differences, generally do not compete directly for the same customer designs. Altera was an early entrant in the CPLD sub-segment and, based on our estimates, has held over 40% market share for more than five years. The FPGA sub-segment has outgrown the CPLD sub-segment. FPGAs now comprise approximately 75% of total PLD sales, and it is generally accepted by participants and observers of the industry that the FPGA sub-segment will continue to be the fastest growing sub-segment of the PLD market. Based on our estimates, we believe that in 2005 we had a 32% share in the FPGA sub-segment, up from 30% in 2004 and 29% in 2003, and that maintaining or increasing market share in this sub-segment is important to our long-term growth.

Competition among vendors is most intense in the design-win phase of the customer s design. The design-win phase refers to the customer s selection of a particular vendor s product for use in the customer s electronic system. Because each vendor s product offering is proprietary, the cost to switch PLD devices after a system has been designed and prototyped is very high. Therefore, customers rarely switch PLD vendors after this initial selection for a particular design. From the time a design-win is secured it can be as long as two years, and sometimes longer, before the customer starts volume, or production, purchases of our devices. Typically, the customer selects the PLD vendor relatively early in the customer s design program. It typically takes several years from that point before the customer has completed its entire system design, built prototypes, sampled the marketplace for customer acceptance, made any modifications, and established volume manufacturing capacity. Thus, movements in PLD market share often occur some time after the change in relative competitiveness that gave rise to the market share shift. Because of this time lag, market share is a lagging indicator of relative competitive strength. Because it is extremely difficult to forecast the degree of success or timing of a customer s program, and because the end markets are so fragmented (we have over 14,000 PLD customers), it is difficult even for PLD vendors to gauge their competitive strength in securing design wins as of a particular point in time.

Principal competitive factors in the programmable logic sub-segment include:

- Technical innovation;
- Device performance and features;
- Capability of software development tools and IP cores;
- Pricing and availability;
- Quality and reliability;
- Technical service and customer support;
- Manufacturing and operational competence; and
- Customer familiarity with existing vendors and entrenched products.

We believe that we compete favorably with respect to these factors and that our proprietary device architecture and our installed base of software development systems may provide some competitive advantage. We have been able to introduce new product families that, as compared to their predecessors, provide greater functionality at a lower price for any given density because of unique architectural innovation and advanced technologies.

We also believe that in certain circumstances these new product families compete favorably against ASICs and ASSPs, as well as against other types of chips such as microcontrollers, microprocessors, and digital signal processors. Some of the functionality offered by these other types of chips can be implemented in PLDs using pre-built and pre-verified IP cores. An IP core is typically offered in either a hard or soft form. A hard IP core is embedded into the actual circuitry of our chips. A soft IP core is a licensed design file that our customers incorporate into their design and program onto the PLD. By incorporating more functionality and logic capacity on a programmable chip while providing the necessary design tools and IP cores to design a reliable system, we believe we can enhance the advantages of PLDs over competing solutions.

As is true of the semiconductor industry as a whole, the digital logic segment and the PLD sub-segment are intensely competitive and are characterized by rapid technological change, rapid rates of product obsolescence, and price erosion. All of these factors may adversely affect our future operating results. For a discussion of risk factors associated with our strategy and competition, see Item 1A: Risk Factors *Our failure to compete successfully in the highly competitive semiconductor industry would adversely affect our financial results and business prospects* and *Our failure to define, develop, and manufacture technologically-advanced products would adversely affect the success and growth of our company.*

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Products

Our products consist primarily of devices, IP cores, and proprietary development tools. A brief overview of these products follows.

Devices

Our devices fall into the following four categories: (1) FPGAs, (2) CPLDs, (3) low-cost HardCopy structured ASIC devices, and (4) configuration devices that store the programming code for our FPGAs. These devices span multiple architectures and device families, with numerous product options. Each device family offers unique functional benefits and differing density and performance specifications. Sales of FPGAs accounted for 70% of our total sales in 2005, 68% in 2004 and 65% in 2003. Sales of CPLDs accounted for 20% of our total sales in 2005, 23% in 2004 and 27% in 2003. Sales of our other products accounted for 10% of our total sales in 2005 and less than 10% of our total sales in 2004 and 2003. Some of our latest device families, which are typically designed into new end equipment, are summarized and described below. Certain of our more mature device families, which are not now typically designed into new end equipment but may still comprise significant portions of our total revenue, have been omitted from the descriptions below.

Stratix® and Stratix II High-End, System-Level FPGAs

Our Stratix product families are built using the most advanced CMOS process technology and address a broad range of applications in communications, computing and storage, consumer, and industrial markets. Architectural innovations within Stratix FPGAs help provide industry-leading logic density and performance, while offering high speed and flexible embedded system functionality such as memory and digital signal processing (DSP) blocks. Additionally, our Stratix GX and Stratix II GX FPGA devices offer advanced transceiver capabilities for applications that require reliable, multi-gigabit data transfer rates.

Cyclone and Cyclone II Low-Cost, High-Volume FPGAs

Our Cyclone product families are built using advanced CMOS process technology and bring programmable flexibility to cost-sensitive applications across a vast array of end markets within communications, computing and storage, consumer, and industrial. Architectural innovation allows Cyclone devices to combine a low-cost structure with abundant device resources making them ideal for high-volume applications across all our served markets in areas such as digital set-top boxes, DVD player/recorder systems, automotive telematics, and flat panel televisions.

MAX® and MAX II CPLDs

Our MAX CPLD product families are instant-on, non-volatile devices that address a wide range of high-speed glue logic functions found in a broad range of electronics equipment in the communications, computing and storage, consumer, and industrial markets. Glue logic enables the interaction of multiple subsystem components. Our current generation MAX II devices are based on a newly

developed and revolutionary architecture that reduces costs by up to 50 percent or more, consumes 90 percent less power, and increases performance by as much as 50 percent over the previous generation MAX family.

HardCopy and HardCopy II Structured ASIC Devices

Our HardCopy and HardCopy II (HardCopy) products offer customers a migration path from the highest density FPGA families to a low-cost structured ASIC device for high-volume production applications. In contrast to traditional ASICs, in which every mask layer is custom and unique to the customer s design, structured ASICs share a common set of base layers and the customer s design is implemented in the device by customizing only the last few mask layers. For a given process technology, structured ASIC devices deliver nearly the performance of comparable ASICs, but with reduced development costs and shorter production lead-times.

HardCopy device base arrays are developed from equivalent FPGAs by removing the configuration circuitry, programmable routing, and programmability for logic and memory. This scheme reduces the die size while maintaining compatibility with the FPGA architecture, providing seamless migration of the customer design to a HardCopy device. As a result, HardCopy devices extend the flexibility and time-to-market advantages of high-density FPGAs, which are used typically for prototyping, to high-volume, more cost-sensitive applications traditionally served by fixed ASICs.

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INTELLECTUAL PROPERTY CORES

IP cores are pre-verified building blocks that implement standard system-level functions that customers incorporate in their PLD design by using our proprietary development software. Soft IP cores available for use in our devices consist of our Nios® and Nios II soft core embedded processors and our portfolio of MegaCore® functions, which we license to our customers, and our Altera Megafunction Partners Program, or AMPP℠, cores, which are pre-verified by us and licensed to our customers by third parties.

The Nios and Nios II embedded processors utilize a reduced instruction set computing, or RISC, architecture and are a cost-competitive and flexible alternative to discrete microcontroller solutions. The Nios embedded processors can be efficiently implemented in all of our newer FPGA devices. The Nios II soft core embedded processor provides up to a 300% improvement in price/performance when compared to the original Nios embedded processor and competes favorably with many discrete microcontrollers.

With IP cores, system designers can focus more time and energy on improving and differentiating the unique aspects of their system design, rather than spending time designing common off-the-shelf functions. IP cores are essential to providing our customers solutions that enable higher levels of integration and faster time-to-market. Today, we offer a broad range of soft IP cores for various system blocks for DSP algorithms, bus interfaces, memory controllers, telecommunications, data communications, microprocessors, and peripherals. Prior to licensing a soft IP core, customers may download an encrypted soft IP core from our web-site and verify that it works in their own system design. While licensing soft IP cores represents a small portion of our total revenues, we believe a broad product offering in this area is necessary to compete with ASIC and ASSP suppliers as well as other PLD suppliers.

DEVELOPMENT TOOLS

Our proprietary development tools, consisting primarily of the Quartus® II software, enable our customers to successfully complete all necessary PLD design steps. Our tools enhance engineering productivity by facilitating design entry, design compilation, design verification, and device programming during the initial design and subsequent design revisions.

Our development tools can be used on a variety of computing platforms and have built-in interfaces with other engineering design software, thus making it possible for customers to utilize their existing design environment. Our Quartus II software development tools run under the Microsoft Windows, UNIX (including Solaris and HP-UX), and Linux operating environments. Our development tools also provide interfaces to many industry-standard EDA tools, including those offered by Cadence Design Systems, Inc., Mentor Graphics Corporation, Synopsys, Inc., and Synplicity, Inc.

Like soft IP cores, our development tools generate less than 10% of our total revenues, but are a critical and necessary element of our product portfolio because they are used to program our devices and can drive our success in competing for design wins against ASIC and ASSP suppliers as well as other PLD suppliers.

Research and Development

Our research and development activities have focused primarily on PLDs and on associated IP cores, development software, and hardware. We have developed these related products in parallel to provide comprehensive design support to customers. As a result of our research and development efforts, we have introduced during the past three years a number of new families, including the Stratix II, Stratix II GX, Cyclone II, MAX II, and HardCopy II device families, as well as major enhancements to our IP core offering and the Quartus II development platform.

Our research and development expenditures were $209.8 million in 2005, $181.9 million in 2004, as restated, and $181.3 million in 2003, as restated, which includes stock-based compensation expense as a result of the restatement disclosed in Note 3 Restatement of Previously Issued Financial Statements to our Consolidated Financial Statements. We expense as incurred all research and development costs that have no alternative future use. We intend to continue to spend substantial amounts on research and development in order to continue to develop and achieve market acceptance of our new products. For a discussion of risk factors associated with our research and development efforts, see Item 1A: Risk Factors *Our failure to define, develop, and manufacture technologically-advanced products would adversely affect the success and growth of our company*.

Patents, Trademarks, and Licenses

We generally rely on intellectual property law, including patent, copyright, trademark, and trade secret laws, to establish and maintain our proprietary rights in products and technology. We have increased investment in intellectual property protection in the

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last several years and, as of December 30, 2005, we owned more than 1,100 United States and 180 foreign patents. We also have more than 900 patent applications currently pending. Also, we have used, registered, and applied to register certain trademarks and service marks to distinguish our products, technologies, and services from those of our competitors in the United States and foreign countries. In addition, we file registrations in the United States under the Semiconductor Chip Protection Act to protect our chip designs.

We have entered into technology licensing agreements that give us rights to design, manufacture, and sell products using certain intellectual property owned by others. In July 2001, we entered into a settlement agreement with Xilinx under which we settled all pending patent litigation. As part of the settlement agreement, we entered into a royalty-free patent cross license agreement with Xilinx, including a prohibition of further patent litigation between the two companies through July 2006. In connection with the settlement agreement, we paid Xilinx a one-time payment of $20.0 million. Similarly, in July 2001, we entered into a settlement agreement with Lattice under which we settled all pending patent litigation. As part of the settlement agreement, we entered into a royalty-free patent cross license agreement with Lattice, including a multi-year prohibition of further patent litigation between the two companies. No payments were made by Altera or Lattice as part of the settlement.

When necessary, we seek to enforce our intellectual property rights. For example, in 1999, we brought an action against Clear Logic, Inc. for infringement of our mask work registration rights and for interfering with our license agreements with our customers. A jury in the United States District Court for the Northern District of California decided in our favor on both issues in October 2002, and the jury verdict was affirmed on appeal by the Ninth Circuit Court of Appeals in September 2005. Although we believe that protection afforded by our intellectual property rights has value, the rapidly changing technology in the semiconductor industry makes our future success dependent primarily on the innovative skills, technological expertise, and management abilities of our employees rather than on our patent, trademark, or other proprietary rights. For a discussion of risk factors associated with our patents, trademarks, and licenses, see Item 1A: Risk Factors *The failure of our intellectual property rights to provide meaningful protection from our competitors could harm our competitive position* and *Intellectual property infringement claims could adversely affect our ability to manufacture and market our products.*

Marketing and Sales

We market our products worldwide through a network of distributors, independent sales representatives, and direct sales personnel. From time to time, we may add or remove independent sales representatives or distributors from our selling organization as we deem appropriate.

Altera Distributors

We engage distributors in all major geographic markets that we serve. These distributors are franchised by component manufacturers to sell a wide variety of products to many customers, and they may sell competing products or solutions. We have contracts with our distributors, which can be terminated by either party in a relatively short period of time. The main roles of our independent distributors are to provide demand creation for the broad base of customers and order fulfillment services.

All of our distributors stock inventory of our products. The distributors purchase products from us at a set distributor cost denominated in U.S. dollars. Title and risk of loss generally transfer upon shipment from our stocking locations, which are primarily located at the independent subcontractors we employ for test and assembly services in the Asia Pacific region or our warehouse in

San Jose. Upon shipment to the distributor, we generally defer revenue on the sale in accordance with our revenue recognition policy. Consequently, the deferred revenue and the corresponding deferred cost of sales are recorded as a current liability under the caption titled Deferred income and allowances on sales to distributors. All payments to us are denominated in U.S. dollars. For a detailed discussion of our revenue recognition policy, see Note 2 Significant Accounting Policies Revenue Recognition to our Consolidated Financial Statements.

Our sales cycle begins with a design-win phase, which is generally lengthy and often requires the ongoing participation of sales, engineering, and managerial personnel. Once customer demand has been created and a design is ready to move into prototyping or production, the order fulfillment process begins. Regardless of whether Altera, the independent sales representative, or the distributor created the demand, a local distributor will process and fulfill over 90% of all orders from customers. Our distributors are the legal sellers of the products and therefore bear all risks, such as credit loss, inventory shrinkage and theft, and foreign currency fluctuations that are generally related to the sale of commercial goods.

In accordance with our distribution agreements and industry practice, we have granted our distributors the contractual right to return certain amounts of unsold product on a periodic basis and also to receive price concessions for unsold product in the case

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of a subsequent decrease in list prices. We also provide price concessions to our distributors for a portion of their original purchase price in order for them to address individual negotiations involving high-volume or competitive situations. Typically, a customer purchasing a small quantity of product for prototyping or development from a distributor will pay list price. However, a customer using our products in volume production, purchasing thousands or even hundreds of thousands of units, will often competitively negotiate a substantial price discount from the distributor. Under such circumstances, the distributor will often negotiate and receive a price concession from Altera. In recent years, such concessions have exceeded 50% of list price on average. This is a standard practice in the semiconductor industry and we provide some level of price concession to every distributor.

Total sales is the sum of our own direct sales to original equipment manufacturers, or OEMs, and our distributors resales of Altera products. For the fiscal year ended December 30, 2005, worldwide sales through distributors for subsequent resale to OEMs, or their subcontract manufacturers, accounted for 93% of total sales. Arrow Electronics, Inc. is our largest distributor and on a worldwide basis accounted for 44% of total sales in 2005, 46% of total sales in 2004, 51% of total sales in 2003. Altima Corporation, which serves the Japanese market, accounted for 17% of total sales in 2005, 16% of total sales in 2004, and 16% of total sales in 2003. Paltek Corporation, which also serves the Japanese market, accounted for 10% of total sales in 2004, and less than 10% of total sales in 2005 and 2003. In March 2006, we terminated our distribution relationship with Paltek Corporation.

For a discussion of the risk factors associated with our distribution model, see Item 1A: Risk Factors *We rely heavily on distributors to generate a significant portion of our sales and fulfill our customer orders. The failure of our distributors to perform as expected would materially reduce our future sales* and *Conditions outside the control of our independent subcontractors and distributors may impact their business operations and thereby adversely interrupt our manufacturing and sales processes*. See also Note 2 - Significant Accounting Policies - Concentrations of Credit Risk to our Consolidated Financial Statements.

Altera Sales, Marketing, and Customer Support

Altera also maintains a dedicated global sales and marketing organization to create customer demand and manage the network of distributors and independent sales representatives. In general, Altera focuses its direct demand creation efforts on a limited number of key accounts, as well as providing technical, business, and marketing support to distributors and independent sales representatives. Independent sales representatives are mostly located in North America and in select European countries. Independent sales representatives create demand and provide customer support in a defined territory and, in many cases, with a defined set of customers. They stock no inventory and provide no order fulfillment services. All of our contracts with independent sales representatives may be terminated by either party in a relatively short period of time.

Customer support and service are important aspects of selling and marketing our products. We provide several levels of technical user support, including applications assistance, design services, and customer training. Also, we publish data sheets and application notes, conduct technical seminars, and provide design assistance via the Internet and electronic links to the customer.

Throughout the United States, we have domestic sales offices in numerous major metropolitan areas. In addition, we maintain international sales support offices in various metropolitan areas including Bangalore, Beijing, Cork, Helsinki, Hong Kong, London, Munich, Osaka, Ottawa, Paris, Seoul, Shanghai, Shenzhen, Singapore, Stockholm, Taipei, Tokyo, and Turin.

No single end customer accounted for more than 10% of our total sales in 2005, 2004, or 2003.

INTERNATIONAL SALES

International sales, which consist of all sales outside of North America, constituted 75% of total sales in 2005, 71% of total sales in 2004, and 67% of total sales in 2003. Sales to Japan accounted for 25% of total sales in 2005 and 2004, and 24% in 2003. Except for the United States and Japan, no other country accounted for sales in excess of 10% of total sales during 2005, 2004, or 2003. We expect international sales to continue to increase as a percentage of our total sales in the future. All of our sales to foreign entities are denominated in United States dollars. For a detailed description of our sales by geographic region, see Item 7: Results of Operations Sales by Geography and Note 11 - Segment and Geographic Information to our Consolidated Financial Statements. For a discussion of the risk factors associated with our foreign operations, see Item 1A: Risk Factors *Because we depend on international sales for a majority of our total sales, we may be subject to political, economic and other conditions that could increase our operating expenses and disrupt our business* and *Our business is subject to tax risks associated with being a multinational corporation.*

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Backlog

Our backlog consists mostly of distributor orders, as well as limited OEM orders, that are for delivery within the next three months. Our backlog of orders on December 30, 2005, was approximately $522.7 million, compared to $330.8 million on December 31, 2004.

Historically, backlog has been a poor predictor of future customer demand. While our backlog can increase during periods of high demand and supply constraints, purchasers may generally cancel product orders up to 30 days prior to the scheduled delivery date without incurring significant cancellation penalties. Further, we generally defer recognition of revenue on shipments to distributors until the product is resold. For all of these reasons, backlog as of any particular date should not be used as a predictor of future sales.

Manufacturing

Wafer Supply

Die, cut from silicon wafers, are the essential components of all our devices and a significant portion of the total device cost. Our manufacturing strategy is known as a fabless business model since we do not directly manufacture our silicon wafers. Instead, our silicon wafers are produced by independent semiconductor foundries. This enables us to take advantage of these suppliers high-volume economies of scale and also gives us direct and timely access to advanced process technology. We purchase nearly all of our silicon wafers from Taiwan Semiconductor Manufacturing Company, or TSMC, an independent semiconductor foundry. We have no formalized long-term supply or allocation commitments from TSMC. In the past, we have used other foundry vendors, and we may establish additional foundry relationships as they become economically beneficial or technically necessary. For a discussion of risk factors associated with our wafer supply arrangements, see Item 1A: Risk Factors *We depend entirely on independent subcontractors to supply us with finished silicon wafers. The failure of these subcontractors to satisfy our demand could materially disrupt our business,* *Shortages of, and/or increased costs for, our silicon wafers could lower our gross margins, reduce our sales, or otherwise materially disrupt our business,* *The manufacture of our products is complex, and the foundries on which we depend may not achieve the necessary yields or product reliability that our business requires,* and *Conditions outside the control of our independent subcontractors and distributors may impact their business operations and thereby adversely interrupt our manufacturing and sales processes*.

Testing and Assembly

After wafer manufacturing is completed, each silicon wafer is tested using a variety of test and handling equipment. The vast majority of our silicon wafer testing is performed at TSMC, and our San Jose pilot line facility, which is used primarily for new product development. This testing is performed on equipment owned by us and consigned to our partners.

The wafers are then shipped to various assembly suppliers in Asia, where good die are separated into individual chips that are then encapsulated in packages. We employ a number of independent suppliers for assembly purposes. This enables us to take advantage of these subcontractors high-volume economies of scale and supply flexibility, and gives us direct and timely access to

advanced packaging technology. We purchase almost all of our assembly services from Amkor Electronics, Inc., in Korea and the Philippines, and Advanced Semiconductor Engineering, Inc., or ASE, in Malaysia and Taiwan.

Following assembly, each of the packaged units receives final testing, marking, and inspection prior to being packaged for storage as finished goods. We obtain almost all of our final test and back-end operation services from Amkor and ASE. Final testing by these assembly suppliers is accomplished through the use of our proprietary test software operating on hardware that is consigned to or owned by our suppliers.

The majority of our inventory, including finished goods, is warehoused at our subcontract test and assembly partners located in Asia with a smaller portion located at our corporate facility in San Jose, California. On our behalf, these suppliers also ship our products to OEMs and distributors.

For a discussion of risk factors associated with our testing and assembly arrangements, see Item 1A: Risk Factors *We depend on independent subcontractors, located in Asia, to assemble, test, and ship our semiconductor products. The failure of these subcontractors to satisfy our demand could materially disrupt our business* and *Conditions outside the control of our independent subcontractors and distributors may impact their business operations and thereby adversely interrupt our manufacturing and sales processes*.

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Executive Officers of the Registrant

Our executive officers and their ages as of March 14, 2006 are as follows:

Name	Age	Position
John P. Daane	42	Chairman, President and Chief Executive Officer
Denis M. Berlan	56	Executive Vice President and Chief Operating Officer
John R. Fitzhenry	56	Vice President, Human Resources
Lance M. Lissner	56	Senior Vice President, Business Development
George A. Papa	57	Senior Vice President, Worldwide Sales
Jordan S. Plofsky	45	Senior Vice President, Marketing
Nathan M. Sarkisian	47	Senior Vice President and Chief Financial Officer
Katherine E. Schuelke	43	Vice President, General Counsel and Secretary

There are no family relationships among our executive officers or between any executive officer and any of our directors.

John P. Daane joined us as our President and Chief Executive Officer in November 2000 and was elected as one of our directors in December 2000 and our Chairman of the Board in May 2003. Prior to joining us, Mr. Daane spent 15 years at LSI Logic Corporation, a semiconductor manufacturer, most recently as Executive Vice President, Communications Products Group, with responsibility for ASIC technology development and the Computer, Consumer, and Communications divisions. Mr. Daane earned his bachelors degree from the University of California, Berkeley in 1986.

Denis M. Berlan joined us in December 1989 as Vice President, Product Engineering and was named Vice President, Operations and Product Engineering in October 1994. In January 1996, he was named Vice President, Operations. In January 1997, he was named Executive Vice President and Chief Operating Officer. He was previously employed by Advanced Micro Devices, Inc., or AMD, a semiconductor manufacturer, and by Lattice Semiconductor Corporation, a semiconductor manufacturer, in engineering management capacities. Mr. Berlan received his M.S.E.E. in 1972 and Ph.D. in 1977 from the University of Grenoble in France and an M.B.A. in 1987 from the University of Santa Clara.

John R. Fitzhenry joined us in May 1995 as Vice President, Human Resources. From February 1983 to May 1995, he was employed by Apple Computer, Inc., a manufacturer of personal computers, in various human resource management positions. Mr. Fitzhenry earned his bachelors degree from the University of California, Santa Barbara in 1971 and his J.D. from the University of the Pacific McGeorge School of Law in 1976.

Lance M. Lissner joined us in May 1998 as Vice President of Business Development and Investor Relations and was appointed Senior Vice President, Business Development in November 2000. Prior to that time, Mr. Lissner was a corporate officer of Measurex Corporation, a developer of computer-integrated measurement, control, and information systems, where he was employed since 1973 and held various positions in sales, marketing, engineering, and business development. Mr. Lissner earned his bachelors degree from Harvey Mudd College in 1972 and his masters degree from Stanford University in 1973.

George A. Papa joined us in February 2002 as Senior Vice President, Worldwide Sales. From February 2000 to February 2002, Mr. Papa served as Vice President of Worldwide Sales of the Communications Business Group of Marvell Semiconductor, Inc., a semiconductor company. From March 1997 to February 2000, he served as Vice President of Worldwide Sales for Level One Communications, Inc., a subsidiary of Intel Corporation, a semiconductor company. From February 1991 to March 1997, Mr. Papa served as Vice President of North American Sales for Siemens Corporation, a diversified global technology company. Mr. Papa earned his bachelors degree from Northeastern University in 1971.

Jordan S. Plofsky joined us in February 2001 as Senior Vice President, Vertical Markets and Embedded Processor Products and became Senior Vice President, Applications Business Groups in March 2002 and Senior Vice President, Marketing in November 2004. Prior to joining us, Mr. Plofsky was employed by LSI Logic from October 1996 to February 2001, most recently as Executive Vice President, Enterprise Infrastructure Group from November 2000 to February 2001 and Vice President and General Manager, Networking Products Division from June 1998 to November 2000. Mr. Plofsky earned a bachelors degree from the University of Illinois, Urbana-Champaign in 1982.

Nathan M. Sarkisian joined us in June 1992 as Corporate Controller. He was appointed Vice President, Finance and Chief Financial Officer in August 1995 and Senior Vice President and Chief Financial Officer in March 1998. On March 6, 2006, we announced Mr. Sarkisian s planned retirement by the end of 2006. Prior to joining us, Mr. Sarkisian held various accounting and financial positions at Fairchild Semiconductor and at Schlumberger Limited, an oil field services company. Mr. Sarkisian earned a bachelors degree from Stanford University in 1981 and an M.B.A. from Harvard University in 1992.

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Katherine E. Schuelke joined us in March 1996 as Corporate Attorney. She became Senior Corporate Attorney in July 1997 and Assistant General Counsel and Assistant Secretary in July 1999. In October 2001, she was appointed Vice President, General Counsel and Secretary. Prior to March 1996, Ms. Schuelke was an attorney at the law firm of Morrison & Foerster LLP for seven years. Ms. Schuelke earned a bachelors degree from the State University of New York at Buffalo in 1986 and a J.D. from New York University School of Law in 1989.

Employees

As of December 30, 2005, we had 2,361 regular employees. Of these employees, 1,428 were located in the United States. None of our employees is represented by a labor union or collective bargaining agreement. We have not experienced any work stoppages, and we believe that our employee relations are good.

Web-site Access to Company s Reports

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to reports filed, or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, are available free of charge on our web-site at www.altera.com, as soon as reasonably practical after these reports are electronically filed with, or furnished to, the Securities and Exchange Commission (www.sec.gov). We will also provide a copy, free of charge, upon request made to Altera Corporation, Attn: Investor Relations, 101 Innovation Drive, San Jose, California 95134.

This annual report includes trademarks and service marks of Altera and other companies which are unregistered and registered in the United States and other countries.

ITEM 1A. RISK FACTORS.

The following risk factors, among others, could in the future affect our actual results of operations and could cause our actual results to differ materially from those expressed in forward-looking statements made by us. Before you decide to buy, hold, or sell our common stock, you should carefully consider the risks described below, in addition to the other information contained elsewhere in this report. The following risk factors are not the only risk factors facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. Our business, financial condition, and results of operation could be seriously harmed if any of the events underlying any of these risks or uncertainties actually occurs. In that event, the market price for our common stock could decline, and you may lose all or part of your investment.

Our failure to compete successfully in the highly competitive semiconductor industry would adversely affect our financial results and business prospects.

The semiconductor industry, including the PLD market, is intensely competitive. Our ability to compete successfully in the semiconductor industry will depend on our ability to provide our customers with solutions offering greater value than solutions offered by competing programmable logic vendors, such as Xilinx and Lattice, and other semiconductor companies that indirectly

compete with us.

Because we develop PLDs for applications that are presently served by vendors of ASICs, ASSPs, microcontrollers, and digital signal processors, we indirectly compete against vendors of these products. Many of these vendors, including International Business Machines Corporation and Texas Instruments Inc., have substantially greater financial, technical, and marketing resources than we do and have well-established market positions and solutions that have been proven technically feasible and economically competitive over several decades. We may not be able to displace these vendors in the targeted applications and densities. Further, other programmable logic vendors are targeting these applications and may be successful in securing market share from us. Moreover, some of our customers have historically used standard cell technologies to achieve greater integration in their systems; this may not only impede our efforts to penetrate the markets for ASICs, ASSPs, microcontrollers, and digital signal processors, but may also displace our products in the applications that we presently serve.

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Our failure to define, develop, and manufacture technologically-advanced products would adversely affect the success and growth of our company.

As a semiconductor company, we operate in a dynamic market characterized by rapid technological change. The manufacture of our products is a highly complex and precise process, requiring production in a tightly controlled environment. Our current product development efforts focus on developing new PLDs, related development software and hardware, and advanced semiconductor wafer fabrication processes. Our development efforts may not result in the timely introduction of competitive new products, or enhancements to existing products. Additionally, we may not be successful in developing new products or using and converting established products to new and more advanced process technologies. For example, our current generation product families, the Stratix II and Cyclone II families, are manufactured on a 90-nanometer all-layer-copper interconnect process. Our next generation product families will be manufactured on a 65-nanometer all-layer-copper interconnect process for which we have no production history. We will continue to transition our fabrication process arrangements to smaller circuit geometries. The use of advanced process technology entails inherent technological risks and start-up difficulties that can adversely affect research and development spending, yields, product costs, and timeliness of delivery.

We depend entirely on independent subcontractors to supply us with finished silicon wafers. The failure of these subcontractors to satisfy our demand could materially disrupt our business.

Nearly all of our silicon wafers are produced by Taiwan Semiconductor Manufacturing Company, or TSMC, in its manufacturing facilities located primarily in Taiwan. The remaining portion of our silicon wafers are produced by Sharp Corporation in Japan. Silicon wafer production facilities have at any given time a fixed capacity, the allocation of which is determined solely by our vendors and over which we have no direct control. We have no formalized long-term supply or allocation commitments from our foundry suppliers. Our operations would be disrupted if TSMC terminates its relationship with us and we are unable to arrange a satisfactory alternative to fulfill customer orders on a timely basis and in a cost-effective manner.

To ensure the continued supply of wafers, we may establish other sources of wafer supply for our products as these arrangements become economically advantageous or technically necessary. However, there are only a few foundry vendors that have the capabilities to manufacture our most advanced products. If we engage alternative sources of supply with foundry vendors that have the capabilities to manufacture our products, we may encounter start-up difficulties and incur additional costs. Also, shipments could be delayed significantly while these sources are qualified for volume production.

Furthermore, as a result of our reliance on third-party foundries, we have little or no direct control over production costs, delivery schedules, and wafer quality. We also face increased exposure to potential misappropriation of our intellectual property.

Shortages of, and/or increased costs for, our silicon wafers could lower our gross margins, reduce our sales, or otherwise materially disrupt our business.

If market demand for silicon wafers suddenly exceeds market supply, our supply of silicon wafers could quickly become limited. A shortage in foundry manufacturing capacity could hinder our ability to meet demand for our products. Moreover, silicon wafers constitute more than half of our product cost. If we are unable to procure wafers at favorable prices, our gross margins will be adversely affected.

The manufacture of our products is complex, and the foundries on which we depend may not achieve the necessary yields or product reliability that our business requires.

The manufacture of our products is a highly complex and precise process, requiring production in a tightly controlled environment. In addition to sufficient foundry manufacturing capacity and wafer prices, we depend on good production yields (the number of good die per wafer), and timely delivery of silicon wafers to meet our customers demand for products and to maintain profit margins. Wafer production yields depend on a wide variety of factors including the level of contaminants in the manufacturing environment, impurities in the materials used, and the performance of personnel and equipment. As is common in the semiconductor industry, we have experienced, and may experience from time to time, problems with achieving acceptable production yields and timely delivery from our foundry vendors.

Difficulties in production yields can often occur when we begin production of new products, when we transition to new processes, or when our principal wafer supplier, TSMC, moves production of a product from one manufacturing plant to another, or manufactures the same product at multiple factories. As a result of manufacturing defects, TSMC has also, from time to time, scrapped wafers, resulting in longer manufacturing lead times. Further, production throughput times vary considerably among the various factories used by our wafer suppliers, and we may experience delays from time to time in processing some of our products. These difficulties and delays can potentially result in significantly higher costs and lower product availability.

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We depend on independent subcontractors, located in Asia, to assemble, test, and ship our semiconductor products. The failure of these subcontractors to satisfy our demand could materially disrupt our business.

Because we rely on independent subcontractors to assemble, test, and ship our semiconductor products, we cannot directly control our product delivery schedules or quality levels. Our future success also depends on the financial viability of our independent subcontractors. If the capital structures of our independent subcontractors weaken, we may experience product shortages, quality assurance problems, and/or increased manufacturing costs.

Conditions outside the control of our independent subcontractors and distributors may impact their business operations and thereby adversely interrupt our manufacturing and sales processes.

The economic, market, social, and political situations in countries where certain independent subcontractors and distributors are located are unpredictable, can be volatile, and can have a significant impact on our business because we may not be able to obtain or distribute product in a timely manner. Market and political conditions, including currency fluctuation, terrorism, political strife, war, labor disruption, and other factors, including natural or man-made disasters, adverse changes in tax laws, tariff, import or export quotas, power and water shortages, or interruption in air transportation, in areas where our independent subcontractors and distributors are located also could have a severe negative impact on our operating capabilities. For example, because we rely heavily on TSMC to produce a significant portion of our silicon wafers, earthquakes or other natural disasters in Taiwan and Asia generally could limit our supply of silicon wafers and thereby harm our business, financial condition, and results of operation.

Our business is subject to the risks of earthquakes and other catastrophic events.

Our corporate headquarters in San Jose, California is located near major earthquake faults. A significant natural disaster, such as an earthquake, may cause significant disruption to our business. Any catastrophic event, such as an earthquake or other natural disaster, could significantly impair our ability to meet product design deadlines, maintain our records, pay our suppliers, or manufacture or ship our products.

Any prolonged disruption to our global communications infrastructure could impair our ability to plan factory activity and respond to customer demand.

Demand for our products is highly volatile, especially at the detailed ordering code level. To achieve short delivery lead times and superior levels of customer service, while maintaining low levels of inventory, we constantly adjust our manufacturing subcontractors production schedules. We develop and adjust these schedules based on end customer demand as placed on our distributors and based on our inventory levels, manufacturing cycle times, component lead times, and projected production yields. We aggregate and disseminate all of this information electronically over a complex global communications network. Our ability to aggregate demand and to adjust our production schedules is highly dependent on this network; we have no manual back-up. If a portion of this network were to experience a prolonged disruption or failure in service, our ability to plan factory activity and respond to demand would be impaired.

The failure of our intellectual property rights to provide meaningful protection from our competitors could harm our competitive position.

We rely significantly on patents to protect our intellectual property rights. We have increased investment in intellectual property protection in the last several years and, as of December 30, 2005, we owned more than 1,100 United States and 180 foreign patents. We also have more than 900 patent applications currently pending. Our patents and patent applications may not provide meaningful protection from our competitors as the status of any patent involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Our competitors may be able to circumvent our patents or develop new patentable technologies that displace our existing products. In addition to patent protection, we rely on trademark, trade secret, copyright, and mask work laws to protect our unpatented proprietary information or technologies. Despite our efforts to protect our proprietary rights from unauthorized use or disclosure, other parties, including our former employees or consultants, may attempt to disclose, obtain, or use our proprietary information or technologies without our authorization. If other companies obtain our proprietary information or technologies, or develop substantially equivalent information or technologies, they may develop products that compete against our products.

Moreover, the laws of certain countries in which our products are or may be developed, manufactured or sold may not protect our products and intellectual property rights to the same extent as the laws of the United States. Policing the unauthorized use of our products is difficult and may result in significant expense to us and could divert the efforts of our technical and management personnel. Even if we spend significant resources and efforts to protect our intellectual property, we may not be able to prevent misappropriation of our technology. Use by others of our proprietary rights could materially harm our business and expensive litigation may be necessary in the future to enforce our intellectual property rights.

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Intellectual property infringement claims could adversely affect our ability to manufacture and market our products.

From time to time in the normal course of business, we receive inquiries from other parties with respect to possible patent infringements. As a result of these inquiries, it may be necessary or desirable for us to obtain licenses relating to one or more of our current or future products. We may not be able to obtain licenses on reasonable terms. Additionally, license agreements may have set durations and/or have limited license grants and therefore may not provide complete protection against infringement claims involving all of our current or future products. For example, the settlement agreement that we entered into with Xilinx in July 2001 prohibits patent litigation between the two companies only through July 2006.

If we are sued for patent infringement, the costs and outcome of litigation could be unpredictable and could have a negative impact on our financial results. Intellectual property claims, regardless of their merit, can result in costly litigation and divert the efforts of our technical and management personnel. Legal proceedings also tend to be unpredictable and may be affected by events outside of our control. If we are unsuccessful in defending against intellectual property infringement claims, we may be required to pay significant monetary damages or be subject to an injunction against the manufacture and sale of one or more of our product families. Alternatively, we could be required to expend significant resources to develop non-infringing technology, the success of which may be uncertain. Intellectual property litigation may have an adverse effect on our financial position, results of operation, or cash flows.

Product quality problems could lead to reduced revenue, gross margins, and net income.

We produce highly complex products that incorporate leading-edge technology, including both hardware and software. Our pre-shipment testing programs may not detect all defects, either ones in individual products or ones that could affect numerous shipments. Because we generally warrant our products for varying lengths of time against defects in materials and workmanship and non-conformance to our specifications, we have on occasion been required to repair or replace certain components or refund the purchase price paid by our customers due to product defects. If there are material increases in customer claims or the costs to service warranty claims compared with our historical experience, our revenue, gross margins, and net income may be adversely affected. For example, an inability to cure a product defect in a timely manner could result in product reengineering expenses, increased inventory costs, or damage to our reputation, any of which could materially impact our revenue, gross margins, and net income.

We may be subject to product liability claims.

We sell to customers in the automotive, military, aerospace, avionics, medical equipment, and other industries where our devices are used in systems that could cause damage to property or persons if those systems were to fail. We may be subject to product liability claims if our devices are the cause of system failures. Based on our historical experience, we believe that the risk of exposure to product liability claims is currently low. However, we will face increased exposure to product liability claims if there are substantial increases in both the volume of our sales into these applications and the frequency of system failures caused by our devices.

We rely heavily on distributors to generate a significant portion of our sales and fulfill our customer orders. The failure of our distributors to perform as expected could materially reduce our future sales.

Worldwide sales through distributors accounted for 93% of our total sales during 2005. We rely on many distributors to assist us in creating customer demand, providing technical support and other value-added services to our customers, filling customer orders, and stocking our products. Our contracts with our distributors may be terminated by either party in a relatively short period of time.

Our distributors are located all over the world and are of various sizes and financial conditions. Lower sales, lower earnings, debt downgrades, the inability to access capital markets, and higher interest rates could potentially impact our distributors operations.

We are highly dependent on Arrow Electronics, Inc., in many locations across the world, particularly in North America.

During 2005, Arrow on a worldwide basis accounted for approximately 44% of total sales, while our next largest distributors accounted for approximately 17% and 9% of total sales, respectively. At December 30, 2005, four distributors, each of which accounted for more than 10% of total accounts receivable, accounted for 40%, 19%, 13%, and 11% of total accounts receivable.

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Our complex communications infrastructure limits our ability to add or replace distributors or manufacturing subcontractors.

Our distributors and manufacturing subcontractors must have a relatively high level of data processing and communications expertise to link to our global communications network. Even for distributors or manufacturing subcontractors with sophisticated data processing and communications capabilities, the process of integrating their system with our system over our network can take weeks or months. Thus, there is a long lead time to add new or replace existing distribution or manufacturing partners.

The length of our design-in and sales cycle could impact our ability to forecast future sales.

Our sales depend on our products being designed into our end customers products and those products achieving volume production. Our products are very complex in nature, and the time from design-in to volume production ranges from 6 months to 3 years. From initial product design-in to volume production, many factors could impact the timing and/or amount of sales actually realized. These factors include, but are not limited to, changes in the competitive position of our technology, the competitiveness of our customers products in the markets they serve, our customers financial stability, customer program delays and cancellations, and our ability to ship products according to our customers schedule.

Our business is characterized by a general decline in selling prices of semiconductor products that may materially adversely affect our profitability.

We have experienced and continue to experience a decrease in the selling prices of our products. We have attempted to offset the decrease in selling prices through manufacturing cost reductions, improving our yields, and increasing unit sales. However, there is no guarantee that our ongoing efforts will be successful or that they will keep pace with the anticipated, continued decline in selling prices of our products, which could ultimately lead to a decline in revenues and have a negative effect on our gross margins.

Because we depend on international sales for a majority of our total sales, we may be subject to political, economic and other conditions that could increase our operating expenses and disrupt our business.

During each of the last three years, international sales were a majority of our total sales. During 2005, international sales constituted approximately 75% of our total sales. We expect that international sales will continue to account for a significant portion of our total sales. Risks related to our foreign operations include unfavorable economic, market, political, and social conditions in a specific country or region, fluctuation in foreign currency exchange rates, adverse changes in tax laws, increased freight costs, interruptions in air transportation, reduced protection for intellectual property rights in some countries, generally longer receivable collection periods, and natural or man-made disasters in a specific country or region where we sell our products. Our business is also subject to the burdens of complying with a variety of foreign laws and risks associated with the imposition of legislation and regulations relating specifically to the importation or exportation of semiconductor products. Quotas, duties, tariffs, taxes, or other charges, restrictions, or trade barriers may be imposed by the United States or other countries on the import or export of our products in the future.

Our business is subject to tax risks associated with being a multinational corporation.

As a multinational corporation, we conduct our business in many countries and are subject to taxation in many jurisdictions. The taxation of our business is subject to the application of multiple and sometimes conflicting tax laws and regulations as well as multinational tax conventions. The application of tax law is subject to legal and factual interpretation, judgment, and uncertainty, and tax laws themselves are subject to change. Consequently, taxing authorities may impose tax assessments or judgments against us that could result in a significant charge to earnings relating to prior periods and/or an increase in our effective income tax rate.

Our gross margins are subject to fluctuations due to many factors.

Our gross margins may fluctuate depending on many factors, including, but not limited to, our product mix, market acceptance of our new products, competitive pricing dynamics, geographic and/or market segment pricing strategies, changes in the mix of our business between prototyping- and production-based demand, and various manufacturing cost variables including product yields, wafer prices, package and assembly costs, provisions for excess and obsolete inventory, and absorption of manufacturing overhead.

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Our financial results are affected by general economic conditions and the highly cyclical nature of the semiconductor industry.

Semiconductor companies, such as Altera, experience significant fluctuations in sales and profitability. During 2000-2001, the semiconductor industry was significantly impacted by the economic downturn and contraction in the computing and communication equipment markets and by the ensuing inventory correction in the supply chain for those industries. This down cycle, like many of the preceding down cycles, resulted in significant reductions in unit demand, excess customer inventories, price erosion, and excess production capacity. We experienced five consecutive declines in quarterly sales beginning in the fourth quarter of 2000 and ending in the fourth quarter of 2001. The protracted deceleration resulted in a peak-to-trough decline in quarterly sales of nearly 60%.

In addition to reductions in sales, our profitability decreases during downturns as we are unable to reduce our expenses at the same rate as our sales decline. For example, at the height of the previous up cycle, in the third quarter of 2000, our operating expenses were less than 27% of sales compared to 50% (as restated) in the first quarter of 2002. Similarly, our gross margins tend to deteriorate and fluctuate during down cycles. For example, in the third quarter of 2000, our reported gross margin was over 66% of sales compared to 60% of sales in the first quarter of 2002. Furthermore, the industry contraction during 2000-2001 was prolonged and severe and resulted in an inventory charge of $154.5 million in 2001 relating primarily to the write-off of inventories in excess of projected demand. Additionally, as a result of reduced demand and in an effort to reduce our ongoing expense levels, we incurred restructuring charges and write-downs totaling $47.7 million in 2001. In the fiscal year ended December 31, 2000, our net income was $491.7 million (as restated) on sales of $1.4 billion whereas for the fiscal year ended December 31, 2001, we reported a net loss of $46.5 million (as restated) on sales of $839.4 million. We expect that our future sales and profitability will continue to be volatile.

In an effort to reduce the possibility of future excess inventory, we reduced our inventory carrying targets in 2002. Reductions in targeted inventory carrying levels may result in poorer delivery performance relative to our customers desired lead times. Poor delivery performance over time may erode our competitive position and result in a loss of market share. Despite our intent to operate with lower inventory levels, we are likely to experience inventory write-downs in the future, especially if our inventory becomes out-of-mix with, or excess to, customer demand.

As we carry only limited insurance coverages, any incurred liability resulting from uncovered claims could adversely affect our financial condition and operating results.

Our insurance policies may not be adequate to fully offset losses resulting from covered incidents. Additionally, we do not have coverage for certain losses. We have made certain judgments regarding our existing insurance coverage that we believe are consistent with common practice and economic and availability considerations. If our insurance coverage is inadequate to protect us against unforeseen catastrophic losses, any uncovered losses could adversely affect our financial condition and operating results.

We depend on independent subcontractors, located in Asia, to assemble, test, and ship our semiconductor products. The failure of these subcontractors to satisfy our demand could materially disrupt our business.

Because we rely on independent subcontractors to assemble, test, and ship our semiconductor products, we cannot directly control our product delivery schedules or quality levels. We are dependent upon sufficient subcontractor assembly and test capacities, both in raw materials and services, to enable us to meet the demand for our own products. Our future success also depends on the financial viability of our independent subcontractors. If market demand for subcontractor material and services exceeds available supply or if the subcontractors capital structures weaken, we may experience product shortages, quality assurance problems, and/or increased manufacturing costs.

As a result of our internal reviews and related restatements, we are being investigated by the SEC and DOJ. These investigations may not be resolved favorably and have required and may continue to require a significant amount of management time and attention and accounting and legal resources, which could adversely affect our business, results of operations, and cash flows.

We are currently being investigated by the SEC and DOJ in connection with our historical stock option practices and related accounting. The period of time necessary to resolve the SEC and DOJ investigations is uncertain, and these matters could require significant management and financial resources which could otherwise be devoted to the operation of our business. In addition, considerable legal and accounting expenses related to these matters have been incurred to date and significant expenditures may continue to be incurred in the future. We cannot predict the outcome of either of the SEC or DOJ investigations. If we or any of our current or former officers or directors is subject to an adverse finding resulting from the SEC or DOJ investigations, we could be required to pay damages or penalties or have other remedies imposed upon us which could adversely affect our business, results of operations, financial position, cash flows and the trading price of our securities. In addition, if the investigations continue for a prolonged period of time, this could have the same effects, regardless of the outcome of the investigations.

We have been named as a party to several lawsuits related to our historical stock option practices and related accounting, and we may be named in additional litigation in the future, all of which could result in an unfavorable outcome and have a material adverse effect on our business, financial condition, results of operations, cash flows and the trading price for our securities.

Several lawsuits have been filed against us, our current directors and officers and certain of our former directors and officers relating to our historical stock option practices and related accounting. See Part I, Item 1, Note 11 Subsequent Events for a more detailed description of these proceedings. We may become the subject of additional private or government actions regarding these matters in the future. These actions are in the preliminary stages, and their ultimate outcome could have a material adverse effect on our business, financial condition, results of operations, cash flows and the trading price for our securities. Litigation may be time-consuming, expensive and disruptive to normal business operations, and the outcome of litigation is difficult to predict. The defense of these lawsuits will result in significant expenditures and the continued diversion of our management s time and attention from the operation of our business, which could impede our business. All or a portion of any amount we may be required to pay to satisfy a judgment or settlement of any or all of these claims may not be covered by insurance.

If we do not maintain compliance with the listing requirements of the NASDAQ Global Market, our common stock could be delisted, which could, among other things, reduce the price of our common stock and the levels of liquidity available to our stockholders.

In connection with the special committee investigation and the restatement of our financial statements, we were delinquent in filing certain of our periodic reports with the SEC, and consequently we were not in compliance with the listing requirements under the NASDAQ Global Market s Marketplace Rules. As a result, we underwent an extensive review and hearing process with the NASDAQ Global Market to determine our listing status. The NASDAQ Global Market ultimately permitted our securities to remain listed, however, our securities could be delisted in the future if we do not maintain compliance with applicable listing requirements. If our securities are delisted from the NASDAQ Global Market, they would subsequently be transferred to the National Quotation Service Bureau, or Pink Sheets. The trading of our common stock on the Pink Sheets may reduce the price of our common stock

and the levels of liquidity available to our stockholders. In addition, the trading of our common stock on the Pink Sheets will materially adversely affect our access to the capital markets and our ability to raise capital through alternative financing sources on terms acceptable to us or at all. Securities that trade on the Pink Sheets are no longer eligible for margin loans, and a company trading on the Pink Sheets cannot avail itself of federal preemption of state securities or blue sky laws, which adds substantial compliance costs to securities issuances, including pursuant to employee option plans, stock purchase plans and private or public offerings of securities. If we are delisted in the future from the NASDAQ Global Market and transferred to the Pink Sheets, there may also be other negative implications, including the potential loss of confidence by suppliers, customers and employees and the loss of institutional investor interest in our company.

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ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

Our headquarters facility is located in San Jose, California, on approximately 25 acres of land that we purchased in June 1995. The campus for the headquarters facility currently consists of four interconnected buildings totaling approximately 500,000 square feet. Design, research, marketing, administrative, and limited manufacturing activities are performed in this facility. We also have a 240,000 square foot design and test engineering facility in Penang, Malaysia. This facility is situated on land leased on a long-term basis from the Penang Development Corporation. Finally, we lease our domestic and international offices, including our European Technology Center in the United Kingdom, our Toronto Technology Center, and our Ottawa Technology Center. Rental expense under all operating leases amounted to approximately $9.3 million in 2005. We believe that our existing facilities and any planned future expansions are adequate for our current and foreseeable future needs.

ITEM 3. LEGAL PROCEEDINGS.

None as of December 30, 2005.

In May and July 2006, we were notified that three shareholder derivative lawsuits had been filed in the Superior Court of the State of California, County of Santa Clara, by persons identifying themselves as Altera shareholders and purporting to act on behalf of Altera, naming Altera Corporation as a nominal defendant and naming some of our current and former officers and directors as defendants. On July 12, 2006, one of these derivative actions was voluntarily dismissed by the plaintiff shareholder. The remaining two derivative lawsuits pending in Santa Clara Superior Court were consolidated into a single action on September 5, 2006. The consolidated action names as defendant Altera Corporation (nominal defendant) and the following current and former Altera officers and directors: John P. Daane, Nathan M. Sarkisian, Denis M. Berlan, Scott Wylie, Robert W. Reed, Robert J. Finocchio, Jr., Kevin McGarity, Paul Newhagen, William E. Terry, Susan Wang, Charles M. Clough, Rodney Smith, Erik Cleage, Michael B. Jacobs and Katherine E. Schuelke.

In the consolidated action, the plaintiffs assert claims against these individual defendants for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment, violations of California Corporation Code sections 25402 and 25403, breach of fiduciary duty for insider selling and misappropriation of information, rescission, constructive trust, and an accounting. Plaintiffs claims concern the granting of stock options by Altera between 1996 and December 2000 and the alleged filing of false and misleading financial statements between 1996 and 2006. All of these claims are asserted derivatively on behalf of Altera. Plaintiffs seek, among other relief, an indeterminate amount of damages from the individual defendants and a judgment directing Altera to reform its corporate governance.

During the months of May, June, and July 2006, four other derivative lawsuits were filed by purported Altera shareholders, on behalf of Altera, in the United States District Court for the Northern District of California. On August 8, 2006, these actions were consolidated. The plaintiffs have not yet filed a consolidated complaint. The initial complaints filed by the four shareholders included claims for violations of Sections 10(b), 14(a), 20(a), and Rule 10b-5 of the Securities Exchange Act of 1934, unjust enrichment,

breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, breach of contract, an accounting, constructive fraud, rescission, and violations of California Corporations Code section 25402. Plaintiffs claims concern the granting of stock options by Altera between 1995 and December 2000 and the alleged filing of false and misleading financial statements between 1996 and 2005. Among the defendants named in these derivative actions are Altera Corporation as a nominal defendant and the following current and former officers and directors of Altera: John P. Daane, Robert W. Reed, Denis M. Berlan, Nathan M. Sarkisian, Katherine E. Schuelke, Robert J. Finocchio, Jr., Kevin McGarity, Paul Newhagen, William E. Terry, Susan Wang, Rodney Smith, Erik Cleage, and Michael Jacobs.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None during the quarter ended December 30, 2005.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock trades on the NASDAQ National Market under the symbol ALTR. As of February 15, 2006, there were approximately 600 stockholders of record. The majority of our shares are held by brokers and other institutions on behalf of approximately 100,000 stockholders as of February 15, 2006.

The closing price of our common stock on February 15, 2006 was $19.98 per share as reported by the NASDAQ National Market. The following table sets forth, for the periods indicated, the high and low closing sale prices for our common stock as reported by the NASDAQ National Market:

	2005		2004	
	High	Low	High	Low
First Quarter	$ 21.37	$ 17.88	$ 26.82	$ 19.32
Second Quarter	22.60	18.28	23.57	19.75
Third Quarter	22.88	18.49	21.39	17.75
Fourth Quarter	19.69	16.28	24.04	19.57

Our policy has been to reinvest our earnings to fund future growth and to repurchase shares of our common stock. Accordingly, we have not paid cash dividends on our common stock and currently do not intend to pay cash dividends in the foreseeable future.

ISSUER PURCHASES OF EQUITY SECURITIES | During the fourth quarter of 2005, we repurchased shares of our common stock as follows:

(*In thousands, except footnotes and per share amounts*)		Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Additional shares authorized for repurchase	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
10/03/2005	10/28/2005	6,495	$ 17.99	6,495	20,000	25,911
10/31/2005	11/25/2005	3,935	$ 16.87	3,935		21,976
11/28/2005	12/30/2005	619	$ 18.69	619		21,357

(1) No shares were purchased outside of publicly announced plans or programs.

The company repurchases shares under the program announced on July 15, 1996 that has no specified expiration. As of December 30, 2005, the board of directors had authorized, since the inception of the program, a total of 108.0 million shares for repurchase. No existing repurchase plans or programs expired, nor has the company decided to terminate any repurchase plans or programs prior to expiration. There are no existing plans or programs under which the company does not intend to make further purchases.

During each quarter of 2005, we entered into an agreement pursuant to SEC Rule 10b5-1 under which we authorized a third-party broker to purchase shares on our behalf during our normal blackout period according to predetermined trading instructions. In addition, we may repurchase shares of our common stock under the guidelines of SEC Rule 10b-18.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The following selected financial data should be read in conjunction with our consolidated financial statements and related notes, Management s Discussion and Analysis of Financial Condition and Results of Operations, and other financial information appearing elsewhere in this Annual Report on Form 10-K/A. We derived the selected consolidated financial data for the fiscal years ended 2005, 2004, and 2003 from our audited restated consolidated financial statements and notes thereto appearing in this report on Form 10-K/A. The consolidated statement of operations data for the fiscal years ended 2002 and 2001 and the consolidated balance sheet data as of the years ended 2003, 2002 and 2001 have been restated to conform to the restated consolidated financial statements included in this Form 10-K/A and are presented herein on an unaudited basis.

Five Years Ended (In thousands, except per share amounts)	2005	2004(1)	2003(1)	2002(1)(2)			2001(1)(2)		
		(As restated)	(As restated)	As Previously Reported	Adjustments	(As restated)	As Previously Reported	Adjustments	(As restated)
Statements of Operations Data									
Net sales	$ 1,123,739	$ 1,016,364	$ 827,207	$ 711,684	$	$ 711,684	$ 839,376	$	$ 839,376
Cost of sales	365,946	308,741	266,435	263,067	337	263,404	458,699	808	459,507
Gross margin	757,793	707,623	560,772	448,617	(337)	448,280	380,677	(808)	379,869
Research and development expenses	209,765	181,881	181,279	182,766	758	183,524	170,869	2,237	173,106
Selling, general, and administrative expenses	225,861	212,980	189,654	168,484	2,202	170,686	215,318	1,468	216,786
Restructuring and other special charges							47,669		47,669
Income (loss) from operations	322,167	312,762	189,839	97,367	(3,297)	94,070	(53,179)	(4,513)	(57,692)
Interest and other income, net	34,869	18,739	20,218	25,961	(4,744)	21,217	40,176	(3,838)	36,338
Income (loss) before income taxes	357,036	331,501	210,057	123,328	(8,041)	115,287	(13,003)	(8,351)	(21,354)
Provision for income taxes	78,207	55,426	57,848	32,065	(1,536)	30,529	26,779	(1,660)	25,119
Net income (loss)	$ 278,829	$ 276,075	$ 152,209	$ 91,263	$ (6,505)	$ 84,758	$ (39,782)	$ (6,691)	$ (46,473)
Net income (loss) per share:									
Basic	$ 0.75	$ 0.74	$ 0.40	$ 0.24	$ (0.02)	$ 0.22	$ (0.10)	$ (0.02)	$ (0.12)
Diluted	$ 0.74	$ 0.72	$ 0.39	$ 0.23	$ (0.01)	$ 0.22	$ (0.10)	$ (0.02)	$ (0.12)
Shares used in computing net income (loss) per share:									
Basic	370,164	373,785	381,387	383,619		383,619	386,097		386,097
Diluted (as restated) (3)	376,302	382,616	389,910	391,708	103	391,811	386,097		386,097
Balance Sheet Data (4)									
Working capital (as restated) (5)	$ 930,964	$ 1,059,519	$ 871,588	$ 909,858	(11,181)	$ 898,677	$ 850,561	(7,548)	$ 843,013
Total assets (as restated) (4)	1,827,696	1,768,581	1,578,746	1,407,087	46,739	1,453,826	1,361,427	49,324	1,410,751
Long-term portion of capital lease obligations	3,871								
Stockholders equity (as restated) (4)	1,259,588	1,274,003	1,094,227	1,131,236	(5,383)	1,125,853	1,114,500	(2,197)	1,112,303
Book value per share (as restated) (4)	3.50	3.41	2.91	2.95	(0.01)	2.94	2.89	(0.01)	2.88

(1) See Note 3 Restatement of Previously Issued Consolidated Financial Statements to our Consolidated Financial Statements for a discussion of these adjustments.

(2) The unaudited consolidated statements of operations data for the fiscal years ended 2002 and 2001, and the unaudited consolidated balance sheet data as of the years ended 2003, 2002 and 2001 have been revised to reflect adjustments related to the restatement described below under Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements and Note 3 of the Notes to Consolidated Financial Statements. Pre-tax adjustments recorded in 2002 and 2001 include non-cash stock-based compensation adjustments totaling $5.2 million and $8.1 million, respectively. The cumulative after tax impact of all restatement adjustments related to years prior to 2001 totaled $20.0 million and has been reflected as an adjustment to retained earnings at December 29, 2000.

On a pre-tax basis, the cumulative impact of all restatement adjustments related to years prior to 2001 totaled $29.4 million. These adjustments consist primarily of the following:

The pre-tax impact of charges related to stock option modifications connected primarily with employee terminations in 1997 and 1996 totaling $16.3 million and $2.1 million, respectively,

The pre-tax impact of charges related to stock option grant measurement date errors primarily in 2000, 1999, and 1998 totaling $3.5 million, $2.3 million, and $0.7 million, respectively, and

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The pre-tax income increase (decrease) impact of other previously unrecorded adjustments primarily in 2000, 1997 and 1996 totaling ($3.3) million, ($6.0) million, and $6.0 million, respectively.

The cumulative pre-tax restatement adjustments related to years prior to 2001 resulted in an income tax benefit of $9.4 million.

The impact on previously reported net income of these adjustments was a decrease (increase) of $5.2 million, $2.3 million, $0.8 million, $14.0 million, and ($2.3 million) or 1.1%, 1.0%, 0.5%, 10.4%, and (2.1%) for fiscal years 2000, 1999, 1998, 1997, and 1996, respectively. The impact on previously reported diluted income per share of these adjustments was a decrease (increase) of $0.01, $0.01, $0, $0.14, and ($0.02) for fiscal years 2000, 1999, 1998, 1997, and 1996, respectively.

(3) Diluted shares increased from 2002 to 2005 as a result of the restatement adjustments to correct the accounting for stock options granted with intrinsic value. As part of the restatement, we reperformed the treasury stock calculation in accordance with Statement of Financial Accounting Standards No. 128 (SFAS No. 128) Earnings Per Share. The treasury stock calculation used to determine diluted share count assumes that all in-the-money options are exercised and that we repurchase shares with the proceeds of these hypothetical exercises along with the tax benefit resulting from the hypothetical option exercises. We further assume that any unamortized deferred stock-based compensation is also used to repurchase shares. When the treasury stock method was applied to the options affected by the restatement, the additional intrinsic value recorded for these stock options reduced the hypothetical tax benefit that would result upon a hypothetical exercise, reducing the number of hypothetical shares that would be repurchased and thereby increasing diluted share count.

(4) The unaudited consolidated balance sheet data have been adjusted to reflect the cumulative restatement adjustments. See Note 3 Restatement of Previously Issued Consolidated Financial Statements to our Consolidated Financial Statements for a discussion of these adjustments. The restatement adjustments are composed primarily of the reclassification of our Nonqualified Deferred Compensation Plan assets and liabilities of $49.9 million in 2003, $40.9 million in 2002 and $44.0 million in 2001 that were previously presented net in our consolidated balance sheet.

(5) The unaudited consolidated working capital as previously reported for the fiscal years ended 2002 and 2001 includes reclassifications of certain deferred tax balances to conform to 2003 and later years presentation.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The discussion and analysis set forth below has been amended to reflect the restatement as described below and in Note 3, Restatement of Previously Issued Consolidated Financial Statements to the Consolidated Financial Statements. For this reason, the data set forth in this section may not be comparable to discussions and data in our previously filed Annual Reports.

Restatement of Consolidated Financial Statements and Related Proceedings

Restatement of Consolidated Financial Statements

On May 3, 2006, our Chief Executive Officer and General Counsel, on their own initiative, commenced a review of the company s historical stock option practices. This review was initiated in response to media attention about stock option practices at various other public companies. On May 6, 2006, the board of directors formed a special committee composed solely of independent directors and tasked the committee with the responsibility to conduct a review of the company s historical stock option practices and related accounting. The special committee, with the assistance of its independent legal counsel and forensic accountants, undertook a comprehensive internal review of the facts giving rise to the restatement. The investigation included an extensive review of our accounting policies, accounting records, supporting documentation, and e-mail communications, as well as interviews with numerous current and former employees and current and former members of our board of directors.

On June 21, 2006, we announced that our audit committee, after consultation with management and the special committee, determined that our prior consolidated financial statements and any related reports of our independent registered public accounting firm should no longer be relied upon and would be restated. Although we do not believe that the effects of the restatement are material to the results of operations for our fiscal years ended 2005, 2004, or 2003, we are restating prior financial statements because the alternative method of correcting the error, which is to record the cumulative impact of the corrections in the quarter ended March 31, 2006, would result in a material charge to that period and such a charge would likely have a material impact on our fiscal year ended December 29, 2006. The effects of this restatement on the fiscal year ended December 30, 2005 were negligible and therefore we did not restate any fiscal 2005 consolidated financial statements, except to reflect the cumulative restatement adjustments made to the consolidated balance sheet as of December 30, 2005 as well as a negligible change to fully diluted shares outstanding. We also are restating the pro forma disclosures for stock-based compensation expense required under

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Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, (SFAS 123) included in Note 2 to the consolidated financial statements. The Original Filing was filed with the Securities and Exchange Commission (SEC) on March 14, 2006.

The restatement pre-tax adjustments total $47.6 million and relate to (1) stock option grant measurement date errors from 1996 through February 2001 ($17.8 million), (2) stock option grant agreement modifications from 1996 through 2002 made in connection with termination of certain employees employment ($24.3 million), and (3) other adjustments ($5.5 million).

Management concurs with the special committee s conclusion that from December 1996 through February 2001 there were seven occasions on which the recorded grant dates for certain employee stock option grants differed from the actual grant dates. None of these employee stock option grants was made to our current CEO. The price of Altera s stock on the recorded grant dates was lower than the price on the actual grant date thus permitting recipients to exercise these options at a lower strike price. On six occasions, the grants had intrinsic value at the time of grant; that is, they were issued in-the-money . On the seventh occasion, the grants were repriced shortly after the grant date and did not result in a material charge. Under these circumstances, we should have amortized the in-the-money portion of the options over their vesting periods in our previously issued financial statements. To correct this error, we are recording $17.8 million of additional pre-tax, non-cash stock-based compensation expense in the restatement for the periods 1996 to 2004.

Over 99 percent of this $17.8 million additional pre-tax, non-cash stock-based compensation expense relates to five grant dates in December in each of the years 1996 to 2000. During this time, the Company granted stock options in December of each year to senior management, including our former Chief Executive Officer and former General Counsel, as part of the annual performance and compensation review process (the December Focal). The compensation committee delegated authority to our former CEO to select the grant date for the grants to our former CEO and his staff so that it would coincide with the completion of the December Focal and the CEO s approval of stock option grants to members of senior management other than the CEO and executive officers. Instead of granting options on the date intended by the compensation committee, our former CEO and former General Counsel chose as the grant date the date with the lowest closing price in December. Minutes of the December compensation committee and board meetings were then prepared after the December Focal grant date had been selected; the grant dates recorded in the minutes did not reflect the grant date intended by the compensation committee, but rather falsely indicated that the actual grant date was the date with the lowest December closing price in each of the years 1996 to 2000. The compensation committee and board minutes were prepared by our former General Counsel. Both the former CEO and former General Counsel received some of these in-the-money options in December of each year from 1996 to 2000.

The special committee also concurred with management s conclusion that from 1996 to 2002, certain employees stock option agreements were modified in connection with the termination of their employment. Generally, these modifications were made in the context of separation agreements that permitted additional vesting and/or additional time to exercise options after the employee ceased performing services and beyond the periods originally specified in the stock option grant agreements. At the time these agreements were entered into, the Company did not have sufficient controls in place to ensure that the accounting consequences of these transactions were properly identified, accounted for and reported in the proper period. As a result, we should have recorded additional stock-based compensation expense related to the modifications in our previously issued financial statements. To correct this error, we are recording $24.3 million of additional pre-tax, non-cash stock-based compensation expense in the restatement for the periods 1996 to 2002. The majority of this expense relates to only a limited number of modifications that provided an extension of the exercise period for options that were already vested at the time of the modification and approximately 75 percent of this additional expense is attributable to years 1996 and 1997.

In addition to restating the consolidated financial statements for the periods prior to 2005 in response to the special committee s findings, we are recording additional differences that were previously considered to be immaterial. In particular, we are reclassifying investment gains (losses) under our Nonqualified Deferred Compensation Plan (the NQDC Plan). Prior to 2004, the NQDC Plan

assets and liabilities were netted in our consolidated balance sheets. The restated consolidated balance sheets show the NQDC Plan assets and liabilities separately for all periods presented. Prior to 2005, investment income earned by the NQDC Plan and the corresponding compensation expense were included net in interest and other income. The restated consolidated results of operations reflect the NQDC Plan investment gains (losses) as increases (decreases) in compensation expense offset by increases (decreases) in interest and other income, net for all periods presented. The reclassification of gains (losses) for the NQDC Plan had no impact on our net income for any of the periods presented.

We have also determined that we need to record additional expense related to our service award program. The service award program provides employees with one to three weeks of additional paid vacation upon their attainment of five, ten, fifteen, and twenty year service anniversaries. We are recording $5.1 million of expense prior to 2003 to increase our accrual for the potential service awards that may be awarded, discounted by the estimated probability of termination.

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We also recorded certain tax-related adjustments in connection with stock-based compensation expense and other adjustments discussed above. We recorded an adjustment for a cumulative tax benefit of $12.5 million as of December 31, 2004. Such amount differs from the statutory tax benefit principally as a result of limitations on the deduction for certain executive stock-based compensation and change in geographical mix of income. In the restatement, we recorded an additional income tax benefit of $0.3 million for the fiscal year ended December 31, 2004, an additional income tax provision of $0.5 million for the fiscal year ended January 2, 2004, and a cumulative $12.7 million income tax benefit for adjustments prior to fiscal 2003.

We recorded a $12.5 million tax benefit on the cumulative pre-tax restatement adjustments of $47.6 million resulting in a cumulative net income restatement impact of $35.1 million.

As a result of the restatement, previously reported net income was reduced (increased) by $(1.0) million, $2.9 million, $6.5 million for the years 2004, 2003, and 2002, respectively, and the previously reported net loss for 2001 was increased by $6.7 million. The cumulative after tax impact of the adjustments to periods prior to 2003 amounted to $33.2 million and has been reflected as a prior period adjustment as of December 27, 2002 to retained earnings. The restatement adjustments resulted in no change to previously reported net income per share for the year 2004, reduced previously reported diluted net income per share by $0.01 for the year 2003, reduced previously reported diluted income per share by $0.01 for the year 2002, and increased diluted net loss per share by $0.02 for the year 2001.

The cumulative pre-tax effect of the stock-based compensation adjustments on the consolidated balance sheet at December 31, 2004 was an increase in Capital in Excess of Par Value offset by a corresponding decrease in retained earnings which resulted in no net effect on stockholders equity. The balance sheet impact of the service award program accrual was to increase accrued compensation with a corresponding net of tax reduction to retained earnings. There was no impact on net sales or net cash provided by operating activities as a result of these additional compensation expense adjustments. We are also amending certain other stock option disclosures in the accompanying notes to the consolidated financial statements.

Enacted October 22, 2004, Section 409A of the Internal Revenue Code significantly changed the rules for nonqualified deferred compensation plans. Section 409A imposes certain restrictions on stock awards that constitute deferred compensation. The Company is currently reviewing the implications of 409A on grants awarded with intrinsic value that vested after December 31, 2004 and modifications made to existing grants after October 3, 2004 along with potential remedial actions. The Company does not expect to incur a material charge as a result of any potential remedial actions.

As of September 29, 2006, the Company had incurred direct costs of approximately $9 million associated with the special committee s investigation and additional related professional services and consulting fees associated with the restatement effort and litigation. We expect to incur up to several million dollars of additional expense in the fourth quarter of 2006 associated with the conclusion of the investigation, litigation defense, and financial restatement.

Related Proceedings

Regulatory Proceedings

On May 11, 2006, we were notified by the SEC that they initiated an informal inquiry into our stock option accounting practices. On August 10, 2006, we received from the SEC an informal request for the production of documents relating to its inquiry. On May 25, 2006, we also received a subpoena from the office of the United States Attorney for the Northern District of California relating to such stock option practices.

We continue to cooperate with the SEC and Department of Justice with respect to these investigations. If we are subject to adverse findings resulting from the above investigations, we could be required to pay significant damages or penalties or have other remedies imposed upon us.

Other regulatory inquiries could be commenced by other U.S. Federal, state or foreign agencies.

Legal Proceedings

In May and July 2006, we were notified that three shareholder derivative lawsuits had been filed in the Superior Court of the State of California, County of Santa Clara, by persons identifying themselves as Altera shareholders and purporting to act on behalf of Altera, naming Altera Corporation as a nominal defendant and naming some of our current and former officers and directors as defendants. On July 12, 2006, one of these derivative actions was voluntarily dismissed by the plaintiff shareholder. The remaining two derivative lawsuits pending in Santa Clara Superior Court were consolidated into a single action on September 5, 2006. The consolidated action names as defendant Altera Corporation (nominal defendant) and the following current and former Altera officers and directors: John P. Daane, Nathan M. Sarkisian, Denis M. Berlan, Scott Wylie, Robert W. Reed, Robert J. Finocchio, Jr., Kevin McGarity, Paul Newhagen, William E. Terry, Susan Wang, Charles M. Clough, Rodney Smith, Erik Cleage, Michael B. Jacobs and Katherine E. Schuelke.

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In the consolidated action, the plaintiffs assert claims against these individual defendants for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment, violations of California Corporation Code sections 25402 and 25403, breach of fiduciary duty for insider selling and misappropriation of information, rescission, constructive trust, and an accounting. Plaintiffs claims concern the granting of stock options by Altera between 1996 and December 2000 and the alleged filing of false and misleading financial statements between 1996 and 2006. All of these claims are asserted derivatively on behalf of Altera. Plaintiffs seek, among other relief, an indeterminate amount of damages from the individual defendants and a judgment directing Altera to reform its corporate governance.

During the months of May, June, and July 2006, four other derivative lawsuits were filed by purported Altera shareholders, on behalf of Altera, in the United States District Court for the Northern District of California. On August 8, 2006, these actions were consolidated. The plaintiffs have not yet filed a consolidated complaint. The initial complaints filed by the four shareholders included claims for violations of Sections 10(b), 14(a), 20(a), and Rule 10b-5 of the Securities Exchange Act of 1934, unjust enrichment, breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, breach of contract, an accounting, constructive fraud, rescission, and violations of California Corporations Code section 25402. Plaintiffs claims concern the granting of stock options by Altera between 1995 and December 2000 and the alleged filing of false and misleading financial statements between 1996 and 2005. Among the defendants named in these derivative actions are Altera Corporation as a nominal defendant and the following current and former officers and directors of Altera: John P. Daane, Robert W. Reed, Denis M. Berlan, Nathan M. Sarkisian, Katherine E. Schuelke, Robert J. Finocchio, Jr., Kevin McGarity, Paul Newhagen, William E. Terry, Susan Wang, Rodney Smith, Erik Cleage, and Michael Jacobs.

We may become subject to additional private or government actions. The expense of defending such litigation may be significant. In addition, an unfavorable outcome in such litigation could have a material adverse effect on our business and financial statements.

NASDAQ Delisting

We have received two NASDAQ Staff Determinations stating that we are not in compliance with Marketplace Rule 4310(c)(14) because we have not timely filed our Forms 10-Q for the quarters ended March 31, 2006 and June 30, 2006 and therefore, that our securities are subject to delisting from the NASDAQ Global Market.

On June 22, 2006, we attended a NASDAQ hearing, at which we sought an exception to the filing requirement. On August 1, 2006, we announced that a NASDAQ Listing Qualifications Panel (the Panel) had granted our request for continued listing of our securities on the NASDAQ Global Market subject to the following conditions: (1) on or before September 14, 2006, we had to file with the SEC our Form 10-Q for the period ended March 31, 2006, as well as any necessary restatements; (2) on or before September 28, 2006, we had to file with the SEC our Form 10-Q for the period ended June 30, 2006; and (3) we were required to submit additional information regarding our internal review of our historical stock option practices and related accounting.

On September 5, 2006, we filed a revised plan of compliance with the Panel, pursuant to which we requested an additional extension of time through October 26, 2006 in which to complete and file the aforementioned periodic reports. On September 13, 2006, the Panel granted our request for the extension of time. On October 16, 2006, we announced that we expected to file with the SEC a Form 10-K/A for 2005 and Form 10-Q s for the first and second quarters of 2006 by October 26, 2006, the deadline established by a NASDAQ Listing Panel.

Critical Accounting Estimates

The preparation of our consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires our management to make judgments and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our management believes that we consistently apply these judgments and estimates and the consolidated financial statements and accompanying notes fairly represent all periods presented. However, any differences between these judgments and estimates and actual results could have a material impact on our consolidated statements of income and financial condition. Critical accounting estimates, as defined by the Securities and Exchange Commission, are those that are most important to the portrayal of our financial condition and results of operations and require our management s most difficult and subjective judgments and estimates of matters that are inherently uncertain. Our critical accounting estimates include those regarding (1) revenue recognition; (2) valuation of inventories; (3) income taxes; and (4) stock-based compensation.

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REVENUE RECOGNITION | We sell our products to original equipment manufacturers, or OEMs, and to electronic components distributors who resell these products to OEMs, or their subcontract manufacturers. We sell more than 90% of our products to distributors for subsequent resale to OEMs or their subcontract manufacturers. In almost all cases, sales to distributors are made under agreements allowing for returns and subsequent price adjustments, and we defer recognition of revenue until the products are resold by the distributor. Our revenue reporting is highly dependent on receiving pertinent and accurate data from our distributors in a timely fashion. Distributors provide us periodic data regarding the product, price, quantity, and end customer when products are resold as well as the quantities of our products they still have in stock. Because the data set is so large and because there are errors in the reported data, we must use estimates and apply judgments to reconcile distributors reported inventories to their activities. Any error in our judgment could lead to inaccurate reporting of our revenues, deferred income and allowances on sales to distributors, and net income.

VALUATION OF INVENTORIES | Inventories are recorded at the lower of cost determined on a first-in-first-out basis (approximated by standard cost) or market. We establish provisions for inventory if it is in excess of projected customer demand, and the creation of such provisions results in a write-down of inventory to net realizable value and a charge to cost of goods sold. Historically, it has been difficult to forecast customer demand especially at the part-number level. Many of the orders we receive from our customers and distributors request delivery of product on relatively short notice and with lead times less than our manufacturing cycle time. In order to provide competitive delivery times to our customers, we build and stock a certain amount of inventory in anticipation of customer demand that may not materialize. Moreover, as is common in the semiconductor industry, we allow customers to cancel orders with minimal advance notice. Thus, even product built to satisfy specific customer orders may not ultimately be required to fulfill customer demand.

We routinely compare our inventory against projected demand and record provisions for excess and obsolete inventories as necessary. However, actual demand may materially differ from our projected demand, and this difference could have a material impact on our gross margin and inventory balances based on additional provisions for excess or obsolete inventory or a benefit from inventory previously written down.

INCOME TAXES | We make certain estimates and judgments in the calculation of tax liabilities and the determination of net deferred tax assets, which arise from temporary differences between tax and financial statement recognition methods. We record valuation allowances, when necessary, to reduce our deferred tax assets to the amount that management estimates is more likely than not to be realized. If in the future we determine that we are not likely to realize all or part of our net deferred tax assets, an adjustment to the deferred tax asset valuation allowance would be recorded as a charge to earnings in the period such determination is made.

In addition, the calculation of our tax liabilities involves the inherent uncertainty associated with the application of complex tax laws. We are subject to examination by various taxing authorities. We believe we have adequately provided in our financial statements for additional taxes that we estimate may be required to be paid as a result of such examinations. If the payment ultimately proves to be unnecessary, the reversal of the tax liabilities would result in tax benefits being recognized in the period we determine the liabilities are no longer necessary. If an ultimate tax assessment exceeds our estimate of tax liabilities, an additional charge to expense will result. See Provision for Income Taxes and Note 10 Income Taxes for further discussion.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed. Adjustments for differences between our tax provisions and tax returns are recorded when identified, which is generally in the third or fourth quarter of our subsequent year.

STOCK-BASED COMPENSATION | As allowed under SFAS No. 123, Accounting for Stock-Based Compensation, or SFAS 123, we account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, or APB No. 25, Accounting for Stock Issued to Employees and related interpretations. Under APB No. 25, compensation cost is measured as of the date the number of shares and exercise price become fixed. The terms of an award are generally fixed on the date of grant, requiring the stock option to be accounted for as a fixed award. For fixed awards, compensation expense is measured as the excess, if any, of the quoted market price of our stock at the date of grant over the exercise price of the option granted. Compensation expense for fixed awards, if any, is recognized ratably over the vesting period using the straight-line single option method.

If the number of shares or exercise price is not fixed upon the date of grant, the award is accounted for as a variable award until the number of shares or the exercise price become fixed, or until the award is exercised, canceled, or expires unexercised. For variable awards, intrinsic value is remeasured each period and is equal to the fair market value of our stock as of the end of the reporting period less the grant exercise price. As a result, the amount of compensation expense or benefit to be recognized each

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period fluctuates based on changes in our closing price from the end of the previous reporting period to the end of the current reporting period. In cases when our closing stock price does not exceed the recipient s exercise price, no compensation expense results. Compensation expense for variable awards, if any, is recognized in accordance with FIN No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plan , An Interpretation of APB Opinions No. 15 and 25.

We account for modifications to stock options under APB No. 25, as subsequently interpreted by FIN No. 44. Modifications include, but are not limited to, acceleration of vesting, extension of the exercise period following termination of employment and/or continued vesting while not providing substantive services. Compensation expense for modified awards is recorded in the period of modification for the intrinsic value of the vested portion of the award, including vesting that occurs while not providing substantive services, after the date of modification. The intrinsic value of the award is the difference between the fair market value of our common stock on the date of modification and the recipient s exercise price.

Stock options issued to non-employees are accounted for in accordance with the provisions of SFAS No. 123 and EITF No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services . Compensation expense for stock options issued to non-employees is valued using the Black-Scholes model and is amortized over the vesting period in accordance with FIN No. 28.

We value stock options assumed in conjunction with business combinations accounted for using the purchase method at fair value on the date of acquisition using the Black-Scholes option pricing model, in accordance with FIN No. 44. The fair value of the assumed options is included as a component of the purchase price. The intrinsic value of unvested stock options is recorded as deferred stock-based compensation and amortized to expense over the remaining vesting period of the stock options using the straight-line method. SFAS No. 123 established a fair value based method of accounting for stock-based plans. We elected to account for stock-based compensation plans in accordance with APB 25 and we elected the disclosure only alternative permitted under SFAS No. 123 as amended by Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123 (SFAS No. 148), for fixed stock-based awards to employees.

Executive Overview

Company and Market Overview

We are a global semiconductor company, serving over 14,000 customers in communications, computer and storage, industrial, and consumer market segments. We design, manufacture, and market: (1) programmable logic devices, or PLDs; (2) HardCopy structured application-specific integrated circuit, or ASIC, devices; (3) pre-defined design building blocks known as intellectual property, or IP cores; and (4) associated development tools.

PLDs are semiconductor integrated circuits that are built as standard chips that customers program to perform desired logic functions within their electronic systems. Our PLDs consist of field-programmable gate arrays, or FPGAs, and complex programmable logic devices, or CPLDs. Over 90% of our revenue is generated from the sales of our PLDs. The majority of the remainder of our revenue is derived from (1) the sale of our HardCopy devices, which enable our customers to move from a high-density FPGA to a low-cost, high-volume non-programmable implementation of their designs, and (2) the licensing of IP cores and proprietary development tools. Our IP cores enable customers to easily implement standard functions in their PLD designs,

and our development tools are necessary to program our PLDs.

We believe that the greatest opportunity for our growth is displacing fixed chip logic alternatives, namely ASICs and ASSPs. We estimate based on publicly available data, and with information derived from Gartner Dataquest, that the PLD market was approximately $3.3 billion in 2005, whereas the digital logic market, consisting primarily of ASICs and ASSPs, amounted to approximately $34 billion. Because PLDs can be quickly programmed by the customer to perform the specific function the customer desires, we believe that PLDs provide greater advantages in flexibility, development cost, and time-to-market over ASIC and ASSP alternatives. However, PLDs generally have a higher cost structure than these alternatives. Thus PLDs are particularly favored in applications where there is a substantial premium afforded to time-to-market and in end-applications where unit volumes are low. Because of the relatively higher cost of PLDs, customers often use PLDs for their system development and prototyping and then use ASIC technology in volume production. Nevertheless, we believe that (1) advances in PLD technology and in semiconductor manufacturing technology in general are lowering the relative cost differential between PLDs and fixed chip alternatives, (2) we have been and can continue to be increasingly successful in selling PLDs into applications and markets that have been traditionally served by ASICs and ASSPs, and (3) we can compete successfully for customer s volume production needs as well as their initial prototyping and development needs.

Competing for Design Wins

We compete with other PLD vendors to displace fixed chip logic alternatives and for market share within the PLD market. The programmable logic market is highly concentrated with two vendors accounting for a majority of the total market: ourselves and

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Xilinx, Inc. Competition between PLD vendors is most intense in the design-win phase of the customer s design. A design win occurs when a customer selects a particular vendor product for use in the customer s electronic system. Because each vendor s product offering is proprietary, the cost to switch PLD devices after a system has been designed and prototyped is very high. Therefore, a design win can provide the PLD vendor a profitable revenue stream through the life of the customer s program.

From the time a design win is secured, it can be as long as two years, and sometimes longer, before a customer starts the volume production of its system. Typically, a PLD vendor for a particular application is selected relatively early in a customer s design program. It may take several years from that point before the customer has completed its entire system design, built prototypes, sampled the marketplace for customer acceptance, made any modifications, and established volume manufacturing capacity. Thus, movements in PLD market share often occur some time after the change in relative competitiveness that gave rise to the market share shift. Because of this time lag, market share is a lagging indicator of relative competitive strength. Because it is extremely difficult to forecast the degree of success and timing of customers programs, and because the end markets are so fragmented (we have over 14,000 PLD customers), it is difficult even for PLD vendors to gauge their own competitive strength in securing design wins as of a particular point in time.

Developing Competitive Products

A PLD vendor s ability to secure design wins and to maintain or increase market share is highly dependent on the cost and quality of the vendor s products, particularly the effectiveness and reliability of a vendor s proprietary development software. All PLD vendors provide proprietary development software at little or no cost to the customer. The software, working in tandem with device logic architecture and features, creates the functionality desired by the customer. We develop our software in parallel with device development, and there are schedule and integration risks between the two processes. If we fail to create adequate software to support our new devices as they are introduced, we weaken our competitive position, which can have long lasting effects if customers switch to competing solutions and become less familiar and less skilled in using our software. As customers gain familiarity with a particular vendor s software, there is often an increasing likelihood that the customer will want to use that same software again in another design, giving that vendor a potential advantage as the next system is designed.

Poorly performing development software introduced in the late 1990s weakened the design win competitiveness of our FPGAs, ultimately leading to FPGA market share loss in 2001 and 2002. In early 2001, we released a major upgrade to our development software, which eliminated the performance and reliability deficiencies of the prior version.

In a parallel move, we elected to focus our research and development resources on new generation FPGA devices because increasing market share in the FPGA sub-segment is important to our long-term growth and profitability. Due to the higher integration density and lower cost per function, the FPGA sub-segment has outgrown the CPLD sub-segment in recent times, and it is generally accepted by participants and observers of the industry that this trend will continue. In 2002, we introduced two new FPGAs: the Stratix high-density and the Cyclone low-cost families. In 2003, we introduced a transceiver-based Stratix GX family. In 2004, we introduced the next generation high-end FPGA, the Stratix II family, and, in early 2005, the new low-cost Cyclone II family. As a result of these product introductions, we estimate based on publicly available data, and with information derived from Gartner Dataquest, that our FPGA market share versus our main competitor has increased from 31 percent in 2002 to 36 percent in 2005. Our current overall PLD market share is 34 percent.

Adding to the strength of our Stratix FPGAs is our HardCopy family of structured ASICs. We first shipped HardCopy devices in 2001, offering to our customers low-cost, non-programmable production devices that use our highest density FPGAs as an integrated development vehicle. The conversion from the FPGA is virtually seamless and requires very little additional customer

engineering. This product is targeted specifically at those applications and customers that have used PLDs for prototyping and development and ASICs from other vendors for their volume production needs. We believe that the HardCopy family may become 10 to 15 percent of revenues over the long term. In 2005, the family was 4 percent of our sales.

The presence of a HardCopy conversion path for high-density designs differentiates our FPGA offering competitively. Since 2001, we have introduced newer versions of the HardCopy family to support newer generations of FPGAs. Our approach is unique in the industry and may under perform our expectations. There are other structured ASIC competitors who are larger in size than we are and who have established reputations as ASIC suppliers, but currently only we provide customers with an automated conversion from an FPGA to a structured ASIC. As we develop new generations of FPGAs, we will need to successfully create parallel HardCopy devices, which entails ongoing engineering effort and expense.

In 2004, we also improved our CPLD offering with the introduction of the MAX II family. The MAX II family offers price and features that we believe are competitively attractive, with economics, performance, and density that are superior to our previous offerings. Since the unit price of these devices is low compared to our other new products, we will need to ship substantial unit quantities to increase market share in the CPLD market.

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An FPGA family typically reaches peak sales 4 to 5 years after product introduction. The products we introduced from 2002 to 2005 have yet to reach peak sales, but will eventually experience sales declines. For us to sustain or even improve our rate of growth, we must successfully introduce successor generations of devices. Within the next several quarters, we plan to introduce newer families of FPGA devices using more advanced production techniques that will further improve product performance and lower cost. Our foundry partner, TSMC, will manufacture these die using production processes that are new to the industry. Given the extreme complexity of semiconductor fabrication, TSMC may encounter difficulties that could delay our product launch or limit supply so that we would be unable to meet customer commitments. We may discover manufacturing errors after we begin shipping, which will harm customer relations and cause us to incur additional unforeseen costs. Simultaneous introduction of new PLD architectures and ramp of new technology processes are inherently risky. Diagnosing failures, identifying root causes, and implementing corrective actions in a production wafer fabrication facility are expensive and time-consuming processes. We may not successfully commercialize our new products, or our new products may not enable us to maintain or increase market share. It is possible that our competitive offering will be less effective or offered later than the competition, thus weakening our market share.

It is also possible that our primary competitor may have secured design wins, that when they enter production, will reverse some of our current market share success. Our main competitor is larger in size with more sales resources, and we may not enjoy the same success that we saw with previous FPGA generations.

Customer Intimacy and Cost-Optimized Product Strategy

In general, we rely on interaction with our customers to gain product development insights, and we make development decisions years before a product begins to ship. We have been able to gain market share on the strength of our product definition methodology and the successful rollout of new products. However, because our products are complex, we assume considerable risk with every new product introduction. If we misinterpret customer requirements or changes in demand, our products may become uncompetitive. Our competitors are knowledgeable and skilled and, in some cases, larger than we are. Since it is difficult to gauge competitive success until the design-win phase is well underway, it may be too late to make any changes to a generation of products if those products are uncompetitive. If a generation of our products is uncompetitive and we lose market share, regaining customers subsequently is very challenging.

Since the late 1990s, our strategy to displace ASICs and ASSPs has emphasized the development of cost-optimized products. These products have contributed to growth across all of our market segments and are increasingly being used by our customers in production volumes, not just as a prototyping or low-volume solutions. Production volumes vary by industry, but customers buying our products for use in production volumes expect lower unit pricing. Consequently, our business today is subject to a wider range of gross margins than the range of gross margins associated with a less diverse, largely prototyping business. Depending on the mix of high- and low-volume business, our gross margins can vary more quarter to quarter than in the past. Since the majority of our business books and ships in the same quarter, forecasting our gross margins has also become more difficult. While we believe that growth will occur across all of our market segments, our gross margins could move upward or downward if our growth pattern favors a low-volume or high-volume market segment.

Results of Operations

Results of operations expressed as a percentage of net sales were as follows:

	Years Ended		
	December 30, 2005	December 31, 2004 (as restated) (1)	January 2, 2004 (as restated) (1)
Net sales	100%	100%	100%
Cost of sales	33%	30%	32%
Gross margin	67%	70%	68%
Research and development expenses	18%	18%	22%
Selling, general, and administrative expenses	20%	21%	23%
Income from operations	29%	31%	23%
Interest and other income, net	3%	1%	2%
Provision for income taxes	7%	5%	7%
Net income	25%	27%	18%

(1) See Note 3 Restatement of Previously Issued Consolidated Financial Statements to our Consolidated Financial Statements.

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SALES | Sales were $1.12 billion in 2005, $1.02 billion in 2004, and $0.83 billion in 2003. Sales increased 11% in 2005 from 2004 and increased 23% in 2004 from 2003.

The increase in sales in 2005 was driven entirely by the sales of our New Products (see Sales by Product Category for the composition of our product categories) which increased 73% year-over-year predominantly due to higher sales of our Stratix and Cyclone families. Stratix was our largest selling family in 2005. Our 2005 sales reflected higher unit sales of all product categories, with New Product unit sales increasing the most.

The increase in sales in 2004 was driven primarily by sales of our New Products which increased 186% year-over-year predominantly due to higher sales of our Stratix and Cyclone families. Stratix was our largest selling family during 2004. The sales increase in 2004 reflected higher unit sales of all product categories, with the largest unit increases in New and Mainstream Products, partially offset by routine declines in average unit selling prices primarily in our Mainstream and Mature and Other categories.

Sales of FPGAs and CPLDs

Our PLDs consist of field-programmable gate arrays, or FPGAs, and complex programmable logic devices, or CPLDs. FPGAs consist of our Stratix, Stratix GX, Stratix II, Cyclone, Cyclone II, APEX , APEX II, FLEX®, ACEX®, Excalibur , and Mercury families, and CPLDs consist of our MAX, MAX II, and Classic families. Our other products consist of HardCopy, HardCopy II and other masked programmed logic devices, configuration devices, software and other tools and intellectual property cores. Our sales of FPGAs and CPLDs, as a percentage of total sales, as well as year-over-year growth or decline for the periods indicated, were as follows:

	Years Ended				
	December 30, 2005	December 31, 2004	January 2, 2004	2005 vs. 2004 Change	2004 vs. 2003 Change
FPGA	70%	68%	65%	13%	28%
CPLD	20%	23%	27%	-4%	7%
Other	10%	9%	8%	32%	34%
Total Sales	100%	100%	100%	11%	23%

Sales by Product Category

We classify our products into three categories: New, Mainstream, and Mature and Other Products. The composition of each product category is as follows:

New Products include the Stratix, Stratix II, Stratix GX, Cyclone, Cyclone II, MAX 3000A, MAX II, HardCopy, and HardCopy II devices;

Mainstream Products include the APEX 20K, APEX 20KC, APEX 20KE, APEX II, FLEX 10KE, ACEX 1K, Excalibur, Mercury, MAX 7000A, and MAX 7000B families; and

Mature and Other Products include the FLEX 6000, FLEX 8000, FLEX 10K, FLEX 10KA, MAX 7000, MAX 7000S, MAX 9000, Classic, configuration and other devices, software and other tools, and intellectual property cores.

Sales by product category, as a percentage of total sales, as well as yearly growth or decline, for the periods indicated were as follows:

	Years Ended				
	December 30, 2005	December 31, 2004	January 2, 2004	2005 vs. 2004 Change	2004 vs. 2003 Change
New	43%	27%	12%	73%	186%
Mainstream	33%	42%	50%	-12%	2%
Mature and Other	24%	31%	38%	-14%	0%
Total Sales	100%	100%	100%	11%	23%

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Our New Products have been developed and introduced to the marketplace over the last several years and have additional features and higher densities than their predecessors.

Sales by Market Segment

The following market segment data is derived from data that is provided to us by our distributors and end customers. With a broad base of customers, who in some cases manufacture end products spanning multiple market segments, the assignment of revenue to a market segment requires the use of estimates, judgment, and extrapolation. As such, actual results may differ from those reported. During our second quarter ended July 1, 2005, we refined our methodology for classifying revenue by market segment. Prior year data has been adjusted to conform to our current methodology.

Sales by market segment, as a percentage of total sales, as well as yearly growth or decline, were as follows for the periods indicated:

	Years Ended				
	December 30, 2005	December 31, 2004	January 2, 2004	2005 vs. 2004 Change	2004 vs. 2003 Change
Communications	42%	40%	39%	16%	25%
Industrial	32%	35%	35%	3%	22%
Consumer	16%	14%	15%	20%	21%
Computer and Storage	10%	11%	11%	3%	21%
Total Sales	100%	100%	100%	11%	23%

During 2005, the Communications and Consumer segments grew as a result of increased customer demand, penetration into new applications, and market share gains. We expect the Communications segment will remain our largest market segment as a percentage of our total sales.

In absolute dollars, sales grew across all market segments in 2004 as a result of increased customer demand and penetration into new applications.

No single end customer provided more than 10% of our total sales for each of the three years ended December 30, 2005.

Sales by Geography

The following table is based on the geographic location of the original equipment manufacturers or the distributors who purchased our products. For sales to our distributors, their geographic locations may be different from the geographic locations of the ultimate end users. Sales by geography, as a percentage of total sales, as well as yearly growth or decline, for the periods indicated, were as follows:

	Years Ended				
	December 30, 2005	December 31, 2004	January 2, 2004	2005 vs. 2004 Change	2004 vs. 2003 Change
North America	25%	29%	33%	-5%	7%
Europe	25%	23%	22%	21%	27%
Japan	25%	25%	24%	9%	29%
Asia Pacific (other than Japan)	25%	23%	21%	21%	36%
Total International	75%	71%	67%	17%	30%
Total Sales	100%	100%	100%	11%	23%

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In absolute dollars, sales increased in all international locations in 2005 compared to 2004, while North America sales decreased. In 2005, the decrease in North America sales as a percentage of total sales was a result of the continuing transfer of end customer manufacturing from North America to Asia Pacific.

In absolute dollars, sales increased in all geographies in 2004, but most significantly in international geographies. The percentage of total sales represented by international locations increased due to increased sales to international end customers, as well as the transfer of end customers business from North America to international locations.

GROSS MARGIN

	Years Ended		
(Dollars in millions)	December 30, 2005	December 31, 2004 (as restated) (1)	January 2, 2004 (as restated) (1)
Gross Margin Percentage	67.4%	69.6%	67.8%
Included in Reported Gross Margin Percentage Above:			
Gross Margin Benefit from Sale of Inventory Written down in 2001	$ 11.1	$ 14.7	$ 29.0
Percentage of Net Sales	1.0%	1.4%	3.5%

(1) See Note 3 Restatement of Previously Issued Consolidated Financial Statements to our Consolidated Financial Statements.

Gross margin decreased 2.2 percentage points in 2005 from 2004. The decrease was primarily due to reduced demand in certain high-margin programs and increasing success in securing high-volume design wins with discounted prices. Gross margin increased 1.8 percentage points in 2004 from 2003. The increase was primarily due to yield enhancements especially in newer products, as well as overall declines in material and subcontractor costs. The stock based compensation restatement adjustments did not result in a significant change to gross margin in the years ended 2004 and 2003.

In 2001, we recorded total inventory provisions of $154.5 million as a result of unfavorable economic conditions and diminished demand for semiconductor products. As of December 30, 2005, substantially all of the inventory that was written-down in 2001 had been either sold or scrapped. The gross margin benefit resulting from the sale of inventory previously written down in 2001 was $11.1 million in 2005, compared to $14.7 million in 2004 and $29.0 million in 2003. As of December 30, 2005, the book value of the inventory written down in 2001 was zero while the cost basis was $3.8 million. The cost basis was comprised of $2.2 million of raw materials and work in process inventory and $1.6 million of finished goods inventory.

In 2006, we will adopt Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R) which will require us to recognize compensation expense for all employee stock-based compensation beginning in the quarter ending March 31, 2006 (see New Accounting Pronouncements). SFAS 123R is expected to have an immaterial impact on our gross margin.

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RESEARCH AND DEVELOPMENT EXPENSES

	Years Ended				
	December 30, 2005	December 31, 2004 (as restated) (1)	January 2, 2004 (as restated) (1)	2005 vs. 2004 Change (as restated) (1)	2004 vs. 2003 Change (as restated) (1)
(Dollars in millions)					
Research and Development	$ 209.8	$ 181.9	$ 181.3	15%	
Percentage of Net Sales	19%	18%	22%		

(1) See Note 3 Restatement of Previously Issued Consolidated Financial Statements to our Consolidated Financial Statements.

Research and development expenses include expenditures for labor and benefits, masks, prototype wafers, and depreciation. These expenditures were for the design of new PLD and structured ASIC families, and the development of process technologies, new packages, software to support new products and design environments, and IP cores. Also included in Research and Development expenses is the mark-to-market impact of our NQDC Plan of $1.1 million in 2005, $1.0 million in 2004 (as restated), and $2.1 million in 2003 (as restated).

Research and development expenses increased $27.9 million in 2005 compared to 2004. The increase in spending was primarily due to higher spending on prototype wafers for next generation products, and higher spending on labor and benefit costs due to increased headcount.

Research and development expenses increased $0.6 million in 2004 compared to 2003. Higher labor and benefit costs and higher spending on masks for our next generation products were offset by a decrease in depreciation as well as lower spending on prototype wafers. Historically, the level of our research and development expenses has fluctuated in part due to the timing of the purchase of masks and prototype wafers used in the development of new products. Also included in research and development expenses was stock-based compensation expense of $2.1 million in 2004 (as restated) compared with $8.4 million in 2003 (as restated). We will continue to make significant investments in the development of new products and focus our efforts on the development of new programmable logic devices that utilize advanced semiconductor wafer fabrication processes, as well as related development software. We are currently investing in the development of our Stratix II, Stratix II GX, Cyclone II, and HardCopy II families, our Nios II soft core embedded processor, our Quartus II software, our library of IP cores, and other future products.

Beginning in the quarter ending March 31, 2006, research and development expenses are expected to increase significantly as a result of the adoption of SFAS 123R.

SELLING, GENERAL, AND ADMINISTRATIVE EXPENSES

	Years Ended				
	December 30, 2005	December 31, 2004 (as restated) (1)	January 2, 2004 (as restated) (1)	2005 vs. 2004 Change (as restated) (1)	2004 vs. 2003 Change (as restated) (1)
(Dollars in millions)					
Selling, General, and Administrative	$ 225.9	$ 213.0	$ 189.7	6%	12%
Percentage of Net Sales	20%	21%	23%		

(1) See Note 3 Restatement of Previously Issued Consolidated Financial Statements to our Consolidated Financial Statements.

Selling, general, and administrative expenses primarily include labor and benefit expenses related to sales, marketing, and administrative personnel, commissions and incentives, depreciation, legal, advertising, facilities, and travel expenses. Also included in Selling, General, and Administrative expenses is the mark-to-market impact of our NQDC Plan of $1.4 million in 2005, $1.8 million in 2004 (as restated), and $3.6 million in 2003 (as restated).

Selling, general, and administrative expenses increased by $12.9 million in 2005 compared to 2004. The increase was primarily driven by higher labor and benefit costs as we added sales and marketing personnel to drive our revenue growth. Also included in selling, general, and administrative expenses in 2005 was $0.3 million of stock-based compensation expense compared with $1.1 million in 2004 (as restated).

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Selling, general, and administrative expenses increased by $23.3 million in 2004 compared to 2003. The increase was primarily attributable to higher spending on labor and benefit costs. The increase was also due to higher spending on commissions and incentives, and various marketing programs as we continued to invest in the rollout of newer products. Consulting expenses also increased in part due to costs related to the initial adoption of Section 404 of the Sarbanes Oxley Act of 2002. These increases were partially offset by lower depreciation expense. Also included in selling, general, and administrative expenses was stock-based compensation expense of $1.1 million in 2004 (as restated) compared with $4.2 million in 2003 (as restated).

Beginning in the quarter ending March 31, 2006, selling, general, and administrative expenses are expected to increase significantly as a result of the adoption of SFAS 123R.

INTEREST AND OTHER INCOME, NET

	Years Ended				
	December 30, 2005	December 31, 2004 (as restated) (1)	January 2, 2004 (as restated) (1)	2005 vs. 2004 Change (as restated) (1)	2004 vs. 2003 Change (as restated) (1)
(Dollars in millions)					
Interest and Other Income, Net	$ 34.9	$ 18.7	$ 20.2	87%	-7%
Percentage of Net Sales	3%	2%	2%		

(1) See Note 3 Restatement of Previously Issued Consolidated Financial Statements to our Consolidated Financial Statements.

Interest and Other Income, Net consists mainly of interest income generated from investments in high-quality fixed income securities, as well as the mark-to-market impact of our NQDC Plan.

Interest and Other Income, Net increased by 87% in 2005 compared to 2004 primarily as a result of higher investment yields.

Interest and Other Income, Net decreased by 7% in 2004 compared to 2003 primarily due to a decrease in interest income in 2004 due to lower investment yields and a decrease of $3 million in the net investment gain on the NQDC Plan assets from $5.9 million in 2003 (as restated) to $2.9 million in 2004 (as restated).

PROVISION FOR INCOME TAXES

Our effective tax rate reflects the impact of significant amounts of our earnings being taxed in foreign jurisdictions at rates below the U.S. statutory rate. Our effective tax rates were 22% for 2005, 17% for 2004 (as restated), and 28% for 2003 (as restated). The results of the restatement had no impact to our effective tax rate for 2005, an insignificant impact for 2004, and an approximate one

percentage point increase for 2003. The increase in our effective tax rate in 2005 compared to 2004 is due to an additional provision of $24.6 million related to the repatriation during 2005 of $535.1 million of foreign earnings of which $500 million represented an extraordinary dividend under the American Jobs Creation Act of 2004, partially offset by an income tax benefit of $12.6 million arising primarily from the settlement of federal and California income tax audits. Our 2004 effective tax rate also included an income tax benefit of $17.1 million, primarily related to a tax settlement with the Hong Kong Inland Revenue Department, which contributed to a 5 percentage point rate decrease in our effective tax rate in 2004.

Our adoption of SFAS 123R in the quarter ending March 31, 2006 is currently expected to have a favorable impact on our 2006 effective tax rate and may have a favorable or unfavorable impact on our effective tax rate in future years.

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Financial Condition, Liquidity, and Capital Resources

	Years Ended	
	Dec. 30, 2005	Dec. 31, 2004
(Dollars in thousands)		
Cash and cash equivalents	$ 787,707	$ 579,936
Short-term investments	378,881	623,312
Long-term investments	115,965	
Total cash, cash equivalents, and investments	$ 1,282,553	$ 1,203,248
Percentage of total assets, as restated	70%	68%
Net cash provided by operating activities	$ 415,142	$ 313,992
Net cash provided by investing activities	102,506	134,930
Net cash used for financing activities	(309,877)	(127,817)
Net increase in cash and cash equivalents	$ 207,771	$ 321,105

LIQUIDITY | We derive our liquidity and capital resources primarily from our cash flows from operations. We continue to generate positive operating cash flows and remain debt-free. We currently use cash generated from operations for capital expenditures, investments and repurchases of our common stock. Based on past performance and current expectations, we believe our current available sources of funds including cash, cash equivalents, and investments, plus the anticipated cash generated from operations, will be adequate to finance our operations and capital expenditures for at least the next year. The restatement of previously issued financial statements discussed in Note 3 to our consolidated financial statements had no impact on our reported net cash flows.

YEAR 2005 | In 2005, we spent $369.9 million to repurchase our common stock, compared to $176.3 million in 2004. We also spent $25.9 million on capital expenditures in 2005, compared to $24.7 million in 2004. We expect that capital expenditures will increase in 2006 as we launch a program to replace our enterprise resource planning system (ERP). As of the date of this filing, total planned expenditures for the ERP system are estimated to be $35 million and we expect to install and have the system operational in 2007. We also plan to continue to use a portion of our available capital to repurchase shares of our common stock.

CASH FLOWS | Our positive cash flows from operating activities for the fiscal year ended December 30, 2005 were primarily attributable to net income and cash inflows of $65.6 million resulting from year-over-year changes in working capital, excluding cash. These changes included an increase in accounts receivable of $13.0 million, a decrease in other current assets primarily due to the collection in 2005 of a $17 million income tax refund related to the filing of our 2004 federal income tax return, a $37.2 million increase in deferred income and allowances on sales to distributors due to an increase in inventory held by distributors, and a $25.1 million increase in income taxes payable resulting primarily from the accrual for income taxes to be paid as a result of the repatriation of unremitted foreign earnings under the American Jobs Creation Act (see Note 10 Income Taxes to our Consolidated Financial Statements).

Cash provided by investing activities for the fiscal year ended December 30, 2005 primarily consisted of proceeds from the maturities and sales of investments, net of purchases, of $128.4 million, partially offset by capital expenditures of $25.9 million.

Cash used for financing activities for the fiscal year ended December 30, 2005 consisted of repurchases of common stock of $369.9 million, which was partially offset by net proceeds of $57.8 million from the issuance of common stock to employees through our stock option and employee stock purchase plans.

YEAR 2004 (as restated) | In 2004, we spent $176.3 million to repurchase our common stock, compared to $239 million in 2003. We also spent $24.7 million on capital expenditures in 2004, compared to $13.9 million in 2003. We made additional capital expenditures in 2005 and plan to continue to use a portion of our cash to repurchase shares of our common stock.

CASH FLOWS (as restated) | Our positive cash flows from operating activities for 2004 were primarily due to net income and adjustments for non-cash items offset by a cash outflow of $15.6 million resulting from year-over-year changes in working capital, excluding cash. These changes included a decrease in accounts receivable of $19.7 million, an increase in accounts payable and accrued liabilities of $23.8 million, and an increase in income taxes payable of $5.6 million offset by increase in other assets of $17.5 million and inventories of $22.9 million, and a decrease in deferred income and allowances on sales to distributors of $24.3 million.

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Cash and cash equivalents increased $321.1 million, or 124%, to $579.9 million for the fiscal year ended December 31, 2004, from $258.8 million at January 2, 2004. Our positive cash flow from operating activities was primarily attributable to net income, adjusted for non-cash items.

Cash provided by investing activities of $134.9 million primarily consisted of proceeds from the maturity and sale of investments, net of purchases, of $161.4 million. We also spent $24.7 million on capital expenditures and $1.8 million on intangible assets in 2004.

Cash used for financing activities of $127.8 million resulted from repurchases of our common stock of $176.3 million, which was partially offset by net proceeds of $49.6 million from the issuance of our common stock to employees through our stock option and employee stock purchase plans.

CONTRACTUAL OBLIGATIONS | The following table summarizes our significant contractual cash obligations at December 30, 2005, and the effect that such obligations are expected to have on liquidity and cash flow in future periods:

		Payments Due by Period			
(Dollars in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating Lease Obligations (1)	$ 16.5	$ 6.5	$ 7.9	$ 2.1	$
Capital Lease Obligations, including Interest	7.4	3.0	4.4		
Inventory and Related Purchase Obligations (2)	121.0	121.0			
Total Contractual Cash Obligations	$ 144.9	$ 130.5	$ 12.3	$ 2.1	$

(1) We lease facilities under non-cancelable lease agreements expiring at various times through 2011. Rental expense under all operating leases amounted to $9.3 million in 2005, $9.1 million in 2004, and $7.7 million in 2003.

(2) We depend entirely upon subcontractors to manufacture our silicon wafers and provide assembly and test services. Due to lengthy subcontractor lead times, we must order materials and services from these subcontractors well in advance, and we are obligated to pay for the materials and services once they are completed. We expect to receive and pay for these materials and services within the next four to six months.

IMPACT OF CURRENCY TRANSLATION AND INFLATION | We purchase the majority of our materials and services in U.S. dollars and sell our products to OEMs and distributors in U.S. dollars. As of December 30, 2005, we had no open forward contracts; however, we may enter into contracts from time to time to hedge foreign exchange exposure. We have, in the past, entered into forward contracts to hedge against currency fluctuations associated with contractual commitments denominated in foreign currencies.

COMMON STOCK REPURCHASES | In 2005, our board of directors approved increases totaling 20.0 million shares in the shares authorized for repurchase from 88.0 million shares to 108.0 million shares. Share repurchase activities for 2005, 2004, and 2003, were as follows:

(In millions, except per share amounts)	2005	2004	2003
Shares repurchased	19.9	8.3	12.5
Cost of shares repurchased	$ 369.9	$ 176.3	$ 239.0
Average price per share	$ 18.59	$ 21.36	$ 19.17

Since the inception of our repurchase program in 1996 through December 30, 2005, we have repurchased a total of 86.6 million shares of our common stock for an aggregate cost of $1.8 billion. All shares were retired upon acquisition. At December 30, 2005, 21.4 million shares remained authorized for repurchases under the plan.

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In each quarter of 2005, we entered into an agreement pursuant to SEC Rule 10b5-1 under which we authorized a third-party broker to purchase shares on our behalf during our normal blackout period according to predetermined trading instructions. In addition, we have repurchased shares of our common stock under the guidelines of SEC Rule 10b-18.

OFF-BALANCE SHEET ARRANGEMENTS | We do not have any financial partnerships with unconsolidated entities, such as entities often referred to as structured finance or special purpose entities.

NEW ACCOUNTING PRONOUNCEMENTS | In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which requires the measurement and recognition of compensation expense for all stock-based compensation payments and supersedes the current accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). SFAS 123R is effective for all annual periods beginning after December 15, 2005. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to the adoption of SFAS 123R. SAB 107 content is primarily interpretive addressing certain interactions between SFAS 123R and certain SEC rules and regulations.

We will adopt SFAS 123R in the first quarter of 2006 and will continue to evaluate the impact of SFAS 123R on our operating results and financial condition. The adoption of SFAS 123R s fair value method will have a significant and adverse impact on our results of operations, significantly increasing our operating expenses. The adoption of SFAS 123R is also expected to have a favorable impact on our 2006 effective tax rate and may have a favorable or unfavorable impact on our effective tax rate in future years. The pro forma information in Note 8 Stock-Based Compensation to our Consolidated Financial Statements presents the estimated compensation charges for the periods presented under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation. As a result of the provisions of SFAS 123R and SAB 107, we expect the compensation charges under SFAS 123R to be approximately $80 million in 2006, pre-tax. The total compensation charges that we expect to record in 2006 includes expense relating to unvested stock options outstanding as of December 30, 2005 and stock-based awards that we expect to grant in 2006. Our assessment of the estimated compensation charges is affected by our stock price as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, the volatility of our stock price and employee stock option exercises.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs, an amendment to ARB No. 43, Chapter 4 (SFAS 151). SFAS 151 amends ARB No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current period charges. In addition, SFAS 151 requires that the allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred for fiscal years beginning after June 15, 2005. We, therefore, are required to adopt the standard effective with our 2006 fiscal year. We do not expect the adoption of SFAS 151 to have a significant impact on our consolidated financial condition or results of operations.

In June 2005, the FASB issued Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections (SFAS 154), which changes the requirements for the accounting for and reporting of voluntary changes in accounting principle. SFAS 154 requires retrospective application to prior periods consolidated financial statements of changes in accounting principle, unless impracticable. SFAS 154 supersedes Accounting Principles Board Opinion No. 20, Accounting Change (APB 20), which previously required that most voluntary changes in accounting principle be recognized by including in the current period s net income the cumulative effect of changing to the new accounting principle. SFAS 154 also makes a distinction between retrospective application of an accounting principle and the restatement of consolidated financial statements to reflect correction of an error. SFAS 154 carries forward without changing the guidance contained in APB 20 for reporting the correction of an error in previously issued consolidated financial statements and a change in accounting estimate. SFAS 154 applies to voluntary changes in accounting principle that are made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 did not have a material impact on our financial condition or results of operations, however, we cannot assure you that there will not be a material

impact in the future.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48 Accounting for Uncertainty in Income Taxes an interpretation of SFAS 109. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return, including a decision whether to file or not to file in a particular jurisdiction. FIN 48 is effective for fiscal years beginning after December 15, 2006. If there are changes in net assets as a result of application of FIN 48, they will be accounted for as an adjustment to retained earnings. We are currently assessing the impact of FIN 48 on our consolidated financial position and results of operations.

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On September 13, 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. (SAB No. 108) which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The guidance is applicable for our fiscal 2007. We are not yet in a position to determine what, if any, effects SAB No. 108 will have on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our investment portfolio consisted of fixed income securities of various durations depending on the nature of the investments totaling $1.3 billion as of December 30, 2005. These securities are subject to interest rate risk and will vary in value as market interest rates fluctuate. If market interest rates were to increase or decline immediately and uniformly by 10% from levels as of December 30, 2005, the increase or decline in the fair value of the portfolio would not be material.

Although we purchase the majority of our materials and services in U.S. dollars and sell our products to OEMs and distributors in U.S. dollars, we do have international operations and are, therefore, subject to foreign currency rate exposure. To date, our exposure to exchange rate volatility has been insignificant. If foreign currency rates were to fluctuate by 10% from rates at December 30, 2005, our financial position, results of operations and cash flows would not be materially affected. However, we cannot assure you that there will not be a material impact in the future.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

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ALTERA CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except par value amount)	December 30, 2005 (as restated) (1)	December 31, 2004 (as restated) (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 787,707	$ 579,936
Short-term investments	378,881	623,312
Total cash, cash equivalents, and short-term investments	1,166,588	1,203,248
Accounts receivable, net of allowances for doubtful accounts of $5,055 and $5,057, respectively	80,509	67,522
Inventories	70,711	67,454
Deferred income taxes	66,264	85,582
Deferred compensation plan assets	61,567	56,148
Other current assets	49,562	74,143
Total current assets	1,495,201	1,554,097
Long-term investments	115,965	
Property and equipment, net	165,999	159,587
Deferred income taxes and other assets, net	50,531	54,897
Total assets	$ 1,827,696	$ 1,768,581
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 29,388	$ 31,507
Accrued liabilities	30,462	23,983
Accrued compensation	50,631	53,055
Deferred compensation plan obligations	61,567	56,148
Deferred income and allowances on sales to distributors	258,285	221,081
Income taxes payable	133,904	108,804
Total current liabilities	564,237	494,578
Capital lease obligations	3,871	
Commitments and contingencies (See Note 7 Commitments and Contingencies and Note 14 Subsequent Events)		
Stockholders equity:		
Common stock: $.001 par value; 1,000,000 shares authorized; outstanding 359,419 at December 30, 2005 and 373,759 shares at December 31, 2004	359	374
Capital in excess of par value	385,201	416,546
Retained earnings	875,164	858,455
Deferred stock-based compensation	(46)	(328)
Accumulated other comprehensive loss	(1,090)	(1,044)
Total stockholders equity	1,259,588	1,274,003

Total liabilities and stockholders equity	$ 1,827,696	$ 1,768,581

(1) See Note 3, Restatement of Previously Issued Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

See accompanying notes to consolidated financial statements.

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ALTERA CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended		
	December 30, 2005	December 31, 2004	January 2, 2004
(In thousands, except per share amounts)		(as restated) (1)	(as restated) (1)
Net sales	$ 1,123,739	$ 1,016,364	$ 827,207
Cost of sales	365,946	308,741	266,435