FORM 10−K

MONOLITHIC SYSTEM TECHNOLOGY INC − MOSY

Filed: March 16, 2006 (period: December 31, 2005)

Annual report which provides a comprehensive overview of the company for the past year

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

FORM 10−K

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

For the Fiscal Year December 31, 2005, or

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

Commission file number: 000−32929

MONOLITHIC SYSTEM TECHNOLOGY, INC.
(Exact name of registrant as specified in its charter)

Delaware	**77−0291941**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

755 N. Mathilda Avenue, Suite 100
Sunnyvale, California 94085
(Address of principal executive offices)

(408) 731−1800
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
None	None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $0.01 per share
Series AA Preferred Stock, par value $0.01 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 ☐ 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 ☒

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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S−K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10−K or any amendment to this Form 10−K. ☐

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

Large accelerated filer ☐ Accelerated filer ☒ 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 ☒

The aggregate market value of the common stock held by non−affiliates of the Registrant, as of June 30, 2005 was approximately $141,050,000 based upon the last sale price reported for such date on the Nasdaq National Market. For purposes of this disclosure, shares of common stock held by persons who beneficially own more than 5% of the outstanding shares of common stock and shares held by officers and directors of the Registrant have been excluded because such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

As of March 1, 2006, 31,102,247 shares of the registrant's common stock, $0.01 per value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement to be delivered to stockholders in connection with the registrant's 2006 Annual Meeting of Stockholders to be held on or about May 25, 2006 are incorporated by reference into Part III of this Form 10−K. The registrant intends to file its proxy statement within 120 days after its fiscal year end.

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Part I

This Annual Report on Form 10−K and the documents incorporated herein by reference contain forward−looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which include, without limitation, statements about the market for our technology, our strategy, competition, expected financial performance and other aspects of our business identified in this Annual Report, as well as other reports that we file from time to time with the Securities and Exchange Commission. Any statements about our business, financial results, financial condition and operations contained in this Annual Report that are not statements of historical fact may be deemed to be forward−looking statements. Without limiting the foregoing, the words "believes," "anticipates," "expects," "intends," "plans", "projects," or similar expressions are intended to identify forward−looking statements. Our actual results could differ materially from those expressed or implied by these forward−looking statements as a result of various factors, including the risk factors described in Part I., Item 1A, "Risk Factors," and elsewhere in this report. We undertake no obligation to update publicly any forward−looking statements for any reason, except as required by law, even as new information becomes available or other events occur in the future.

MoSys®, MultiBank® and 1T−SRAM® are our trademarks. Product names, trade names and trademarks of other companies are also referred to in this report.

Item 1. Business

Company Overview

We design, develop, market and license memory technologies used by the semiconductor industry and electronic product manufacturers. We have developed a patented semiconductor memory technology, called 1T−SRAM, that offers a combination of high density, low power consumption and high speed at performance and cost levels that other available memory technologies do not match. We license this technology to companies that incorporate, or embed, memory on complex integrated circuits, such as System−on−Chip or SoC. We have also sold memory chips based on our 1T−SRAM technologies, but in 2004, we ceased shipments of 1T−SRAM memory chips. We do not expect to make and sell memory chips in the future.

We signed our first license agreement related to our 1T−SRAM technologies at the end of the fourth quarter of 1998 and recognized licensing revenue from our 1T−SRAM technologies for the first time in the first quarter of 2000. Since then, we have introduced improved and enhanced versions of our technology.

We generate revenue from the licensing of our memory technologies, which consists of licensing revenues, customization services, maintenance and support fees and royalties. Royalty revenues are earned under each of our license agreements when our licensees manufacture or sell products that incorporate any of our 1T−SRAM technologies and report the results to us. Generally, we expect our total sales cycle, or the period from our initial discussion with a prospective licensee to our receipt of royalties from the licensee's use of our 1T−SRAM technologies, to run from 18 to 24 months after the commencement of the project.

In 2005, we began delivering our new family of 1T−SRAM CLASSIC Memory Macro products to licensees. These macros are silicon−proven, high−density solutions offering customers rapid memory block integration into their SoC designs. They are pre−configured and require minimal additional customization. They are targeted for high volume consumer products that require larger embedded memory to support device enhancements, such as higher resolution cameras and high quality audio and video capabilities.

Industry Background

Trends in the Semiconductor Industry

Electronic products play an increasingly important role in our lives, as evidenced by the growth of the personal computer, wireless communications, networking equipment and consumer electronics markets. These markets are characterized by intensifying competition, rapid innovation, increasing performance requirements and continuing cost pressures. To manufacture electronic products that achieve optimal performance and cost levels, semiconductor companies must produce integrated circuits that offer higher performance, greater functionality and lower cost.

Two important measures of performance are speed and power consumption. Higher−speed integrated circuits allow electronic products to operate faster, enabling the performance of more functions. Reducing the power consumption of integrated circuits contributes to increased battery life and reduced heat generation in electronic products. Reduced power consumption also enables integrated circuit designers to overcome costly design hurdles, such as meeting the thermal limitations of low−cost packaging materials.

In addition to offering high−performance products, semiconductor companies must produce integrated circuits that are cost effective. High−density integrated circuits require less silicon, thus reducing their size and cost. Cost reductions also can be achieved by simplifying the integrated circuit's manufacturing process and improving the manufacturing yield.

To avoid the high cost of substantial redesign, semiconductor companies typically use technology that is scalable, which means it can be readily incorporated into multiple generations of manufacturing process technologies. Process technology generations are distinguished in terms of the dimension of the integrated circuit's smallest topographical features, as measured in microns (one millionth of a meter). The semiconductor industry has continuously developed advanced process technologies that enable the reduction of silicon area on integrated circuits and consequently lower costs. Today, the industry is predominantly using 0.25−micron, 0.18−micron and 0.15−micron manufacturing process technology. However, current designs are now being implemented in 0.13−micron and in 90 nanometers (nm) manufacturing process technologies, with 65nm technologies anticipated in the near future.

Importance of Integration

For decades, the semiconductor industry has continuously increased the value of integrated circuits by improving their density, power consumption, speed and cost. The main driver for these improvements has been the success of shrinking the size of the basic semiconductor building block, or transistor. Transistors have become small enough to make it economical to combine multiple functions, such as microprocessors, graphics, memory, analog components and digital signal processors, on a SoC. Highly integrated circuits such as SoCs often offer advantages in density, power consumption, speed and cost that cannot be matched using separate, discrete integrated circuits. SoCs are essential for most electronic products, such as cellular phones, video game consoles, portable media players, communication and networking equipment and internet appliances, to achieve increasing performance requirements at a reasonable cost.

Importance of Embedded Memory

Historically, semiconductor companies implemented memory in separate integrated circuits. Rather than using separate memory chips, many semiconductor companies today are embedding memory on highly integrated circuits in order to optimize performance and power consumption. At the same time, the increasing sophistication of electronic products is driving a rapid increase in the amount of memory required. Current industry estimates are that more than half of the chip area of a SoC is comprised of embedded memory and this proportion is forecasted to increase in the future with the growth of more memory−intensive applications.

The high cost of incorporating the memory component represents a major challenge to achieving high levels of integration. As embedded memories account for an increasing percentage of the size of a highly integrated circuit, they are often the slowest or limiting function in the circuit. Not only must integrated circuits contain a larger amount of embedded memory, this memory must be dense enough to be economically attractive and must offer sufficiently high speed and low power consumption. In many applications, embedded memory has become a crucial design consideration for determining the overall cost and performance of highly integrated circuits and the growing number of electronic products in which they are incorporated.

Traditional SRAM and Embedded DRAM

The most common form of embedded memory today utilizes traditional static random access memory, or SRAM. This technology is in the public domain and can be designed by any semiconductor company. Traditional SRAM has the following characteristics—

- it can operate at the same high speeds as other functions of the integrated circuit;
- it provides a simple and familiar interface that allows for quick design into an integrated circuit with less risk that the design will not function according to specification; and
- it utilizes the standard logic manufacturing process that is both economical and the most widely available.

As memory requirements increase, however, traditional SRAM becomes relatively more expensive compared to the total cost of the integrated circuit. Specifically, traditional SRAM has the following drawbacks that can lead to higher cost—

- it requires a substantial amount of silicon area because of its low density; and
- it consumes a significant amount of power when operating at high speeds.

To overcome the density limitations of traditional SRAM, some manufacturers have utilized embedded dynamic random access memory, or embedded DRAM. While embedded DRAM is denser than traditional SRAM, it is typically ten times slower. Manufacturing embedded DRAM also requires additional process steps and results in lower yields, which translate into increased manufacturing time and cost. Additionally, because of its complex interface requirements, embedded DRAM is more difficult to incorporate on integrated circuits, leading to a higher risk of failure. As integrated circuit designers have experimented with embedded DRAM, they have discovered that these limitations of embedded DRAM preclude its use in most applications. Therefore, traditional SRAM continues to be the most widely used technology for embedded memory. One of the major challenges for the semiconductor industry today is to find an embedded memory solution that combines high density, low power consumption, high speed and low cost.

Our Solution

We have developed a series of innovative memory technologies, 1T−SRAM technologies, which provide major advantages over traditional SRAM in density, power consumption and cost, thus making it more economical for designers to incorporate large amounts of embedded memory in their designs. In

addition, our 1T−SRAM technologies offer all the benefits of traditional SRAM, such as high speed, simple interface and ease of manufacturability. Its core circuitry is already production proven in millions of memory chips and offers integrated circuit designers the following characteristics compared to traditional SRAM:

Parameters	**Typical Characteristics of 1T−SRAM technologies vs. traditional SRAM**
Density	Uses 50% to 75% less silicon for the same amount of memory
Cost	50% to 70% less cost for the same amount of memory
Power	Can save up to 75% of the power when operating at the same speed
Speed	Can provide speeds equal to or greater than those offered by traditional SRAM, especially for larger memory sizes

Our 1T−SRAM technologies can achieve these advantages while utilizing standard logic manufacturing processes and providing the simple, standard SRAM interface that designers are accustomed to today.

High Density

Embedded memory utilizing our 1T−SRAM technologies is typically two to three times denser than traditional SRAM. Increased density enables manufacturers of electronic products, such as cellular phones, video game consoles and digital cameras and camcorders, to incorporate additional functionality into a single integrated circuit, resulting in overall cost savings. Semiconductor designers can take advantage of the high density of our 1T−SRAM technologies and embed large quantities of high−performance memory and other components that in the past might not have been feasible.

Low Power Consumption

Embedded memory utilizing our 1T−SRAM technologies can consume as little as one−quarter the power and generates less heat than traditional SRAM when operating at the same speed. This feature facilitates longer battery life, reduces system level cooling costs and enables reliable operation using lower−cost packaging.

High Speed

Embedded memory utilizing our 1T−SRAM technologies typically provides speeds equal to or greater than the speeds of traditional SRAM, especially for larger memory sizes. Our 1T−SRAM memory designs can sustain random access cycle times of less than three nanoseconds. In today's 0.13−micron manufacturing process technology, our 1T−SRAM technologies can operate with a random access frequency in excess of 400 megahertz for multi−megabit memory.

Manufacturing Process Independence

We have been able to implement our technology without requiring the manufacturer to make any significant changes to either standard logic or alternative manufacturing processes. 1T−SRAM's portability, or the ease with which it can be implemented in different semiconductor manufacturing facilities, has been proven operational in the fabrication of chips at the world's largest independent foundries, including Taiwan Semiconductor Manufacturing Co., Ltd., or TSMC, United Microelectronics Corporation, or UMC, Chartered Semiconductor Manufacturing Ltd., or Chartered, and Semiconductor Manufacturing International Corporation, or SMIC. It has also been proven in the manufacturing processes of integrated device manufacturers, or IDM's, such as Fujitsu and NEC Electronics. 1T−SRAM's scalability, or the ease with which it can be implemented in different generations of manufacturing processes, has already been demonstrated in the fabrication of chips in 0.25−micron, 0.18−micron, 0.15−micron, 0.13−micron and 90nm process generations, without extensive modifications. We expect our technology to continue to scale

readily to future process generations. This portability and scalability provides for wide availability, inexpensive implementation and quick product time to market for our licensees.

Simplicity of Interface

Our 1T−SRAM technologies internal circuitry connects to the simple, standard SRAM interface that designers are accustomed to today. Our use of this standard high−performance interface minimizes design time, thus optimizing time to market for our licensees. This simple interface also helps minimize the risk that integrated circuit designs will not operate according to specifications.

Our Strategy

Our goal is to establish our 1T−SRAM technologies as the standard for all large embedded memories in SoC applications. We intend to achieve this goal by licensing our technology on a non−exclusive and worldwide basis to foundries, integrated device manufacturers, fabless semiconductor companies and electronic product manufacturers.

The following are integral aspects of our strategy.

Target Large and Growing Markets

We target the large and growing market for SoC applications requiring large embedded memories, which are in excess of one megabyte, with our 1T−SRAM technologies that offer chip designers improved performance in embedded memories thus optimizing the cost and performance of the SoC.

Although our 1T−SRAM technologies are applicable to many markets, we presently focus on the rapidly growing consumer electronics and communications sectors. These sectors increasingly require embedded memory solutions with higher density, lower power consumption, higher speeds and lower cost. We also will focus over the longer term on other markets that are projected to achieve strong, long−term growth.

Work Closely with Semiconductor Companies and Foundries to Deliver Optimal Technology Solutions

We work closely with semiconductor companies to gain broad and detailed insight into their and their customers' current and next−generation technology requirements. This insight helps us identify trends and focus our development efforts on optimizing our technology solution, resulting in shorter product time to market and lower costs. We plan to continue to qualify and license our technology with the leading IDM's and foundries in order to provide a wide range of manufacturing choices for our customers.

Extend our Technology Offerings

Our goal is to continue to enhance our 1T−SRAM technologies and increase our share of the embedded memory market. We will continue to develop our technology in order to offer even higher−density, lower−power consumption, higher−speed and lower−cost designs for our licensees. As such, we continue to invest heavily in research to develop more advanced memory technologies. Since the introduction of 1T−SRAM in 1998, we have introduced and currently offer the following improvements to the 1T−SRAM technology:

- TEC® Error Correction Circuitry, which automatically corrects memory errors during operation, including soft errors caused by high−energy particles, and eliminates the need for laser repair in manufacturing test. This is accomplished without adding silicon area or cost. Introduced in November 2001, our TEC® Error Correction Circuitry has now become the standard within 1T−SRAM in most of our licensing activities.

- Lower power version of 1T−SRAM memory macros, well−suited to particular applications requiring very low operating and standby power, such as cell phone handsets, digital cameras, personal digital assistants and other consumer, wireless devices. We introduced the 1T−SRAM Low−Power family of products in April 2001.
- 1T−SRAM with extended density memory (twice the density of the original version of our technology) and up to four times the density of traditional SRAM. These products embed our advanced, folded capacitor 1T−Q bit cell. We introduced our 1T−Q−based products in December 2002.

In addition, we have developed new generations of our 1T−SRAM technologies, most recently in the 90nm manufacturing process. We intend to continue to develop our technologies for future process generations such as 65nm and 45nm.

Licensing and Distribution Strategy

We offer our technology on a non−exclusive and worldwide basis to semiconductor companies, electronic product manufacturers, foundries, intellectual property companies and design companies through product development, technology licensing and joint marketing relationships.

Licensing

We license our technology to semiconductor companies who incorporate our technology into integrated circuits that they sell to their customers. In addition, we engage in joint marketing activities with foundries, intellectual property companies and design companies to promote our technology to a wide base of customers. These distribution channels have broadened the acceptance and availability of our technology in the industry. As our technology becomes available through an increasing number of channels, we believe it will be less likely that customers will have to alter their procurement practices in order to acquire our technology. We intend to continue to expand significantly this base of strategic relationships to further proliferate our technology.

We form product development and licensing relationships directly with semiconductor companies and original equipment manufacturers or OEM. The prospective licensee’s implementation of our 1T−SRAM technologies typically includes customized development. Usually, these relationships involve both engineering work to implement our technology in the specified product and licensing the technology for manufacture and sale of the product. Although the precise terms contained in our 1T−SRAM macro development and license agreements vary, every agreement provides for the payment of contract fees to us at the beginning of the contract and the joint development of specifications and initial product design and engineering. Contract fees include licensing fees, development fees for customizations based on the achievement of specified development milestones and royalties. The vast majority of our contracts allow billing between milestones based on work performed. Typically under our agreements, the licensee is obligated to complete the project within a stated timeframe and to assist us in completing the final milestone. If we perform the contracted services, usually the licensee is obligated to pay the license fees even if the licensee fails to complete verification or cancels the project prior to completion. The agreements often also provide for the payment of additional contract fees if we provide engineering or manufacturing support services related to the manufacture of the product. Provisions in all of our license agreements require the payment of royalties to us based on the future sale or manufacture of products utilizing our 1T−SRAM technologies. Generally, our licenses grant rights on a non−exclusive, non−transferable basis, limited to the use of our technology as modified for the project covered by the license agreement. Our license agreements generally have a fixed five−year term and are subject to renewal. Each new project requires a separate agreement or an addendum to modify an existing agreement.

We have license agreements with many companies, including Agere Systems, Inc., Agilent Technologies, Analog Devices, Inc., Broadcom Corporation, eSilicon Corporation, Fujitsu Limited, Hitachi, Ltd., Kawasaki Micoroelectronics, Inc., LG Electronics, Inc., LSI Logic Corporation, Marvell Semiconductor, Inc., Matsushita Communication Industrial Co., Ltd., National Semiconductor Corporation, NEC Electronics Corporation, Open−Silicon, Inc., Philips Semiconductors, Inc., Pixelworks, Inc., Pixim, Inc., SMIC, Sanyo Electric Co., Ltd., Sony Corporation, TSMC, UMC, and Via Technologies, Inc.

Joint Marketing Arrangement

We have formed joint marketing relationships with dedicated foundries such as TSMC, UMC, Chartered and SMIC. These foundries have cooperated with us to prove the manufacturability of integrated circuits utilizing our 1T−SRAM technologies in their particular manufacturing process. Once manufacturability has been proven, the foundries can then offer their manufacturing services to our licensees, and their integrated circuit device customers can fabricate integrated circuits incorporating our 1T−SRAM technologies.

Custom Memory Designs

We offer directly to our licensees customized 1T−SRAM memory designs to meet their specific design parameters. We also offer a variety of options for optimizing the design specification in order to improve performance and cost effectiveness.

Standard Macro Designs

In addition to licensing our customized 1T−SRAM designs, companies also can license standard 1T−SRAM off−the−shelf memory designs from us, known as CLASSIC Macros. These readily available standard memory designs can assist the licensee in getting its SoC quickly to market.

Technology Licenses

We also offer our technology to semiconductor companies through 1T−SRAM technology license agreements, under which we grant the licensee the additional right to create and modify 1T−SRAM designs to offer to its own customers. The contract fees associated with these arrangements require the licensee to pay us to port our technology to its manufacturing process and develop a template design that the licensee will be able to use to generate future designs. These agreements also obligate the licensee to pay contract fees to us upon the achievement of specified development milestones and may provide for the payment of additional contract fees if we provide engineering or manufacturing support services. Under these agreements we will be entitled to receive royalties based on the future sale or manufacture of products utilizing our 1T−SRAM technologies. The licenses are non−exclusive and non−transferable and authorize the licensee to modify designs for its customers from the template design that we provide under the agreement. Typically, the template design applies only to a specified manufacturing process generation. The licensee may add future process generations to the license agreement for additional contract fees.

Technology

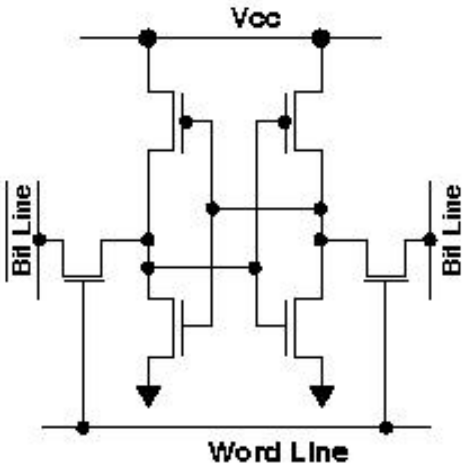
Our innovative 1T−SRAM technologies include many new and proprietary features. These technologies combine the high−density advantages of DRAM with the high performance and utility of SRAM. Underlying this technology are several distinct pieces of our proprietary technology.

Single−Transistor Memory Storage Cell

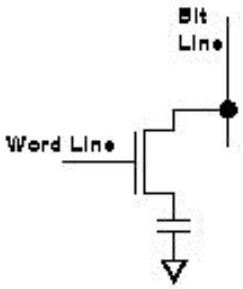
The high density of our 1T−SRAM technologies stems from the use of a single−transistor, or 1T, which is similar to DRAM, with a storage cell for each bit of information. Our 1T storage cell using one transistor and one capacitor represents a very significant improvement in density over the six−transistor storage cells used by traditional SRAM.

The following diagrams, drawn to scale, but not to actual size, are electrical schematics of the traditional SRAM storage cell and our 1T−SRAM storage cell. The comparison of the two diagrams illustrates the small size and reduced complexity of the 1T−SRAM storage cell. This results in significant cost savings because less silicon space is required by 1T−SRAM storage cells.

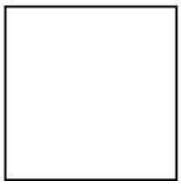
Six Transistor SRAM Storage Cell Schematic



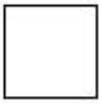
1T-SRAM Storage Cell Schematic



Six Transistor Storage Cell Area

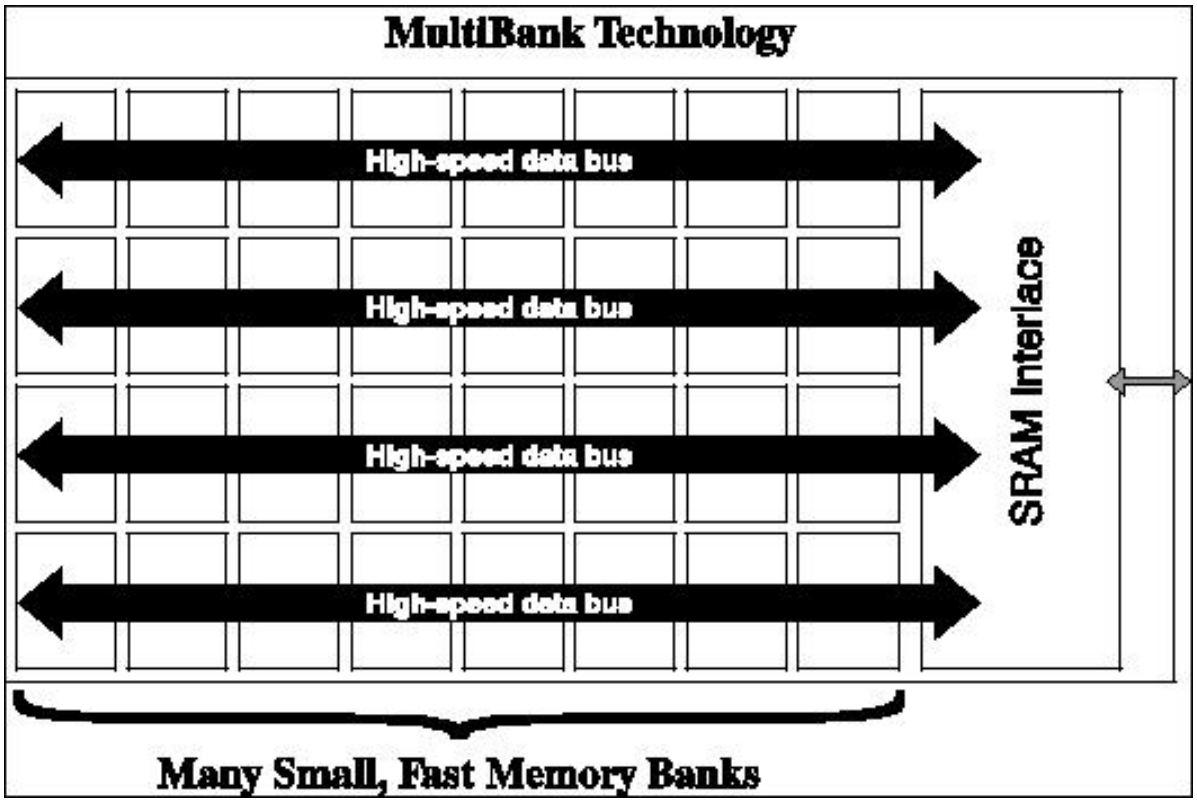


1T-SRAM Storage Cell Area



MultiBank Technology

The high speed and low power consumption of 1T−SRAM are enabled by our MultiBank technology, as illustrated above. This technology efficiently partitions the memory into many, typically hundreds, of fast, small sub−blocks of memory, or banks, that can operate independently over high−speed data buses. Only one small bank containing the required memory data must be active for each access to the memory. Therefore, the remaining banks can stay in a low−power, standby mode, reducing the overall power consumption of the memory.



Pipelined Self−timed Access

The easy to use standard SRAM interface of 1T−SRAM technologies is enabled by our innovative and proprietary circuit designs, generating all the necessary dynamic memory array operation timing signals transparently to user's application.

Refresh Management Circuitry

Refresh operations required to ensure data is maintained to a minimum level in dynamic cells may be performed transparently to a user's application, allowing designers to fully disregard any of the traditional requirements of dynamic cell arrays.

Leakage Suppression Circuitry

Our unique patented architecture, circuits and proprietary design techniques that manage process leakage allow MoSys 1T−SRAM technologies to be manufactured on any CMOS process, including generic ASIC processes, thus removing the need for complicated embedded memory process development.

TEC® Error Correction Circuitry

We offer our 1T−SRAM technologies with embedded error correction circuitry for higher reliability and quality. This circuitry automatically corrects memory errors during operation, including soft errors caused by high−energy particles, and eliminates the need for laser repair in manufacturing test. This is accomplished without adding any additional silicon area or cost. The TEC® Error Correction Circuitry is currently incorporated into all of our designs developed targeting 0.13−micron and more recent technologies.

1T−Q® Folded Area Capacitor (FAC)

Using an innovative capacitor technology called Folded Area Capacitor (FAC), we can provide our licensees with a very high−density memory solution. Requiring only two additional non−critical masks during the manufacturing process, utilizing our 1T−Q® Folded Area Capacitor, our 1T−SRAM products can achieve densities up to four times that of traditional SRAM and twice the density of the original version of our technology.

Advanced Manufacturing Processes

We have continued to implement our 1T−SRAM technologies on advanced generations of manufacturing processes. As a result, our licensees are able to implement integrated circuits incorporating 1T−SRAM embedded memories on the highest performance manufacturing processes available. The chart below illustrates a sampling of test chips we have made for initially implementing and verifying 1T−SRAM technologies on the latest generations of manufacturing processes nodes. The processes with the smaller micron dimensions have higher random access speeds and typically enable larger capacity memories.

Processes Generation	**0.18−micron**	**0.15−micron**	**0.13−micron**	**90nm**
Date of 1T−SRAM Verification	January 2000	May 2000	April 2001	December 2005
Typical Memory	1−32	1−48	1−64	1−128
Capacity	megabits	megabits	megabits	megabits

Research and Development

Our ability to compete in the future will depend on improving our technology to meet the market's increasing demand for higher performance and lower cost requirements. We have assembled a team of highly skilled engineers whose activities are focused on developing even higher−density, lower−power consumption, higher−speed and lower−cost 1T−SRAM designs. We expect to continue to focus our research and development efforts on extending our 1T−SRAM technologies and developing new memory technologies. We also intend to continue our focus on porting our technology to additional semiconductor manufacturing facilities and scaling our technology to new generations of manufacturing process technologies.

As of December 31, 2005, we employed 51 engineers, representing 67% of our employees, with specific expertise in circuit design, layout and a variety of manufacturing processes. Effective November 10, 2004, we closed the ATMOS' research and development facility and terminated the employment of approximately 20 employees of ATMOS. We have a design center in Seoul, South Korea where 10 of our engineers reside. For the years ended December 31, 2005, 2004, and 2003, research and development expenditures totaled approximately $5.8 million, $8.1 million, and $8.7 million, respectively.

Sales and Marketing

As of December 31, 2005, we had a staff of 14 sales and marketing executives managing our technology licensing activities. We have 11 sales and marketing personnel in the United States who are responsible for licensing activities in North America and Asia. Two are located in Sophia−Antipolis, France and are responsible for licensing activities in Europe and the Middle East. One sales and marketing manager is located in Yokohama, Japan and is responsible for licensing activities in Japan. This group manages the negotiation of license agreements, provides technical support during the sales cycle to licensees and administers the contracts. As we have multiple sales channels through our relationships with semiconductor companies, foundries, intellectual property companies and design companies, we do not believe that we require a large internal sales force. Our marketing and promotional activities include participation in industry trade shows, distribution of collateral marketing material, publication of articles in

trade journals and publicizing our licensing activities and technology achievements. We also provide presentations and working sessions with the senior technical and business staff of prospective customers.

Intellectual Property

We regard our patents, copyrights, trademarks, trade secrets and similar intellectual property as critical to our success, and rely on a combination of patent, trademark, copyright, and trade secret laws to protect our proprietary rights. As of December 31, 2005, we held 80 U.S. patents on various aspects of our technology, with expiration dates ranging from 2011 to 2023. These 80 patents include claims relating to multibank partitioning, 1T−SRAM internal operation and circuit techniques, high−speed operation techniques, 1T−SRAM refresh management techniques and the interface of embedded 1T−SRAM storage cells in logic processes. We currently have nine pending U.S. patent applications, and have received notices of allowance with respect to one of these applications. We also hold 40 foreign patents with expiration dates ranging from 2012 to 2022, and we have 19 pending foreign patent applications. There can be no assurance that others will not independently develop similar or competing technology or design around any patents that may be issued to us, or that we will be able to enforce our patents against infringement.

The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. Our licensees or we might, from time to time, receive notice of claims that we have infringed patents or other intellectual property rights owned by others. Our successful protection of our patents and other intellectual property rights are subject to a number of factors, particularly those described in Part I, Item 1A. “Risk Factors.”

Competition

In order to remain competitive, we believe we must continue to provide higher−density, lower−power−consumption, higher−speed and lower−cost technology solutions to the semiconductor industry and electronic product manufacturers. We believe that the principal competitive factors in our industry are—

- density and cost;
- power consumption;
- speed;
- portability to different manufacturing processes;
- scalability to different manufacturing process generations;
- reliability and low manufacturing costs;
- interface requirements; and
- the ease with which technology can be customized for and incorporated into customers’ products.

We believe that our 1T−SRAM technologies offer a high degree of overall performance improvement over traditional SRAM. Semiconductor companies may satisfy their embedded memory needs through traditional SRAM and embedded DRAM. Traditional SRAM relies on publicly available process technology and circuit designs, which semiconductor companies can build internally or acquire through a license from a third party provider, without paying a royalty to us. This is currently the preferred choice for embedded memory solutions in SoCs. Companies providing traditional SRAM embedded memories include Artisan Components and Virage Logic. Embedded DRAM is primarily offered by current or former DRAM suppliers, who utilize their own manufacturing process to compete in the semiconductor foundry business. Suppliers of embedded DRAM include substantial competitors such as Toshiba Ltd. and IBM, among others. Although each of these two embedded DRAM suppliers has experienced some

success in obtaining new customers for its technology, we believe that many semiconductor companies using embedded memory may prefer to license our technology instead of implementing either of these alternatives because of 1T−SRAM's overall advantages.

Not all embedded memory applications benefit sufficiently from technological advantages offered by our 1T−SRAM technologies to justify the increased cost to the licensee, however. Our licensees and prospective licensees can meet their current needs for embedded memory using other memory solutions with different cost and performance parameters. For example, our technologies are not suitable for replacing lower−cost traditional DRAM memory chips if higher access speed is unnecessary. In addition, alternative solutions may be more cost−effective for memory block sizes of less than 1 megabit, or applications in which the embedded memory portion is less than 20% of the total chip area.

Moreover, some companies assess greater uncertainty and risk in relying on our newly established 1T−SRAM technologies. As a result, our ability to compete effectively may be limited because such companies may prefer to use more established traditional memory solutions that are freely available without a license.

We have designed the circuitry of our 1T−SRAM technologies so that our licensees can manufacture it in standard logic process, as well as other widely used embedded memory processes.

Employees

As of December 31, 2005, we had 76 full−time employees, consisting of 51 in research and development and engineering, 14 in sales and marketing and 11 in finance and administration. We believe our future success will depend, in part, on our ability to continue to attract and retain qualified technical and management personnel, particularly highly skilled design engineers involved in new product development, for whom competition is intense. Our employees are not represented by any collective bargaining unit, and we have not experienced any work stoppage. We believe that our employee relations are good.

Available Information

Our Web site address is www.mosys.com. The information in our Web site is not incorporated by reference into this report. Through a link on the Investor section of our Web site, we make available our annual report on Form 10−K, quarterly reports on Form 10−Q, current reports on Form 8−K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after they are filed with, or furnished to, the Securities and Exchange Commission.

Executive Officers

The names of the Company's executive officers as of December 31, 2005 and certain information about them are set forth below:

Name	Age	Position(s) with the Company
Chester J. Silvestri	57	Chief Executive Officer and Director
Wingyu Leung	51	Executive Vice President, Chief Technical Officer and Director
Dhaval Ajmera	48	Vice President of Worldwide Sales and Business Development

Chester J. Silvestri, Mr. Silvestri was appointed our Chief Executive Officer and a member of our board of directors on July 26, 2005. Mr. Silvestri held the position of Chief Executive Officer, President and a member of Board of Directors at Ceva, Inc., a leading provider of licensable digital signal processor

(DSP) cores and platform−level IP, from June 2003 to May 2005 and also served as Chairman of Ceva's Board of Directors from February 2004 to May 2005. From January to May 2003, Mr. Silvestri was a private investor and previously, from 1999 to 2002, Mr. Silvestri held the position of Chief Executive Officer of Arcot Systems, a developer of credit card authentication software. Mr. Silvestri also has served as Chief Operating Officer of Tripath Technology, Inc., President of the Microelectronic Division of SUN Microsystems, Inc., and Vice President and General Manager of the Technology Licensing division of MIPS Computer Systems, Inc. Since June 2003, Mr. Silvestri has served as a member of the board of directors of Magma Design Automation, Inc. Mr. Silvestri earned his bachelor of science and master of science degrees in electrical engineering from Michigan State University and his MBA from the Harvard Graduate School of Business.

Wingyu Leung, Dr. Leung has served as our Executive Vice President, Engineering, and Chief Technical Officer and as a member of our board of directors since April 1992. Dr. Leung also served as our Secretary from April 1992 until May 1996 and again from May 1997 until August 2000. Prior to joining us, Dr. Leung served as a technology consultant to several high technology companies, including Rambus, Inc., a developer of a high−speed chip−to−chip interface technology. Prior to that time, Dr. Leung served as a member of the technical staff of Rambus, and as a senior engineering manager at Integrated Device Technology, Inc., where he managed and participated in circuit design activities. Dr. Leung holds a B.S. in electrical engineering from the University of Maryland, a M.S. in electrical engineering from the University of Illinois, and a Ph.D. in electrical engineering and computer science from the University of California at Berkeley.

Dhaval Ajmera, Mr. Ajmera became our Vice President of Worldwide Sales and Business Development on October 3, 2005. Prior to joining the MoSys, Mr. Ajmera held a position of the Vice President of North American Sales at Ceva, Inc., a leading provider of licensable digital signal processor (DSP) cores and platform−level IP, from March 2004 to July 2005. Prior to that, he was Vice President of World Wide Marketing and Sales for Emuzed, Inc., a leader in multimedia solutions from June 2002 through November 2003, and was instrumental in launching the World's first Media Center PC along with Microsoft and very large PC OEMS Worldwide including HP, Dell, Samsung and others. Mr. Ajmera has a MSEE from University of Florida and BSEE from University of Bombay.

Item 1A. *Risk Factors*

If any of the following risks actually occur, our business, results of operations and financial condition could suffer significantly.

Our success depends upon the semiconductor market's acceptance of our 1T−SRAM technologies.

The future prospects of our business depend on the acceptance by our target markets of our 1T−SRAM technologies for embedded memory applications and any future technology we might develop. Our technology is intended to allow our licensees to develop embedded memory integrated circuits to replace other embedded memory technology with different cost and performance parameters. Our 1T−SRAM technologies utilize fundamentally different internal circuitry that is not widely known in the semiconductor industry. Therefore, one of our principal challenges, which we might fail to meet, is to convince a substantial percentage of SoC designers to adopt our technology instead of other memory solutions, which may have proven effective in their products.

- An important part of our strategy to gain market acceptance is to penetrate new markets by targeting market leaders as licensees of our technology. This strategy is designed to encourage other participants in those markets to follow these leaders in adopting our technology. If a high−profile industry participant adopts our technology for one or more of its products but fails to achieve success with those products, or is unable to successfully implement our technology, other industry participants' perception of our technology could be harmed. Any such event could reduce the number of future licenses of our technology. Likewise, if a market leader were to adopt and achieve success with a competing technology, our reputation and licensing program could be harmed.

Our embedded memory technology might not integrate as well as anticipated with other semiconductor functions in all intended applications, which would slow or prevent adoption of our technology and reduce our revenue. Detailed aspects of our technology could cause unforeseen problems in the efficient integration of our technology with other functions of particular integrated circuits. Any significant compatibility problems with our technology could reduce the attractiveness of our solution, impede its acceptance in the industry and result in a decrease in demand for our technology.

Our lengthy licensing cycle and our licensees' lengthy product development cycles make the operating results of our licensing business difficult to predict.

We anticipate difficulty in accurately predicting the timing and amounts of revenue generated from licensing our 1T−SRAM technologies. The establishment of a business relationship with a potential licensee is a lengthy process, generally taking from three to nine months, and sometimes longer during slower periods in our industry. Following the establishment of the relationship, the negotiation of licensing terms can be time−consuming, and a potential licensee may require an extended evaluation and testing period.

Once a license agreement has been executed, the timing and amount of licensing and royalty revenue from our licensing business remain difficult to predict. The completion of the licensee's development projects and the commencement of production are subject to the licensee's efforts, development risks and other factors outside our control. Our royalty revenue will depend on such factors as success of the licensee's project, the licensee's production and shipment volumes, the timing of product shipments and when the licensee reports to us the manufacture or sale of products that include our 1T−SRAM technologies. All of these factors will prevent us from making predictions of revenue with any certainty and could cause us to experience substantial period−to−period fluctuations in operating results.

None of our licensees are under any obligation to incorporate our technology in any present or future product or to pursue the manufacture or sale of any product incorporating our technology. A licensee's decision to complete a project or manufacture a product is subject to changing economic, marketing or strategic factors. The long development cycle of a licensee's products increases the risk that these factors will cause the licensee to change its plans. In the past, some of our licensees have discontinued development of products incorporating our technology. Although in most cases their decisions were based on factors unrelated to our technology, it is unlikely that we will receive royalties in connection with those products. We expect that occasionally our licensees will discontinue a product line or cancel a product introduction, which could adversely affect our future operating results and business.

If the market for SoC integrated circuits does not expand, our business will suffer.

Our ability to achieve sustained revenue growth and profitability in the future will depend on the continued development of the market for SoC integrated circuits, particularly those requiring embedded memory sizes of one megabit or more. In addition, our ability to achieve design wins with customers is dependent upon the growth of embedded memories required in SoCs. SoCs are characterized by rapid technological change and competition from an increasing number of alternate design strategies such as combining multiple integrated circuits to create a System−on−a−Package.

We cannot be certain that the market for SoCs will continue to develop or grow at a rate sufficient to support our business. SoC providers depend on the demand for products requiring SoCs, such as cellular phones, game consoles, PDAs, digital cameras, DVD players and digital media players to name a few. The demand for such products is uncertain and difficult to predict and depends on factors beyond our control. If the market fails to grow or develops more slowly than expected, our business will suffer.

The semiconductor industry is cyclical in nature and subject to periodic downturns, which can negatively affect our revenue.

The semiconductor industry is cyclical and has experienced pronounced downturns for sustained periods of up to several years. To respond to any downturn, many semiconductor manufacturers and their customers will slow their research and development activities, cancel or delay new product developments, reduce their workforces and inventories and take a cautious approach to acquiring new equipment and technologies. As a result, our business has been in the past and could be adversely affected in the future by an industry downturn, which could negatively impact our future revenue and profitability. Also, the cyclical nature of the semiconductor industry may cause our operating results to fluctuate significantly from year−to−year, which may tend to increase the volatility of the price of our common stock.

We might be unable to deliver our customized memory technology within an agreed technical specification in the time frame demanded by our licensees, which could damage our reputation, harm our ability to attract future licensees and adversely impact operating results.

Many of our licenses require us to deliver a customized 1T−SRAM memory block or several blocks, within an agreed technical specification by a certain delivery timetable. This requires us to furnish a unique design for each customer, which can make the development schedule difficult to predict and involves extensive interaction with our customers' engineers. From time to time, we experience delays in delivering our customized memory technology that meets the agreed technical specifications, which can result from slower engineering progress than we originally anticipated or there might be factors outside of our control, such as the customer's delay in completing verification of the customer's chip. Such delays may affect the timing of recognition of revenues from a particular project and can adversely affect our operating results.

In addition, any failure to meet our customers' timetables, as well as the agreed upon technical specifications of our customized memory technology could lead to the failure to collect, or a delay in collecting royalties and licensing fee payments from our licensees, damage our reputation in the industry, harm our ability to attract new licensees and negatively impact our operating results. Furthermore, a customer may assert that we are responsible for delays and cost overruns and demand reimbursement for some of its costs, which we may elect to reimburse in whole or in part in order to address the customer's concerns. For example, in 2004, we reduced revenue by $450,000 for a reimbursement given to a customer for excess verification costs incurred by the customer. In 2005, we also settled with one of our licensees for the amount of $375,000 related to a claim made for excess verification costs incurred by the licensee.

Our business model relies on royalties as a key component in the licensing of our technologies, and if we fail to realize expected royalties our operating results will suffer.

We believe that our long−term success is substantially dependent on the receipt of future royalties. Royalty payments owed to us are calculated based on factors such as our licensees' selling prices, wafer production, and other variables as provided in each license agreement. The amount of royalties we will receive depends on the licensees' business success, production volumes and other factors beyond our control. This exposes our business model to risks that we cannot minimize directly and may result in significant fluctuations in our royalty revenue and operating results from quarter−to−quarter. We recognize royalty revenue in the quarter in which we receive a royalty report from our licensee. As a result, our recognition of royalty revenue typically lags behind the quarter in which the related integrated circuit is

manufactured or sold by our licensee by at least one quarter. We cannot be certain that our business strategy will be successful in expanding the number of licensees, nor can we be certain that we will receive significant royalty revenue in the future.

We expect our revenue to be highly concentrated among a small number of licensees and customers, and our results of operations could be harmed if we lose and fail to replace this revenue.

Our overall revenue has been highly concentrated, with a few customers accounting for a significant percentage of our total revenue. For the year ended December 31, 2005, our two largest customers, NEC and Fujitsu represented 35% and 17% of total revenue, respectively. For the year ended December 31, 2004, our three largest customers NEC, Fujitsu and Marvell represented 19%, 17% and 11% of total revenue, respectively. For the year ended December 31, 2003, our three largest customers, Sony, NEC and UMC represented 17%, 14% and 11% of total revenue, respectively. We expect that a relatively small number of licensees will continue to account for a substantial portion of our revenue for the foreseeable future.

Furthermore, our royalty revenue has been highly concentrated among a few licensees, and we expect this trend to continue for the foreseeable future. In particular, a substantial portion of our licensing and royalty revenue in 2005 and 2004 has come from the licenses for integrated circuits used by Nintendo in its GAMECUBE®. Royalties earned from the production of Gamecube chips incorporating our 1T−SRAM technology represented 14%, 15%, and 11% of total revenue in the 2005, 2004 and 2003, respectively. Nintendo faces intense competitive pressure in the video game market, which is characterized by extreme volatility, costly new product introductions and rapidly shifting consumer preferences, and we cannot assure you that Nintendo's sales of products incorporating our technology will increase beyond prior or current levels.

As a result of this revenue concentration, our results of operations could be impaired by the decision of a single key licensee or customer to cease using our technology or products or by a decline in the number of products that incorporate our technology that are sold by a single licensee or customer or by a small group of licensees or customers.

Our revenue concentration may also pose credit risks, which could negatively affect our cash flow and financial condition.

We might also face credit risks associated with the concentration of our revenue among a small number of licensees and customers. As of December 31, 2005, three customers represented 82% of total trade receivables. Our failure to collect receivables from any customer that represents a large percentage of receivables on a timely basis, or at all, could adversely affect our cash flow or results of operations and might cause our stock price to fall.

Anything that negatively affects the businesses of our licensees could negatively impact our revenue.

The timing and level of our licensing and royalty revenues are dependent on our licensees and the business environment in which they operate. Licensing and royalty revenue are the largest source of our revenues; anything that negatively affects a significant licensee or group of licensees could negatively affect our results of operations and financial condition. Many issues beyond our control influence the success of our licensees, including, for example, the highly competitive environment in which they operate, the strength of the markets for their products, their engineering capabilities and their financial and other resources.

Likewise, we have no control over the product development, pricing and marketing strategies of our licensees, which directly affect the licensing of our technology and corresponding future royalties payable to us from our licensees. Our royalty revenues are subject to our licensees' ability to market, produce and

ship products incorporating our technology. A decline in sales of our licensees' royalty−generating products for any reason would reduce our royalty revenue. In addition, seasonal and other fluctuations in demand for our licensees' products could cause our operating results to fluctuate, which could cause our stock price to fall.

We rely on semiconductor foundries to assist us in attracting potential licensees, and a loss or failure of these relationships could inhibit our growth and reduce our revenue.

Part of our marketing strategy relies upon our relationships and agreements with semiconductor foundries, such as TSMC, UMC, Chartered, and SMIC among others. These foundries have existing relationships, and continually seek new relationships, with companies in the markets we target, and have agreed to utilize these relationships to introduce our technology to potential licensees. If we fail to maintain and expand our current relationships with these foundries, we might fail to achieve anticipated growth. Our relationship with these foundries is not exclusive, and they are free to promote or develop other embedded memory technologies, including their own. The foundries' promotions of alternative technologies reduce the size of our potential market and may adversely affect our revenues and operating results.

Additionally, we rely on third−party foundries to manufacture our silicon test chips, to provide references to their customers and to assist us in the focus of our research and development activities. If we are unable to maintain our existing relationships with these foundries or enter into new relationships with other foundries, we will be unable to verify our technologies for their manufacturing processes and our ability to develop new technologies will be hampered. We would then be unable to license our intellectual property to fabless semiconductor companies that use these foundries to manufacture their silicon chips, which is a significant source of our revenues.

Our embedded memory technology is unique and the occurrence of manufacturing difficulties or low production yields, if not corrected, could hinder market acceptance of our technology and reduce future revenue.

Complex technologies like ours could be adversely affected by difficulties in adapting our 1T−SRAM technologies to our licensees' product designs or to the manufacturing process technology of a particular foundry or semiconductor manufacturer. Some of our customers have experienced lower than expected yields when initially integrating our design into their SoC. We work closely with our customers to resolve any design or process issues in order to achieve the optimum production yield.

Any decrease in manufacturing yields of integrated circuits utilizing our technology could impede the acceptance of our technology in the industry. The discovery of defects or problems regarding the reliability, quality or compatibility of our technology could require significant expenditures and resources to fix, significantly delay or hinder market acceptance of our technology, reduce anticipated revenues and damage our reputation.

Our failure to compete effectively in the market for embedded memory technology could reduce our revenue.

There exists significant competition in the market for embedded memory technologies. Our licensees and prospective licensees can meet their need for embedded memory by using traditional memory solutions with different cost and performance parameters, which they may internally develop or acquire from third−party vendors. In the past two years, the demand for applications for which our 1T−SRAM technologies provide distinct advantages has not experienced significant growth. If alternative technologies are developed that provide comparable system performance at lower cost than our 1T−SRAM technologies for certain applications and/or do not require the payment of comparable royalties, or if the industry

generally demonstrates a preference for applications for which our 1T−SRAM technologies do not offer significant advantages, our ability to realize revenue from our 1T−SRAM technologies could be impaired.

We might be challenged by competitive developers of alternative technologies who are more established, benefit from greater market recognition and have substantially greater financial, development, manufacturing and marketing resources than we have. These advantages might permit these developers to respond more quickly to new or emerging technologies and changes in licensee requirements. We cannot assure you that future competition will not have a material adverse effect on the adoption of our technology and our market penetration.

Our failure to continue to enhance our technology or develop new technology on a timely basis could diminish our ability to attract and retain licensees and product customers.

The existing and potential markets for memory products and technology are characterized by ever increasing performance requirements, evolving industry standards, rapid technological change and product obsolescence. These characteristics lead to frequent new product and technology introductions and enhancements, shorter product life cycles and changes in consumer demands. In order to attain and maintain a significant position in the market, we will need to continue to enhance our technology in anticipation of these market trends.

In addition, the semiconductor industry might adopt or develop a completely different approach to utilizing memory for many applications, which could render our existing technology unmarketable or obsolete. We might not be able to successfully develop new technology, or adapt our existing technology, to comply with these innovative standards.

Our future performance depends on a number of factors, including our ability to—

- identify target markets and relevant emerging technological trends, including new standards and protocols;
- develop and maintain competitive technology by improving performance and adding innovative features that differentiate our technology from alternative technologies;
- enable the incorporation of enhanced technology in our licensees' and customers' products on a timely basis and at competitive prices;
- implement our technology at future manufacturing process generation; and
- respond effectively to new technological developments or new product introductions by others.

Since its introduction in 1998, we have introduced enhancements to our 1T−SRAM technology designed to meet market requirements. However, we cannot assure you that the design and introduction schedules of any additions and enhancements to our existing and future technology will be met, that this technology will achieve market acceptance or that we will be able to license this technology on terms that are favorable to us. Our failure to develop future technology that achieves market acceptance could harm our competitive position and impede our future growth.

We may incur substantial litigation expense, which would adversely affect our profitability.

On March 31, 2004, UniRAM Technology, Inc. filed a complaint against us in the United States District Court for the Northern District of California, alleging trade secret misappropriation and patent infringement. UniRAM's complaint asserts that it provided trade secret information to Taiwan Semiconductor Manufacturing Corporation (TSMC) in 1996−97 and speculated that we improperly obtained unspecified trade secrets of UniRAM from TSMC in an unknown manner. Subsequent to March 31, 2004, UniRAM has amended its complaint twice to add TSMC as a defendant and additional

allegations to the suit, and to drop all infringement claims of patent infringement with respect to one of the two patents originally identified in the initial complaint. UniRAM continues to assert its claims of patent infringement with respect to the other patent. We believe that UniRAM's complaint lacks merit and intend to vigorously defend against it.

We expect to incur substantial expenses litigating the matter in 2006, at least, and potentially thereafter. In addition, although we expect to prevail in the lawsuit, if we do not, we may be required to pay substantial damages and/or the attorneys' fees and expenses of the other party, as well as our own and perhaps the court would enter an injunction. The payment of such damages and expenses could adversely affect our results of operations and cause net losses for the periods in which we record them.

Royalty amounts owed to us might be difficult to verify, and we might find it difficult, expensive and time−consuming to enforce our license agreements.

The standard terms of our license agreements require our licensees to document the manufacture and sale of products that incorporate our technology and report this data to us after the end of each quarter. Though our standard license terms give us the right to audit the books and records of any licensee to attempt to verify the information provided to us in these reports, an audit of a licensee's records can be expensive and time consuming, and potentially detrimental to the business relationship. A failure to fully enforce the royalty provisions of our license agreements could cause our revenue to decrease and impede our ability to maintain profitability.

We might not be able to protect and enforce our intellectual property rights, which could impair our ability to compete and reduce the value of our technology.

Our technology is complex and is intended for use in complicated integrated circuits. A very large number of new and existing products utilize embedded memory, and a large number of companies manufacture and market these products. Because of these factors, policing the unauthorized use of our intellectual property is difficult and expensive. We cannot be certain that we will be able to detect unauthorized use of our technology or prevent other parties from designing and marketing unauthorized products based on our technology. In the event we identify any past or present infringement of our patents, copyrights or trademarks, or any violation of our trade secrets, confidentiality procedures or licensing agreements, we cannot assure you that the steps taken by us to protect our proprietary information will be adequate to prevent misappropriation of our technology. Our inability to protect adequately our intellectual property would reduce significantly the barriers of entry for directly competing technologies and could reduce the value of our technology. Furthermore, we might initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation by us could result in significant expense and divert the efforts of our technical and management personnel, whether or not such litigation results in a determination favorable to us.

Our existing patents might not provide us with sufficient protection of our intellectual property, and our patent applications might not result in the issuance of patents, either of which could reduce the value of our core technology and harm our business.

We rely on a combination of patents, trademarks, copyrights, trade secret laws and confidentiality procedures to protect our intellectual property rights. As of December 31, 2005, we held 80 patents in the United States, which expire at various times from 2011 to 2023, and 40 corresponding foreign patents. In addition, as of December 31, 2005, we had nine patent applications pending in the United States and 19 pending foreign applications, and had received notice of allowance of one patent application pending in the United States. We cannot be sure that any patents will issue from any of our pending applications or that any claims allowed from pending applications will be of sufficient scope or strength, or issued in all countries where our products can be sold, to provide meaningful protection or any commercial advantage

to us. Also, competitors might be able to design around our patents. Failure of our patents or patent applications to provide meaningful protection might allow others to utilize our technology without any compensation to us and impair our ability to increase our licensing revenue.

Any claim that our products or technology infringe third−party intellectual property rights could increase our costs of operation and distract management and could result in expensive settlement costs or the discontinuance of our technology licensing or product offerings.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights or positions, which has resulted in often protracted and expensive litigation. For example, on March 31, 2004, we were sued by UniRAM Technology, Inc. in United States District Court for the Northern District of California based on claims of patent infringement and misappropriation of trade secrets that were allegedly disclosed by UniRAM to TSMC, which allegedly improperly provided them to us. Additionally, our licensees or we might, from time to time, receive notice of claims that we have infringed patents or other intellectual property rights owned by others. Litigation against us, including the UniRAM suit, could result in significant expense and divert the efforts of our technical and management personnel, whether or not the litigation results in a determination adverse to us. Although we believe that UniRAM's claims lack merit and we intend to rigorously defend against them, in the event of an adverse result in any such litigation, we could be required to pay damages in an amount we cannot presently predict, cease the licensing of certain technology and expend resources to develop non−infringing technology or obtain licenses for the infringing technology. We cannot assure you that we would be successful in such development or that such licenses would be available on reasonable terms, or at all.

The discovery of defects in our technology could expose us to liability for damages.

The discovery of a defect in our 1T−SRAM technology could lead our licensees to seek damages from us. Our standard license terms include provisions waiving implied warranties regarding our technology and limiting our liability to our licensees. We also maintain insurance coverage that is intended to protect us against potential liability for defects in our technology. We cannot be certain, however, that the waivers or limitations of liability contained in our license contracts will be enforceable, that insurance coverage will continue to be available on reasonable terms or in amounts sufficient to cover one or more large claims or that our insurer will not disclaim coverage as to any future claim. The successful assertion of one or more large claims that exceed available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co−insurance requirements, could cause our expenses to rise significantly and consequently harm our profitability.

Our failure to manage the growth of our business could reduce our potential revenue and threaten our future profitability.

The size of our company has increased substantially as we grew from 43 employees in January 2001 to 76 employees in December 2005. The efficient management of our planned expansion of the development, licensing and marketing of our technology, including through the acquisition of other companies will require us to continue to—

- implement and manage new marketing channels to penetrate different and broader markets for our 1T−SRAM technologies;
- manage an increasing number of complex relationships with licensees and co−marketers and their customers and other third parties;
- expand our capabilities to deliver our technologies to our customers;
- improve our operating systems, procedures and financial controls on a timely basis;

- hire additional key management and technical personnel; and
- expand, train and manage our workforce and, in particular, our development, sales, marketing and support organizations.

We cannot assure you that we will adequately manage our growth or meet the foregoing objectives. A failure to do so could jeopardize our future revenues and cause our stock price to fall.

If we fail to retain key personnel, our business and growth could be negatively affected.

Our business has been dependent to a significant degree upon the services of a small number of executive officers and technical employees, including Dr. Wingyu Leung, our Executive Vice President and Chief Technical Officer. The loss of his services could negatively impact our technology development efforts and our ability to perform our existing agreements and obtain new customers. We generally have not entered into employment or non−competition agreements with any of our employees and do not maintain key−man life insurance on the lives of any of our key personnel.

Our failure to successfully address the potential difficulties associated with our international operations could increase our costs of operation and negatively impact our revenue.

We are subject to many difficulties posed by doing business internationally, including—

- foreign currency exchange fluctuations;
- unanticipated changes in local regulation;
- potentially adverse tax consequences, such as withholding taxes;
- difficulties regarding timing and availability of export and import licenses;
- political and economic instability; and
- reduced or limited protection of our intellectual property.

Because we anticipate that licenses to companies that operate primarily outside the United States will account for a substantial portion of our licensing revenue in future periods, the occurrence of any of these circumstances could significantly increase our costs of operation, delay the timing of our revenue and harm our profitability.

Provisions of our certificate of incorporation and bylaws or Delaware law might delay or prevent a change of control transaction and depress the market price of our stock.

Various provisions of our certificate of incorporation and bylaws might have the effect of making it more difficult for a third party to acquire, or discouraging a third party from attempting to acquire, control of our company. These provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock. Certain of these provisions eliminate cumulative voting in the election of directors, limit the right of stockholders to call special meetings and establish specific procedures for director nominations by stockholders and the submission of other proposals for consideration at stockholder meetings.

We are also subject to provisions of Delaware law which could delay or make more difficult a merger, tender offer or proxy contest involving our company. In particular, Section 203 of the Delaware General Corporation Law prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years unless specific conditions are met. Any of these provisions could have the effect of delaying, deferring or preventing a change in control, including without limitation, discouraging a proxy contest or making more difficult the acquisition of a substantial block of our common stock.

Our board of directors may issue up to 20,000,000 shares of preferred stock without stockholder approval on such terms as the board might determine. The rights of the holders of common stock will be subject to, and might be adversely affected by, the rights of the holders of any preferred stock that might be issued in the future.

Our stockholder rights plan could prevent stockholders from receiving a premium over the market price for their shares from a potential acquirer.

We have adopted a stockholder rights plan, which entitles our stockholders to rights to acquire additional shares of our common stock generally when a third party acquires 15% of our common stock or commences or announces its intent to commence a tender offer for at least 15% of our common stock. In 2004, we amended our stockholder rights plan twice; once, in connection with the proposed acquisition of corporation by Synopsys, Inc, and a second time to permit the acquisition of shares representing more than 15% of our common stock by a brokerage firm that manages independent customer accounts and generally does not have any discretionary voting power with respect to such shares. Notwithstanding amendments of this nature, our intention is to maintain and enforce the terms of this plan, which could delay, deter or prevent an investor from acquiring us in a transaction that could otherwise result in stockholders receiving a premium over the market price for their shares of common stock.

A limited number of stockholders have the ability to influence the outcome of director elections and other matters requiring stockholder approval.

Our executive officers, directors and their affiliates or non−affiliate related entities, in the aggregate, beneficially own approximately 11% of our common stock. These stockholders acting together have the ability to exert substantial influence over all matters requiring the approval of our stockholders, including the election and removal of directors and any proposed acquisition, consolidation or sale of all or substantially all of our assets. In addition, they could dictate the management of our business and affairs. This concentration of ownership could have the effect of delaying, deferring or preventing a change in control, or impeding an acquisition, consolidation, takeover or other business combination, which might otherwise result in stockholders receiving a premium over the market price for their shares of common stock.

Potential volatility of the price of our common stock could negatively affect your investment.

We cannot assure you that there will continue to be an active trading market for our common stock. Recently, the stock market, as well as our common stock, has experienced significant price and volume fluctuations. Market prices of securities of technology companies have been highly volatile and frequently reach levels that bear no relationship to the operating performance of such companies. These market prices generally are not sustainable and are subject to wide variations. If our common stock trades to unsustainably high levels, it is likely that the market price of our common stock will thereafter experience a material decline. In April 2004, we announced that our board of directors had authorized the repurchase of up to $25 million of our common stock from time to time over the succeeding 12 months, and as result, we repurchased approximately $4.7 million or 1.2 million shares of our common stock. On April 29, 2005, we announced a repurchase program for up to $20 million of outstanding common stock over the next 12 months. Any such repurchases could impact the price of our common stock and increase volatility.

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We could be the target of similar litigation in the future. Securities litigation could cause us to incur substantial costs, divert management’s attention and resources, harm our reputation in the industry and the securities markets and reduce our profitability.

The price of our stock could decrease as a result of shares being sold in the market by directors, officers and other significant stockholders.

Sales of a substantial number of shares of common stock in the public market could adversely affect the market price of the common stock prevailing from time to time. The number of shares of our common stock available for sale in the public market is limited by restrictions under the Securities Act of 1933, as amended, or the Securities Act, but taking into account sales of stock made in accordance with the provisions of Rules 144(k), 144 and 701, substantially all the shares of common stock currently outstanding are eligible for sale in the public market.

Our Executive Vice President, Chief Technical Officer, and Director, Wingyu Leung has entered into a new plan under Rule 10b5−1 of the Securities Exchange Act of 1934. It provides for aggregate sales of 500,000 shares in blocks of 25,000 shares each on the 3rd day and the 18th day of each month. Sales are executed using a market not held order entered prior to market open on the 3rd day and the 18th day of each month. Trading shall commence on March 3, 2006. The duration of this plan is from February 20, 2006 to December 29, 2006. Sales of the shares are further subject to the volume restrictions set forth in SEC Rule 144(e). The plan provides for termination upon the completion of the specified trading program, the instruction of the stockholder, or the occurrence of other specified events, whichever is earliest. All of the shares are sold through broker−dealers in ordinary market transactions. Pre−designated trading under this plan may cause unexpected declines in the market price of our common stock. In addition, subject to compliance with applicable securities laws and our insider trading policies, each of our directors and executive officers may sell shares of common stock from time to time.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

On May 6, 2005, we signed a new lease agreement for our facility to accommodate our principal administrative, sales, marketing, support and research and development functions. Under the new lease agreement, we occupy approximately 26,000 square feet of space in Sunnyvale, California. This lease expires at the end of June 2010. The lease for our previous facility expired at the end of June 2005. We have leased approximately 19,000 square feet of space in Ontario, Canada for our research and development facility. The lease expires at the end of April 2008. In connection with the closure of ATMOS' operation, in July 2005, we signed an agreement to sublease the ATMOS facility, which we occupy under long−term leases in Canada. The sublease expires at the end of April 2008. We have leased approximately 3,700 square feet of space in Seoul, South Korea for our engineering design center. This lease expires at the end of April 2008. Additionally, we have leased approximately 1,340 square feet of space in Yokohama, Japan and 140 square feet of space in Sophia−Antipolis, France for our sales and marketing offices. These leases expire at the end of November 2006 and March 2006, respectively. We believe that our existing facilities are adequate to meet our current needs.

Item 3. *Legal Proceedings*

On March 31, 2004, UniRAM Technology, Inc. filed a complaint against us in the United States District Court for the Northern District of California, alleging trade secret misappropriation and patent infringement. UniRAM's complaint asserts that it provided trade secret information to Taiwan Semiconductor Manufacturing Corporation (TSMC) in 1996−97 and speculated that we improperly obtained unspecified trade secrets of UniRAM from TSMC in an unknown manner. Subsequent to March 31, 2004, UniRAM amended its complaint twice to add TSMC as a defendant and additional allegations to the suit, and to drop all infringement claims for one of the two patents identified in the initial

complaint. UniRAM continues to maintain its claims of patent infringement with respect to the other patent being asserted against us. In October 2005, the court held a "Markman hearing" to construe and interpret the claims of the patent that UniRAM continues to assert against us and TSMC. As yet, the court has not issued its claim construction ruling. We believe that UniRAM's complaint lacks merit and intend to vigorously defend against it.

From time to time we may be subject to legal proceedings and claims in the ordinary course of business. These claims, even if not meritorious, could result in the expenditure of significant financial resources.

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

No matter was submitted to a vote of stockholders during the fourth quarter of the fiscal year covered by this report. The 2006 Annual Meeting of Stockholders will be held at 9:30 a.m., local time, on or about May 25, 2006, at our principal executive office located at 755 North Mathilda Avenue, Sunnyvale, California 94085.

Part II

Item 5. *Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities*

Our common stock is quoted on the NASDAQ National Market under the symbol MOSY. The following table sets forth the range of high and low sales prices of our common stock for each period indicated.

Quarter ended	High	Low
December 31, 2005	$ 6.22	$ 4.99
September 30, 2005	$ 5.66	$ 4.60
June 30, 2005	$ 6.18	$ 4.83
March 31, 2005	$ 6.42	$ 5.44
December 31, 2004	$ 6.66	$ 4.07
September 30, 2004	$ 8.30	$ 3.67
June 30, 2004	$ 13.45	$ 6.45
March 31, 2004	$ 13.40	$ 6.90

Dividend Policy

We have not declared or paid any cash dividends on our common stock and presently intend to retain future earnings, if any, to fund the development and growth of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On April 29, 2005, we announced a repurchase program for up to $20 million of outstanding common stock over the next 12 months. No repurchases were made pursuant to this program in 2005.

Use of Proceeds from Registered Securities

The Securities and Exchange Commission declared the Company's first registration statement, filed on Form S−1 under the Securities Act of 1933 (File No. 333−43122) relating to the Company's initial public offering (IPO) of its common stock, effective on June 27, 2001. The Company realized approximately $51.6 million after offering expenses. To date, the Company has not used any of the net proceeds of the IPO except to acquire short−term and long−term investments and cash equivalents.

Securities Authorized for Issuance under Equity Compensation Plan

See Item 12.—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Item 6. *Selected Financial Data*

The following selected financial data presented below are derived from our consolidated financial statements. The selected financial data should be read in conjunction with our financial statements and notes related to those statements, and with "Management's Discussion and Analysis of Financial Condition and Results of Operations" included herein.

	Year Ended December 31,				
	2005 *	2004 *	2003 *	2002	2001
	(In thousands, except per share data)				
Net revenue:					
Product	$ 10	$ 952	$ 1,904	$ 2,924	$ 12,991
Licensing	7,725	4,544	10,418	10,523	6,053
Royalty	4,547	5,325	6,911	14,344	3,446
Total net revenue	12,282	10,821	19,233	27,791	22,490
Cost of net revenue					
Product	—	655	1,217	1,668	5,776
Licensing	1,986	1,613	1,970	1,730	633
Total cost of net revenue	1,986	2,268	3,187	3,398	6,409
Gross profit	10,296	8,553	16,046	24,393	16,081
Operating expenses:					
Research and development	5,839	8,096	8,741	6,926	5,201
Selling, general and administrative	9,922	13,331	6,432	5,266	5,340
Restructuring expenses	119	585	—	—	—
Total operating expenses	15,880	22,012	15,173	12,192	10,541
Operating income (loss)	(5,584)	(13,459)	873	12,201	5,540
Interest and other income	2,591	11,578	1,914	1,539	1,818
Income (loss) before income taxes	(2,993)	(1,881)	2,787	13,740	7,358
Income tax benefit (provision)	11	(26)	(279)	(1,373)	(367)
Net income (loss)	$ (2,982)	$ (1,907)	$ 2,508	$ 12,367	$ 6,991
Net income (loss) per share:					
Basic	$ (0.10)	$ (0.06)	$ 0.08	$ 0.41	$ 0.35
Diluted	$ (0.10)	$ (0.06)	$ 0.08	$ 0.40	$ 0.25
Shares used in computing net income (loss) per share:					
Basic	30,534	30,750	30,504	29,902	19,709
Diluted	30,534	30,750	30,998	31,275	28,390
Allocation of stock−based compensation to operating expenses					
Research and development	$ —	$ 44	$ 148	$ 340	$ 781
Selling, general and administrative	36	24	311	316	654
	$ 36	$ 68	$ 459	$ 656	$ 1,435

	Year Ended December 31,				
	2005 *	2004 *	2003	2002	2001
	(In thousands)				
Balance Sheet Data:					
Cash, cash equivalents and short−term investments and auction rate securities	$ 68,650	$ 62,349	$ 41,365	$ 68,433	$ 84,293
Working capital	68,179	62,535	44,426	71,213	82,343
Total assets	103,637	104,582	106,892	103,090	89,596
Deferred revenue	1,309	501	506	1,779	3,418
Long−term obligations	196	239	13	25	—
Stockholders' equity	99,332	100,408	103,511	98,697	84,104

* Derived from the financial statements that are included in Item 8.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying consolidated financial statements and notes included in this report.

Overview

We design, develop, market and license memory technologies used by the semiconductor industry and electronic product manufacturers. We have developed a patented semiconductor memory technology, called 1T−SRAM, that offers a combination of high density, low power consumption and high speed at performance and cost levels that other available memory technologies do not match. We license this technology to companies that incorporate, or embed, memory on complex integrated circuits, such as SoCs. We have also sold memory chips based on our 1T−SRAM technologies, but in 2004, we ceased actively selling them. We do not expect to make and sell memory chips in the future.

Using elements of our existing memory technology as a foundation, however, we completed development of our first memory chips incorporating our 1T−SRAM technologies in the fourth quarter of 1998. We signed our first license agreement related to our 1T−SRAM technologies at the end of the fourth quarter of 1998 and recognized licensing revenue from our 1T−SRAM technologies for the first time in the first quarter of 2000. Since then, we have introduced improved and enhanced versions of our technology, such as 1T−SRAM−R, 1T−SRAM−M, and 1T−SRAM−Q.

We generate revenue from the licensing of our memory technologies, which consists of licensing revenues, customization services, maintenance and support fees and royalties. Royalty revenues are earned under each of our license agreements when our licensees manufacture or sell products that incorporate any of our 1T−SRAM technologies and report the results to us. Generally, we expect our total sales cycle, or the period from our initial discussion with a prospective licensee to our receipt of royalties from the licensee's use of our 1T−SRAM technologies, to run from 18 to 24 months after the commencement of the project.

During 2002, we purchased ATMOS Corporation, a semiconductor memory company focused on creating high−density, compiler−generated embedded memory solutions for SoC applications. Effective November 10, 2004, we closed the ATMOS research and development facility in Canada and terminated the employment of approximately 20 employees working there. We recorded restructuring charges related to the closure of approximately $119,000 in 2005 and $585,000 in the fourth quarter of 2004. The charges incurred in 2005 were related to our revised estimate due to the new sublease agreement signed in the second quarter of 2005.

In 2005, we began delivering our new family of 1T−SRAM CLASSIC Memory Macro products to licensees. These macros are silicon−proven, high−density solutions offering customers rapid memory block integration into their SoC designs. They are pre−configured and require minimal additional customization and we believe they will enable us to increase our penetration of the market for very dense, low power, high speed embedded memory applications.

Sources of Revenue

We generate two types of revenue: licensing and royalties. In the past, we also sold our proprietary memory chips, and prior to 2001, we derived almost all our revenue from them. From 2001 through 2004, product revenue as a percentage of our total revenue declined significantly, while licensing and royalty revenues grew substantially as a percentage of total revenue. In the third quarter of 2001, for the first time, combined license and royalty revenue exceeded product revenue. By the end of third quarter of 2004, we had exited the product business except for minor sales of products required by our historical customers from time−to−time.

Licensing. Our license agreements involve long sales cycles, which makes it difficult to predict when the agreements will be signed. In addition, our licensing revenues fluctuate from period−to−period, and it is difficult for us to predict the timing and magnitude of such revenue from quarter−to−quarter. Moreover, we believe that the amount of licensing revenues for any period is not necessarily indicative of results in any future period. Our future revenue results are subject to a number of factors, particularly those described in Part I, Item 1A. “Risk Factors.”

Our licensing revenue consists of fees for providing circuit design, layout and design verification and granting a license to a customer for embedding our memory technology into its product. For some customers, we also provide engineering support services to assist in the initial production of products utilizing the licensed 1T−SRAM technologies. License fees generally range from $80,000 to several million dollars per contract, depending on the scope and complexity of the development project, and the licensee’s rights. The licensee generally pays the license fees in installments at the beginning of the license term and upon the attainment of specified milestones. The vast majority of our contracts allow billing between milestones based on work performed. All license agreements entered into to date require us to meet performance specifications. Fees collected prior to revenue recognition are recorded as deferred contract revenue. However, if the agreement involves performance specifications that we have significant experience in meeting and the cost of contract completion can be reasonably estimated, we recognize revenue over the period in which the contract services are performed under the percentage of completion accounting method. Revenue is recognized when collectibility is probable. We use actual direct labor hours incurred to measure progress towards completion. We periodically evaluate the actual status of each project to determine whether the estimates to complete each contract remain accurate and update our estimated costs to complete as necessary. Revenue recognized in any period is dependent on our progress toward completion of projects in progress. Significant management judgment and discretion are used to estimate total direct labor hours. Changes in or deviations from these estimates could have a material effect on the amount of revenue we recognize in any period. If the amount of revenue recognized under the percentage of completion method exceeds the amount of billings to a customer, then under the percentage of completion accounting method, we account for the excess amount as an unbilled contract receivable. Our total unbilled contract receivable was $368,000, $57,000 and $1.1 million as of December 31, 2005, 2004, and 2003, respectively. For agreements involving performance specifications that we have not met and for which we lack the historical experience to reasonably estimate the costs, we defer recognition of all revenue until the licensee manufactures products that meet the contract performance specifications and recognize revenue under the completed contract accounting method.

From time to time, a licensee may cancel a project during the development phase. Such a cancellation is not within our control and is often caused by changes in market conditions or the licensee’s business. Cancellations of this nature are an aspect of our licensing business, and most of our newer contracts allow us to retain all payments that we have received or are entitled to collect for items and services provided before the cancellation occurs. We will consider a project to have been canceled even in the absence of specific notice from our licensee, if there has been no activity under the contract for a significant period, and we believe that completion of the contract is unlikely. In this event, we recognize revenue in the amount of cash received, if we have performed a sufficient portion of the development services. If a

cancelled contract had been entered into before the establishment of technological feasibility, the costs associated with the contract would have been expensed prior to the recognition of revenue. In that case, there would be no costs associated with that revenue recognition, and gross margin would increase for the corresponding period. In 2005, we recognized $240,000 of licensing revenue from cancelled contracts, compared to none in 2004 and $759,000 in 2003.

Royalty. Each license agreement provides for royalty payments at a stated rate. We negotiate royalty rates by taking into account such factors as the anticipated volume of the licensee's sales of products utilizing our technologies and the cost savings to be achieved by the licensee through the use of our technology. Our license agreements require the licensee to report the manufacture or sale of products that include our technology after the end of the quarter in which the sale or manufacture occurs. We recognize royalties from reports provided by the licensee that are received in the quarter immediately following the quarter during which the licensee has sold or manufactured products containing our technology.

As with our licensing revenues, the timing and level of royalties are difficult to predict. They depend on the licensee's ability to market, produce and sell products incorporating our technology. Many of the products of our licensees that are currently subject to licenses from us are consumer products, such as electronic game consoles, for which demand can be seasonal and generally highest in the fourth quarter. We do not report royalties from products sold in the fourth quarter until the first quarter of the following year. Also, if a licensee holds excess inventory of products using our licensed technology, we are unlikely to report additional royalty revenue attributable to that product until the quarter after the licensee restarts production. For a discussion of factors that could contribute to the fluctuation of our revenues, see Part I, Item 1A. "Risk Factors—Our lengthy licensing cycle and our licensees' lengthy development cycles will make the operating results of our licensing business difficult to predict," and "—Anything that negatively affects the business of our licensees could negatively impact our revenue."

Product sales. In the second quarter of 2004, we notified customers of our decision to discontinue sales of our memory chip products. As of the end of the third quarter of 2004, we had no remaining product inventory. We do not expect to develop, market and sell memory chips in the future.

Critical Accounting Policies

Use of estimates. Our discussion and analysis of our financial condition and results of operation are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis we make these estimates based on our historical experience and on assumptions that we consider reasonable under the circumstances. Actual results may differ from these estimates, and reported results could differ under different assumptions or conditions.

We believe that the following accounting policies are affected by estimates and judgments in the following manner:

Revenue.

Licensing. In accordance with SOP 81−1 "Accounting for performance of construction−type and certain production type contracts", when license agreements include deliverables that require "significant production, modification or customization", contract accounting is applied. If a licensing contract involves performance specifications that we have significant experience in meeting and the direct labor hours to be incurred to complete the contract can be reasonably estimated, we recognize the revenue over the period in which the contract services are performed using the percentage of completion method. The percentage of completion method includes judgmental elements, such as determining that we have the experience to meet the design specifications and estimation of the total direct labor hours. We follow this method

because we can obtain reasonably dependable estimates of the direct labor hours to perform the contracted services. The direct labor hours for the development of the licensee's design are estimated at the beginning of the contract. As these direct labor hours are incurred, they are used as a measure of progress towards completion. We have the ability to reasonably estimate direct labor hours on a contract to contract basis from our experience in developing prior licensee's designs. During the contract performance period, we review estimates of direct labor hours to complete the contracts as the contract progresses to completion and will revise our estimates of revenue and gross profit under the contract if we revise the estimations of the direct labor hours to complete. Our policy is to reflect any revision in the contract gross profit estimate in reported income in the period in which the facts giving rise to the revision become known. Under the percentage of completion method, provisions for estimated losses on uncompleted contracts are recognized in the period in which the likelihood of such losses is determined.

Prior to 2005, we recorded deferred revenue when cash was received. However, the terms of our license contracts allow us to bill customers upon achieving the milestones stated in the contracts. We believe that now we have adequate history and experience in fulfilling licensing contract obligations to our customers and collecting payments from them. Therefore, starting in 2005, we began recording accounts receivable and deferred revenue at the time of billing. This change had no impact on the statement of operations, or net cash provided by (used in) operations, investing, or financing activities in the statement of cash flows. The December 31, 2004 accounts receivable and deferred revenue amounts are presented by reducing both accounts receivable and deferred revenue by $871,000, consistent with the presentation used in 2004.

For contracts involving design specifications that we have not met previously, we defer the recognition of revenue until the design meets the contractual design specifications and expense the cost of services as incurred. When we have experience in meeting design specifications but do not have significant experience to reasonably estimate the direct labor hours related to services to meet a design specification, we defer both the recognition of revenue and the cost. For these arrangements, we recognize revenue using the completed contract method. Under the completed contract method, we recognize revenue when we have knowledge that the customer has successfully verified our design. In 2005 and 2004, none of our license revenue was recognized under the completed contract method.

We also provide support and maintenance. Under these arrangements, we provide unspecified upgrades, design rule changes and technical support. No other upgrades, products or other post−contract support are provided. When we provide a combination of services related to licensing and support and maintenance to customers, in addition to the considerations noted above, we evaluate the arrangements under EITF 00−21, "Revenue Arrangements with Multiple Deliverables". Specifically, we analyze the separate elements to determine if vendor specific objective evidence, or VSOE, exists for the undelivered elements. We believe we have established VSOE for our support and maintenance arrangements. These arrangements are renewable annually by the customer. Support and maintenance revenue is recognized at its fair value ratably over the period during which the obligation exists, typically 12 months. The fair value of any support and maintenance obligation is established based on the specified renewal rate for such support and maintenance. Revenue from support and maintenance service represented $512,000 and $60,000 in 2005 and 2004, respectively, and was included in licensing revenue in the statement of operations.

Royalty. Licensing contracts provide also for royalty payments at a stated rate and require licensees to report the manufacture or sale of products that include our 1T−SRAM technologies after the end of the quarter in which the sale or manufacture occurs. We recognize royalties in the quarter in which we receive the licensee's report. Generally, royalty payments are made by the licensees around the time we receive their reports.

Goodwill. We review goodwill, recorded from the acquisition of ATMOS Corp. in August 2002, for impairment annually and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with the Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The provisions of SFAS No. 142 require that a two−step impairment test be performed on goodwill. In the first step, we compare the fair value of each reporting unit to its carrying value. Subsequent to the acquisition of ATMOS, its business became an integrated part of our operations. In 2004, we closed the operation of ATMOS as our Canadian research and development facility. Using the guidance in SFAS No. 142, we consider there to be only one reporting unit at the entity level. For step one, we determine the fair value of our reporting unit using the market approach. Under the market approach, we estimate the fair value based on the market value of the reporting unit at the entity level. If the fair value of the reporting unit exceeds the carrying value of net assets assigned to the reporting unit, goodwill is not impaired, and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, we must perform the second step in order to determine the implied fair value of the reporting unit's goodwill and compare it to the carrying value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we must record an impairment loss equal to the difference. We performed the annual impairment test during the third quarter of 2005 and the test did not indicate impairment of goodwill as of September 30, 2005. As of December 31, 2005, we found no indicators of potential impairment.

Restructuring Charges. Restructuring charges related to the closure of our ATMOS research and development facility in Canada in 2004 require the use of estimates, primarily related to the cost of exiting facilities, including estimates and assumptions related to future maintenance costs, our ability to secure a sub−tenant, and any sublease income to be received in the future.

We accounted for the restructuring charges under SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than at the date of an entity's commitment to an exit plan. If we fail to make accurate estimates regarding these costs or to accurately estimate the timing of the completion of planned activities, we may be required to record additional expenses or expense reductions in the future.

Tax valuation allowance. When we prepare our consolidated financial statements, we estimate our income tax liability for each of the various jurisdictions where we conduct business. This requires us to estimate our actual current tax exposure and to assess temporary differences that result from differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which we show on our consolidated balance sheet under the category of other current assets. The net deferred tax assets are reduced by a valuation allowance if, based upon weighted available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. When we establish a valuation allowance or increase this allowance in an accounting period, we must record a tax expense in our consolidated statement of operations unless the increase is attributable to stock−based compensation deductions, which are recorded directly to equity. We must make significant judgments to determine our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance to be recorded against our net deferred tax asset. As of December 31, 2005, we had a valuation allowance of approximately $10.9 million, of which approximately $6.1 million was attributable to Canadian loss and research and development pool carryforwards, and $4.1million was attributable to U.S. and state net operating loss and tax credit carryforwards.

Results of Operations

The following discussion compares the historical results of operations based on U.S. generally accepted accounting principles for the years ended December 31, 2005, 2004 and 2003. For these three years, results of operations as a percentage of net revenue were as follows:

	Year Ended December 31,		
	2005	2004	2003
Net revenue:			
Product	—%	9%	10%
Licensing	63	42	54
Royalty	37	49	36
Total net revenue	100	100	100
Cost of net revenue			
Product	—	6	6
Licensing	16	15	11
Total cost of net revenue	16	21	17
Gross profit	84	79	83
Operating expenses:			
Research and development	48	75	46
Selling, general and administrative	81	123	33
Restructuring expenses	—	5	—
Total operating expenses	129	203	79
Operating income (loss)	(45)	(124)	4
Interest and other income	21	106	10
Income tax benefit (provision)	—	—	(1)
Net income (loss)	(24)%	(18)%	13%

Years Ended December 31, 2005, 2004 and 2003

Revenue. In 2005, total revenue increased to $12.3 million representing a 14% increase from total revenue in 2004. Licensing revenue increased to $7.7 million in 2005 from $4.5 million in 2004 mainly due to increased numbers of projects commenced under new contracts signed in 2005 and revenue generated under a large contract signed in 2003 and completed in 2005. Royalty revenue decreased to $4.5 million in 2005 from $5.3 million in 2004 as customer sales of chips incorporating our technology declined. Royalties related to the production of Nintendo Gamecube chips in 2005 was $1.7 million, which was consistent with royalties in 2004.

In 2004, total revenue decreased to $10.8 million representing a 44% decline from total revenue in 2003. Licensing revenue declined to $4.5 million in 2004 from $10.4 million in 2003 because we did not add new licensing projects to offset the decrease in licensing revenue earned from older projects that we completed in 2004. In 2004, we reduced revenue by $450,000 for a reimbursement given to a customer for excess verification costs incurred by the customer. Royalty revenue decreased to $5.3 million in 2004 from $6.9 million in 2003, which included a one−time past due royalty payment of approximately $713,000 from Conexant. Excluding that one−time payment, total royalties in 2004 declined by approximately $900,000 from 2003, as customer sales of chips incorporating our technology declined. For example, royalties related to the production of Nintendo Gamecube chips represented $1.7 million in 2004 compared to $2.1 million in 2003.

In 2003, total revenue was $19.2 million primarily from licensing and royalty activities. The majority of licensing revenue earned in 2003 was derived from development projects other than Gamecube−related

projects. Royalties earned from the sale of Gamecube chips incorporating our 1T−SRAM technology represented 11% of our total revenue in 2003. A significant portion of royalty revenues from other licensees in 2003 represented sales of royalty−bearing products first shipped in 2002. During the second quarter of 2003, we collected $1.0 million in cash from Conexant for the termination of its October 2000 license agreement with us. That payment consisted of current and past due royalty payments totaling $713,000, and a contract termination fee of $287,000, which we included in other income.

During the years ended December 31, 2005, 2004, and 2003, our product sales totaled $10,000, $952,000 and $1.9 million, respectively. Sales of our memory chips have declined sharply as we shifted our primary focus from product sales to the licensing of our 1T−SRAM technologies after 1999. In the second quarter of 2004, we notified customers of our decision to discontinue sale of our memory chip products. As of the end of the third quarter of 2004, we had no remaining product inventory of value. Accordingly, we will only have minor ongoing sales of products required from time to time by customers. In the future, we do not expect to develop, market and sell memory chips.

Gross Profit. Gross profit increased to $10.3 million in 2005 from $8.6 million in 2004 primarily due to an increase in our licensing revenue. Our gross profit as a percentage of total revenue increased to 84% in 2005 from 79% in 2004 primarily due to a higher licensing gross profit, which increased to 74% of total revenue in 2005 from 65% of total revenue in 2004. This increase occurred because lower cost for fulfilling our obligations under new license agreements that required less customization.

Gross profit decreased to $8.6 million in 2004 from $16.0 million in 2003 primarily due to the significant decline in our licensing revenue. Our gross profit as a percentage of total revenue decreased to 79% in 2004 from 83% in 2003 primarily due to the decline in licensing gross profit which fell to 65% of total revenue in 2004 from 81% of total revenue in 2003. This decline occurred because we incurred higher cost under new license agreements than we had originally estimated or had historically experienced. In addition, we recognized revenue under some lower margin license projects including a few contracts in which our estimated cost exceeded the amount of revenue to be recognized.

In 2004, product gross margin as a percentage of product revenue decreased to 31% compared to 36% in 2003 mainly due to an inventory write−off of approximately $230,000 in 2004, which was not previously reserved for. In 2003, product gross margin as a percentage of product revenue decreased to 36% compared to 43% in 2002. The decline resulted primarily from lower average selling prices for our memory chips in 2003.

Research and Development. Our research and development expenses include development and design of variations of the 1T−SRAM technologies for use in different manufacturing processes used by licensees and the development and testing of prototypes to prove the technological feasibility of embedding our memory designs in the licensees' products. Research and development expenses decreased to $5.8 million in 2005 from $8.1 million in 2004 mainly due to the closure of our ATMOS research and development facility in Ottawa, Canada in November of 2004. There were no research and development expenses incurred at the ATMOS facility in 2005 as compared to $2.2 million incurred in 2004.

Research and development expenses decreased to $8.1 million in 2004 from $8.7 million in 2003 mainly because more engineering time was spent on licensing development projects, therefore, more engineering expenses were allocated to cost of licensing revenue in 2004 compared to 2003. Effective November 10, 2004, we closed the ATMOS research and development facility in Ottawa, Canada and terminated the employment of approximately 20 employees working there.

Research and development expenses increased to $8.7 million in 2003 because we had increased engineering staff from our acquisition of ATMOS and to support our memory compiler development. ATMOS' research and development expenses represented approximately $2.6 million in 2003.

Selling, General and Administrative. Selling, general and administrative expenses decreased to $9.9 million in 2005 from $13.3 million in 2004 primarily due to $5.5 million of expenses incurred in 2004 related to the aborted acquisition by Synopsys, Inc. and legal expenses related to litigation with Synopsys over its abandonment of the acquisition and $800,000 of litigation expenses with respect to the patent infringement and trade secret misappropriation suit brought against us by UniRAM Technology, Inc. incurred in 2004. We did not incur Synopsys−related costs in 2005, but incurred approximately $1.6 million of legal expenses related to the clams brought by UniRAM. Expenses related to testing and assessment of effectiveness of our internal control over financial reporting required by Section 404 of Sarbanes−Oxley Act were approximately $466,000 in 2005. We expect the expenses related to UniRAM litigation and testing and assessment required by Section 404 of Sarbanes−Oxley Act to continue in 2006.

Selling, general and administrative expenses increased to $13.3 million in 2004 from $6.4 million in 2003 due primarily to expenses related to the aborted acquisition by Synopsys and litigation expenses related to litigation with Synopsys and UniRAM. In 2004, expenses related to testing and assessment of effectiveness of our internal control over financial reporting required by Section 404 of Sarbanes−Oxley Act were approximately $690,000. Selling, general and administrative expenses increased to $6.4 million in 2003 due primarily to increased sales and marketing activities, including the establishment of a sales office in Japan in January 2003 and higher professional fees.

Restructuring Charges. On November 10, 2004, we announced our plan to close the ATMOS research and development facility in Canada in order to reduce operating expenses and to further align our business with market conditions, future revenue expectations and planned future product direction. As a part of the plan, we implemented a reduction in workforce of approximately 20 employees, which represented 20% of our workforce.

We recorded restructuring costs of $585,000 in the fourth quarter of 2004, consisting of $179,000 of severance and fringe benefits and lease abandonment charges of $406,000. At December 31, 2004, we have a total restructuring accrual of $429,000, comprised of unpaid employee severance costs of $19,000 and estimated lease abandonment costs of $410,000. All employees to be affected by our reduction in workforce were notified of the termination of their employment on November 10, 2004.

On July 15, 2005, we signed an agreement to sublease the ATMOS facility, which we occupy under a long−term operating lease through April 2008. The sublease expires at the end of April 2008.As a result of the sublease, we incurred $119,000 of additional restructuring expenses in 2005. As of December 31, 2005, we had a total restructuring estimated lease abandonment accrual of $293,000. We review these estimates periodically if these assumptions materially change due to rental market factors, the ultimate restructuring expense for the abandoned facilities would be adjusted.

Interest and Other Income. Interest and other income decreased to $2.6 million in 2005 from $11.6 million in 2004, which included the $10 million Synopsys termination fee related to the aborted acquisition. Interest income increased to $2.6 million in 2005 from $1.5 million in 2004 due to higher interest rates in 2005. Interest and other income increased to $11.6 million in 2004 from $1.9 million in 2003 primarily due to a $10.0 million termination fee paid by Synopsys. In addition, interest income increased slightly to $1.5 million in 2004 from $1.4 million in 2003 as income attributable to higher interest rates in 2004 was impacted adversely by the requirement that we liquidated the short−term and long−term investments in the second quarter of 2004 prior to the abandonment of its acquisition of our company by Synopsys. In 2003, interest and other income increased to $1.9 million primarily due to the $287,000 contract termination fee from Conexant and $241,000 of Canadian research and development incentive credits. Interest income was $1.4 million in 2003. We incurred no interest expense in 2005, 2004, and 2003.

Deferred stock−based compensation cost to employees. During the year ended December 31, 2004, we recorded deferred compensation cost of $74,000, which would be amortized in future periods. No such costs were incurred in 2005 or 2003. The 2004 deferred compensation costs represented the intrinsic value

of options granted to purchase shares of our stock to newly appointed members of our board of directors that had an exercise price less than the fair market value of our common stock on the date of the option grant. This deferred compensation cost will be amortized over the vesting period of 36 months using the graded vesting method.

During the years ended December 31, 2005, 2004, and 2003, we recorded stock compensation expenses of $36,000, $68,000, and $459,000, respectively, of which $0, $50,000 and $211,000, respectively, was attributable to the excess of the fair market value of our common stock over the price at which we granted stock options to employees. In 2005 and 2004, we incurred $36,000 and $5,000, respectively, of stock compensation expenses related to the issuance of options to purchase our stock to newly appointed members of our board of directors that had an exercise price less than the fair market value of our stock on the date of the option grant. Stock compensation expenses in 2004 and 2003 also included $13,000 and $227,000, respectively, for amortization of deferred compensation cost attributable to the fair market value of shares of our common stock issued to certain employees of ATMOS. We also incurred $21,000 of stock compensation expense in 2003 due to modification of our 2000 employee stock option held by a former member of our board of directors.

Deferred compensation expense is being amortized using the graded vesting method over the vesting period of each respective option, generally four years. The accelerated amortization results in expensing approximately 52% of the total award in the first year, 27% in the second year, 15% in the third year and 6% in the fourth year.

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share−Based Payment* (SFAS 123R) which will become effective beginning in the first quarter of 2006. SFAS 123R will result in the recognition of substantial compensation expense relating to our employee stock options and employee stock purchase plans. We currently use the intrinsic value method to measure compensation expense for stock−based awards to its employees. Under this standard, we generally do not recognize any compensation related to stock option grants under our stock option plans or related to the discounts provided under our employee stock purchase plans. Under the new rules however, we will be required to adopt a fair−value−based method for measuring the compensation expense related to employee stock awards. We estimate the impact of adopting SFAS No. 123R will have an earnings impact of approximately nine to ten cents per share in 2006, based on estimated compensation expense from unvested options outstanding as of the end of December 31, 2005. Compensation expense calculated upon adoption of SFAS No. 123R for future grants may differ from pro−forma amounts currently disclosed in our footnotes based on changes in the fair value of our common stock, the treatment of tax benefits, different assumptions and treatment of forfeitures under SFAS No. 123R, and changes in interest rates or other factors. We are currently considering our method of adoption, modified prospective approach or modified retrospective approach.

Provision for Income Taxes. Provisions (benefit) for income taxes of approximately ($11,000), $26,000, and $279,000, were recorded in 2005, 2004, and 2003, respectively. The effective income tax rate was (0.4%) for 2005, 1.4% for 2004, and 10% for 2003. As of December 31, 2005, we had net operating loss carryforwards of approximately $9.4 million for federal tax purposes, approximately $6.9 million for state tax purposes and Canadian loss and research and development pool carryforwards of approximately $12.1 million that we expect to be available to reduce future income tax liabilities to the extent permitted under federal, Canadian and applicable state income tax laws. The net operating loss carryforwards expire from 2008 to 2025. The decrease in our effective tax rate in 2005 was mainly due to a state income tax refund received in 2005 as a result of an amended 2001 California income tax return. In 2006, we anticipate that our effective income tax rate will be less than the federal statutory tax rate but higher than the 2005 effective income tax rate.

Liquidity and Capital Resources

As of December 31, 2005, we had cash and cash equivalents of $9.2 million, short−term investments and auction rate securities of $59.5 million and long−term investments of $17.3 million resulting in a total balance of cash, cash equivalents, and investments of $86.0 million. As of the same date, we had total working capital of $68.2 million. As of December 31, 2004, we had cash and cash equivalents of $31.7 million, short−term investments and auction rate securities of $30.6 million and long−term investments of $24.6 million resulting in a total balance of cash, cash equivalents, and investments of $86.9 million. In July 2001, we completed the sale of a total of 5,750,000 shares of common stock in our initial public offering. We realized total net proceeds of approximately $51.6 million upon the close of the IPO, which proceeds have not been used to fund our operations to date. Our primary capital requirements are to fund working capital needs. We believe that our current focus on licensing and royalty revenues with reduced levels of memory chip sales has generally enabled us to steadily improve our liquidity.

Net cash provided by (used in) operating activities was ($1.3) million, $2.7 million, and $4.7 million for the years ended 2005, 2004 and 2003, respectively. In 2005, net cash used in operating activities consisted primarily of net loss of $3.0 million offset by a non−cash charge of $614,000 for depreciation and amortization and higher deferred revenue of $808,000 in 2005. In addition, net cash used in operating activities in 2005 included tax benefits associated with the exercise of stock options of $482,000, which was recorded under additional paid in capital. In 2004, net cash provided by operating activities consisted primarily of net loss of $1.9 million offset by a non−cash charge of $1.5 million for depreciation and amortization, reduced unbilled contract receivables of $1.0 million, and prepaid expenses and other assets of $858,000, which included a reduction in deferred tax assets in 2004. In addition, net cash provided by operating activities in 2004 included restructuring related liabilities of $429,000. In 2003, net cash provided by operating activities was principally represented by our net profit of $2.5 million plus a non−cash charge of $2.0 million for depreciation and amortization, although deferred revenue associated with cash receipts in excess of recognized revenue declined by $1.3 million.

Net cash provided by (used in) investing activities was approximately ($22.8) million, $7.9 million, and ($10.8) million for the years ended 2005, 2004 and 2003, respectively. Aside from investing in marketable securities, we added $1.1 million of property and equipment in 2005 primarily due to leasehold improvements related to our new office lease for our U.S. corporate headquarters beginning in June 2005, new testing equipment and engineering design software. We purchased $349,000 and $493,000 of property and equipment in 2004 and 2003, respectively, consisting principally of engineering design software.

Net cash provided by (used in) financing activities was approximately $1.5 million, ($982,000), and $1.8 million for the years ended 2005, 2004 and 2003, respectively. In 2005, we received proceeds in the amount of $1.5 million from the exercise of employee options to purchase common stock. On April 29, 2005, we announced a repurchase program for up to $20 million of outstanding common stock over the next 12 months. However, no repurchases were made in 2005. In 2004, the major financing use of cash was $4.7 million for the repurchase of 1.2 million shares of common stock. We received proceeds in the amount of $3.7 million from the exercise of employee options to purchase common stock during 2004. Cash received upon the issuance of common stock in connection with the exercise of options totaled $1.9 million in 2003.

Our future liquidity and capital requirements are expected to vary from quarter to quarter, depending on numerous factors, including—

- level and timing of licensing and royalty revenues;
- cost, timing and success of technology development efforts;
- market acceptance of our existing and future technologies and products;

- competing technological and market developments;
- cost of maintaining and enforcing patent claims and intellectual property rights;
- variations in manufacturing yields, materials costs and other manufacturing risks;
- costs of acquiring other businesses and integrating the acquired operations;
- profitability of our business; and
- litigation expenses.

We expect that existing cash, and equivalents, short−term and long−term investments along with our existing capital and cash generated from operations, if any, will be sufficient to meet our capital requirements for the foreseeable future. We expect that a licensing business such as ours generally will require less cash to support operations after multiple licensees begin to ship products and pay royalties.

However, we cannot be certain that we will not require additional financing at some point in time. Should our cash resources prove inadequate, we may need to raise additional funding through public or private financing. There can be no assurance that such additional funding will be available to us on favorable terms, if at all. The failure to raise capital when needed could have a material, adverse effect on our business and financial condition.

Lease Commitments and Off Balance Sheet Financing

The impact that our contractual obligations as of December 31, 2005 are expected to have on our liquidity and cash flow in future periods is as follows:

	Payment Due by Period				
	Total	Less than 1 year	1−3 years	4−5 years	Over 5 years
Minimum Lease Commitments	$2,796	$870	$1,367	$ 559	$ —
Sublease Income	384	201	183	—	—
Net Lease Commitments	$2,412	$669	$1,184	$ 559	$ —

The Company did not have any unconditional purchase obligations as of December 31, 2005.

Recent Accounting Pronouncements

See Note 1 of the Consolidated Financial Statements for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of operations and financial condition.

Item 7A. *Quantitative and Qualitative Discussion of Market Interest Rate Risk*

Our investment portfolio consists of money market funds, corporate−backed debt obligations and mortgage−backed government obligations generally due within one year. Our primary objective with investment portfolio is to invest available cash while preserving principal and meeting liquidity needs. In accordance with our investment policy, we place investments with high credit quality issuers and limit the amount of credit exposure to any one issuer. These securities, which approximate $76.8 million as of December 31, 2005, and have an average interest rate of approximately 3.00%, are subject to interest rate risks. As of December 31, 2005, our portfolio had unrealized losses of approximately $389,000 as a result of rising interest rates. We believe these losses are temporary and expect to hold these investments to maturity. However, based on the investment portfolio contents and our ability to hold these investments

until maturity, we believe that if a significant change in interest rates were to occur, it would not have a material effect on our financial condition.

Item 8. *Financial Statements and Supplementary Data*

Reference is made to the financial statements listed under the heading (a) (1) Financial Statements and Reports of BDO Seidman LLP and Ernst & Young LLP of Item 15, which financial statements are incorporated by reference in response to this Item 8.

Quarterly Results of Operations

The following tables set forth unaudited results of operations data for the eight quarters ended December 31, 2005. This unaudited information has been prepared on a basis consistent with our audited financial statements appearing elsewhere in this report and, in the opinion of our management, includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the information for the periods presented. The unaudited quarterly information should be read in conjunction with the financial statements and notes included elsewhere in this report. For a discussion of charges and other income pertaining to the aborted acquisition of our company by Synopsys, Inc. and restructuring charges associated with the closing of our ATMOS research and development operation, which significantly affected the last three quarters of 2004, refer to Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations.”

	Dec. 31, 2005	Sep. 30, 2005	Jun. 30, 2005	Mar. 31, 2005	Dec. 31, 2004	Sep. 30, 2004	Jun. 30, 2004	Mar. 31, 2004
	(In thousands, except per share data) (Unaudited—All periods)							
Net revenue:								
Product	$ —	$ —	$ 6	$ 4	$ 33	$ 76	$ 681	$ 162
Licensing	1,339	3,233	1,940	1,213	118	128	1,310	2,988
Royalty	1,063	897	1,121	1,466	1,069	1,488	1,415	1,353
Total net revenue	2,402	4,130	3,067	2,683	1,220	1,692	3,406	4,503
Cost of net revenue								
Product	—	—	—	—	25	86	394	150
Licensing	243	668	609	466	519	236	483	375
Total cost of net revenue	243	668	609	466	544	322	877	525
Gross profit	2,159	3,462	2,458	2,217	676	1,370	2,529	3,978
Operating expenses:								
Research and development	1,557	1,359	1,320	1,603	1,728	2,174	1,968	2,226
Selling, general and administrative	2,519	2,721	2,206	2,476	1,355	3,949	5,263	2,764
Restructuring expenses	5	—	114	—	585	—	—	—
Total operating expenses	4,081	4,080	3,640	4,079	3,668	6,123	7,231	4,990
Operating income (loss)	(1,922)	(618)	(1,182)	(1,862)	(2,992)	(4,753)	(4,702)	(1,012)
Interest and other income	794	679	605	513	550	10,398	269	361
Income (loss) before income taxes	(1,128)	61	(577)	(1,349)	(2,442)	5,645	(4,433)	(651)
Income tax benefit (provision)	44	(11)	(2)	(20)	31	(565)	378	130
Net income (loss)	$(1,084)	$ 50	$ (579)	$(1,369)	$(2,411)	$ 5,080	$(4,055)	$ (521)
Net income (loss) per share:								
Basic	$ (0.04)	$ —	$ (0.02)	$ (0.04)	$ (0.08)	$ 0.16	$ (0.13)	$ (0.02)
Diluted	$ (0.04)	$ —	$ (0.02)	$ (0.04)	$ (0.08)	$ 0.15	$ (0.13)	$ (0.02)
Shares used in computing net income (loss) per share:								
Basic	30,698	30,531	30,465	30,442	30,296	31,074	30,786	30,845
Diluted	30,698	31,504	30,465	30,442	30,296	33,350	30,786	30,845

In the third quarter of 2004, interest and other income included a $10 million termination fee paid by Synopsys related to an aborted acquisition.

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

None.

Item 9A. *Controls and Procedures*

(a) Management's annual report on internal control over financial reporting

Monolithic System Technology, Inc.'s management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a−15(f) under the Securities Exchange Act of 1934. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily is required to apply its judgment in evaluating the cost−benefit relationship of possible controls. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, and principal accounting officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2005.

BDO Seidman, LLP, the independent registered public accounting firm that audited the 2005 consolidated financial statements included in this Annual Report on Form 10−K, has also audited management's assessment of our internal control over financial reporting and the effectiveness of our internal control over financial reporting as of December 31, 2005, as stated in their report which is included elsewhere herein.

(b) Evaluation of disclosure controls and procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, and principal accounting officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a−15(e) and 15d−15(e) under the Securities Exchange Act of 1934. Based on this evaluation, our management concluded that as of December 31, 2005, our disclosure controls and procedures were effective such that the information relating to us, including our consolidated subsidiaries, required to be disclosed in our reports filed with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to our management including our Chief Executive Officer and our principal accounting officer, as appropriate to allow timely decisions regarding required disclosure.

(c) Changes in internal control

There was no change in the internal control over financial reporting during the fourth fiscal quarter of 2005 that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

Item 9B. *Other Information*

None.

Part III

Item 10. *Directors and Executive Officers of the Registrant*

Information regarding our directors is incorporated by reference from the sections titled "Management" and "Section 16(A) Beneficial Ownership Reporting Compliance" in the Registrant's Proxy Statement for its 2006 Annual Meeting of Stockholders. Information regarding current executive officers found under the heading "Executive Officers" in Item 1 of Part I hereof is also incorporated by reference into this Item 10.

We have adopted a code of ethics that applies to all of our employees. The code of ethics is designed to deter wrongdoing and to promote, among other things, honest and ethical conduct, full, fair, accurate, timely, and understandable disclosures in reports and documents submitted to the Securities and Exchange Commission and other public communications, compliance with applicable governmental laws, rules and regulations, the prompt internal reporting of violations of the code to an appropriate person or persons identified in the code and accountability for adherence to such code.

The code of ethics is available on our website www.mosys.com. If we make any substantive amendments to the code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer or Corporate Controller, or persons performing similar functions, where such amendment or waiver is required to be disclosed under applicable SEC rules, we intend to disclose the nature of such amendment or waiver on our website.

Item 11. *Executive Compensation*

The response to this item is incorporated by reference from the section titled "Executive Compensation", but not from the Sections titled "Executive Compensation—Performance Graph" and "Executive Compensation—Report on Executive Compensation by the Compensation Committee of the Board of Directors", in the Registrant's Proxy Statement for its 2006 Annual Meeting of Stockholders.

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

The response to this item is incorporated by reference from the sections titled "Share Ownership of Certain Beneficial Owners and Management and "Securities Authorized for Issuance Under Equity Compensation Plans" in the Registrant's Proxy Statement for its 2006 Annual Meeting of Stockholders.

Item 13. *Certain Relationships and Related Transactions*

The response to this item is incorporated by reference from the section titled "Certain Relationships and Related Transactions" in the Registrant's Proxy Statement for its 2006 Annual Meeting of Stockholders.

Item 14. *Principal Accountant Fees and Services*

The response to this item is incorporated by reference from the section titled "Ratification of Independent Registered Public Accounting Firm for 2006" in the Registrant's Proxy Statement for its 2006 Annual Meeting of Stockholders.

Part IV

Item 15. *Exhibits and Financial Statement Schedules*

(a) The following documents are filed as part of this report:

(1) Financial Statements and Reports of Independent Registered Public Accounting Firm, which are set forth in the index to Consolidated Financial Statements on pages 48 through 79 of this report.

(2) Financial Statement Schedule—Schedule II—Valuation and Qualifying Accounts

(3) Exhibits

2.1(1)	Merger Agreement regarding the Registrant's reincorporation in Delaware
2.2(4)	Share Purchase Agreement for the shares for ATMOS Corporation
2.3(5)	Agreement and Plan of Reorganization, dated February 23, 2004, among Synopsys, Inc., Mountain Acquisition Sub, Inc., a wholly owned subsidiary of Synopsys, Inc., and Monolithic System Technology, Inc.—Terminated agreement.
2.4(6)	Form of Stockholder Agreement, dated February 23, 2004, among Synopsys, Inc., Mountain Acquisition Sub, Inc., a wholly owned subsidiary of Synopsys, Inc., and the stockholder of Monolithic System Technology, Inc.—Terminated agreement.
3.1	Not currently in use
3.2	Not currently in use
3.3(1)	Restated Certificate of Incorporation of the Registrant
3.4(1)	Bylaws of the Registrant
4.1(1)	Specimen common stock certificate
4.2(1)	Not currently in use
4.3(1)	Rights Agreement
4.3.1(7)	First Amendment to Rights Agreement, dated as of February 23, 2004.
4.3.2(8)	Second Amendment to Rights Agreement, dated as of December 14, 2004.
10.1(1)	Form of Indemnity Agreement between the Registrant and each of its directors and executive officers
10.2(1)	Not currently in use
10.3(1)	1996 Stock Plan and form of Option Agreement thereunder
10.4(1)	Form of Restricted Stock Purchase Agreement
10.5(1)	2000 Employee Stock Option Plan and form of Option Agreement thereunder
10.5.1(9)	Amended and Restated 2000 Equity Incentive and Stock Option Plan
10.6(1)	2000 Employee Stock Purchase Plan and form of Subscription Agreement thereunder
10.7(1)	Not currently in use
10.8(1)	Not currently in use
10.9(1)	Agreement between Nintendo Co., Ltd. and the Registrant dated August 31, 1999
10.10(1)	License Agreement between NEC Corporation and the Registrant dated January 31, 1999
10.11(1)(2)	License Agreement between NEC Corporation and the Registrant dated December 17, 1999
10.12(1)	Not currently in use

10.13(10)	Employment offer letter agreement and Mutual Agreement to Arbitrate between the Registrant and Chester J. Silvestri dated July 21, 2005
10.14(10)	Change−in−Control Agreement between the Registrant and Chester J. Silvestri dated as of July 21, 2005
10.15(10)	Form of Stock Option Agreement pursuant to Amended and Restated 2000 Stock Option and Equity Incentive Plan
10.16	Lease Agreement between Registrant and Sunnyvale Mathilda Investors, LLC dated as of May 6, 2005
10.17	Employment offer letter agreement between the Registrant and Dhaval Ajmera dated October 3, 2005
21.1	List of subsidiaries
23.1	Consent of Independent Registered Public Accounting Firm—BDO Seidman LLP
23.2	Consent of Independent Registered Public Accounting Firm—Ernst and Young LLP
24.1(3)	Power of Attorney
31.1	Rule 13a−14 certification
31.2	Rule 13a−14 certification
32	Section 1350 certification

(1) Incorporated by reference to the same−numbered exhibit to the Company's Registration Statement on Form S−1, as amended, originally filed August 4, 2000, declared effective June 27, 2001 (Commission file No. 333−43122).

(2) Portions of this exhibit have been omitted pursuant to Order Granting Confidential Treatment Under the Securities Act of 1933 dated June 27, 2001 (Commission File No. 333−43122—CF#10183).

(3) Set forth on page 46 of this report.

(4) Incorporated by reference to the same−numbered exhibit to the Company's report on Form 8−K/A filed on November 13, 2002.

(5) Incorporated by reference to Exhibit 2.1 of the Current Report on Form 8−K filed by Synopsys, Inc. on February 26, 2004, (Commission File No. 000−19807).

(6) Incorporated by reference to Exhibit 2.2 of the Current Report on Form 8−K filed by Synopsys, Inc. on February 26, 2004. (Commission File No. 000−19807).

(7) Incorporated by reference to Exhibit 1 to Form 8−A/A filed by the Company on December 22, 2004 (Commission File No. 000−32929).

(8) Incorporated by reference to Exhibit 4.01 to Form 8−K filed by the Company on December 20, 2004 (Commission File No. 000−32929).

(9) Incorporated by reference to the Company's proxy statement on Schedule 14A filed on October 7, 2004 (Commission File No. 000−32929).

(10) Incorporated by reference to the same−numbered exhibit to Form 10−Q filed by the Company on August 9, 2005.

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 16th day of March 2006.

MONOLITHIC SYSTEM TECHNOLOGY, INC.
By: /s/ CHESTER J. SILVESTRI
Chester J. Silvestri
Chief Executive Officer and President

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Chester J. Silvestri as his true and lawful attorney−in−fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to his Report on Form 10−K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney−in−fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney−in−fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

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

Signature	Title	Date
/s/ CHESTER J. SILVESTRI Chester J. Silvestri	Chief Executive Officer and President (Principal Executive Officer and Principal Financial Officer)	March 16, 2006
/s/ YOSHIKO RIBAR Yoshiko Ribar	Controller (Principal Accounting Officer)	March 16, 2006
/s/WINGYU LEUNG Wingyu Leung	Executive Vice President, Chief Technical Officer and Director	March 16, 2006
/s/ CARL E. BERG Carl E. Berg	Director	March 16, 2006
/s/ TOMMY ENG Tommy Eng	Director	March 16, 2006
/s/ CHI−PING HSU Chi−Ping Hsu	Director	March 16, 2006
/s/ JAMES D. KUPEC James D. Kupec	Director	March 16, 2006
/s/ CHENMING HU Chenming Hu	Director	March 16, 2006

INDEX OF EXHIBITS

2.1(1)	Merger Agreement regarding the Registrant's reincorporation in Delaware
2.2(4)	Share Purchase Agreement for the shares for ATMOS Corporation
2.3(5)	Agreement and Plan of Reorganization, dated February 23, 2004, among Synopsys, Inc., Mountain Acquisition Sub, Inc., a wholly owned subsidiary of Synopsys, Inc., and Monolithic System Technology, Inc.—Terminated agreement.
2.4(6)	Form of Stockholder Agreement, dated February 23, 2004, among Synopsys, Inc., Mountain Acquisition Sub, Inc., a wholly owned subsidiary of Synopsys, Inc., and the stockholder of Monolithic System Technology, Inc.—Terminated agreement.
3.1	Not currently in use
3.2	Not currently in use
3.3(1)	Restated Certificate of Incorporation of the Registrant
3.4(1)	Bylaws of the Registrant
4.1(1)	Specimen common stock certificate
4.2(1)	Not currently in use
4.3(1)	Rights Agreement
4.3.1(7)	First Amendment to Rights Agreement, dated as of February 23, 2004.
4.3.2(8)	Second Amendment to Rights Agreement, dated as of December 14, 2004.
10.1(1)	Form of Indemnity Agreement between the Registrant and each of its directors and executive officers
10.2(1)	Not currently in use
10.3(1)	1996 Stock Plan and form of Option Agreement thereunder
10.4(1)	Form of Restricted Stock Purchase Agreement
10.5(1)	2000 Employee Stock Option Plan and form of Option Agreement thereunder
10.5.1(9)	Amended and Restated 2000 Equity Incentive and Stock Option Plan
10.6(1)	2000 Employee Stock Purchase Plan and form of Subscription Agreement thereunder
10.7(1)	Not currently in use
10.8(1)	Not currently in use
10.9(1)	Agreement between Nintendo Co., Ltd. and the Registrant dated August 31, 1999
10.10(1)	License Agreement between NEC Corporation and the Registrant dated January 31, 1999
10.11(1)(2)	License Agreement between NEC Corporation and the Registrant dated December 17, 1999
10.12(1)	Not currently in use
10.13(10)	Employment offer letter agreement and Mutual Agreement to Arbitrate between the Registrant and Chester J. Silvestri dated July 21, 2005
10.14(10)	Change−in−Control Agreement between the Registrant and Chester J. Silvestri dated as of July 21, 2005
10.15(10)	Form of Stock Option Agreement pursuant to Amended and Restated 2000 Stock Option and Equity Incentive Plan
10.16	Lease Agreement between Registrant and Sunnyvale Mathilda Investors, LLC dated as of May 6, 2005
10.17	Employment offer letter agreement between the Registrant and Dhaval Ajmera dated October 3, 2005
21.1	List of subsidiaries
23.1	Consent of Independent Registered Public Accounting Firm−BDO Seidman LLP
23.2	Consent of Independent Registered Public Accounting Firm−Ernst and Young LLP
24.1(3)	Power of Attorney
31.1	Rule 13a−14 certification
31.2	Rule 13a−14 certification
32	Section 1350 certification

(1) Incorporated by reference to the same−numbered exhibit to the Company's Registration Statement on Form S−1, as amended, originally filed August 4, 2000, declared effective June 27, 2001 (Commission file No. 333−43122).

(2) Portions of this exhibit have been omitted pursuant to Order Granting Confidential Treatment Under the Securities Act of 1933 dated June 27, 2001 (Commission File No. 333−43122—CF#10183).

(3) Set forth on page 46 of this report.

(4) Incorporated by reference to the same−numbered exhibit to the Company's report on Form 8−K/A filed on November 13, 2002.

(5) Incorporated by reference to Exhibit 2.1 of the Current Report on Form 8−K filed by Synopsys, Inc. on February 26, 2004, (Commission File No. 000−19807).

(6) Incorporated by reference to Exhibit 2.2 of the Current Report on Form 8−K filed by Synopsys, Inc. on February 26, 2004. (Commission File No. 000−19807).

(7) Incorporated by reference to Exhibit 1 to Form 8−A/A filed by the Company on December 22, 2004 (Commission File No. 000−32929).

(8) Incorporated by reference to Exhibit 4.01 to Form 8−K filed by the Company on December 20, 2004 (Commission File No. 000−32929).

(9) Incorporated by reference to the Company's proxy statement on Schedule 14A filed on October 7, 2004 (Commission File No. 000−32929).

(10) Incorporated by reference to the same−numbered exhibit to Form 10−Q filed by the Company on August 9, 2005.

MONOLITHIC SYSTEM TECHNOLOGY, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Monolithic Systems Technology, Inc.
Sunnyvale, California

We have audited the accompanying consolidated balance sheet of Monolithic Systems Technology, Inc. ("MoSys") as of December 31, 2005 and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of MoSys' management. We have also audited Schedule II—Valuation and Qualifying Accounts as of and for the year ended December 31, 2005. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedule are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MoSys at December 31, 2005, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, Schedule II—Valuation and Qualifying Accounts presents fairly, in all material respects, the information set forth therein as of and for the year ended December 31, 2005.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of MoSys' internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 24, 2006 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

San Francisco, California
February 24, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Board of Directors and Stockholders
Monolithic Systems Technology, Inc.
Sunnyvale, California

We have audited management's assessment, included in the accompanying Management Report on Internal Control over Financial Reporting, that Monolithic Systems Technology Inc. ("MoSys") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that MoSys maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, MoSys maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2005 and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended, and the 2005 financial statement schedule listed in the accompanying index, of MoSys and our report dated February 24, 2006, expressed an unqualified opinion thereon.

\s\ BDO Seidman, LLP

San Francisco, California
February 24, 2006

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of
Monolithic System Technology, Inc.

We have audited the accompanying consolidated balance sheet of Monolithic System Technology, Inc. as of December 31, 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2004. Our audits also included the financial statement schedule for each of the two years in the period ended December 31, 2004 listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Monolithic System Technology, Inc. at December 31, 2004, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule for each of the two years in the period ended December 31, 2004, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

San Jose, California
March 15, 2005

MONOLITHIC SYSTEM TECHNOLOGY, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	December 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,171	$ 31,714
Short−term investments and auction rate securities	59,479	30,635
Accounts receivable, net	638	1,125
Unbilled contract receivable	368	57
Prepaid expenses and other current assets	2,632	2,939
Total current assets	72,288	66,470
Long−term investments	17,339	24,562
Property and equipment, net	1,121	685
Goodwill	12,326	12,326
Other assets	563	539
Total assets	$ 103,637	$ 104,582
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 236	$ 120
Accrued expenses and other liabilities	2,564	3,314
Deferred revenue	1,309	501
Total current liabilities	4,109	3,935
Long−term portion of restructuring liability	196	239
Total liabilities	4,305	4,174
Commitment and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value; 20,000 shares authorized; none issued and outstanding at December 31, 2005 and December 31, 2004	—	—
Common stock, $0.01 par value; 120,000 shares authorized; 30,768 shares and 30,296 shares issued and outstanding at December 31, 2005 and December 31, 2004	308	303
Additional paid−in capital	100,280	98,278
Deferred stock−based compensation	(33)	(69)
Accumulated other comprehensive loss	(389)	(252)
Retained earnings (deficit)	(834)	2,148
Total stockholders' equity	99,332	100,408
Total liabilities and stockholders' equity	$ 103,637	$ 104,582

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

MONOLITHIC SYSTEM TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended December 31,		
	2005	2004	2003
Net revenue:			
Product	$ 10	$ 952	$ 1,904
Licensing	7,725	4,544	10,418
Royalty	4,547	5,325	6,911
Total net revenue	12,282	10,821	19,233
Cost of net revenue			
Product	—	655	1,217
Licensing	1,986	1,613	1,970
Total cost of net revenue	1,986	2,268	3,187
Gross profit	10,296	8,553	16,046
Operating expenses:			
Research and development	5,839	8,096	8,741
Selling, general and administrative	9,922	13,331	6,432
Restructuring expenses	119	585	—
Total operating expenses	15,880	22,012	15,173
Income (loss) from operations	(5,584)	(13,459)	873
Interest and other income	2,591	11,578	1,914
Income (loss) before income taxes	(2,993)	(1,881)	2,787
Income tax benefit (provision)	11	(26)	(279)
Net income (loss)	$ (2,982)	$ (1,907)	$ 2,508
Net income (loss) per share:			
Basic	$ (0.10)	$ (0.06)	$ 0.08
Diluted	$ (0.10)	$ (0.06)	$ 0.08
Shares used in computing net income (loss) per share:			
Basic	30,534	30,750	30,504
Diluted	30,534	30,750	30,998
Allocation of stock−based compensation to operating expenses			
Research and development	$ —	$ 44	$ 148
Selling, general and administrative	36	24	311
	$ 36	$ 68	$ 459

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

MONOLITHIC SYSTEM TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid−In Capital	Deferred Stock−Based Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total
Balance at December 31,2002	30,230	$ 302	$ 97,796	$ (1,064)	$ 116	$ 1,547	$ 98,697
Issuance of Common Stock upon exercise of options	439	5	1,460	—	—	—	1,465
Issuance of Common Stock for Employee Stock Purchase Plan	55	—	442	—	—	—	442
Amortization of deferred stock−based compensation and other change in employee status	—	—	21	438	—	—	459
Other comprehensive income—unrealized loss on available−for−sale investments	—	—	—	—	(60)	—	(60)
Net income	—	—	—	—	—	2,508	2,508
Comprehensive income							2,448
Balance at December 31,2003	30,724	307	99,719	(626)	56	4,055	103,511
Issuance of Common Stock upon exercise of options	688	7	3,226	—	—	—	3,233
Issuance of Common Stock for Employee Stock Purchase Plan	66	1	463	—	—	—	464
Repurchase and Retirement of Common Stock	(1,182)	(12)	(4,641)	—	—	—	(4,653)
Amortization of deferred stock−based compensation and other change in employee status	—	—	(489)	557	—	—	68
Other comprehensive income—unrealized loss on available−for−sale investments	—	—	—	—	(308)	—	(308)
Net income (loss)	—	—	—	—	—	(1,907)	(1,907)
Comprehensive income (loss)							(2,215)
Balance at December 31,2004	30,296	303	98,278	(69)	(252)	2,148	100,408
Issuance of Common Stock upon exercise of options	406	4	1,205	—	—	—	1,209
Issuance of Common Stock for Employee Stock Purchase Plan	66	1	315	—	—	—	316
Amortization of deferred stock−based compensation	—	—	—	36	—	—	36
Tax benefits associated with exercise of stock options	—	—	482	—	—	—	482
Other comprehensive income—unrealized loss on available−for−sale investments	—	—	—	—	(137)	—	(137)
Net income (loss)	—	—	—	—	—	(2,982)	(2,982)
Comprehensive income (loss)							(3,119)
Balance at December 31,2005	30,768	$ 308	$ 100,280	$ (33)	$ (389)	$ (834)	$ 99,332

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

MONOLITHIC SYSTEM TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2005	2004	2003
Cash flows from operating activities:			
Net income (loss)	$ (2,982)	$ (1,907)	$ 2,508
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Provision for doubtful accounts	105	—	—
Depreciation and amortization	614	1,460	2,049
Amortization of deferred stock−based compensation	36	68	459
Changes in current assets and liabilities:			
Accounts receivable	382	(98)	(84)
Unbilled contract receivable	(311)	1,049	(413)
Inventories	—	474	563
Prepaid expenses and other assets	765	858	570
Deferred revenue	808	(5)	(1,273)
Accounts payable	116	4	(16)
Accrued expenses and other liabilities	(657)	391	365
Restructuring liability	(136)	429	—
Net cash provided by (used in) operating activities	(1,260)	2,723	4,728
Cash flows from investing activities:			
Purchase of property and equipment	(1,051)	(349)	(493)
Proceeds from sales and maturity of marketable securities	225,879	469,336	258,752
Purchase of marketable securities	(247,636)	(461,047)	(269,094)
Net cash provided by (used in) investing activities	(22,808)	7,940	(10,835)
Cash flows from financing activities:			
Payment of capital lease obligations	—	(26)	(88)
Proceeds from issuance of common stock	1,525	3,697	1,907
Repurchase and retirement of common stock	—	(4,653)	—
Net cash provided by (used in) financing activities	1,525	(982)	1,819
Net increase (decrease) in cash and cash equivalents	(22,543)	9,681	(4,288)
Cash and cash equivalents at beginning of year	31,714	22,033	26,321
Cash and cash equivalents at end of year	$ 9,171	$ 31,714	$ 22,033
Supplemental disclosure:			
Cash paid for income taxes	$ 29	$ 24	$ 394

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

Note 1: The Company and Summary of Significant Accounting Policies

The Company

Monolithic System Technology, Inc. (the "Company") was incorporated in California on September 16, 1991 to design, develop and market high performance semiconductor memory products and technologies used by the semiconductor industry and electronic product manufacturers. On September 12, 2000, the stockholders approved the Company's reincorporation in Delaware.

The Company has developed an innovative embedded−memory technology, called 1T−SRAM, which the Company licenses on a non−exclusive and worldwide basis to semiconductor companies and electronic product manufacturers. From its inception in 1991 through 1998, the Company focused primarily on the sale of stand−alone memory products. In the fourth quarter of 1998, the Company changed the emphasis of its business model to focus primarily on the licensing of its 1T−SRAM technologies and completed this transition in 2002 when a majority of the Company's revenues were derived from licensing and royalty of its 1T−SRAM technologies. In the second quarter of 2004, the Company notified its customers of its decision to discontinue sales of its memory chip products and only license its technology.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly−owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. The Company reports financial results on a calendar fiscal year.

Use of Estimates

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

Foreign Currency Translation

The Company has foreign offices located in Korea, Japan and France, which are operated by subsidiaries of the Company. The functional currency of the Company's foreign entities is the U.S. dollar. Accordingly, the financial statements of these entities are remeasured into U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation." Exchange gains or losses from remeasurement of monetary assets and liabilities that are not denominated in U.S. dollar were not material for any period presented and are included in the consolidated statements of operations.

Cash Equivalents, Short−term and Long−term Investments

The Company accounts for investments in accordance with Statement of Financial Accounting Standards No. 115 "Accounting for Certain Investments in Debt and Equity Securities". Management determines the appropriate classification of debt securities at the time of purchase. All securities are classified as available−for−sale. The Company's short−term and long−term investments are carried at fair value, based on quoted market prices, with the unrealized holding gains and losses reported in stockholders' equity. The Company evaluates declines in market value for potential impairment if the

decline results in a value below cost and is determined to be other than temporary. Realized gains and losses and declines in the value judged to be other−than−temporary are included in interest income. The cost of securities sold is based on the specific identification method.

The Company invests its excess cash in money market accounts and debt instruments and considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Investments with original maturities greater than three months and remaining maturities less than one year are classified as short−term investments. Investments with remaining maturities greater than one year are classified as long−term investments.

Allowance for Doubtful Accounts.

The Company determines its allowance for doubtful accounts to ensure its trade receivables balances are not overstated due to uncollectibility. The Company performs ongoing customer credit evaluation within the context of the industry in which it operates. A specific allowance of up to 100% of the invoice value will be provided for any problematic customer balances. Delinquent account balances are written off after management has determined that the likelihood of collection is not possible. As of December 31, 2005, the Company reported a balance of $105,000 in its allowance for doubtful accounts. There was no balance of allowance for doubtful accounts in 2004.

Unbilled Contract Receivable

Under the percentage of completion method, if the amount of revenue recognized exceeds the amount of billings to a customer; the excess amount is carried as an unbilled contract receivable. The Company has recorded $368,000 and $57,000 of unbilled contract receivable as of December 31, 2005 and 2004, respectively.

Property and Equipment

Property and equipment are stated at cost. Depreciation is generally computed using the straight−line method over the estimated useful lives of the assets, generally three years. During the year, the Company wrote off approximately $9.4 million of fully depreciated assets. Depreciation and amortization expense for the years ended December 31, 2005, 2004 and 2003 was $614,000, $1.5 million, and $2.0 million, respectively.

	December 31,	
	2005	2004
Property and equipment:		
Equipment, furniture and fixtures	$ 1,364	$ 5,638
Acquired software	836	4,888
	2,200	10,526
Less: Accumulated depreciation	(1,079)	(9,841)
	$ 1,121	$ 685

Valuation of Long−lived Assets

Long−lived assets, such as property, plant and equipment, are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When impairment is identified, the carrying amount of the asset is reduced to its estimated fair value.

Goodwill

The Company reviews goodwill, recorded from the acquisition of ATMOS Corp. on August 2002, for impairment annually and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with the Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The provisions of SFAS No. 142 require that a two−step impairment test be performed on goodwill. In the first step, the Company compares the fair value of each reporting unit to its carrying value. Subsequent to the acquisition of ATMOS, its business became integrated part of the Company's operations. In 2004, the Company closed the operation of ATMOS as its Canadian research and development facility. Using the guidance in SFAS No. 142, the Company determined that it has only one reporting unit at the entity level. For step one, the Company determines the fair value of its reporting unit using the market approach. Under the market approach, the Company estimates the fair value based on the market value of the reporting unit at the entity level. If the fair value of the reporting unit exceeds the carrying value of net assets to the reporting unit, goodwill is not impaired and the Company is not required to perform further testing. If the carrying value of the net assets to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step in order to determine the implied fair value of the reporting unit's goodwill and compare it to the carrying value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then the Company must record an impairment loss equal to the difference. The Company performs its annual impairment test during the third quarter of each year and at times impairment indicators are noted. The Company performed the annual impairment test during the third quarter of 2005 and the test did not indicate impairment of goodwill as of September 30, 2005. As of December 31, 2005, the Company found no indicators of potential impairment.

Revenue Recognition

Licensing

Licensing revenue consists of fees earned for engineering development and engineering support services. All contracts the Company has entered into to date require the Company to develop a design that meets a licensee's specifications. In accordance with SOP 81−1 "Accounting for Performance of Construction−Type and Certain Production−Type Contracts", when license agreements include deliverables that require "significant production, modification or customization", contract accounting is applied. When the Company has significant experience in meeting the design specification involved in the contract and the direct labor hours related to services under the contract can be reasonably estimated, the Company recognizes revenue over the period in which the contract services are performed. For these arrangements, the Company recognizes revenue using the percentage of completion method. Revenues are only recognized when collection is probable. The direct labor hours for the development of the licensee's design are estimated at the beginning of the contract. As these direct labor hours are incurred, they are used as a measure of progress towards completion. The Company has the ability to reasonably estimate the direct labor hours on a contract−by−contract basis based on its experience in developing prior licensees' designs. The Company periodically evaluates the actual status of each project to ensure that the estimates to complete each contract remain accurate and updates its estimated costs to complete as necessary. Under the percentage of completion method, provisions for estimated losses on uncompleted contracts are recognized in the period in which the likelihood of such losses is determined. Revenue recognized in any period is dependent on the Company's progress toward completion of projects in progress. Significant management judgment and discretion are used to estimate total direct labor hours. Any changes in or deviation from these estimates could have a material effect on the amount of revenue the Company recognizes in any period. If inherent risks make estimates doubtful, the contract is accounted for under the completed contract method. Completion of the contract is based on the production of integrated circuit devices that have been validated by the customer.

Prior to 2005, the Company recorded deferred revenue when cash was received. However, the terms of the license contracts allow the Company to bill customers upon achieving the milestones stated in the contracts. The Company believes that now it has adequate history and experience in fulfilling licensing contract obligations to its customers and collecting payments from them. Therefore, starting in 2005, the Company began recording accounts receivable and deferred revenue at the time of billing. This change had no impact on the statement of operations, or net cash provided by (used in) operations, investing, or financing activities in the statement of cash flows. The December 31, 2004 accounts receivable and deferred revenue amounts are presented by reducing both accounts receivable and deferred revenue by $871,000, consistent with the presentation used in 2004.

For contracts involving design specifications that the Company has not previously met, the Company defers the recognition of all revenue until the design meets the contractual design specifications and expenses the cost of revenue as incurred. When the Company has experience in meeting design specifications but does not have significant experience to reasonably estimate the cost of services to meet a design specification, the Company defers both the recognition of revenue and the cost. For these arrangements, the Company recognizes revenue using the completed contract method. In 2005 and 2004, none of the Company's license revenue was recognized under the completed contract method.

The Company also provides support and maintenance. Under these arrangements, the Company provides unspecified upgrades, design rule changes and technical support. No other upgrades, products or other post−contract support are provided. When the Company provides a combination of services related to licensing and support and maintenance to customers, in addition to the considerations noted above, the Company evaluates the arrangements under EITF 00−21, "Revenue Arrangements with Multiple Deliverables". Specifically, the Company analyzes the separate elements to determine if vendor specific objective evidence, or VSOE, exists for the undelivered elements. The Company believes it has established VSOE for its support and maintenance arrangements. These arrangements are renewable annually by the customer. Support and maintenance revenue is recognized at its fair value ratably over the period during which the obligation exists, typically 12 months. The fair value of any support and maintenance obligation is established based on the specified renewal rate for such support and maintenance. Revenue from support and maintenance service represented $512,000 and $60,000 in 2005 and 2004, respectively, and was included in licensing revenue in the statement of operations.

From time to time, a licensee may cancel a project during the development phase. Such a cancellation is not within the Company's control and is often caused by changes in market conditions or the licensee's business. Cancellations of this nature are an aspect of the Company's licensing business, and, in general license contracts signed since the beginning of 2002 allow the Company to retain all payments that the Company has received or is entitled to collect for items and services provided before the cancellation occurs. Typically under our agreements, the licensee is obligated to complete the project within a stated timeframe, including assisting us in completing the final milestone, and if the Company performs the contracted services, is obligated to pay the license fees even if the licensee fails to complete verification or cancels the project prior to completion. The Company will consider a project to have been canceled even in the absence of specific notice from its licensee, if there has been no activity under the contract for a significant period, and the Company believes that completion of the contract is unlikely. In this event, the Company recognizes revenue in the amount of cash received, if the Company has performed a sufficient portion of the development services. If a cancelled contract had been entered into before the establishment of technological feasibility, the costs associated with the contract would have been expensed prior to the recognition of revenue. In that case, there would be no costs associated with that revenue recognition, and gross margin would increase for the corresponding period. In 2005, the Company recognized $240,000 of licensing revenue from cancelled contracts, compared to none in 2004 and $759,000 in 2003.

Royalty

Licensing contracts provide also for royalty payments at a stated rate and require licensees to report the manufacture or sale of products that include the Company's technology after the end of the quarter in which the sale or manufacture occurs. The Company recognizes royalties in the quarter in which the Company receives the licensee's report. Generally, royalty payments are made by the licensees at about the same time as the Company receives their reports. The Company recognized no royalty revenue from terminated contracts in 2005 and 2004, compared to $713,000 in 2003.

Product

Revenue from product sales is recognized upon shipment provided that persuasive evidence of a sales arrangement exists, the price is fixed or determinable, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements and there are no remaining significant obligations. For each of the periods presented, there were no formal acceptance provisions with the Company's end customers. During 2004, we phased out sales of our proprietary 1T−SRAM memory chips. The Company does not expect to sell memory chips in the future.

Cost of Revenue

Licensing

Cost of licensing revenue consists primarily of engineering costs directly related to engineering development projects specified in agreements we have with licensees of our 1T−SRAM technologies. These projects typically include customization of 1T−SRAM circuitry to enable embedding our memory on a licensee's integrated circuit and may include engineering support to assist in the commencement of production of a licensee's products. We recognize costs of licensing revenue in the following manner:

- If licensing revenue is recognized using the percentage of completion method, the associated cost of licensing revenue is recognized in the period in which we incur the engineering costs.
- If licensing revenue is recognized using the completed contract method, and to the extent that the amount of engineering cost does not exceed the amount of the related licensing revenue, this cost is deferred on a contract−by−contract basis from the time we have established technological feasibility of the product to be developed under the license. Technological feasibility is established when we have completed all activities necessary to demonstrate that the licensee's product can be produced to meet the performance specifications when incorporating our technology. Deferred costs are charged to cost of licensing revenue when the related revenue is recognized.
- For contracts entered into prior to establishing technological feasibility, we do not defer related development costs, but rather expense them in the period in which they are incurred. Consequently, upon completion of these contracts, we recognize the related revenues without any corresponding costs.

In addition, cost of licensing revenue includes costs related to support and maintenance services.

Royalty

There are no reported costs associated with royalty revenue.

Product

Cost of product revenue consists primarily of costs associated with the manufacture, assembly and testing of the Company's memory chip products by independent, third−party contractors. There were no

reported costs associated with product revenue in 2005 as the products were sold from the inventory previously written off.

Research and Development

Engineering cost is generally recorded as research and development expense in the period incurred.

Stock−based Compensation

The Company accounts for stock−based compensation arrangements in accordance with the provisions of APB No. 25 (“APB No. 25”), “Accounting for Stock Issued to Employees” and complies with the disclosure provisions of Statement of Financial Accounting Standard No. 123 (“SFAS No. 123”), “Accounting for Stock−Based Compensation.” Under APB No. 25, compensation cost is, in general, recognized based on the excess, if any, of the fair market value of the Company’s stock on the date of grant over the amount an employee must pay to acquire the stock. Equity instruments issued to non−employees are accounted for in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force 96−18. Deferred stock−based compensation is being amortized using the graded vesting method over the vesting period of each respective option, which is generally four years.

Had compensation cost for the Company’s option plans been determined based on the fair value at the grant dates, as prescribed in SFAS 123, the Company’s net income (loss) would have been as follows (in thousands, except per share amounts):

	Year Ended December 31,		
	2005	2004	2003
Net income (loss):			
As reported	$ (2,982)	$ (1,907)	$ 2,508
Add: stock−based compensation expense reported in consolidated statements of operations, net of related tax effects	36	68	459
Less: stock compensation related to stock awards assumed during the ATMOS acquisition, net of related tax effects			(248)
Total stock−based compensation expense determined under fair value based method for all awards, net of related tax effects	(6,046)	(4,434)	(4,537)
	$ (8,992)	$ (6,273)	$ (1,818)
Earnings (losses) per share:			
Basic—as reported	$ (0.10)	$ (0.06)	$ 0.08
Basic—pro forma	$ (0.29)	$ (0.20)	$ (0.06)

The fair value of each grant is estimated on the date of grant using the Black−Scholes method with the following assumptions used for grants during the applicable periods:

	Year Ended December 31,		
Employee stock options	2005	2004	2003
Expected life (in years)	4.0 − 5.0	5.0	5.0
Risk−free interest rate	3.7% − 4.5%	3.2% − 3.7%	2.1% − 3.6%
Volatility	56.7%	81.5%	75.9%
Dividend yield	0%	0%	0%

Employee stock purchase plan shares	2005	2004	2003
Expected life (in years)	1.0	1.0	1.0
Risk−free interest rate	2.8% − 3.5%	1.2% − 2.2%	1.1% − 1.4%
Volatility	44.0%	80.3%	69.9%
Dividend yield	0%	0%	0%

The Company selected the Black−Scholes option valuation model, which is one of the permitted methods to estimate the fair market value of options under SFAS No. 123. The weighted average fair value of options granted during 2005, 2004 and 2003 was $3.38, $4.08, and $4.97, respectively. The weighted average estimated fair value of shares granted under the employee stock purchase plan during 2005, 2004 and 2003 was $2.22, $2.95 and $4.21, respectively. On December 14, 2005, the Company fully accelerated the vesting of all outstanding stock options that have an exercise price greater than or equal to $7.42 and were granted before April 19, 2004, pursuant to the authorization of the Compensation Committee of the board of directors. As a result of this option vesting acceleration, approximately $1.1 million of additional stock−based compensation expense was included in the pro forma stock−based compensation expense of $6.0 million in 2005 under SFAS No. 123.

Per Share Amounts

Basic net income (loss) per share is computed by dividing net income (loss) for the period by the weighted−average number of shares of common stock outstanding during the period. Diluted net income per share for the year ended December 31, 2003 was computed by dividing the net income for the period by the weighted average number of common and potential common equivalent shares outstanding during the period. Potential common shares are composed of incremental shares of common stock issuable upon the exercise of stock options or warrants. Diluted net loss per share for the years ended December 31, 2005 and 2004 are the same as basic net loss per share for the same period because the impact of including potential common shares is anti−dilutive. For the years ended December 31, 2005 and 2004, stock options to purchase 1.4 and 1.3 million shares with exercise prices greater than the average market prices of common stock were excluded from computation of diluted net loss per share as their inclusion would be anti−dilutive. The following table sets forth the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Year Ended December 31,		
	2005	2004	2003
Numerator:			
Net income (loss)	$ (2,982)	$ (1,907)	$ 2,508
Denominator:			
Shares used in computing net income (loss) per share:			
Basic	30,534	30,750	30,504
Employee stock options and unvested common stock outstanding			494
Diluted	30,534	30,750	30,998
Net income (loss) per share:			
Basic	$ (0.10)	$ (0.06)	$ 0.08
Diluted	$ (0.10)	$ (0.06)	$ 0.08

Income Taxes

The Company accounts for income taxes using the asset and liability method as prescribed by Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (“SFAS 109”). Under the asset and liability method, the expected future tax consequences of temporary differences between the book and tax basis of assets and liabilities are recognized as deferred tax assets and liabilities. A valuation allowance is established for any deferred tax assets for which realization is more likely than not that all or a portion of the deferred tax assets will not be realized.

Comprehensive Income (Loss)

Statement of Financial Accounting Standards No. 130 “Reporting Comprehensive Income” (“SFAS No. 130”) requires the Company to display comprehensive income and its components as part of the

financial statements. The Company's only component of comprehensive income (loss) is unrealized gains and losses on available for sale securities. Accumulated other comprehensive income (loss) as of December 31, 2005, 2004 and 2003 was ($389,000), ($252,000) and $56,000, respectively. The changes in other comprehensive income (loss) were as follows, for the years ended December 31, 2005, 2004, and 2003:

	2005	2004	2003
		(in thousands)	
Net income (loss)	$ (2,982)	$ (1,907)	$ 2,508
Net unrealized loss on available−for−sale securities:			
Change in net unrealized loss	(137)	(308)	(60)
Comprehensive income (loss)	$ (3,119)	$ (2,215)	$ 2,448

Segment Reporting

Financial Accounting Standards Board Statement No. 131, "Disclosure about Segments of an Enterprise and Related Information" ("SFAS No. 131") requires that companies report separately in the financial statements certain financial and descriptive information about operating segment profit or loss, certain specific revenue and expense items and segment assets. The Company operates in one segment, using one measurement of profitability for its business. The Company has sales outside the United States that are described in Note 9. The vast majority of long−lived assets are maintained in the United States.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share−Based Payment" (SFAS 123R) which will become effective beginning in the first quarter of 2006. SFAS 123R will result in the recognition of substantial compensation expense relating to our employee stock options and employee stock purchase plans. The Company currently uses the intrinsic value method to measure compensation expense for stock−based awards to its employees. Under this standard, the Company generally does not recognize any compensation related to stock option under its stock option plans or related to the discounts the Company provided under its employee stock purchase plans. Under the new rules however, the Company will be required to adopt a fair−value−based method for measuring the compensation expense related to employee stock awards. The Company estimates the impact of adopting SFAS No. 123R will have an earnings impact of approximately nine to ten cents per share in 2006, based on estimated compensation expense from unvested options outstanding as of the end of December 31, 2005. Compensation expense calculated upon adoption of SFAS No. 123R for future grants may differ from pro−forma amounts currently disclosed in our footnotes based on changes in the fair value of our common stock, the treatment of tax benefits, different assumptions and treatment of forfeitures under SFAS No. 123R, and changes in interest rates or other factors. The Company is currently considering its method of adoption, modified prospective approach or modified retrospective approach"

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections", which is a replacement of APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. This statement changes the requirements for the accounting for and reporting of a change in accounting principle. It applies to all voluntary changes in accounting principle. It requires retrospective application to prior periods' financial statements of changes in accounting principle unless it is impracticable. It is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Note 2: Restructuring

On November 10, 2004, the Company announced its plan to close the ATMOS research and development facility in Canada to reduce operating expenses and to further align the Company's business with market conditions, future revenue expectations and planned future product direction. As part of this plan, the Company implemented a reduction in workforce of approximately 20 employees, which represented 20% of its workforce. On July 15, 2005, the Company signed an agreement to sublease the ATMOS facility, which the Company occupies under long−term operating leases through 2008.

The Company had a total restructuring estimated lease abandonment accrual of $293,000 and $429,000 for the years ended 2005 and 2004, respectively. The Company reviews these estimates periodically, and if the pertinent assumptions materially change, the ultimate restructuring expense for the abandoned facilities will be adjusted in accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities".

The following table summarizes 2005 activities under the Restructuring Plan (amounts in thousands):

	Abandoned Space	Severance Related	Total
Restructuring liability at December 31, 2004	$ 410	$ 19	$ 429
Less current portion	171	19	190
Long−term portion of restructuring liability	239	—	239
2005 adjustments	121	—	121
Cash payments	(247)	(18)	(265)
Foreign exchange fluctuations	9	(1)	8
Restructuring liability at December 31, 2005	293	—	293
Less current portion	97	—	97
Long−term portion of restructuring liability	$ 196	$ —	$ 196

Note 3: Details of Balance Sheet Components and Consolidated Statements of Operations

	December 31,	
	2005	2004
	(in thousands)	
Prepaid expenses and other current assets:		
Deferred costs of revenue	$ 24	$ 338
Deferred tax assets	1,316	831
Prepaid expenses and other assets	1,292	1,770
	$ 2,632	$ 2,939
Accrued expenses and other liabilities:		
Accrued wages and employee benefits	$ 631	$ 621
Professional fees	432	711
Deferred rent	51	65
Accrued restructuring liability—current portion	97	190
Income taxes payable	22	19
Withholding tax payable	1,052	1,052
License fees payable	—	453
Other	279	203
	$ 2,564	$ 3,314

Interest and other income:

	2005	2004	2003
		(in thousands)	
Interest Income	$ 2,608	$ 1,527	$ 1,350
Other Income (loss)	(17)	10,051	564
	$ 2,591	$ 11,578	$ 1,914

In 2004, the Company received the $10 million termination fee from Synopsys as a result of the settlement agreement regarding the aborted merger. In 2003, other income included the $287,000 contract termination fee from Conexant.

Note 4: Fair Value of Financial Instruments

The estimated fair values of financial instruments outstanding at fiscal year−ends were as follows:

	2005		
	Cost	Gross Unrealized Loss	Fair Value
		(in thousands)	
Cash	$ 8,148	$ —	$ 8,148
Cash Equivalents:			
Commercial and US government agencies paper	1,027	(4)	1,023
Total cash and cash equivalents	$ 9,175	$ (4)	$ 9,171
Short−term investments and auction rate securities:			
Corporate notes	$12,063	$ (83)	$11,980
US government debt securities	21,490	(141)	21,349
Market auction rate certificates	26,150	—	26,150
Total short−term investments and auction rate securities	$59,703	$ (224)	$59,479
Long−term investments:			
US government debt securities	$12,179	$ (107)	$12,072
Corporate notes	5,321	(54)	5,267
Total long−term investments	$17,500	$ (161)	$17,339

	2004		
	Cost	Gross Unrealized Loss	Fair Value
		(in thousands)	
Cash	$ 7,564	$ —	$ 7,564
Cash Equivalents:			
Commercial and US government agencies paper	24,150	—	24,150
Total cash and cash equivalents	$31,714	$ —	$31,714
Short−term investments and auction rate securities:			
US government debt securities	$11,800	$ (39)	$11,761
Corporate notes	17,949	(75)	17,874
Market auction preferred securities	1,000	—	1,000
Total short−term investments and auction rate securities	$30,749	$ (114)	$30,635
Long−term investments:			
US government debt securities	$17,500	$ (80)	$17,420
Corporate notes	7,200	(58)	7,142
Total long−term investments	$24,700	$ (138)	$24,562

The following table shows the cost and fair value of cash equivalents, short−term and long−term investments based on two maturity groups as of December 31, 2005 (amounts in thousands):

	Cost	Gross Unrealized Loss	Fair Value
Due within 1 year	$ 60,730	$ (228)	$ 60,502
Due 1−2 years	17,500	(161)	17,339
Total	$ 78,230	$ (389)	$ 77,841

There were no realized gains or losses for 2005, 2004 and 2003.

The following table shows the fair value of the Company's investments with unrealized losses that are not deemed to be other−than−temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2005 (amounts in thousands):

	Less than 12 months		12 months or greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of securities:						
US Government Debt Securities	$ 21,349	$ (141)	$ 12,072	$ (107)	$33,421	$ (248)
Corporate Notes	13,003	(87)	5,267	(54)	18,270	(141)
Total	$ 34,352	$ (228)	$ 17,339	$ (161)	$51,691	$ (389)

U.S. Government Debt Securities. The Company's investment in U.S. Government Debt Securities consists of low risk government agency bonds typically with a rating of AAA. The unrealized losses on the Company's investments in U.S. Government Debt Securities were caused by interest rate increases during 2005. Because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other−than−temporarily impaired at December 31, 2005.

Corporate Notes. The Company's investment in corporate notes consists primarily of investment grade corporate bonds and notes. The unrealized losses on the Company's investment grade corporate bonds and notes were caused by interest rate increases during 2005. Due to the fact that the decline in market value is attributable to changes in interest rates and not credit quality, and because the severity and duration of the unrealized losses were not significant, the Company considered these unrealized losses to be temporary at December 31, 2005. Because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other−than−temporarily impaired at December 31, 2005.

Note 5: Income Taxes

The (provision) benefit for income taxes consists of the following (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Current portion:			
U.S. federal	$ —	$ 904	$ 634
State	31	(3)	(2)
Foreign	(23)	(104)	(150)
	8	797	482
Deferred:			
U.S. federal	3	(823)	(761)
State	—	—	—
Foreign	—	—	—
	3	(823)	(761)
	$ 11	$ (26)	$ (279)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of the Company's deferred tax assets and liabilities were as follows:

	December 31,	
	2005	2004
Deferred tax assets (liabilities):		
Federal and state loss carryforwards	3,586	1,614
Reserves, accruals and other	490	271
Deferred revenue	—	799
Depreciation and amortization	(94)	(212)
Deferred compensation	268	455
Research and development credit carryforwards	1,301	2,013
Foreign tax credits	553	435
Canadian loss and research and development pool carryforwards	6,124	6,238
	12,228	11,613
Less: Valuation allowance	(10,912)	(10,782)
Net deferred tax assets	$ 1,316	$ 831

The valuation allowance increased by $130,000 and $2.5 million, during the years ended December 31, 2005 and 2004, respectively. The valuation allowance at December 31, 2005 includes $1.9 million related to stock option deductions, the benefit of which will be credited to additional paid in capital when realized.

As of December 31, 2005, the Company had net operating loss carryforwards of approximately $9.4 million for federal income tax purposes and approximately $6.9 million for state income tax purposes. These losses are available to reduce taxable income and expire beginning 2013 through 2025. The Company also had federal research and development tax credit carryforwards of approximately $750,000, which will expire beginning in 2021, and California research and development credits of approximately $842,000, which do not have an expiration date. The Company had foreign tax credits available for federal income tax purposes of approximately $553,000, which will begin to expire in 2008. The Company had

Canadian operating loss and research and development pool carryforwards of $12.1 million, which will begin to expire in 2008. Utilization of the Company's net operating loss and tax credit carryforwards may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration or elimination of the net operating loss and tax credit carryforwards before utilization. Management does not believe it is likely that utilization will in fact be significantly limited due to ownership change limitation provisions.

The Company's U.S. income tax return for 2002 is under examination. Management believes that adequate amounts have been provided for any adjustments that may ultimately result from this examination.

A reconciliation of income taxes provided at the federal statutory rate (35% in 2005, 2004 and 2003) to actual income tax expense follows:

	Year Ended December 31,		
	2005	2004	2003
	(in thousands)		
Income tax (provision) benefit computed at federal statutory rate	$ 1,048	$ 659	$ (976)
State income tax (net of federal benefit)	(4)	(3)	(2)
Foreign income tax at rate different from US statutory rate	(47)	(28)	15
Utilization of previously reserved NOL's	—	—	834
Research & development credits	96	—	—
Valuation allowance changes affecting tax provision	(1,029)	(641)	(73)
Tax benefit from extraterritorial income exclusion	—	—	206
Other	(53)	(13)	(283)
	$ 11	$ (26)	$ (279)

The domestic and foreign components of earnings before taxes were as follows for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
	(in thousands)		
U.S.	$ (2,851)	$ (1,685)	$ 2,316
Non−U.S.	(142)	(196)	471
	$ (2,993)	$ (1,881)	$ 2,787

Note 6: Guarantees

Indemnifications

In the ordinary course of business, the Company enters into contractual arrangements under which the Company may agree to indemnify the third party to such arrangement from any losses incurred relating to the services they perform on behalf of the Company or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to patent infringement. The maximum amount of indemnification the Company could be required to make under these agreements is generally limited to the fees received by the Company, although in some contracts the Company's potential obligation could be equal to the third parties' actual damages and losses. The Company has not estimated the maximum potential amount of indemnification liability under these agreements due to the limited history of prior claims and the unique facts and circumstances applicable to

each particular agreement. To date, the Company has not made any payments related to these indemnifications.

Note 7: Stockholders' Equity

Common Stock Option Plans

In 1996, the Company adopted the 1996 Stock Plan (the "1996 Plan"), which authorizes the board of directors to grant incentive stock options and nonqualified stock options for up to 2,500,000 shares of common stock to employees, directors and consultants. The option terms under the 1996 Plan are substantially the same as the 1992 Plan except that options granted under the 1996 Plan may be exercised immediately. Common stock purchased pursuant to the exercise of an unvested option is subject to repurchase by the Company, at the exercise price, under certain conditions. Options generally vest over a four−year period and are exercisable for a maximum period of ten years after the date of grant.

The Company's 2000 employee stock option plan (the "2000 plan") was adopted in October 2000 in connection with the Company's reincorporation in the state of Delaware. In 2004, the Company obtained shareholders' approval to its Amended and Restated 2000 Stock Option and Equity Incentive Plan (the "Amended 2000 Plan") to provide additional incentive to our employees and directors. The Amended 2000 plan authorizes the board or Committee to grant a broad range of awards in addition to stock options, including stock grants, restricted stock, performance−based awards, restricted stock units representing a right to acquire shares in the future and stock appreciation rights and to determine the applicable terms, including price, of such awards. Under the Amended 2000 plan, the maximum number of shares, which are reserved for issuance is 7,207,000, plus an annual increase of 500,000 on January 1 of each year, or a lesser amount determined by our board of directors. The term of options granted under the Amended 2000 plan may not exceed ten years. The term of all incentive stock options granted to an optionee who, at the time of grant, owns stock representing more than 10% of the voting power of all classes of the Company's stock may not exceed five years. Generally, 25% of the options granted under the Amended 2000 Plan will vest and become exercisable on the first anniversary of the date of grant, and 1/48th of the options will vest and become exercisable each month thereafter.

The exercise price of incentive stock options granted under the Amended 2000 Plan must be at least equal to the fair market value of the shares on the date of grant. The exercise price of nonstatutory stock options granted under the amended 2000 plan will be determined by the board of directors and the exercise price of a nonqualified stock option will not be subject to any price restriction under the Amended 2000 Plan. No incentive stock option may be granted to any employee who on the date of grant owns more than ten percent of our common stock, unless the exercise price of the option is equal to at least 110% of the fair market value of such shares on the date of grant. In addition, the Amended 2000 Plan provides for automatic acceleration of vesting for options granted to non−employee directors in the event of an acquisition of the Company.

A summary of the status of all the Company's stock option plans as of December 31, 2003, 2004 and 2005 and changes during the years ended on these dates are presented below (in thousands, except per share amounts):

		Options Outstanding	
	Available for Grant	Number of Options	Weighted Average Exercise Prices
Balance at December 31, 2002	3,917	4,105	$7.47
Additional authorized under the 2000 Plan	500		
Granted	(1,066)	1,066	$7.99
Cancelled	360	(360)	$8.60
Exercised	—	(439)	$3.30
Balance at December 31, 2003	3,711	4,372	$7.92
Additional authorized under the 2000 Plan	500		
Granted	(3,324)	3,324	$4.00
Cancelled	1,251	(1,251)	$7.62
Exercised	—	(688)	$4.70
Balance at December 31, 2004	2,138	5,757	$6.11
Additional authorized under the 2000 Plan	500		
Granted	(2,648)	2,648	$5.41
Cancelled	1,522	(1,522)	$5.80
Exercised	—	(406)	$2.98
Balance at December 31, 2005	1,512	6,477	$6.09

Options exercisable under the Company's options plans were 2.7 million, 2.1 million and 2.3 million in 2005, 2004 and 2003, respectively.

Information relating to stock options outstanding at December 31, 2005 is as follows (in thousands, except per share amounts):

	Options Outstanding at December 31, 2005			Options Exercisable at December 31, 2005	
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
$1.00−$4.09	1,870	8.15	$ 3.67	696	$ 3.35
$4.10−$8.00	3,350	8.86	$ 5.82	794	$ 7.17
$8.01−$10.00	489	6.14	$ 9.46	489	$ 9.46
$10.01−$15.69	768	6.26	$ 11.06	768	$ 11.06
	6,477			2,747	

The Company's board of directors may issue up to 20,000,000 shares of preferred stock without stockholder approval on such terms as the board might determine. The rights of the holders of common stock will be subject to, and might be adversely affected by, the rights of the holders of any preferred stock that might be issued in the future.

On December 14, 2005, the Company fully accelerated the vesting of all outstanding stock options granted under the Company's Amended 2000 Plan that have an exercise price greater than or equal to $7.42 and were granted before April 19, 2004, pursuant to the authorization of the Compensation Committee of the board of directors. As a result of this action, options to purchase approximately 220,000 shares of the Company's common stock became immediately exercisable. This option vesting acceleration

eliminated approximately $1.1 million of stock−based compensation expense that would have been recorded over the remaining terms of the affected options under Statement of Financial Accounting Standards No. 123 (revised 2004), Share−Based Payment ("SFAS 123R"), which became effective for the Company on January 1, 2006.

On December 14, 2005, pursuant to authorization by the Compensation Committee of the board of directors, the Company commenced an offer of restricted shares of its common stock under the Amended 2000 Plan to the United States employees holding outstanding options to purchase common stock granted before April 19, 2004 having an exercise price of $7.42 or more per share upon the surrender of 100% such options for cancellation. If all eligible options were tendered, the Company would issue approximately 284,000 shares of restricted stock, which would vest in annual installments over three years and would cancel options to purchase approximately 1,276,000 shares of common stock. See Note 11, "Subsequent Events".

Employee Stock Purchase Plan

The Company's 2000 employee stock purchase plan was adopted in October 2000 in connection with the Company's Delaware re−incorporation, to become effective upon the pricing date of the Company's initial public offering. A total of 500,000 shares of common stock have been reserved for issuance under the purchase plan. In addition, the purchase plan provides for an automatic annual increase in the number of shares reserved under the plan on January 1 of each year, equal to the lesser of 100,000 shares, one percent of the Company's outstanding shares of common stock on such date or a lesser amount determined by the board of directors. The purchase plan, which is intended to qualify under Section 423 of the Internal Revenue Code, is administered by the board of directors or a committee appointed by the board of directors.

Employees, including officers and employee directors but excluding 5% stockholders, are eligible to participate if they are customarily employed for at least 20 hours per week and for more than five months in any calendar year. The purchase plan permits eligible employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation. Employees will be permitted to invest a maximum of $25,000 in any offering period.

The purchase plan has been implemented in a series of overlapping offering periods, each to be approximately 12 months in duration. Offering periods begin on the first trading day on or after January 1 and July 1 of each year and end on the last trading day in the period ending twelve months later. Each participant is granted an option on the first day of the offering period, and such option will be automatically exercised at the end of month six of the offering period and on the last day of the offering period. The purchase price of the common stock under the purchase plan is equal to 85% of the lesser of the fair market value per share of common stock on the start date of the offering period or on the date on which the option is exercised. Employees may end their participation in an offering period at any time during that period, and participation ends automatically on termination of employment with the Company. The purchase plan will terminate in June 2010, unless sooner terminated by the board of directors.

On December 14, 2005, pursuant to authorization by the Compensation Committee of the board of directors the Company announced that there would be no offering period from January 1, 2006 to June 30, 2006 under the Company's 2000 Employee Stock Purchase Plan (the "ESPP"). This action avoids the recognition of stock−based compensation expense for shares purchased under the ESPP under SFAS 123R, which took effect for the Company as of January 1, 2006.

Of the 600,000 shares authorized to be issued under the purchase plan, 365,000 shares remained available for issuance at December 31, 2005. Employees purchased 66,000, 66,000 and 55,000 shares in 2005, 2004 and 2003, respectively.

Deferred Stock−based Compensation Cost to Employees

During the year ended December 31, 2004, the Company recorded deferred compensation cost of approximately $74,000, which is amortized to expense over 36 months. The 2004 deferred compensation cost represents the intrinsic value of options granted to purchase shares of the Company's stock to newly appointed members of the Company's board of directors that had an exercise price less than the fair market value of the Company's common stock on the date of the option grant. This deferred compensation cost will be amortized over the option vesting period of 36 months using the graded vesting method. No deferred stock compensation cost was recorded in 2005 or 2003.

During the years ended December 31, 2005, 2004 and 2003, the Company recorded stock compensation expenses of $36,000, $68,000, and $459,000, respectively, of which $0, $50,000, and $211,000, respectively, was attributable to the excess of the fair market value of the Company's common stock over the price at which the Company granted stock options to employees. Stock compensation expenses in 2005, 2004 and 2003 also included $0, $13,000 and $227,000, respectively, for amortization of deferred compensation cost attributable to the fair market value of shares of the Company's common stock issued to certain employees of ATMOS. In addition, the Company incurred $5,000 of stock compensation expense in 2004 related to the issuance of options to purchase the Company's stock to newly appointed members of the Company's board of directors that had an exercise price less than the fair market value of the Company's stock on the date of the option grant. The Company also incurred $21,000 of stock compensation expense in 2003 due to modification of the Company's 2000 employee stock option held by a former member of the Company's board of directors.

Deferred compensation expense is being amortized using the graded vesting method over the vesting period of each respective option, generally four years. The accelerated amortization results in expensing approximately 52% of the total award in the first year, 27% in the second year, 15% in the third year and 6% in the fourth year.

Stockholder Rights Plan

The Company's Stockholder Rights Plan, which was adopted in October 2000 and became effective June 27, 2001, is intended to protect stockholders from unfair or unfriendly takeover practices. In accordance with this plan, the board of directors declared a dividend distribution of one Series AA preferred stock purchase right on each outstanding share of its common stock held as of June 27, 2001, and on each share of common stock issued by the Company thereafter. Each right entitles the registered holder to purchase from the Company one one−thousandth share of Series AA preferred stock at a price of $110. The rights become exercisable in certain circumstances, including the acquisition by any person or group, or the commencement or announcement of a tender or exchange offer for the acquisition, of beneficial ownership of 15 % or more of the Company's common stock without the approval of the board of directors (except for certain affiliates prior to the effective date of the Plan as to whom this ownership limit is 25%). The rights do not confer any rights as a stockholder until they are exercised. In the event the rights become exercisable, each right will entitle the holder to acquire shares of common stock of the Company or the acquiring corporation (in the event of merger or similar business combination) having a value equal to twice the purchase price of the right. The rights are redeemable by the Company prior to exercise at $0.01 per right and expire on October 11, 2010.

In 2004, the Company amended its Stockholder Rights Plan twice; once, in connection with the proposed acquisition of the Company by Synopsys, Inc, and a second time to permit the acquisition of shares representing more than 15% of its common stock by a brokerage firm that manages independent customer accounts and generally does not have any discretionary voting power with respect to such shares. Notwithstanding amendments of this nature, the Company's intention is to maintain and enforce the terms of this plan, which could delay, deter or prevent an investor from acquiring the Company in a transaction

that could otherwise result in stockholders receiving a premium over the market price for their shares of common stock.

Stock Repurchase Plan

On April 19, 2004, the Company announced that its board of directors authorized the repurchase of up to $25 million of its common stock over the next 12 months. The Company repurchased approximately $4.7 million or 1.2 million shares of its common stock in 2004 under that repurchase program. On April 29, 2005, the Company's board of directors authorized a new stock repurchase program for the purchase of up to $20 million of the Company's common stock over the next 12 months. No shares were repurchased under the new stock repurchase program in 2005.

Note 8: Retirement Savings Plan

Effective January 1997, the Company adopted the MoSys 401(k) Plan (the "Savings Plan") which qualifies as a thrift plan under Section 401(k) of the Internal Revenue Code. All full−time employees who are at least 21 years old are eligible to participate in the Savings Plan at the time of hire. Participants may contribute up to 15% of their earnings to the Savings Plan. The Company makes a Matching Contribution on behalf of each Participant in an amount equal to 25% of a Participant's Deferral Contributions during the Plan Year. The Company made matching contributions of $127,000, $110,000, and $107,000 in 2005, 2004 and 2003, respectively.

Note 9: Business Segments, Concentration of Credit Risk and Significant Customers

The Company has adopted SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." Although the Company offers various intellectual property components and services to its customers, the Company does not manage its operations by these intellectual property components and services, but instead views the Company as one operating segment when making business decisions. The Company does not manage its operations on a geographical basis. Revenue attributed to the United States and to all foreign countries is based on the geographical location of the customer. The Company uses one measurement of profitability for its business.

The Company supplies semiconductor memories to the electronics industry. This industry segment is characterized by rapid technological change and significant competition.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents short−term and long−term investments and accounts receivable. Cash, cash equivalents short−term and long term investments are deposited with high credit quality institutions.

The Company sells its products and licenses its 1T−SRAM technologies to customers in the Far East, North America and Europe as follows (in thousands):

	Years Ended December 31,		
	2005	2004	2003
North America	$ 3,630	$ 4,602	$ 7,767
Japan	7,636	4,609	7,146
Asia	1,016	1,191	3,969
Europe	—	419	351
Total	$ 12,282	$ 10,821	$ 19,233

Customers who accounted for at least 10% of total revenues were as follows:

	Years Ended December 31,		
	2005	2004	2003
NEC	35%	19%	14%
Fujitsu	17%	17%	—
Marvel	—	11%	—
UMC	—	—	11%
Sony	—	—	17%

Three customers accounted for 40%, 22% and 20% of gross accounts receivable, respectively, at December 31, 2005. Three customers accounted for 46%, 17% and 11% of gross accounts receivable, respectively, at December 31, 2004. The Company performs ongoing credit evaluations of its customers' financial condition and maintains an allowance for uncollectible accounts receivable based upon the expected collectibility of all accounts receivable. $105,000 was reserved in the allowance for uncollectible accounts receivable in 2005. No amounts were written off in 2004 and 2003.

Net property, plant and equipment, classified by major geographic areas were as follows at December 31, 2005 and 2004.

	December 31,	
	2005	2004
	(in thousands)	
U.S.	$ 1,075	$ 621
Non−U.S.	46	64
Total	$ 1,121	$ 685

Note 10: Commitments and Contingencies

The Company leases its facilities under non−cancelable operating leases that expire in 2006 through 2010. Rent expense was approximately $797,000, $1,157,000, and $1,143,000 for the years ended December 31, 2005, 2004 and 2003, respectively. The leases provide for monthly payments and are being charged to operations ratably over the lease terms. In addition to the minimum lease payments, the Company is responsible for property taxes, insurance and certain other operating costs. Future minimum lease payments under the non−cancelable operating leases as of December 31, 2005 are as follows (in thousands):

Year Ended December 31,	Minimum Lease Commitments	Sublease Income	Net Lease Commitments
2006	$ 870	$ 201	$ 669
2007	842	137	705
2008	525	46	479
2009	370	—	370
2010 and thereafter	189	—	189
Total minimum payments	$ 2,796	$ 384	$ 2,412

In July 2005, one of the Company's customers filed a claim concerning excess verification costs incurred by the customer in implementing a custom design for 1T−SRAM memory technology under a licensing contract. The claim was settled in December 2005 with a net−down of $304,000 in accounts receivable and contingent liability. There was no contingent liability as of December 31, 2005, however, the Company has given up the right to receive $71,000 in future royalties from this customer, should they be earned.

Legal Matters

On March 31, 2004, UniRAM Technology, Inc. filed a complaint against the Company in the United States District Court for the Northern District of California, alleging trade secret misappropriation and patent infringement. UniRAM's complaint asserts that it provided trade secret information to Taiwan Semiconductor Manufacturing Corporation (TSMC) in 1996−97 and speculated that we improperly obtained unspecified trade secrets of UniRAM from TSMC in an unknown manner. Subsequent to March 31, 2004, UniRAM amended its complaint twice to add TSMC as a defendant and additional allegations to the suit, and to drop all infringement claims for one of the two patents identified in the initial complaint. The Company believes that UniRAM's complaint lacks merit and intends to vigorously defend against it. In October 2005, the court held a "Markman hearing" to construe and interpret the claims of the patent which UniRAM continues to assert against the Company and TSMC. As yet, the court has not issued its claim construction order.

From time to time the Company may be subject to legal proceedings and claims in the ordinary course of business. These claims, even if not meritorious, could result in the expenditure of significant financial resources.

Note 11: Subsequent Events

On December 14, 2005, pursuant to authorization by the Compensation Committee of the board of directors, the Company commenced an offer of restricted shares of its common stock under the Amended 2000 Plan to the United States employees holding outstanding options to purchase common stock granted before April 19, 2004 having an exercise price of $7.42 or more per share upon the surrender of such options for cancellation.

The offer expired at midnight, Pacific Time, on Friday, January 13, 2006. The eligible participants elected to surrender for cancellation an aggregate of approximately 318,054 shares of Company common stock underlying eligible options and received an aggregate of approximately 76,654 shares of restricted Company common stock. The value of the Company's common stock on the offer termination date was $5.91 per share. Upon the terms and subject to the conditions of the offer, the Company promptly issued to eligible participants restricted shares of Company common stock. No executive officers elected to accept the offer.

Schedule II—Valuation and Qualifying Accounts
(In thousands)

Description	Balance at beginning of period	Additions		Deductions	Balance at end of period
		Charged to costs and expenses	Charged to other accounts	Amount recovered (written off)	
Year ended December 31, 2005					
Allowance for doubtful accounts	$ —	$ 105	$ —	$ —	$ 105
Deferred tax asset valuation allowance	$ 10,782	$ —	$ 133	$ (3)	$ 10,912
Year ended December 31, 2004					
Allowance for doubtful accounts	$ —	$ —	$ —	$ —	$ —
Year ended December 31, 2003					
Allowance for doubtful accounts	$ —	$ —	$ —	$ —	$ —

Exhibit 10.16

OFFICE BUILDING LEASE

BETWEEN

SUNNYVALE MATHILDA INVESTORS, LLC
a California limited liability company

LANDLORD

AND

MONOLITHIC SYSTEM TECHNOLOGY, INC., dba MOSYS,
a Delaware corporation

TENANT

OFFICE BUILDING LEASE

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EXHIBITS:

OFFICE BUILDING LEASE

This OFFICE BUILDING LEASE ("Lease") is entered into as of the 6th day of May, 2005 by and between SUNNYVALE MATHILDA INVESTORS, LLC, a California limited liability company ("Landlord"), and MONOLITHIC SYSTEM TECHNOLOGY, INC., dba MOSYS , a Delaware corporation ("Tenant").

1. **BASIC LEASE TERMS.** For purposes of this Lease, the following terms have the following definitions and meanings:

(a) **Landlord:** SUNNYVALE MATHILDA INVESTORS, LLC, a California limited liability company.

(b) **Landlord's Address (For Notices):**

SUNNYVALE MATHILDA INVESTORS, LLC
c/o Matteson Real Estate Equities, Inc.
1991 Broadway, Suite 300
Redwood City, CA 94063−1994
Attention: James A. Blake

or such other place as Landlord may from time to time designate by notice to Tenant.

(c) **Tenant:** MONOLITHIC SYSTEM TECHNOLOGY, INC., dba MOSYS , a Delaware corporation.

(d) **Tenant's Address (For Notices):**

MOSYS, INC.
755 No. Mathilda Avenue, Suite 100
Sunnyvale, California 94086
Attention: Chief Financial Officer

(e) **Project:** The parcel(s) of real property (the "Land") commonly known as 755 N. Mathilda Avenue/680 Vaqueros Avenue, and located in the City of Sunnyvale (the "City"), County of Santa Clara (the "County"), State of California ("State"). The project (the "Project") includes the Land, the Building (described below) and appurtenant surface parking areas, landscaping, walkways and other common areas located on the Land.

(f) **Building:** A two (2) story office/research and development building within the Project (the "Building"), which Building contains approximately 52,500 Rentable Square Feet, with the street address of 755 North Mathilda Avenue, Sunnyvale, California.

(g) **Premises:** Those certain premises comprising all of the First Floor of the Building as generally shown on the floor plan attached hereto as Exhibit "A", which Premises contains approximately 26,250 total Rentable Square Feet.

(h) **Tenant's Percentage:** Tenant's percentage of the Building on a Rentable Square Foot basis, which is 50%.

(i) **Term:** Five (5) years.

(j) **Commencement Date:** June 27, 2005. The Commencement Date shall not be delayed by reason of a delay resulting from Force Majeure (as defined in Paragraph 32 below), or for any other reason.

Expiration Date: June 30, 2010.

(k) **Intentionally Omitted.**

(l) **Intentionally Omitted.**

m) **Monthly Base Rent:** This Lease is intended to be a "triple net lease" as more fully described in Paragraph 6 below. Monthly Base Rent is set forth below in the following table, subject to adjustment as provided in this Lease:

Months	Monthly Rent/RSF	Monthly Base Rent
1 – 12	$ 1.00	$ 26,250.00
13 – 24	$ 1.05	$ 27,562.50
25 – 36	$ 1.10	$ 28,875.00
37 – 48	$ 1.15	$ 30,187.50
49 – 60	$ 1.20	$ 31,500.00

Tenant's obligation to pay its share of Operating Expenses shall be 100% abated for the first month of the Term but not thereafter.

(n) **Intentionally Omitted.**

(o) **Security Deposit:** $31,500.00.

(p) **Intentionally Omitted.**

(q) **Intentionally Omitted.**

(r) **Permitted Use:** General office use and administration, research and development and related uses, but no other use without the written consent of Landlord.

(s) **Parking:** Eighty−three (83) unassigned parking spaces, subject to the terms and conditions of Paragraphs 32 and 43 below and the Rules and Regulations regarding parking contained in Exhibit "E".

(t) **Intentionally Omitted.**

(u) **Intentionally Omitted.**

(v) **Interest Rate:** The greater of ten percent (10%) per annum or two percent (2%) in excess of the prime lending or reference rate of Wells Fargo Bank N.A. or any successor bank in effect on the twenty−fifth (25th) day of the calendar month immediately prior to the event giving rise to the Interest Rate imposition; provided, however, the Interest Rate will in no event exceed the maximum interest rate permitted to be charged by California law.

(w) **Exhibits:** A through E, inclusive, which Exhibits are attached to this Lease and incorporated herein by this reference.

This Paragraph 1 represents a summary of the basic terms and definitions of this Lease. In the event of any inconsistency between the terms contained in this Paragraph 1 and any specific provision of this Lease, the terms of the more specific provision shall prevail.

2. **PREMISES AND COMMON AREAS.**

(a) **Premises.** Landlord hereby leases to Tenant and Tenant hereby leases from Landlord the Premises as improved or to be improved with the Tenant Improvements described in Exhibit "B".

(b) **Mutual Covenants.** Landlord and Tenant agree that the letting and hiring of the Premises is upon and subject to the terms, covenants and conditions contained in this Lease and each party covenants as a material part of the consideration for this Lease to keep and perform their respective obligations under this Lease.

(c) **Tenant's Use of Common Areas.** During the Term of this Lease, Tenant shall have the nonexclusive right to use in common with Landlord and all persons, firms and corporations conducting business in the Project and their respective customers, guests, licensees, invitees, subtenants, employees and agents (collectively, "Project Occupants"), subject to the terms of this Lease, the Rules and Regulations referenced in Paragraph 32 below and all covenants, conditions and restrictions now or hereafter affecting the Project, the following common areas of the Building and/or the Project (collectively, the "Common Areas"):

(i) The Building's common entrances, hallways, lobbies, public restrooms on multi−tenant floors, elevators, stairways and accessways, loading docks, ramps, drives and platforms and any passageways and serviceways thereto, and the common pipes, conduits, wires and appurtenant equipment within the Building which serve the Premises (collectively, "Building Common Areas"); and

(ii) The parking facilities of the Project which serve the Building, loading and unloading areas, trash areas, roadways, sidewalks, walkways, parkways, driveways, landscaped areas, plaza areas, fountains and similar areas and facilities situated within the Project and appurtenant to the Building which are not reserved for the exclusive use of any Project Occupants (collectively, "Project Common Areas").

(d) **Landlord's Reservation of Rights.** Provided Tenant's use of and access to the Premises and parking to be provided to Tenant under this Lease is not interfered with in an unreasonable manner, Landlord reserves for itself the right from time to time to: (i) install, use, maintain, repair, replace and relocate pipes, ducts, conduits, wires and appurtenant meters and equipment above the ceiling surfaces, below the floor surfaces, within the walls and in the central core areas of the Building; (ii) make changes to the design and layout of the Project, including, without limitation, changes to buildings, driveways, entrances, loading and unloading areas, direction of traffic, landscaped areas and walkways, and parking spaces and parking areas; provided, however, that any material adverse changes to the Building Common Areas, or any reduction in the parking available to Tenant, shall require Tenant's prior approval, which shall not be unreasonably withheld; and (iii) use or close temporarily the Building Common Areas, the Project Common Areas and/or other portions of the Project while engaged in making improvements, repairs or alterations to the Building, the Project, or any portion thereof.

3. **TERM.** The term of this Lease ("Term") will be for the period designated in Subparagraph 1(i), commencing on the Commencement Date, and ending on the Expiration Date, subject to the terms of this Lease. Each consecutive twelve (12) month period of the Term of this Lease, commencing on the first day of the month following the month in which the Commencement Date occurs, will be referred to herein as a "Lease Year".

4. **POSSESSION.** Landlord represents and warrants to Tenant that as of the Commencement Date only,(i) the roof, exterior and structural components of the Project shall be in good condition and repair and water−tight, and the electrical, mechanical, plumbing, HVAC, security, elevator and lighting systems shall be in good working condition, free of material defects and in compliance with all applicable laws and (ii) to Landlord's actual knowledge, there are no Hazardous Materials (as defined in Section 8(c) in, on, under or about the Premises, the Building or the Project (collectively, the "Landlord Reps"). Landlord agrees to deliver possession of the Premises to Tenant in accordance with the terms of Exhibit "B". By taking possession of the Premises, subject only to the Landlord Reps, Tenant is deemed to have accepted the Premises in its "AS−IS" and "WITH ALL FAULTS" condition on the Commencement Date except as to any latent defects and to have acknowledged that there are no items known to Tenant needing work or repair which are Landlord's responsibility. Tenant acknowledges that except for the Landlord Reps, neither Landlord nor any agent of Landlord has made any representation or warranty with respect to the Premises, the Building, the Project or any portions thereof or with respect to the suitability of same for the conduct of Tenant's business and Tenant further acknowledges that Landlord will have no obligation to construct or complete any improvements within the Project.

5. **RENT.**

(a) **Monthly Base Rent.** Tenant agrees to pay Landlord the Monthly Base Rent for the Premises (subject to adjustment as hereinafter provided) in advance on the first day of each calendar month during the Term without prior notice or demand, except that Tenant agrees to pay (i) the Monthly Base Rent for the first month of the Term and (ii) estimated Operating Expenses for the second month of the Term directly to Landlord concurrently with Tenant's delivery of the executed Lease to Landlord. If the Term of this Lease commences or ends on a day other than the first day of a calendar month, then the rent for such period will be prorated in the proportion that the number of days this Lease is in effect during such period bears to the number of days in such month. All rent must be paid to Landlord, without any deduction or offset, in lawful money of the United States of America, at the address designated by Landlord or to such other person or at such other place as Landlord may from time to time designate in writing. Monthly Base Rent will be adjusted during the Term of this Lease as provided in Subparagraph l(m).

(b) **Additional Rent.** All amounts and charges to be paid by Tenant hereunder, including, without limitation, payments for Operating Expenses, insurance, repairs and parking, will be considered additional rent for purposes of this Lease, and the word "rent" as used in this Lease will include all such additional rent unless the context specifically or clearly implies that only Monthly Base Rent is intended.

(c) **Late Payments.** Late payments of Monthly Base Rent and/or any item of additional rent will be subject to interest and a late charge as provided in Subparagraph 22(f) below.

6. **OPERATING EXPENSES.**

(a) **Operating Expenses.** Commencing on the date which is one (1) month following the Commencement Date and throughout the Term of this Lease, Tenant agrees to pay Landlord as additional rent in accordance with the terms of this Paragraph 6, Tenant's Percentage of Operating Expenses as defined in Exhibit "C" attached hereto. It is intended that this Lease be a "triple net lease" and, except as expressly provided to the contrary in this Lease, Landlord shall not be required to make any expenditure or incur any liability in connection with this Lease or the ownership, construction, maintenance, operation or repair of the Premises which is not to be reimbursed by Tenant on a pro rata basis as Tenant's Percentage of Operating Expenses.

(b) **Estimate Statement.** Prior to the Commencement Date and on or about March 1st of each subsequent calendar year during the Term of this Lease, Landlord will endeavor to deliver to Tenant a statement ("Estimate Statement") wherein Landlord will estimate both the Operating Expenses and Tenant's Percentage of Operating Expenses for the then current calendar year. Tenant agrees to pay Landlord, as "Additional Rent", one−twelfth (1/12th) of Tenant's Percentage of Operating Expenses each month thereafter, beginning with the next installment of rent due, until such time as Landlord issues a revised Estimate Statement or the Estimate Statement for the succeeding calendar year; except that, concurrently with the regular monthly rent payment next due following the receipt of each such Estimate Statement, Tenant agrees to pay Landlord an amount equal to one monthly installment of Tenant's Percentage of Operating Expenses (less any applicable Operating Expenses already paid) multiplied by the number of months from January, in the current calendar year, to the month of such rent payment next due, all months inclusive. If at any time during the Term of this Lease, but not more often than quarterly, Landlord reasonably determines that Tenant's Percentage of Operating Expenses for the current calendar year will be greater than the amount set forth in the then current Estimate Statement, Landlord may issue a revised Estimate Statement and Tenant agrees to pay Landlord, within thirty (30) days of receipt of the revised Estimate Statement, the difference between the amount owed by Tenant under such revised Estimate Statement and the amount owed by Tenant under the original Estimate Statement for the portion of the then current calendar year which has expired. Thereafter Tenant agrees to pay Tenant's Percentage of Operating Expenses based on such revised Estimate Statement until Tenant receives the next calendar year's Estimate Statement or a new revised Estimate Statement for the current calendar year.

(c) **Actual Statement.** By June 1st of each calendar year during the Term of this Lease, Landlord will also endeavor to deliver to Tenant a statement ("Actual Statement") which states the actual Operating Expenses for the preceding calendar year. If the Actual Statement reveals that Tenant's Percentage of the actual Operating Expenses is more than the total Additional Rent paid by Tenant for Operating Expenses on account of the preceding calendar year, Tenant agrees to pay Landlord the difference in a lump sum within thirty (30) days of receipt of the Actual Statement. If the Actual Statement reveals that Tenant's Percentage of the actual Operating Expenses is less than the Additional Rent paid by Tenant for Operating Expenses on account of the preceding calendar year, Landlord will credit any overpayment toward the next monthly installment(s) of Tenant's Percentage of the Operating Expenses due to Tenant under this Lease; provided that in the last year of the Term, Landlord shall refund any overpayment within thirty (30) days of the end of the Term.

(d) **Miscellaneous.** Any delay or failure by Landlord in delivering any Estimate Statement or Actual Statement pursuant to this Paragraph 6 will not constitute a waiver of its right to require an increase in rent nor will it relieve Tenant of its obligations pursuant to this Paragraph 6, except that Tenant will not be obligated to make any payments based on such Estimate Statement or Actual Statement until thirty (30) days after receipt of such Estimate Statement or Actual Statement. Even though the Term has expired and Tenant has vacated the Premises, when the final determination is made of Tenant's Percentage of the actual Operating Expenses for the year in which this Lease terminates, Tenant agrees to promptly pay any increase due over the estimated expenses paid and, conversely, any overpayment made in the event said expenses decrease shall promptly be rebated by Landlord to Tenant. Such obligation will be a continuing one which will survive the expiration or earlier termination of this Lease. Prior to the expiration or sooner termination of the Lease Term and Landlord's acceptance of Tenant's surrender of the Premises, Landlord will have the right to estimate the actual Operating Expenses for the then current Lease Year and to collect from Tenant prior to Tenant's surrender of the Premises, Tenant's Percentage of any excess of such actual Operating Expenses over the estimated Operating Expenses paid by Tenant in such Lease Year. Landlord shall maintain its books and records pertaining to Operating Expenses for at least three (3) years. Tenant shall have the right, upon reasonable notice and during ordinary business hours, to inspect Landlord's books and records relating to Operating Expenses at Landlord's offices. If Tenant disputes the amount of Operating Expenses set forth in any Actual Statement, Tenant shall have the right to cause Landlord's books and records to be audited by a certified public accountant who is paid on an hourly

basis (and not contingent fee basis). The amounts payable hereunder by Landlord to Tenant or by Tenant to Landlord as the case may be shall be appropriately adjusted on the basis of such audit.

7. **SECURITY DEPOSIT.** Concurrently with Tenant's execution of this Lease, Tenant will deposit with Landlord the Security Deposit designated in Subparagraph 1(o). The Security Deposit will be held by Landlord as security for the full and faithful performance by Tenant of all of the terms, covenants, and conditions of this Lease to be kept and performed by Tenant during the Term hereof. If Tenant fully and faithfully performs its obligations under this Lease, including, without limitation, surrendering the Premises upon the expiration or sooner termination of this Lease in compliance with Subparagraph 11(a) below, the Security Deposit or any balance thereof will be returned to Tenant (or, at Landlord's option, to the last assignee of Tenant's interest hereunder) within thirty (30) days following the expiration of the Lease Term or as required under applicable law, provided that Landlord may retain the Security Deposit until such time as any outstanding rent or additional rent amount has been determined and paid in full. The Security Deposit is not, and may not be construed by Tenant to constitute, rent for the last month or any portion thereof. If Tenant defaults with respect to any provisions of this Lease including, but not limited to, the provisions relating to the payment of rent or additional rent, Landlord may (but will not be required to) use, apply or retain all or any part of the Security Deposit for the payment of any rent or any other sum in default, or for the payment of any other amount which Landlord may spend or become obligated to spend by reason of Tenant's default or to compensate Landlord for any loss or damage which Landlord may suffer by reason of Tenant's default. If any portion of the Security Deposit is so used or applied, Tenant agrees, within five (5) days after Landlord's written demand therefor, to deposit cash with Landlord in an amount sufficient to restore the Security Deposit to its original amount and Tenant's failure to do so shall constitute a default under this Lease. Landlord is not required to keep Tenant's Security Deposit separate from its general funds, and Tenant is not entitled to interest on such Security Deposit. Should Landlord sell its interest in the Premises during the Term hereof, Landlord will comply with its obligations under California Civil Code Section 1950.7(d) with regard to the relief of Landlord for further liability with respect to the Security Deposit.

8. **USE.**

(a) **Tenant's Use of the Premises.** The Premises may be used for the use or uses set forth in Subparagraph 1(r) only, and Tenant will not use or permit the Premises to be used for any other purpose without the prior written consent of Landlord, which consent Landlord may withhold in its sole discretion. Nothing in this Lease will be deemed to give Tenant any exclusive right to such use in the Building or the Project.

(b) **Compliance.** At Tenant's sole cost and expense, Tenant agrees to procure, maintain and hold available for Landlord's inspection, all governmental licenses and permits required for the proper and lawful conduct of Tenant's business from the Premises, if any. Tenant agrees not to use, alter or occupy the Premises or allow the Premises to be used, altered or occupied in violation of, and Tenant, at its sole cost and expense, agrees to use and occupy the Premises and cause the Premises to be used and occupied in compliance with: (i) any and all laws, statutes, zoning restrictions, ordinances, rules, regulations, orders and rulings now or hereafter in force and any requirements of any insurer, insurance authority or duly constituted public authority having jurisdiction over the Premises, the Building or the Project now or hereafter in force, including, without limitation, the provisions of Title III of the Americans With Disabilities Act of 1990, as same has been and may be subsequently amended, and all rules and regulations promulgated pursuant thereto (the "ADA"), as it relates to Tenant's particular use, alteration and occupancy of the Premises, (ii) the requirements of the Board of Fire Underwriters and any other similar body, and (iii) any recorded covenants, conditions and restrictions and similar regulatory agreements, if any, which affect the use, occupation or alteration of the Premises and/or the Building. Notwithstanding the foregoing, Landlord shall be responsible for ensuring that the Building Common Areas are in compliance with all laws, statutes, zoning restrictions, ordinances, rules, regulations, orders and rulings (including those promulgated pursuant to the ADA) as they pertain generally to facilities for office, administration, research and development use. Tenant agrees to comply with the Rules and Regulations referenced in Paragraph 28 below. Tenant agrees not to do or permit anything to be done in or about the Premises which will unreasonably obstruct or interfere with the rights of other tenants or occupants of the Building, or injure or unreasonably annoy them, or use or allow the Premises to be used for any unlawful or unreasonably objectionable purpose. Tenant agrees not to cause, maintain or permit any nuisance or waste in, on, under or about the Premises or elsewhere within the Project.

(c) **Hazardous Materials.** Except for ordinary and general office supplies typically used in the ordinary course of business within office buildings, such as copier toner, liquid paper, glue, ink and common household cleaning materials (some or all of which may constitute "Hazardous Materials" as defined in this Lease) which are used in strict compliance with all applicable environmental laws, Tenant agrees not to cause or permit any Hazardous Materials to be brought upon, stored, used, handled, generated, released or disposed of on, in, under or about the Premises, the Building, the Common Areas or any other portion of the Project by Tenant, its agents, employees, subtenants,

assignees, licensees, contractors or invitees (collectively, "Tenant's Parties"), without the prior written consent of Landlord, which consent Landlord may withhold in its sole and absolute discretion. Notwithstanding the foregoing, Tenant shall have the right to use acetone in amounts reasonably necessary for the conduct of its business if and only if the acetone is used, treated, stored, handled, transported and disposed of in strict compliance with all environmental laws and such use does not expose the Premises, the Building or the soil, air or groundwater in or around the Premises to risk of contamination or expose Landlord to any liability therefor. Landlord shall have the right to review and inspect Tenant's use, treatment, storage, handling, transportation and disposal of the acetone and Tenant's records pertaining to the same. Upon the expiration or earlier termination of this Lease, Tenant agrees to promptly remove from the Premises, the Building and the Project, at its sole cost and expense, any and all Hazardous Materials, including any equipment or systems containing Hazardous Materials which are installed, brought upon, stored, used, generated or released upon, in, under or about the Premises, the Building and/or the Project or any portion thereof by Tenant or any of Tenant's Parties. Except for ordinary and general office supplies typically used in the ordinary course of business within office buildings, such as copier toner, liquid paper, glue, ink and common household cleaning materials (some or all of which may constitute "Hazardous Materials" as defined in this Lease), Landlord agrees not to cause or permit any Hazardous Materials to be brought upon, stored, used, handled, generated, released or disposed of on, in, under or about the Premises, the Building, the Common Areas or any other portion of the Project by Landlord, its agents, employees, assignees, or s (collectively, "Landlord's Parties"). To the fullest extent permitted by law, Tenant agrees to promptly indemnify, protect, defend and hold harmless Landlord and Landlord's partners, officers, directors, employees, agents, successors and assigns (collectively, "Landlord Indemnified Parties") from and against any and all claims, damages, judgments, suits, causes of action, losses, liabilities, penalties, fines, expenses and costs (including, without limitation, clean−up, removal, remediation and restoration costs, sums paid in settlement of claims, attorneys' fees, consultant fees and expert fees and court costs) which arise or result from the presence of Hazardous Materials on, in, under or about the Premises, the Building or any other portion of the Project and which are caused or permitted by Tenant or any of Tenant's Parties (regardless of whether or not Landlord consented to Tenant's use of such Hazardous Materials). To the fullest extent permitted by law, Landlord agrees to promptly indemnify, protect, defend and hold harmless Tenant and Tenant's partners, officers, directors, employees, agents, successors and assigns (collectively, "Tenant Indemnified Parties") from and against any and all claims, damages, judgments, suits, causes of action, losses, liabilities, penalties, fines, expenses and costs (including, without limitation, clean−up, removal, remediation and restoration costs, sums paid in settlement of claims, attorneys' fees, consultant fees and expert fees and court costs) which arise or result from the presence of Hazardous Materials on, in, under or about the Premises, the Building or any other portion of the Project and which are caused or permitted by Landlord or any of Landlord's Parties.

Each party agrees to promptly notify the other of any release of Hazardous Materials at the Premises, the Building or any other portion of the Project which such party becomes aware of during the Term of this Lease, whether caused by such party or any other persons or entities. In the event of any release of Hazardous Materials caused or permitted by Tenant or any of Tenant's Parties, Landlord shall have the right, but not the obligation, to cause Tenant to immediately take all steps Landlord deems necessary or appropriate to remediate such release and prevent any similar future release to the satisfaction of Landlord and Landlord's mortgagee(s). As used in this Lease, the term "Hazardous Materials" shall mean and include any hazardous or toxic materials, substances or wastes as now or hereafter designated under any law, statute, ordinance, rule, regulation, order or ruling of any agency of the State, the United States Government or any local governmental authority, including, without limitation, asbestos, petroleum, petroleum hydrocarbons and petroleum based products, urea formaldehyde foam insulation, polychlorinated biphenyls ("PCBs"), and freon and other chlorofluorocarbons. The provisions of this Subparagraph 8(c) will survive the expiration or earlier termination of this Lease.

9. **NOTICES.** Any notice required or permitted to be given hereunder must be in writing and may be given by personal delivery (including delivery by overnight courier or an express mailing service) or by mail, if sent by registered or certified mail. Notices to Tenant shall be sufficient if delivered to Tenant at the address designated in Subparagraph 1(d) and notices to Landlord shall be sufficient if delivered to Landlord at the address designated in Subparagraph 1(b). Either party may specify a different address for notice purposes by written notice to the other, except that the Landlord may in any event use the Premises as Tenant's address for notice purposes.

10. **Intentionally Omitted.**

11. **SURRENDER; HOLDING OVER.**

(a) **Surrender.** The voluntary or other surrender of this Lease by Tenant, or a mutual cancellation thereof, shall not constitute a merger, and shall, at the option of Landlord, operate as an assignment to Landlord of any or all subleases or subtenancies. Upon the expiration or earlier termination of this

Lease, Tenant agrees to peaceably surrender the Premises to Landlord broom clean and in a state of good order, repair and condition, ordinary wear and tear and casualty damage (if this Lease is terminated as a result thereof pursuant to Paragraph 20) excepted, with all of Tenant's personal property and Alterations (as defined in Paragraph 13) removed from the Premises to the extent required under Paragraph 13 and all damage caused by such removal repaired as required by Paragraph 13. Prior to the date Tenant is to actually surrender the Premises to Landlord, Tenant agrees to give Landlord reasonable prior notice of the exact date Tenant will surrender the Premises so that Landlord and Tenant can schedule a walk−through of the Premises to review the condition of the Premises and identify the Alterations and personal property which are to remain upon the Premises and which items Tenant is to remove, as well as any repairs Tenant is to make upon surrender of the Premises. The delivery of keys to any employee of Landlord or to Landlord's agent or any employee thereof alone will not be sufficient to constitute a termination of this Lease or a surrender of the Premises.

(b) **Holding Over.** Tenant will not be permitted to hold over possession of the Premises after the expiration or earlier termination of the Term without the express written consent of Landlord, which consent Landlord may withhold in its sole and absolute discretion. If Tenant holds over after the expiration or earlier termination of the Term, Landlord may, at its option, treat Tenant as a tenant at sufferance only, and such continued occupancy by Tenant shall be subject to all of the terms, covenants and conditions of this Lease, so far as applicable, except that the Monthly Base Rent for any such holdover period shall be equal to the greater of (i) one hundred twenty−five percent (125%) of the Monthly Base Rent in effect under this Lease immediately prior to such holdover, or (ii) the then currently scheduled rental rate for comparable space in the Building, in either event prorated on a daily basis. Acceptance by Landlord of rent after such expiration or earlier termination will not result in a renewal of this Lease. The foregoing provisions of this Paragraph 11 are in addition to and do not affect Landlord's right of re−entry or any rights of Landlord under this Lease or as otherwise provided by law. If Tenant fails to surrender the Premises upon the expiration of this Lease in accordance with the terms of this Paragraph 11 despite demand to do so by Landlord, Tenant agrees to promptly indemnify, protect, defend and hold Landlord harmless from all claims, damages, judgments, suits, causes of action, losses, liabilities, penalties, fines, expenses and costs (including attorneys' fees and costs), including, without limitation, costs and expenses incurred by Landlord in returning the Premises to the condition in which Tenant was to surrender it and claims made by any succeeding tenant founded on or resulting from Tenant's failure to surrender the Premises. The provisions of this Subparagraph 11(b) will survive the expiration or earlier termination of this Lease.

12. **TAXES ON TENANT'S PROPERTY.** Tenant agrees to pay before delinquency, all taxes and assessments (real and personal) levied against (a) any personal property or trade fixtures placed by Tenant in or about the Premises (including any increase in the assessed value of the Premises based upon the value of any such personal property or trade fixtures); and (b) any Tenant Improvements or Alterations in the Premises (whether installed and/or paid for by Landlord or Tenant) to the extent such items are assessed at a valuation higher than the valuation at which tenant improvements conforming to Landlord's building standard tenant improvements are assessed. If any such taxes or assessments are levied against Landlord or Landlord's property, Landlord may, after written notice to Tenant (and under proper protest if requested by Tenant) pay such taxes and assessments, in which event Tenant agrees to reimburse Landlord all amounts paid by Landlord within thirty (30) business days after demand by Landlord; provided, however, Tenant, at its sole cost and expense, will have the right, with Landlord's cooperation, to bring suit in any court of competent jurisdiction to recover the amount of any such taxes and assessments so paid under protest.

13. **ALTERATIONS.** After installation of the initial Tenant Improvements for the Premises pursuant to Exhibit "B", Tenant may, at its sole cost and expense, make alterations, additions, improvements and decorations to the Premises (collectively, "Alterations") subject to and upon the following terms and conditions:

(a) **Prohibited Alterations.** Tenant may not make any Alterations which: (i) affect any area outside the Premises; (ii) affect the Building's structure, equipment, services or systems, or the proper functioning thereof, or Landlord's access thereto; (iii) affect the outside appearance, character or use of the Building or the Building Common Areas; (iv) in the reasonable opinion of Landlord, lessen the value of the Building; or (v) will violate or require a change in any occupancy certificate applicable to the Premises.

(b) **Landlord's Approval.** Before proceeding with any Alterations which are not prohibited in Subparagraph 13(a) above, Tenant must first obtain Landlord's written approval of the plans, specifications and working drawings for such Alterations, which approval Landlord will not unreasonably withhold or delay; provided, however, Landlord's prior approval will not be required for any such Alterations which are not prohibited by Subparagraph 13(a) above and which cost less than Five Thousand Dollars ($ 5,000) as long as (i) such Alterations do not require a building permit, (ii) Tenant delivers to Landlord notice and a copy of any final plans, specifications and working drawings for any such Alterations at least ten (10) days prior to commencement of the work thereof and (iii) the

other conditions of this Paragraph 13 are satisfied, including, without limitation, conforming to Landlord's rules, regulations and insurance requirements which govern contractors. Landlord's approval of plans, specifications and/or working drawings for Alterations will not create any responsibility or liability on the part of Landlord for their completeness, design sufficiency, or compliance with applicable permits, laws, rules and regulations of governmental agencies or authorities. In approving any Alterations, Landlord reserves the right to require Tenant to increase its Security Deposit to provide Landlord with additional reasonable security for the removal of such Alterations by Tenant as may be required by this Lease.

(c) **Contractors.** Alterations may be made or installed only by contractors and subcontractors which have been approved by Landlord, which approval Landlord will not unreasonably withhold or delay. Before proceeding with any Alterations, Tenant agrees to provide Landlord with ten (10) days prior written notice and Tenant's contractors must obtain and maintain, on behalf of Tenant and at Tenant's sole cost and expense: (i) all necessary governmental permits and approvals for the commencement and completion of such Alterations; and (ii) if requested by Landlord, a completion and lien indemnity bond, or other surety, reasonably satisfactory to Landlord for such Alterations. Throughout the performance of any Alterations, Tenant agrees to obtain, or cause its contractors to obtain, workers compensation insurance and general liability insurance in compliance with the provisions of Paragraph 19 of this Lease.

(d) **Manner of Performance.** All Alterations must be performed: (i) in accordance with the approved plans, specifications and working drawings; (ii) in a lien−free and first−class and workmanlike manner; (iii) in compliance with all applicable permits, laws, statutes, ordinances, rules, regulations, orders and rulings now or hereafter in effect and imposed by any governmental agencies and authorities which assert jurisdiction; (iv) in such a manner so as not to unreasonably interfere with the occupancy of any other tenant in the Building, nor impose any additional expense upon nor delay Landlord in the maintenance and operation of the Building; and (v) at such times, in such manner, and subject to such rules and regulations as Landlord may from time to time reasonably designate.

(e) **Ownership.** The Tenant Improvements, including, without limitation, all affixed sinks, dishwashers, microwave ovens and other fixtures, and all Alterations will become the property of Landlord and will remain upon and be surrendered with the Premises at the end of the Term of this Lease; provided, however, Landlord may, by written notice delivered to Tenant concurrently with Landlord's approval of the final working drawings for any Alterations, identify those Alterations which Landlord will require Tenant to remove at the end of the Term of this Lease. Landlord may also require Tenant to remove Alterations which Landlord did not have the opportunity to approve as provided in this Paragraph 13. If Landlord requires Tenant to remove any Alterations, Tenant, at its sole cost and expense, agrees to remove the identified Alterations on or before the expiration or earlier termination of this Lease and repair any damage to the Premises caused by such removal (or, at Landlord's option, Tenant agrees to pay to Landlord all of Landlord's costs of such removal and repair).

(f) **Plan Review.** Tenant agrees to pay Landlord, as additional rent, the reasonable costs of professional services and costs for general conditions of Landlord's third party consultants if utilized by Landlord (but not Landlord's "in−house" personnel) for review of all plans, specifications and working drawings for any Alterations, within thirty (30) business days after Tenant's receipt of invoices either from Landlord or such consultants.

(g) **Personal Property.** All articles of personal property owned by Tenant or installed by Tenant at its expense in the Premises (including Tenant's business and trade fixtures, furniture, movable partitions and equipment [such as telephones, copy machines, computer terminals, refrigerators and facsimile machines]) will be and remain the property of Tenant, and must be removed by Tenant from the Premises, at Tenant's sole cost and expense, on or before the expiration or earlier termination of this Lease. Tenant agrees to repair any damage caused by such removal at its cost on or before the expiration or earlier termination of this Lease.

(h) **Removal of Alterations.** If Tenant fails to remove by the expiration or earlier termination of this Lease all of its personal property, or any Alterations identified by Landlord for removal, Landlord may, at its option, treat such failure as a hold−over pursuant to Subparagraph 11(b) above, and/or Landlord may (without liability to Tenant for loss thereof) treat such personal property and/or Alterations as abandoned and, at Tenant's sole cost and expense, and in addition to Landlord's other rights and remedies under this Lease, at law or in equity: (a) remove and store such items; and/or (b) upon ten (10) days prior notice to Tenant, sell, discard or otherwise dispose of all or any such items at private or public sale for such price as Landlord may obtain or by other commercially reasonable means. Tenant shall be liable for all costs of disposition of Tenant's abandoned property and Landlord shall have no liability to Tenant with respect to any such abandoned property. Landlord agrees to apply the proceeds of any sale of any such property to any amounts due to Landlord under this Lease from

Tenant (including Landlord's attorneys' fees and other costs incurred in the removal, storage and/or sale of such items), with any remainder to be paid to Tenant.

14. **REPAIRS.**

(a) **Landlord's Obligations.** Landlord agrees to repair and maintain in good condition and working order the structural portions of the Building and the plumbing, heating, ventilating, air conditioning, elevator and electrical systems installed or furnished by Landlord, unless such maintenance and repairs are (i) attributable to items installed in Tenant's Premises which are above standard interior improvements (such as, for example, custom lighting, special HVAC and/or electrical panels or systems, kitchen or restroom facilities and appliances constructed or installed within Tenant's Premises) or (ii) caused in part or in whole by the act, neglect or omission of any duty by Tenant, its agents, servants, employees or invitees, in which case Tenant will pay to Landlord as direct reimbursement and not as part of shared Operating Expenses, as additional rent, the cost of such maintenance and repairs. Landlord will not be liable for any failure to make any such repairs or to perform any maintenance unless such failure shall persist for an unreasonable time after written notice of the need of such repairs or maintenance is given to Landlord by Tenant. Except as provided in Paragraph 20, Tenant will not be entitled to any abatement of rent and Landlord will not have any liability by reason of any injury to or interference with Tenant's business arising from the making of any repairs, alterations or improvements in or to any portion of the Building or the Premises or in or to fixtures, appurtenances and equipment therein. Landlord shall use commercially reasonable efforts to minimize any unreasonable interference with Tenant's use and enjoyment of the Premises. Tenant waives the right to make repairs at Landlord's expense under any law, statute, ordinance, rule, regulation, order or ruling (including, without limitation, the provisions of California Civil Code Sections 1941 and 1942 and any successor statutes or laws of a similar nature).

(b) **Tenant's Obligations.** Tenant agrees to keep, maintain and preserve the Premises in good condition and repair and, when and if needed, at Tenant's sole cost and expense, to make all repairs to the Premises and every part thereof which are not Landlord's obligation hereunder. Tenant agrees to cause any mechanics' liens or other liens arising as a result of work performed by Tenant or at Tenant's direction to be eliminated as provided in Paragraph 15 below. Except as provided in Subparagraph 14(a) above and Exhibit "B", Landlord has no obligation to alter, remodel, improve, repair, decorate or paint the Premises or any part thereof.

(c) **Tenant's Failure to Repair.** Tenant shall have ten (10) days from the date on which Landlord makes a written demand on Tenant to repair and maintain the Premises properly, as required hereunder to the reasonable satisfaction of Landlord, to perform such repairs and maintenance (or commence to perform, if the nature of the performance is such that more than ten (10) days is reasonably required), or, if Tenant is required to use the Landlord's contractor, as provided in Paragraph 14(b), upon such date as Landlord's contractor is able to complete such repairs. If Tenant fails to perform such repairs or maintenance as required under this Lease, Landlord may enter upon the Premises and make such repairs and/or maintenance. If Landlord does enter upon the Premises for such purposes as discussed herein, Landlord shall exercise commercially reasonable efforts to not unreasonably interfere with Tenant's use of the Premises in performing such repairs and/or maintenance, shall perform such repairs and/or maintenance in the presence of a representative of Tenant (except in the case of emergencies) and shall take appropriate measures to protect the confidentiality of Tenant's files. Upon completion of such repairs and/or maintenance, Tenant agrees to pay to Landlord as additional rent, Landlord's costs for making such repairs plus an amount not to exceed ten percent (10%) of such costs for overhead, within thirty (30) days of receipt from Landlord of a written itemized bill therefor. Any amounts not reimbursed by Tenant within such thirty (30) day period will bear interest at the Interest Rate until paid by Tenant.

15. **LIENS.** Tenant agrees not to permit any mechanic's, materialmen's or other liens to be filed against all or any part of the Project, the Building or the Premises, nor against Tenant's leasehold interest in the Premises, by reason of or in connection with any repairs, alterations, improvements or other work contracted for or undertaken by Tenant or any other act or omission of Tenant or Tenant's agents, employees, contractors, licensees or invitees. At Landlord's request, Tenant agrees to provide Landlord with enforceable, conditional and final lien releases (or other evidence reasonably requested by Landlord to demonstrate protection from liens) from all persons furnishing labor and/or materials at the Premises. Landlord will have the right at all reasonable times to post on the Premises and record any notices of non−responsibility which it deems necessary for protection from such liens. If any such liens are filed, Tenant will, at its sole cost, promptly cause such liens to be released of record or bonded so that it no longer affects title to the Project, the Building or the Premises. If Tenant fails to cause any such liens to be so released or bonded within ten (10) days after filing thereof, such failure will be deemed a material breach by Tenant under this Lease without the benefit of any additional notice or cure period described in Paragraph 22 below, and Landlord may, without waiving its rights and remedies based on such breach, and without releasing Tenant from any of its obligations, cause such liens to be released by any means it shall deem proper, including payment in satisfaction of the claims giving rise to such liens. Tenant agrees to pay to

Landlord within ten (10) days after receipt of invoice from Landlord, any sum paid by Landlord to remove such liens, together with interest at the Interest Rate from the date of such payment by Landlord.

16. **ENTRY BY LANDLORD.** Landlord and its employees and agents will at all times have the right to enter the Premises to inspect the same, to supply janitorial service and any other service to be provided by Landlord to Tenant hereunder, to show the Premises to prospective purchasers or tenants, to post notices of nonresponsibility, and/or to repair the Premises as permitted or required by this Lease. In exercising such entry rights, Landlord will endeavor to minimize, as reasonably practicable, the interference with Tenant's business, and will provide Tenant with reasonable advance notice of any such entry (except in emergency situations). Landlord may, in order to carry out such purposes, erect scaffolding and other necessary structures where reasonably required by the character of the work to be performed. Landlord will at all times have and retain a key with which to unlock all doors in the Premises, excluding Tenant's vaults and safes. Landlord will have the right to use any and all means which Landlord may reasonably deem proper to open said doors in an emergency in order to obtain entry to the Premises. Any entry to the Premises obtained by Landlord by any of said means, or otherwise, will not be construed or deemed to be a forcible or unlawful entry into the Premises, or an eviction of Tenant from the Premises. Landlord will not be liable to Tenant for any damages or losses for any entry by Landlord effected by the foregoing.

17. **UTILITIES AND SERVICES.** Throughout the Term of the Lease so long as the Premises are occupied, Landlord agrees to furnish or cause to be furnished to the Premises the utilities and services described in the Standards for Utilities and Services attached hereto as Exhibit "D", subject to the conditions and in accordance with the standards set forth therein. Landlord may require Tenant from time to time to provide Landlord with a list of Tenant's employees and/or agents which are authorized by Tenant to subscribe on behalf of Tenant for any additional services which may be provided by Landlord. Any such additional services will be provided to Tenant at Tenant's cost. Landlord will not be liable to Tenant for any failure to furnish any of the foregoing utilities and services if such failure is caused by all or any of the following: (i) accident, breakage or repairs; (ii) strikes, lockouts or other labor disturbance or labor dispute of any character; (iii) governmental regulation, moratorium or other governmental action or inaction; (iv) inability despite the exercise of reasonable diligence to obtain electricity, water or fuel; or (v) any other cause beyond Landlord's reasonable control. In addition, in the event of any stoppage or interruption of services or utilities, Tenant shall not be entitled to any abatement or reduction of rent (except as expressly provided below or in Subparagraphs 20(f) or 21(b) if such failure results from a damage or taking described therein), no eviction of Tenant will result from such failure and Tenant will not be relieved from the performance of any covenant or agreement in this Lease because of such failure; provided, however, that if such failure is caused solely by the negligence or willful misconduct of Landlord or Landlord's Parties and Tenant is unable to conduct its business in the Premises for a period exceeding five (5) consecutive calendar days, then and only in such event, Base Rent shall be abated from the sixth calendar day of such interruption until such time as Tenant is able to recommence its business operations in the Premises. In the event of any failure, stoppage or interruption thereof, Landlord agrees to diligently attempt to resume service promptly. If Tenant requires or utilizes more water or electrical power than is considered reasonable or normal by Landlord, Landlord may at its option require Tenant to pay, as additional rent, the cost, as fairly determined by Landlord, incurred by such extraordinary usage and/or Landlord may install separate meter(s) for the Premises, at Tenant's sole expense, and Tenant agrees thereafter to pay all charges of the utility providing service and Landlord will make an appropriate adjustment to Tenant's Operating Expenses calculation to account for the fact Tenant is directly paying such metered charges, provided Tenant will remain obligated to pay its proportionate share of Operating Expenses subject to such adjustment. Landlord shall have the right at any time and from time−to−time during the Term of the Lease to contract for service from any company or companies providing electricity service ("Service Provider"). Tenant shall cooperate with Landlord and the Service Provider at all times and, as reasonably necessary, shall allow Landlord and Service Provider reasonable access to the Building's electric lines, feeders, risers, wiring, and any other machinery within the Premises. Landlord shall in no way be liable or responsible for any loss, damage, or expense that Tenant may sustain or incur by reason of any change, failure, interference, disruption, or defect in the supply or character of the electric energy furnished to the Premises, or if the quantity or character of the electric energy supplied by the Service Provider is no longer available or suitable for Tenant's requirements, no such change, failure, defect, unavailability, or unsuitability shall constitute an actual or constructive eviction, in whole or in part, or entitle Tenant to any abatement or diminution of rent, or relieve Tenant from any of its obligations under the Lease.

18. **ASSUMPTION OF RISK AND INDEMNIFICATION.**

(a) **Assumption of Risk.** Tenant, as a material part of the consideration to Landlord, hereby agrees that neither Landlord nor any Landlord Indemnified Parties (as defined in Subparagraph 8(c) above) will be liable to Tenant for, and Tenant expressly assumes the risk of and waives any and all claims it may have against Landlord or any Landlord Indemnified Parties with respect to, (i) any and all damage to property or injury to persons in, upon or about the Premises, the Building or the Project

resulting from any act or omission of Landlord (except for Landlord's or any Landlord Parties' active negligence or intentionally wrongful act or omission or breach of this Lease), (ii) any such damage caused by other tenants or persons in or about the Building or the Project, or caused by quasi−public work, (iii) any damage to property entrusted to employees of the Building, (iv) any loss of or damage to property by theft or otherwise, or (v) any injury or damage to persons or property resulting from any casualty, explosion, falling plaster or other masonry or glass, steam, gas, electricity, water or rain which may leak from any part of the Building or any other portion of the Project or from the pipes, appliances or plumbing works therein or from the roof, street or subsurface or from any other place, or resulting from dampness; provided that in no event shall the foregoing waiver apply to any damage or injury to the extent caused by the active negligence, willful misconduct or breach of this Lease by Landlord or any Landlord Parties. Notwithstanding anything to the contrary contained in this Lease, neither Landlord nor any Landlord Indemnified Parties will be liable for any special, consequential or punitive damages arising out of any loss of the use of the Premises or any equipment or facilities therein by Tenant or any Tenant Parties. Tenant agrees to give prompt notice to Landlord in case of fire or accidents in the Premises or the Building, or of defects therein or in the fixtures or equipment.

(b) **Indemnification.** Tenant will be liable for, and agrees, to the maximum extent permissible under applicable law, to promptly indemnify, protect, defend and hold harmless Landlord and all Landlord Indemnified Parties, from and against, any and all claims, damages, judgments, suits, causes of action, losses, liabilities, penalties, fines, expenses and costs, including attorneys' fees and court costs (collectively, "Indemnified Claims"), arising or resulting from (i) any act or omission of Tenant or any Tenant Parties (as defined in Subparagraph 8(c) above); (ii) the use of the Premises and Common Areas and conduct of Tenant's business by Tenant or any Tenant Parties, or any other activity, work or thing done, permitted or suffered by Tenant or any Tenant Parties, in or about the Premises, the Building or elsewhere within the Project; and/or (iii) any default by Tenant of any obligations on Tenant's part to be performed under the terms of this Lease. In case any action or proceeding is brought against Landlord or any Landlord Indemnified Parties by reason of any such Indemnified Claims, Tenant, upon written notice from Landlord, agrees to promptly defend the same at Tenant's sole cost and expense by counsel approved in writing by Landlord, which approval Landlord will not unreasonably withhold.

Landlord will be liable for, and agrees, to the maximum extent permissible under applicable law, to promptly indemnify, protect, defend and hold harmless Tenant and all Tenant Indemnified Parties, from and against, any and all claims, damages, judgments, suits, causes of action, losses, liabilities, penalties, fines, expenses and costs, including attorneys' fees and court costs (collectively, "Indemnified Claims"), arising or resulting from (i) any active negligence or willful misconduct of Landlord or any Landlord Parties (as defined in Subparagraph 8(c) above) and/or (ii) any default by Landlord of any obligations on Landlord's part to be performed under the terms of this Lease. In case any action or proceeding is brought against Tenant or any Tenant Indemnified Parties by reason of any such Indemnified Claims, Landlord, upon written notice from Tenant, agrees to promptly defend the same at Landlord's sole cost and expense by counsel approved in writing by Tenant, which approval Tenant will not unreasonably withhold.

(c) **Survival; No Release of Insurers.** Tenant's indemnification obligations under Subparagraph 18(b) are not in any way limited by the amount of insurance proceeds available to Tenant under Tenant's Insurance Policies described in Section 19 below and will survive the expiration or earlier termination of this Lease. Tenant's covenants, agreements and indemnification obligation in Subparagraphs 18(a) and 18(b) above, are not intended to and will not relieve any insurance carrier of its obligations under policies required to be carried by Tenant pursuant to the provisions of this Lease.

19. **INSURANCE.**

(a) **Tenant's Insurance.** On or before the earlier to occur of (i) the Commencement Date, or (ii) the date Tenant commences any work of any type in the Premises pursuant to this Lease (which may be prior to the Commencement Date), and continuing throughout the entire Term hereof and any other period of occupancy, Tenant agrees to keep in full force and effect, at its sole cost and expense, the following insurance:

(i) "All Risks" property insurance including at least the following perils: fire and extended coverage, smoke damage, vandalism, malicious mischief, sprinkler leakage (including earthquake sprinkler leakage). This insurance policy shall insure all property owned by Tenant, for which Tenant is legally liable, or which is installed at Tenant's expense, and which is located in the Building including, without limitation, any Tenant Improvements which satisfy the foregoing qualification and any Alterations, and all furniture, fittings, installations, fixtures and any other personal property of Tenant, in an amount not less than the full replacement cost thereof.

(ii) One (1) year insurance coverage for business interruption and loss of income and extra expense insuring the same perils described in Subparagraph 19(a)(i) above, in such amounts as will reimburse Tenant for any direct or indirect loss of earnings attributable to any such perils including prevention of access to the Premises, Tenant's parking areas or the Building as a result of any such perils.

(iii) Commercial General Liability Insurance or Comprehensive General Liability Insurance (on an occurrence form) insuring bodily injury, personal injury and property damage including the following divisions and extensions of coverage: Premises and Operations; blanket contractual liability (including coverage for Tenant's indemnity obligations under this Lease); products and completed operations; and fire and water damage legal liability including Tenant Improvements, that are rented under the terms of this Lease. Such insurance must have the following minimum limits of liability: bodily injury, personal injury and property damage − $2,000,000 each occurrence; provided that if liability coverage is provided by a Commercial General Liability policy the general aggregate limit shall apply separately and in total to this location only (per location general aggregate), and provided further, such minimum limits of liability may be adjusted from year to year to reflect reasonable and prudent increases in coverages as recommended by Landlord's insurance carrier as being prudent and commercially reasonable for tenants of buildings comparable to the Building, rounded to the nearest five hundred thousand dollars, as reasonably agreed by Landlord and Tenant.

(iv) Comprehensive Automobile Liability insuring bodily injury and property damage arising from all owned, non−owned and hired vehicles, if any, with minimum limits of liability of $1,000,000 per accident.

(v) Worker's Compensation as required by the laws of the State with the following minimum limits of liability: Coverage A − statutory benefits; Coverage B − $1,000,000 per accident and disease. Tenant shall also obtain and furnish evidence to Landlord of the waiver by Tenant's worker's compensation insurance carrier of all rights of recovery by way of subrogation against Landlord, so long as the insurance is not invalidated thereby.

(vi) Any other form or forms of insurance as Tenant or Landlord or any mortgagees of Landlord may reasonably require from time to time in form, in amounts, and for insurance risks against which, a prudent tenant would protect itself, but only to the extent coverage for such risks and amounts are available in the insurance market at commercially acceptable rates. Landlord makes no representation that the limits of liability required to be carried by Tenant under the terms of this Lease are adequate to protect Tenant's interests and Tenant should obtain such additional insurance or increased liability limits as Tenant deems appropriate.

(b) **Supplemental Tenant Insurance Requirements.**

(i) All policies must be in a form reasonably satisfactory to Landlord and issued by an insurer admitted to do business in the State.

(ii) All policies must be issued by insurers with a policyholder rating of "A−" and a financial rating of "VII" in the most recent version of Best's Key Rating Guide.

(iii) All policies must contain a requirement to notify Landlord (and Landlord's property manager and any mortgagees or ground lessors of Landlord who are named as additional insureds, if any) in writing not less than thirty (30) days prior to any material change, reduction in coverage, cancellation or other termination thereof. Tenant agrees to deliver to Landlord, as soon as practicable after placing the required insurance, but in any event within the time frame specified in Subparagraph 19(a) above, certificate(s) of insurance evidencing the existence of such insurance and Tenant's compliance with the provisions of this Paragraph 19. Tenant agrees to cause certificates of insurance to be delivered to Landlord not less than thirty (30) days prior to the expiration of any such policy or policies. If any such initial or replacement policies or certificates are not furnished within the time(s) specified herein, Tenant will be deemed to be in material default under this Lease without the benefit of any additional notice or cure period provided in Subparagraph 22(a)(iii) below, and Landlord will have the right, but not the obligation, to procure such insurance as Landlord deems necessary to protect Landlord's interests at Tenant's expense. If Landlord obtains any insurance that is the responsibility of Tenant under this Paragraph 19, Landlord agrees to deliver to Tenant a written statement setting forth the cost of any such insurance and showing in reasonable detail the manner in which it has been computed and Tenant agrees to promptly reimburse Landlord for such costs as additional rent.

(iv) General Liability policies under Subparagraphs 19(a)(iii) and 19(a)(iv) must name Landlord and Landlord's property manager (and at Landlord's request, Landlord's mortgagees and ground lessors of which Tenant has been informed in writing) as additional insureds and

must also contain a provision that the insurance afforded by such policy is primary insurance and any insurance carried by Landlord and Landlord's property manager or Landlord's mortgagees or ground lessors, if any, will be excess over and non−contributing with Tenant's insurance.

(c) **Tenant's Use.** Tenant will not keep, use, sell or offer for sale in or upon the Premises any article which may be prohibited by any insurance policy periodically in force covering the Building or the Project Common Areas. If Tenant's occupancy or business in, or on, the Premises, whether or not Landlord has consented to the same, results in any increase in premiums for the insurance periodically carried by Landlord with respect to the Building or the Project Common Areas or results in the need for Landlord to maintain special or additional insurance, Tenant agrees to pay Landlord the cost of any such increase in premiums or special or additional coverage as additional rent within thirty (30) days after being billed therefor by Landlord. In determining whether increased premiums are a result of Tenant's use of the Premises, a schedule issued by the organization computing the insurance rate on the Building, the Project Common Areas or the Tenant Improvements showing the various components of such rate, will be conclusive evidence of the several items and charges which make up such rate. Tenant agrees to promptly comply with all reasonable requirements of the insurance authority or any present or future insurer relating to the Premises.

(d) **Cancellation of Landlord's Policies.** If any of Landlord's insurance policies are cancelled or cancellation is threatened or the coverage reduced or threatened to be reduced in any way because of the use of the Premises or any part thereof by Tenant or any assignee or subtenant of Tenant or by anyone Tenant permits on the Premises and, if Tenant fails to remedy the condition giving rise to such cancellation, threatened cancellation, reduction of coverage, threatened reduction of coverage, increase in premiums, or threatened increase in premiums, within forty−eight (48) hours after notice thereof, Tenant will be deemed to be in material default of this Lease and Landlord may, at its option, either terminate this Lease or enter upon the Premises and attempt to remedy such condition, and Tenant shall promptly pay Landlord the reasonable costs of such remedy as additional rent. If Landlord is unable, or elects not to remedy such condition, then Landlord will have all of the remedies provided for in this Lease in the event of a default by Tenant.

(e) **Waiver of Claims; Waiver of Subrogation.**

(i) Landlord and Tenant hereby waive their rights against each other with respect to any claims or damages or losses which are caused by or result from (a) damage to property or loss of income insured against under any insurance policy carried by Landlord or Tenant (as the case may be) pursuant to the provisions of this Lease and enforceable at the time of such damage or loss, or (b) damage to property or loss of income which would have been covered under any insurance required to be obtained and maintained by Landlord or Tenant (as the case may be) under this Paragraph 19 of this Lease (as applicable) had such insurance been obtained and maintained as required therein. The foregoing waivers shall be in addition to, and not a limitation of, any other waivers or releases contained in this Lease.

(ii) Each party shall cause each property and loss of income insurance policy required to be obtained by it pursuant to this Paragraph 19 to provide that the insurer waives all rights of recovery by way of subrogation against either Landlord or Tenant, as the case may be, in connection with any claims, losses and damages covered by such policy. If either party fails to maintain property or loss of income insurance required hereunder, such insurance shall be deemed to be self−insured with a deemed full waiver of subrogation as set forth in the immediately preceding sentence.

20. **DAMAGE OR DESTRUCTION.**

(a) **Partial Destruction.** If the Premises or the Building are damaged by fire or other casualty to an extent not exceeding twenty−five percent (25%) of the full replacement cost thereof, and Landlord's contractor reasonably estimates in a writing delivered to Landlord and Tenant that the damage thereto may be repaired, reconstructed or restored to substantially its condition immediately prior to such damage within two hundred forty (240) days from the date of such casualty, and Landlord will receive insurance proceeds sufficient to cover the costs of such repairs, reconstruction and restoration (including proceeds from Tenant and/or Tenant's insurance which Tenant is required to deliver to Landlord pursuant to Subparagraph 20(e) below to cover Tenant's obligation for the costs of repair, reconstruction and restoration of any portion of the Tenant Improvements and any Alterations for which Tenant is responsible under this Lease), then Landlord agrees to commence and proceed diligently with the work of repair, reconstruction and restoration and this Lease will continue in full force and effect.

(b) **Substantial Destruction.** Any damage or destruction to the Premises or the Building which Landlord is not obligated to repair pursuant to Subparagraph 20(a) above will be deemed a substantial destruction. In the event of a substantial destruction, Landlord may elect to either

(i) repair, reconstruct and restore the portion of the Building or the Premises damaged by such casualty, in which case this Lease will continue in full force and effect, subject to Tenant's termination right contained in Subparagraph 20(d) below; or (ii) terminate this Lease effective as of the date which is thirty (30) days after Tenant's receipt of Landlord's election to so terminate.

(c) **Notice.** Under any of the conditions of Subparagraph 20(a) or (b) above, Landlord agrees to give written notice to Tenant of its intention to repair or terminate, as permitted in such paragraphs, within the later of thirty (30) days after the occurrence of such casualty, or ten (10) days after Landlord's receipt of the estimate from Landlord's contractor (the applicable time period to be referred to herein as the "Notice Period").

(d) **Tenant's Termination Rights.** If Landlord elects to repair, reconstruct and restore pursuant to Subparagraph 20(b)(i) hereinabove, and if Landlord's contractor estimates that as a result of such damage, Tenant cannot be given reasonable use of and access to the Premises within two hundred forty (240) days after the date of such damage, then Tenant may terminate this Lease effective upon delivery of written notice to Landlord within ten (10) days after Landlord delivers notice to Tenant of its election to so repair, reconstruct or restore.

(e) **Tenant's Costs and Insurance Proceeds.** In the event of any damage or destruction of all or any part of the Premises, Tenant agrees to immediately (i) notify Landlord thereof, and (ii) deliver to Landlord all property insurance proceeds received by Tenant with respect to any Tenant Improvements installed by or at the cost of Tenant and any Alterations, but excluding proceeds for Tenant's furniture, fixtures, equipment and other personal property, whether or not this Lease is terminated as permitted in this Paragraph 20, and Tenant hereby assigns to Landlord all rights to receive such insurance proceeds. If, as a result of Tenant's failure to obtain insurance required pursuant to this Lease Tenant fails to receive insurance proceeds covering the full replacement cost of any Tenant Improvements installed by or at the cost of Tenant and any Alterations which are damaged, Tenant will be deemed to have self−insured the replacement cost of such items, and upon any damage or destruction thereto, Tenant agrees to immediately pay to Landlord the full replacement cost of such items, less any insurance proceeds actually received by Landlord from Landlord's or Tenant's insurance with respect to such items.

(f) **Abatement of Rent.** In the event of any damage, repair, reconstruction and/or restoration described in this Paragraph 20, rent will be abated or reduced, as the case may be, from the date of such casualty, in proportion to the degree to which Tenant's use of the Premises is impaired during such period of repair until such use is restored. Except for abatement of rent as provided hereinabove, Tenant will not be entitled to any compensation or damages for loss of, or interference with, Tenant's business or use or access of all or any part of the Premises or for lost profits or any other consequential damages of any kind or nature, which result from any such damage, repair, reconstruction or restoration.

(g) **Inability to Complete.** Notwithstanding anything to the contrary contained in this Paragraph 20, if Landlord is obligated or elects to repair, reconstruct and/or restore the damaged portion of the Building or the Premises pursuant to Subparagraph 20(a) or 20(b)(i) above, but is delayed from completing such repair, reconstruction and/or restoration beyond the date which is ninety (90) days after the date estimated by Landlord's contractor for completion thereof by reason of any causes (other than delays caused by Tenant, its subtenants, employees, agents or contractors or delays which are beyond the reasonable control of Landlord as described in Paragraph 33), then either Landlord or Tenant may elect to terminate this Lease upon ten (10) days prior written notice given to the other after the expiration of such ninety (90) day period.

(h) **Damage Near End of Term.** Landlord and Tenant shall each have the right to terminate this Lease if any damage to the Premises occurs during the last twelve (12) months of the Term of this Lease where Landlord's contractor estimates in a writing delivered to Landlord and Tenant that the repair, reconstruction or restoration of such damage cannot be completed within sixty (60) days after the date of such casualty. If either party desires to terminate this Lease under this Subparagraph (h), it shall provide written notice to the other party of such election within ten (10) days after receipt of Landlord's contractor's repair estimates.

(i) **Waiver of Termination Right.** Landlord and Tenant agree that the foregoing provisions of this Paragraph 20 are to govern their respective rights and obligations in the event of any damage or destruction and supersede and are in lieu of the provisions of any applicable law, statute, ordinance, rule, regulation, order or ruling now or hereafter in force which provide remedies for damage or destruction of leased premises (including, without limitation, the provisions of California Civil Code Section 1932, Subsection 2, and Section 1933, Subsection 4 and any successor statute or laws of a similar nature).

(j) **Termination.** Upon any termination of this Lease under any of the provisions of this Paragraph 20, the parties will be released without further obligation to the other from the date

possession of the Premises is surrendered to Landlord except for any items which have accrued and are unpaid as of the date of termination and matters which are to survive any termination of this Lease as provided herein.

21. **EMINENT DOMAIN.**

(a) **Substantial Taking.** If the whole of the Premises or the Project, or such part thereof as shall substantially interfere with Tenant's use and occupancy of the Premises, as contemplated by this Lease, is taken for any public or quasi−public purpose by any lawful power or authority by exercise of the right of appropriation, condemnation or eminent domain, or sold to prevent such taking, either party will have the right to terminate this Lease effective as of the date possession is required to be surrendered to such authority.

(b) **Partial Taking; Abatement of Rent.** In the event of a taking of a portion of the Premises, the Project, or the parking spaces for the Project or any portion thereof, which does not substantially interfere with Tenant's use and occupancy of the Premises, then, neither party will have the right to terminate this Lease and Landlord will thereafter proceed to make a functional unit of the remaining portion of the Premises or the Project (but only to the extent Landlord receives proceeds therefor from the condemning authority), and rent will be abated with respect to the part of the Premises which Tenant is deprived of on account of such taking.

(c) **Condemnation Award.** In connection with any taking of the Premises or the Building, Landlord will be entitled to receive the entire amount of any award which may be made or given in such taking or condemnation, without deduction or apportionment for any estate or interest of Tenant, it being expressly understood and agreed by Tenant that no portion of any such award will be allowed or paid to Tenant for any so−called bonus or excess value of this Lease, and such bonus or excess value will be the sole property of Landlord. Tenant agrees not to assert any claim against Landlord or the taking authority for any compensation because of such taking (including any claim for bonus or excess value of this Lease); provided, however, if any portion of the Premises is taken, Tenant will have the right to recover from the condemning authority (but not from Landlord) the value of Tenant Improvements or Alterations to the Premises installed by or at the cost of Tenant, and any other compensation as may be separately awarded or recoverable by Tenant for the taking of Tenant's furniture, fixtures, equipment and other personal property within the Premises, for Tenant's relocation expenses, and for any loss of goodwill or other damage to Tenant's business by reason of such taking.

(d) **Temporary Taking.** In the event of taking of the Premises or any part thereof for temporary use, (i) this Lease will remain unaffected thereby and rent will abate for the duration of the taking in proportion to the extent Tenant's use of the Premises is interfered with, and (ii) Landlord will be entitled to receive such portion or portions of any award made for such use provided that if such taking remains in force at the expiration or earlier termination of this Lease, Tenant will then pay to Landlord a sum equal to the reasonable cost of performing Tenant's obligations under Paragraph 11 with respect to surrender of the Premises and upon such payment Tenant will be excused from such obligations. For purpose of this Subparagraph 21(d), a temporary taking shall be defined as a taking for a period of ninety (90) days or less.

22. **DEFAULTS AND REMEDIES.**

(a) **Defaults**. The occurrence of any one or more of the following events will be deemed a default by Tenant:

(i) The abandonment of the Premises as defined in California Civil Code Section 1951.3.

(ii) The failure by Tenant to make any payment of rent or additional rent or any other payment required to be made by Tenant hereunder, as and when due, where such failure continues for a period of three (3) days after written notice thereof from Landlord to Tenant; provided, however, that Landlord shall only be required to give written notice of such monetary default once in any twelve (12) month period, and thereafter Tenant shall be in default of this Lease if Tenant fails to pay rent or additional rent or any other payment required to be made by Tenant hereunder on its due date without any requirement that Landlord give Tenant written notice of such default; and provided further that such three (3) day notice will be in lieu of, and not in addition to, any notice required under applicable law (including, without limitation, the provisions of California Code of Civil Procedure Section 1161 regarding unlawful detainer actions or any successor statute or law of a similar nature).

(iii) The failure by Tenant to observe or perform any of the express or implied covenants or provisions of this Lease to be observed or performed by Tenant, other than as specified in Subparagraph 22(a)(i) or (ii) above, where such failure continues (where no other period of time is expressly provided) for a period of ten (10) days after written notice thereof from Landlord to Tenant.

The provisions of any such notice will be in lieu of, and not in addition to, any notice required under applicable law (including, without limitation, California Code of Civil Procedure Section 1161 regarding unlawful detainer actions and any successor statute or similar law). If the nature of Tenant's default is such that more than ten (10) days are reasonably required for its cure, then Tenant will not be deemed to be in default if Tenant, commences such cure within such ten (10) day period and thereafter diligently prosecutes such cure to completion.

(iv) (A) The making by Tenant of any general assignment for the benefit of creditors; (B) the filing by or against Tenant of a petition to have Tenant adjudged a bankrupt or a petition for reorganization or arrangement under any law relating to bankruptcy (unless, in the case of a petition filed against Tenant, the same is dismissed within sixty (60) days); (C) the appointment of a trustee or receiver to take possession of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Lease, where possession is not restored to Tenant within thirty (30) days; or (D) the attachment, execution or other judicial seizure of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Lease where such seizure is not discharged within thirty (30) days.

(b) **Landlord's Remedies; Termination.** In the event of any default by Tenant, in addition to any other remedies available to Landlord at law or in equity under applicable law (including, without limitation, the remedies of Civil Code Section 1951.4 and any successor statute or similar law), Landlord will have the immediate right and option to terminate this Lease and all rights of Tenant hereunder. If Landlord elects to terminate this Lease then, to the extent permitted under applicable law, Landlord may recover from Tenant (i) The worth at the time of award of any unpaid rent which had been earned at the time of such termination; plus (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rent loss that Tenant proves could have been reasonably avoided; plus (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the Term after the time of award exceeds the amount of such rent loss that Tenant proves could be reasonably avoided; plus (iv) any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which, in the ordinary course of things, results therefrom including, but not limited to: reasonable attorneys' fees and costs; brokers' commissions; the costs of refurbishment, alterations, renovations and repair of the Premises and removal (including the repair of any damage caused by such removal) and storage (or disposal) of Tenant's personal property, equipment, fixtures, Alterations, the Tenant Improvements and any other items which Tenant is required under this Lease to remove but does not remove, as well as the unamortized value of any free rent, reduced rent, free parking, reduced rate parking and any Tenant Improvement allowance or other costs or economic concessions provided, paid, granted or incurred by Landlord pursuant to this Lease. The unamortized value of such concessions shall be determined by taking the total value of such concessions and multiplying such value by a fraction, the numerator of which is the number of months of the Lease Term not yet elapsed as of the date on which the Lease is terminated, and the denominator of which is the total number of months of the Lease Term. As used in Subparagraphs 22(b)(i) and (ii) above, the "worth at the time of award" is computed by allowing interest at the Interest Rate. As used in Subparagraph 22(b)(iii) above, the "worth at the time of award" is computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1%).

(c) **Landlord's Remedies; Re−Entry Rights.** In the event of any default by Tenant, in addition to any other remedies available to Landlord under this Lease, at law or in equity, Landlord will also have the right, with or without terminating this Lease, to re−enter the Premises and remove all persons and property from the Premises; such property may be removed and stored in a public warehouse or elsewhere and/or disposed of at the sole cost and expense of and for the account of Tenant in accordance with the provisions of Subparagraph 13(h) of this Lease or any other procedures permitted by applicable law. No re−entry or taking possession of the Premises by Landlord pursuant to this Subparagraph 22(c) will be construed as an election to terminate this Lease unless a written notice of such intention is given to Tenant or unless the termination thereof is decreed by a court of competent jurisdiction.

(d) **Landlord's Remedies; Re−Letting.** In the event of abandonment of the Premises by Tenant under Paragraph 22(a)(i) above or in the event that Landlord elects to re−enter the Premises or takes possession of the Premises pursuant to legal proceeding or pursuant to any notice provided by law, then if Landlord does not elect to terminate this Lease, Landlord may from time to time, without terminating this Lease, either recover all rent as it becomes due or relet the Premises or any part thereof on terms and conditions as Landlord in its sole and absolute discretion may deem advisable with the right to make alterations and repairs to the Premises in connection with such reletting. If Landlord elects to relet the Premises, then rents received by Landlord from such reletting will be applied: first, to the payment of any indebtedness other than rent due hereunder from Tenant to Landlord; second, to the payment of any cost of such reletting; third, to the payment of the cost of any alterations and repairs to the Premises incurred in connection with such reletting; fourth, to the

payment of rent due and unpaid hereunder and the residue, if any, will be held by Landlord and applied to payment of future rent as the same may become due and payable hereunder. Should that portion of such rents received from such reletting during any month, which is applied to the payment of rent hereunder, be less than the rent payable during that month by Tenant hereunder, then Tenant agrees to pay such deficiency to Landlord immediately upon demand therefor by Landlord. Such deficiency will be calculated and paid monthly.

(e) **Landlord's Remedies; Performance for Tenant.** All covenants and agreements to be performed by Tenant under any of the terms of this Lease are to be performed by Tenant at Tenant's sole cost and expense and without any abatement of rent except as expressly set forth herein. If Tenant fails to pay any sum of money owed to any party other than Landlord, for which it is liable under this Lease, or if Tenant fails to perform any other act on its part to be performed hereunder, and such failure continues for ten (10) days after notice thereof by Landlord, Landlord may, without waiving or releasing Tenant from its obligations, but shall not be obligated to, make any such payment or perform any such other act to be made or performed by Tenant. Tenant agrees to reimburse Landlord upon demand for all sums so paid by Landlord and all necessary incidental costs, together with interest thereon at the Interest Rate, from the date of such payment by Landlord until reimbursed by Tenant. This remedy shall be in addition to any other right or remedy of Landlord set forth in this Paragraph 22.

(f) **Late Payment.** If Tenant fails to pay any installment of rent within five (5) days of when due or if Tenant fails to make any other payment for which Tenant is obligated under this Lease within five (5) days of when due, such late amount will accrue interest at the Interest Rate and Tenant agrees to pay Landlord as additional rent such interest on such amount from the date such amount becomes due until such amount is paid. In addition, Tenant agrees to pay to Landlord concurrently with such late payment amount, as additional rent, a late charge equal to five percent (5%) of the amount due to compensate Landlord for the extra costs Landlord will incur as a result of such late payment. The parties agree that (i) it would be impractical and extremely difficult to fix the actual damage Landlord will suffer in the event of Tenant's late payment, (ii) such interest and late charge represents a fair and reasonable estimate of the detriment that Landlord will suffer by reason of late payment by Tenant, and (iii) the payment of interest and late charges are distinct and separate in that the payment of interest is to compensate Landlord for the use of Landlord's money by Tenant, while the payment of late charges is to compensate Landlord for Landlord's processing, administrative and other costs incurred by Landlord as a result of Tenant's delinquent payments. Acceptance of any such interest and late charge will not constitute a waiver of the Tenant's default with respect to the overdue amount, or prevent Landlord from exercising any of the other rights and remedies available to Landlord. If Tenant incurs a late charge more than three (3) times in any period of twelve (12) months during the Lease Term, then, notwithstanding that Tenant cures the late payments for which such late charges are imposed, Landlord will have the right to require Tenant thereafter to pay all installments of Monthly Base Rent quarterly in advance throughout the remainder of the Lease Term.

(g) **Rights and Remedies Cumulative.** All rights, options and remedies of Landlord contained in this Lease will be construed and held to be cumulative, and no one of them will be exclusive of the other, and Landlord shall have the right to pursue any one or all of such remedies or any other remedy or relief which may be provided by law or in equity, whether or not stated in this Lease. Nothing in this Paragraph 22 will be deemed to limit or otherwise affect Tenant's indemnification of Landlord pursuant to any provision of this Lease.

23. **LANDLORD'S DEFAULT.** Landlord will not be in default in the performance of any obligation required to be performed by Landlord under this Lease unless Landlord fails to perform such obligation within thirty (30) days after the receipt of written notice from Tenant specifying in detail Landlord's failure to perform; provided however, that if the nature of Landlord's obligation is such that more than thirty (30) days are required for performance, then Landlord will not be deemed in default if it commences such performance within such thirty (30) day period and thereafter diligently pursues the same to completion. Upon any default by Landlord, Tenant may exercise any of its rights provided at law or in equity, subject to the limitations on liability set forth in Paragraph 35 of this Lease.

24. **ASSIGNMENT AND SUBLETTING.**

(a) **Restriction on Transfer.** Except as expressly provided in this Paragraph 24, Tenant will not, either voluntarily or by operation of law, assign or encumber this Lease or any interest herein or sublet the Premises or any part thereof, or permit the use or occupancy of the Premises by any party other than Tenant (any such assignment, encumbrance, sublease or the like will sometimes be referred to as a "Transfer"), without the prior written consent of Landlord, which consent Landlord will not unreasonably withhold.

(b) **Corporate and Partnership Transfers.** For purposes of this Paragraph 24, if Tenant is a corporation, partnership or other entity, any transfer, assignment, encumbrance or hypothecation of

fifty percent (50%) or more (individually or in the aggregate) of any stock or other ownership interest in such entity, and/or any transfer, assignment, hypothecation or encumbrance of any controlling ownership or voting interest in such entity, will be deemed a Transfer and will be subject to all of the restrictions and provisions contained in this Paragraph 24. Notwithstanding the foregoing, the immediately preceding sentence will not apply to any transfers of stock of Tenant if Tenant is a publicly−held corporation and such stock is transferred publicly over a recognized security exchange or over−the−counter market.

(c) **Permitted Controlled Transfers.** Notwithstanding the provisions of this Paragraph 24 to the contrary, Tenant may assign this Lease or sublet the Premises or any portion thereof ("Permitted Transfer"), without Landlord's consent and without extending any sublease termination option to Landlord, to any parent, subsidiary or affiliate corporation which controls, is controlled by or is under common control with Tenant, or to any corporation resulting from a merger or consolidation with Tenant, or to any person or entity which acquires all the assets of Tenant's business as a going concern, provided that: (i) at least twenty (20) days prior to such assignment or sublease, Tenant delivers to Landlord the financial statements and other financial and background information of the assignee or sublessee described in Subparagraph 24(d) below; (ii) if an assignment, the assignee assumes, in full, the obligations of Tenant under this Lease (or if a sublease, the sublessee of a portion of the Premises or Term assumes, in full, the obligations of Tenant with respect to such portion); (iii) the financial net worth of the assignee or sublessee as of the time of the proposed assignment or sublease equals or exceeds that of Tenant as of the date of execution of this Lease or is adequate, in Landlord's reasonable judgment, to perform the Tenant's obligations herein; (iv) Tenant remains fully liable under this Lease; and (v) the use of the Premises under Paragraph 8 remains unchanged.

(d) **Transfer Notice.** If Tenant desires to effect a Transfer, other than a Permitted Transfer, then at least thirty (30) days prior to the date when Tenant desires the Transfer to be effective (the "Transfer Date"), Tenant agrees to give Landlord a notice (the "Transfer Notice"), stating the name, address and business of the proposed assignee, sublessee or other transferee (sometimes referred to hereinafter as "Transferee"), reasonable information (including references) concerning the character, ownership, and financial condition of the proposed Transferee, the Transfer Date, any ownership or commercial relationship between Tenant and the proposed Transferee, and the consideration and all other material terms and conditions of the proposed Transfer, all in such detail as Landlord may reasonably require. If Landlord reasonably requests additional detail, the Transfer Notice will not be deemed to have been received until Landlord receives such additional detail, and Landlord may withhold consent to any Transfer until such information is provided to it.

(e) **Landlord's Options.** Within fifteen (15) days of Landlord's receipt of any Transfer Notice, and any additional information requested by Landlord concerning the proposed Transferee's financial responsibility, Landlord will elect to do one of the following (i) consent to the proposed Transfer; (ii) refuse such consent, which refusal shall be on reasonable grounds including, without limitation, those set forth in Subparagraph 24(f) below; or (iii) if the sublease or assignment is for Sixty Percent (60%) or more of the Premises and for substantially the balance of the Lease Term, terminate this Lease as to all or such portion of the Premises which is proposed to be sublet or assigned and recapture all or such portion of the Premises for reletting by Landlord.

(f) **Reasonable Disapproval.** Landlord and Tenant hereby acknowledge that Landlord's disapproval of any proposed Transfer pursuant to Subparagraph 24(e) will be deemed reasonably withheld if based upon any reasonable factor, including, without limitation, any or all of the following factors: (i) the proposed Transferee is a governmental entity; (ii) the portion of the Premises to be sublet or assigned is irregular in shape with inadequate means of ingress and egress; (iii) the use of the Premises by the Transferee (A) is not permitted by the use provisions in Paragraph 8 hereof, (B) violates any exclusive use granted by Landlord to another tenant in the Building, or (C) otherwise poses a risk of increased liability to Landlord; (iv) the Transfer would likely result in a significant and inappropriate increase in the use of the parking areas or Project Common Areas by the Transferee's employees or visitors, and/or significantly increase the demand upon utilities and services to be provided by Landlord to the Premises; (v) the Transferee does not have the financial capability to fulfill the obligations imposed by the Transfer and this Lease; (vi) the Transferee is not in Landlord's reasonable opinion consistent with Landlord's desired tenant mix; or (vii) the Transferee poses a business or other economic risk which Landlord reasonably deems unacceptable. Notwithstanding anything to the contrary contained in this Lease, it is expressly understood and agreed that no further subletting under any sublease shall be permitted under any circumstances, except in the event Landlord (with no obligation to do so) sub−subleases the Premises (or any portion thereof) from such sublessee. Any sublease to which Landlord consents shall expressly prohibit any such further subletting.

(g) **Additional Conditions.** A condition to Landlord's consent to any Transfer of this Lease will be the delivery to Landlord of a true copy of the fully executed instrument of assignment, sublease, transfer or hypothecation, and, in the case of an assignment, the delivery to Landlord of an

agreement executed by the Transferee in form and substance reasonably satisfactory to Landlord, whereby the Transferee assumes and agrees to be bound by all of the terms and provisions of this Lease and to perform all of the obligations of Tenant hereunder. As a condition for granting its consent to any assignment or sublease, Landlord may require that in the event of an uncured default by Tenant under this Lease, the assignee or sublessee remit directly to Landlord on a monthly basis, all monies due to Tenant by said assignee or sublessee. As a condition to Landlord's consent to any sublease, such sublease must provide that it is subject and subordinate to this Lease and to all mortgages; that Landlord may enforce the provisions of the sublease, including collection of rent; that in the event of termination of this Lease for any reason, including without limitation a voluntary surrender by Tenant, or in the event of any reentry or repossession of the Premises by Landlord, Landlord may, at its option, either (i) terminate the sublease, or (ii) take over all of the right, title and interest of Tenant, as sublessor, under such sublease, in which case such sublessee will attorn to Landlord, but that nevertheless Landlord will not (1) be liable for any previous act or omission of Tenant under such sublease, (2) be subject to any defense or offset previously accrued in favor of the sublessee against Tenant, or (3) be bound by any previous modification of any sublease made without Landlord's written consent, or by any previous prepayment by sublessee of more than one month's rent.

(h) **Excess Rent.** If Landlord consents to any assignment of this Lease, Tenant agrees to pay to Landlord, as additional rent, one−half (50%) of all sums and other consideration payable to and for the benefit of Tenant by the assignee on account of the assignment, as and when such sums and other consideration are due and payable by the assignee to or for the benefit of Tenant (or, if Landlord so requires, and without any release of Tenant's liability for the same, Tenant agrees to instruct the assignee to pay such sums and other consideration directly to Landlord). If for any sublease, Tenant receives rent or other consideration, either initially or over the term of the sublease, in excess of the rent fairly allocable to the portion of the Premises which is subleased based on square footage, Tenant agrees to pay to Landlord as additional rent one−half (50%) of the excess of each such payment of rent or other consideration received by Tenant promptly after its receipt. In calculating excess rent or other consideration which may be payable to Landlord under this paragraph, Tenant will be entitled to deduct solely (i) commercially reasonable third party brokerage commissions and marketing costs (ii) reasonable attorneys' fees actually expended by Tenant in connection with such assignment or subletting; (iii) the reasonable and properly documented costs of any tenant improvements paid by Tenant in connection with the sublease; (iv) and any other reasonable and customary costs incurred directly in connection with the sublease if acceptable written evidence of such expenditures is provided to Landlord.

(i) (j) **No Release.** No Transfer will release Tenant of Tenant's obligations under this Lease or alter the primary liability of Tenant to pay the rent and to perform all other obligations to be performed by Tenant hereunder. If Tenant is in default of this Lease after expiration of any applicable cure or notice period, Landlord may require that any Transferee remit directly to Landlord on a monthly basis, all monies due Tenant by said Transferee, however, the acceptance of rent by Landlord from any other person will not be deemed to be a waiver by Landlord of any provision hereof. Consent by Landlord to one Transfer will not be deemed consent to any subsequent Transfer. In the event of default by any Transferee of Tenant or any successor of Tenant in the performance of any of the terms hereof, Landlord may proceed directly against Tenant without the necessity of exhausting remedies against such Transferee or successor. Landlord may consent to subsequent assignments of this Lease or sublettings or amendments or modifications to this Lease with assignees of Tenant, without notifying Tenant, or any successor of Tenant, and without obtaining its or their consent thereto and any such actions will not relieve Tenant of liability under this Lease.

(k) **Administrative and Attorneys' Fees.** If Tenant effects a Transfer or requests the consent of Landlord to any Transfer (whether or not such Transfer is consummated), then, upon demand, Tenant agrees to pay Landlord a non−refundable administrative fee of Two Hundred Fifty Dollars ($250.00), plus any reasonable attorneys' and paralegal fees incurred by Landlord in connection with such Transfer or request for consent (whether attributable to Landlord's in−house or outside attorneys or paralegals or otherwise) not to exceed Two Thousand Dollars ($2000.00) if Tenant effects such Transfer or requests the consent of Landlord to a transfer using Landlord's standard documents. Acceptance of the Two Hundred Fifty Dollar ($250.00) administrative fee and/or reimbursement of Landlord's attorneys' and paralegal fees will in no event obligate Landlord to consent to any proposed Transfer.

25. **SUBORDINATION.** Subject to the provisions of this Section 25, at the election of Landlord or any mortgagee or beneficiary with a deed of trust encumbering the Building and/or the Project, or any lessor of a ground or underlying lease with respect to the Building, this Lease will be subject and subordinate at all times to: (i) all ground leases or underlying leases which may now exist or hereafter be executed affecting the Building; and (ii) the lien of any mortgage or deed of trust which may now exist or hereafter be executed for which the Building, the Project or any leases thereof, or Landlord's interest and estate in any of said items, is specified as security. Landlord shall exercise its commercially reasonable efforts to obtain from any existing ground lessor, mortgagee or beneficiary

under a deed of trust on or before the date which is thirty (30) days following the Commencement Date a commercially reasonable nondisturbance agreement pursuant to which such ground lessor, mortgagee or beneficiary of a deed of trust agrees not to disturb Tenant's right to possession of the Premises so long as Tenant is not in default under this Lease. If, notwithstanding Landlord's exercise of its commercially reasonable efforts, Landlord is unable to obtain the above−referenced nondisturbance agreement within thirty (30) days following the Commencement Date of this Lease, Landlord shall give Tenant written notice of Landlord's inability to obtain such nondisturbance agreement and Tenant shall have three (3) business days following receipt of Landlord's written notice in which to elect to terminate this Lease, in which event this Lease shall terminate and the parties shall be released from their respective obligations hereunder except that Landlord shall promptly refund to Tenant the Security Deposit and any prepaid Rent. Tenant's obligation to subordinate to any future mortgages, deeds of trust or ground leases affecting the Building shall be subject to Tenant's receipt of a commercially reasonable nondisturbance agreement from any such future mortgagee, beneficiary under a deed of trust or ground lessor. Notwithstanding the foregoing, Landlord reserves the right to subordinate any such ground leases or underlying leases or any such liens to this Lease. If any such ground lease or underlying lease terminates for any reason or any such mortgage or deed of trust is foreclosed or a conveyance in lieu of foreclosure is made for any reason, at the election of Landlord's successor in interest, Tenant agrees to attorn to and become the tenant of such successor in which event Tenant's right to possession of the Premises will not be disturbed as long as Tenant is not in default under this Lease. Tenant hereby waives its rights under any law which gives or purports to give Tenant any right to terminate or otherwise adversely affect this Lease and the obligations of Tenant hereunder in the event of any such foreclosure proceeding or sale. Subject to Tenant's receipt of a commercially reasonable nondisturbance agreement, Tenant covenants and agrees to execute and deliver, upon demand by Landlord and in the form reasonably acceptable to Tenant and Landlord, any additional documents evidencing the priority or subordination of this Lease and Tenant's attornment agreement with respect to any such ground lease or underlying leases or the lien of any such mortgage or deed of trust. If Tenant fails to execute and acknowledge any such documents within ten (10) business days of receipt of such documents from Landlord, Tenant will be in default hereunder.

26. **ESTOPPEL CERTIFICATE.**

(a) **Tenant's Obligations.** Within ten business (10) days following any written request which Landlord may make from time to time, Tenant agrees to execute and deliver to Landlord a statement, in a form as may reasonably be required by Landlord or Landlord's lender, certifying: (i) the date of commencement of this Lease; (ii) the fact that this Lease is unmodified and in full force and effect (or, if there have been modifications, that this Lease is in full force and effect, and stating the date and nature of such modifications); (iii) the date to which the rent and other sums payable under this Lease have been paid; (iv) that there are no current defaults under this Lease by either Landlord or Tenant except as specified in Tenant's statement; and (v) such other matters reasonably requested by Landlord. Landlord and Tenant intend that any statement delivered pursuant to this Paragraph 26 may be relied upon by any mortgagee, beneficiary, purchaser or prospective purchaser of the Building or any interest therein.

(b) **Tenant's Failure to Deliver.** Tenant's failure to deliver such statement within such time will be conclusive upon Tenant (i) that this Lease is in full force and effect, without modification except as may be represented by Landlord, (ii) that there are no uncured defaults in Landlord's performance, and (iii) that not more than one (1) month's rent has been paid in advance. Without limiting the foregoing, if Tenant fails to deliver any such statement within such ten (10) business day period, Landlord may deliver to Tenant an additional request for such statement and Tenant's failure to deliver such statement to Landlord within ten (10) business days after delivery of such additional request will constitute a default under this Lease. Tenant agrees to indemnify and protect Landlord from and against any and all claims, damages, losses, liabilities and expenses (including attorneys' fees and costs) attributable to any failure by Tenant to timely deliver any such estoppel certificate to Landlord as required by this Paragraph 26.

27. **RULES AND REGULATIONS.** Tenant agrees to faithfully observe and comply with the "Rules and Regulations," a copy of which is attached hereto and incorporated herein by this reference as Exhibit "E", and all reasonable and nondiscriminatory modifications thereof and additions thereto from time to time put into effect by Landlord. Landlord shall use its commercially reasonable efforts to enforce such Rules and Regulations against other tenants and occupants of the Building; however, Landlord will not be responsible to Tenant for the violation or non−performance by any other tenant or occupant of the Building of any of the Rules and Regulations.

28. **MODIFICATION AND CURE RIGHTS OF LANDLORD'S MORTGAGEES AND LESSORS.**

(a) **Modifications.** If, in connection with Landlord's obtaining or entering into any financing or ground lease for any portion of the Building or the Project, the lender or ground lessor requests modifications to this Lease, Tenant, within ten (10) business days after request therefor, agrees to

execute an amendment to this Lease incorporating such modifications, provided such modifications are reasonable and do not increase the obligations of Tenant under this Lease or adversely affect the leasehold estate created by this Lease.

(b) **Cure Rights.** In the event of any default on the part of Landlord, Tenant will give notice by registered or certified mail to any beneficiary of a deed of trust or mortgage covering the Premises or ground lessor of Landlord whose address has been furnished to Tenant, and Tenant agrees to offer such beneficiary, mortgagee or ground lessor a reasonable opportunity to cure the default (including with respect to any such beneficiary or mortgagee, time to obtain possession of the Premises, subject to this Lease and Tenant's rights hereunder, by power of sale or a judicial foreclosure, if such should prove necessary to effect a cure).

29. **DEFINITION OF LANDLORD.** The term "Landlord," as used in this Lease, so far as covenants or obligations on the part of Landlord are concerned, means and includes only the owner or owners, at the time in question, of the fee title of the Premises or the lessees under any ground lease, if any. In the event of any transfer, assignment or other conveyance or transfers of any such title (other than a transfer for security purposes only), Landlord herein named (and in case of any subsequent transfers or conveyances, the then grantor) will be automatically relieved from and after the date of such transfer, assignment or conveyance of all liability as respects the performance of any covenants or obligations on the part of Landlord contained in this Lease thereafter to be performed, so long as the transferee assumes in writing all such covenants and obligations of Landlord arising after the date of such transfer and the transferee has the financial capabilities to perform Landlord's obligations under this Lease. Landlord and Landlord's transferees and assignees have the absolute right to transfer all or any portion of their respective title and interest in the Project, the Building, the Premises and/or this Lease without the consent of Tenant, and such transfer or subsequent transfer will not be deemed a violation on Landlord's part of any of the terms and conditions of this Lease.

30. **WAIVER.** The waiver by either party of any breach of any term, covenant or condition herein contained will not be deemed to be a waiver of any subsequent breach of the same or any other term, covenant or condition herein contained, nor will any custom or practice which may develop between the parties in the administration of the terms hereof be deemed a waiver of or in any way affect the right of either party to insist upon performance in strict accordance with said terms. The subsequent acceptance of rent or any other payment hereunder by Landlord will not be deemed to be a waiver of any preceding breach by Tenant of any term, covenant or condition of this Lease, other than the failure of Tenant to pay the particular rent so accepted, regardless of Landlord's knowledge of such preceding breach at the time of acceptance of such rent. No acceptance by Landlord of a lesser sum than the basic rent and additional rent or other sum then due will be deemed to be other than on account of the earliest installment of such rent or other amount due, nor will any endorsement or statement on any check or any letter accompanying any check be deemed an accord and satisfaction, and Landlord may accept such check or payment without prejudice to Landlord's right to recover the balance of such installment or other amount or pursue any other remedy provided in this Lease. The consent or approval of Landlord to or of any act by Tenant requiring Landlord's consent or approval will not be deemed to waive or render unnecessary Landlord's consent or approval to or of any subsequent similar acts by Tenant.

31. **PARKING.**

(a) **Grant of Parking Rights.** So long as this Lease is in effect and provided Tenant is not in default hereunder after expiration of any applicable cure or notice period, Landlord grants to Tenant a license to use the number and type of parking spaces designated in Subparagraph 1(s) subject to the terms and conditions of this Paragraph 31, and the Rules and Regulations regarding parking contained in Exhibit "E" attached hereto. Tenant agrees to submit to Landlord or, at Landlord's election, directly to Landlord's parking operator with a copy to Landlord, written notice in a form reasonably specified by Landlord containing the names, office addresses and telephone numbers of those persons who are authorized by Tenant to use Tenant's parking spaces on a monthly basis ("Tenant's Authorized Users") and shall use its best efforts to identify each vehicle of Tenant's Authorized Users by make, model and license number. Tenant agrees to deliver such notice prior to the beginning of the Term of this Lease and to periodically update such notice as well as upon specific request by Landlord or Landlord's parking operator to reflect changes to Tenant's Authorized Users or their vehicles. Tenant will not use or allow any of Tenant's Authorized Users to use any parking spaces which have been specifically assigned by Landlord to other tenants or occupants or for other uses such as visitor parking or which have been designated by any governmental entity as being restricted to certain uses.

(b) **Parking Rules and Regulations.** Tenant and Tenant's Authorized Users shall comply with all rules and regulations regarding parking set forth in Exhibit "E" attached hereto and Tenant agrees to cause its employees, subtenants, assignees, contractors, suppliers, customers and invitees to comply with such rules and regulations. Landlord reserves the right from time to time to modify and/or adopt

such other reasonable and non−discriminatory rules and regulations for the parking facilities as it deems reasonably necessary for the operation of the parking facilities.

32. **FORCE MAJEURE.** If either Landlord or Tenant is delayed, hindered in or prevented from the performance of any act required under this Lease by reason of strikes, lock−outs, labor troubles, inability to procure standard materials, unusual and unforeseeable delay in the course of construction, failure of power, restrictive governmental laws, regulations or orders or governmental action or inaction (including failure, refusal or delay in issuing permits, approvals and/or authorizations which is not the result of the action or inaction of the party claiming such delay), riots, civil unrest or insurrection, war, fire, earthquake, flood or other natural disaster, unusual and unforeseeable delay which results from an interruption of any public utilities (e.g., electricity, gas, water, telephone) or other unusual and unforeseeable delay not within the reasonable control of the party delayed in performing work or doing acts required under the provisions of this Lease, then performance of such act will be excused for the period of the delay and the period for the performance of any such act will be extended for a period equivalent to the period of such delay. The provisions of this Paragraph 32 will not operate to excuse Tenant from prompt payment of rent or any other payments required under the provisions of this Lease.

33. **SIGNS.** At Tenant's sole cost and expense, Tenant shall be entitled to have Building standard identity signs installed and maintained in place throughout the Term (on a non−exclusive basis) (a) at the Building monument sign and (b) on the exterior of the Building, subject (i) to Landlord's reasonable prior approval, (ii) applicable City ordinances and (iii) the signage rights of all existing tenants. Tenant agrees to have Landlord maintain Tenant's foregoing identification signs in such designated locations in accordance with this Paragraph 33 at Tenant's sole cost and expense. Tenant has no right to install Tenant identification signs in any other location in, on or about the Premises or the Project, to change the name upon any such signage and Tenant will not display or erect any other signs, displays or other advertising materials that are visible from the exterior of the Building or from within the Building in any interior or exterior common areas.

34. **LIMITATION ON LIABILITY.** In consideration of the benefits accruing hereunder, Tenant on behalf of itself and all successors and assigns of Tenant covenants and agrees that, in the event of any actual or alleged failure, breach or default hereunder by Landlord: (a) Tenant's recourse against Landlord for monetary damages will be limited to Landlord's interest in the Building including, subject to the prior rights of any Mortgagee, Landlord's interest in the rents of the Building and any insurance proceeds payable to Landlord; (b) Except as may be necessary to secure jurisdiction of the partnership or company, no partner or member of Landlord shall be sued or named as a party in any suit or action and no service of process shall be made against any partner or member of Landlord; (c) No partner or member of Landlord shall be required to answer or otherwise plead to any service of process; (d) No judgment will be taken against any partner or member of Landlord and any judgment taken against any partner or member of Landlord may be vacated and set aside at any time after the fact; (e) No writ of execution will be levied against the assets of any partner or member of Landlord; (f) The obligations under this Lease do not constitute personal obligations of the individual members, partners, directors, officers or shareholders of Landlord, and Tenant shall not seek recourse against the individual members, partners, directors, officers or shareholders of Landlord or any of their personal assets for satisfaction of any liability in respect to this Lease; and (g) These covenants and agreements are enforceable both by Landlord and also by any partner or member of Landlord.

35. **FINANCIAL STATEMENTS.** Prior to the execution of this Lease by Landlord and at any time during the Term of this Lease, upon ten (10) days prior written notice from Landlord, Tenant agrees to provide Landlord with a current financial statement for Tenant and any guarantors of Tenant and financial statements for the two (2) years prior to the current financial statement year for Tenant and any guarantors of Tenant. Such statements are to be prepared in accordance with generally accepted accounting principles and, if such is the normal practice of Tenant, audited by an independent certified public accountant.

36. **QUIET ENJOYMENT.** Landlord covenants and agrees with Tenant that upon Tenant paying the rent required under this Lease and paying all other charges and performing all of the covenants and provisions on Tenant's part to be observed and performed under this Lease, Tenant may peaceably and quietly have, hold and enjoy the Premises in accordance with this Lease without hindrance or molestation by Landlord or its employees or agents.

37. **MISCELLANEOUS.**

(a) **Conflict of Laws.** This Lease shall be governed by and construed solely pursuant to the laws of the State, without giving effect to choice of law principles thereunder.

(b) **Successors and Assigns.** Except as otherwise provided in this Lease, all of the covenants, conditions and provisions of this Lease shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs, personal representatives, successors and assigns.

(c) **Professional Fees and Costs.** If either Landlord or Tenant should bring suit against the other with respect to this Lease, then all costs and expenses, including without limitation, actual professional fees and costs such as appraisers', accountants' and attorneys' fees and costs, incurred by the party which prevails in such action, whether by final judgment or out of court settlement, shall be paid by the other party, which obligation on the part of the other party shall be deemed to have accrued on the date of the commencement of such action and shall be enforceable whether or not the action is prosecuted to judgment. As used herein, attorneys' fees and costs shall include, without limitation, attorneys' fees, costs and expenses incurred in connection with any (i) postjudgment motions; (ii) contempt proceedings; (iii) garnishment, levy, and debtor and third party examination; (iv) discovery; and (v) bankruptcy litigation.

(d) **Terms and Headings.** The words "Landlord" and "Tenant" as used herein shall include the plural as well as the singular. Words used in any gender include other genders. The paragraph headings of this Lease are not a part of this Lease and shall have no effect upon the construction or interpretation of any part hereof.

(e) **Time.** Time is of the essence with respect to the performance of every provision of this Lease in which time of performance is a factor.

(f) **Prior Agreement; Amendments.** This Lease constitutes and is intended by the parties to be a final, complete and exclusive statement of their entire agreement with respect to the subject matter of this Lease. This Lease supersedes any and all prior and contemporaneous agreements and understandings of any kind relating to the subject matter of this Lease. There are no other agreements, understandings, representations, warranties, or statements, either oral or in written form, concerning the subject matter of this Lease. No alteration, modification, amendment or interpretation of this Lease shall be binding on the parties unless contained in a writing which is signed by both parties.

(g) **Separability.** The provisions of this Lease shall be considered separable such that if any provision or part of this Lease is ever held to be invalid, void or illegal under any law or ruling, all remaining provisions of this Lease shall remain in full force and effect to the maximum extent permitted by law unless the provision invalidated is required for Tenant's practical realization of the benefits of this Lease.

(h) **Recording.** Neither Landlord nor Tenant shall record this Lease nor any memorandum thereof without the prior written consent of the other; provided, however, that if and only if Landlord fails to obtain and record a subordination, nondisturbance and attornment agreement from its existing lender on or before the Commencement Date, than and solely in such event the parties shall (i) execute, acknowledge and record a memorandum of lease ("Memorandum") in the form attached hereto as Exhibit F in the Official Records of the County of Santa Clara ("Official Records") and (ii) Tenant shall execute, acknowledge and deliver to Landlord a quitclaim of the Memorandum ("Quitclaim") in the form attached hereto as Exhibit G. Tenant hereby irrevocably authorizes and directs Landlord to record the Quitclaim in the Official Records upon the earlier to occur of the expiration of the term of the Lease or earlier termination of the Lease pursuant to the terms of this Lease.

(i) **Counterparts.** This Lease may be executed in one or more counterparts, each of which shall constitute an original and all of which shall be one and the same agreement.

(j) **Nondisclosure of Lease Terms.** Tenant acknowledges and agrees that the terms of this Lease are confidential and constitute proprietary information of Landlord. Disclosure of the terms could adversely affect the ability of Landlord to negotiate other leases and impair Landlord's relationship with other tenants. Accordingly, Tenant agrees that it, and its partners, officers, directors, employees, agents and attorneys, shall not intentionally and voluntarily disclose the terms and conditions of this Lease to any newspaper or other publication or any other tenant or apparent prospective tenant of the Building or other portion of the Project, or real estate agent, either directly or indirectly, without the prior written consent of Landlord, provided, however, that Tenant may disclose the terms to prospective subtenants or assignees under this Lease, lenders and investors and prospective lenders and investors, and to the extent required by law.

(k) **Non−Discrimination**. Tenant acknowledges and agrees that there shall be no discrimination against, or segregation of, any person, group of persons, or entity on the basis of race, color, creed, religion, age, sex, marital status, national origin, or ancestry in the leasing, subleasing, transferring, assignment, occupancy, tenure, use, or enjoyment of the Premises, or any portion thereof.

38. **EXECUTION OF LEASE.**

(a) **Joint and Several Obligations.** If more than one person executes this Lease as Tenant, their execution of this Lease will constitute their covenant and agreement that (i) each of them is jointly and severally liable for the keeping, observing and performing of all of the terms, covenants, conditions, provisions and agreements of this Lease to be kept, observed and performed by Tenant, and (ii) the term "Tenant" as used in this Lease means and includes each of them jointly and severally. The act of or notice from, or notice or refund to, or the signature of any one or more of them, with respect to the tenancy of this Lease, including, but not limited to, any renewal, extension, expiration, termination or modification of this Lease, will be binding upon each and all of the persons executing this Lease as Tenant with the same force and effect as if each and all of them had so acted or so given or received such notice or refund or so signed.

(b) **Tenant as Corporation or Partnership.** If Tenant executes this Lease as a corporation or partnership, then Tenant and the persons executing this Lease on behalf of Tenant represent and warrant that such entity is duly qualified and in good standing to do business in California and that the individuals executing this Lease on Tenant's behalf are duly authorized to execute and deliver this Lease on its behalf, and in the case of a corporation, in accordance with a duly adopted resolution of the board of directors of Tenant, a copy of which is to be delivered to Landlord on execution hereof, if requested by Landlord, and in accordance with the by−laws of Tenant, and, in the case of a partnership, in accordance with the partnership agreement and the most current amendments thereto, if any, copies of which are to be delivered to Landlord on execution hereof, if requested by Landlord, and that this Lease is binding upon Tenant in accordance with its terms.

(c) **Examination of Lease.** Submission of this instrument by Landlord to Tenant for examination or signature by Tenant does not constitute a reservation of or option for lease, and it is not effective as a lease or otherwise until execution by and delivery to both Landlord and Tenant.

39**. EARLY OCCUPANCY.** Landlord shall permit Tenant to have early occupancy of the Premises following execution of this Lease and payment of the sums required upon Lease execution, for the purposes of preparing the Premises for use by Tenant, subject to the rights and use of the current tenant in occupancy.

40. **OPTION TO EXTEND.** Landlord hereby grants to Tenant two options (the "Option" or "Options") to extend the term of the Lease, for an additional period of five (5) years each (each, an "Option Term"). The Option must be exercised, if at all, by written notice (an "Option Notice") delivered by Tenant to Landlord not later than nine (9) months prior to the end of the term then in effect. Further, the Option shall not be deemed to be properly exercised if, as of the date of the Option Notice or at the end of the term then in effect, Tenant (i) is in default under the Lease, which default has not been cured as of the date in question, (ii) has assigned all or any portion of this Lease or its interest therein or (iii) has sublet sixty percent (60%) or more of the Premises. Provided Tenant has properly and timely exercised the Option, the term of the Lease shall be extended by the Option Term, and all terms, covenants and conditions of the Lease shall remain unmodified and in full force and effect, except that (y) Tenant shall pay initial base rent determined as set forth below in this paragraph, and (z) after the exercise of the second Option, Tenant shall have no further options remaining. Landlord shall have no obligation whatsoever in connection with any extension of the term of this Lease to remodel, alter or improve the Premises for use by Tenant, to provide any improvement or construction allowance to Tenant, or to pay or reimburse Tenant for any remodeling, alterations or improvements to the Premises. The initial base rent during each Option Term shall be ninety−five percent (95%) of the fair market rental value of the Premises as of the commencement of such Option Term, determined as provided below. As used herein, "fair market rental value" shall mean the projected prevailing rental rate as of the first day of the Option Term for similar commercial space improved or presumed to be improved with tenant improvements of substantially similar age, quality and layout as then existing in the Premises and situated in similar office buildings in the Sunnyvale market area including without limitation annual increases in the base rent. Promptly after delivery of an Option Notice, Landlord and Tenant shall meet and confer and attempt to agree upon the fair market rental value of the Premises. If they are not able to agree, either party may give written notice to the other that the fair market rental value is to be determined by appraisal as provided herein. Within twenty (20) days following such notice, each party shall by written notice to the other appoint an independent and qualified appraiser. Each of such appraisers shall, within thirty (30) days following appointment, give written notice to both parties of the appraiser's determination of fair market rental value. If the determinations of such appraisers are in agreement, the initial base rent for the Option Term shall be ninety−five percent (95%) of the fair market rental value so determined. If the difference between such determinations is five percent (5%) of the higher appraisal or less, the average of the two determinations shall be the fair market rental value. If the difference is more than such percentage, then during the ten−day period following the appraisers' determinations, Landlord and Tenant shall again meet and confer and attempt to agree upon the fair market rental value of the Premises. If they are unable to agree, the two appraisers shall appoint an independent M.A.I. appraiser with not less than five (5) years experience with office leases in the area

in which the building is located. Within thirty (30) days following appointment, the third appraiser shall on written notice to the parties determine the fair market rental value, which determination shall be binding upon the parties. Each party shall pay the fees and expenses of the appraiser appointed by it and one−half of the fees and expenses of the third appraiser. If base rent has not been determined as of the commencement of the Option Term, Tenant shall pay the Base Rent in the amount specified by Landlord until base rent is finally determined. Upon such determination.

41. **CONDITIONS PRECEDENT.** This Lease is subject to the following condition precedent which must be satisfied or waived by Landlord on or before April 30, 2005: Landlord shall have obtained the consent of its first mortgage lender to this Lease.
IN WITNESS WHEREOF, the parties have caused this Lease to be duly executed by their duly authorized representatives as of the date first above written.

TENANT:

MONOLITHIC SYSTEM TECHNOLOGY, INC.
a Delaware corporation

By: /s/ Mark Voll
Print Name: Mark Voll
Print Title: Chief Financial Officer

LANDLORD:

SUNNYVALE MATHILDA INVESTORS, LLC
a California limited liability company

By: Matteson Real Estate Equities, Inc.
Manager

By: James A. Blake

Its: Executive Vice President

OUTLINE OF FLOOR
PLAN OF PREMISES

[To be supplied]

TENANT IMPROVEMENTS

1. **TENANT IMPROVEMENTS**. As used in the Lease and this Exhibit B, the term "Tenant Improvements" or "Tenant Improvement Work" or "Tenant's Work" means those items of general tenant improvement construction shown on the Final Plans (described in Section 4 below), more particularly described in Section 5 below.

2. **WORK SCHEDULE**. Prior to commencing construction, Tenant will deliver to Landlord, for Landlord's review and approval, a schedule ("Work Schedule") which will set forth the timetable for the planning and completion of the installation of the Tenant Improvements. Subject to receipt of an acceptable Work Schedule, Tenant shall be granted access to the Premises prior to the Commencement Date for the sole purpose of beginning construction of its Tenant Improvement Work subject to all of the terms and provisions of this Lease except for the payment of Rent and Operating Expenses.

3. **CONSTRUCTION REPRESENTATIVES**. Landlord hereby appoints the following person(s) as Landlord's representative ("Landlord's Representative") to act for Landlord in all matters covered by this Exhibit B: Anne Risberg. Tenant hereby appoints the following person(s) as Tenant's representative ("Tenant's Representative") to act for Tenant in all matters covered by this Exhibit B:

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All communications with respect to the matters covered by this Work Letter Agreement are to be made to Landlord's Representative or Tenant's Representative, as the case may be, in writing in compliance with the notice provisions of the Lease. Either party may change its representative under this Exhibit B at any time by written notice to the other party in compliance with the notice provisions of the Lease.

4. **TENANT IMPROVEMENT PLANS**.

(a) **Preparation of Space Plans**. In accordance with the Work Schedule, Landlord agrees to meet with Tenant's architect and/or space planner for the purpose of promptly preparing preliminary space plans for the layout of Premises ("Space Plans"). The Space Plans are to be sufficient to convey the architectural design of the Premises and layout of the Tenant Improvements therein and are to be submitted to Landlord in accordance with the Work Schedule for Landlord's approval. If Landlord reasonably disapproves any aspect of the Space Plans, Landlord will advise Tenant in writing of such disapproval and the reasons therefor in accordance with the Work Schedule. Tenant will then submit to Landlord for Landlord's approval, in accordance with the Work Schedule, a redesign of the Space Plans incorporating the revisions reasonably required by Landlord. Landlord's failure to deliver written notice of disapproval within the time frame set forth in the Work Schedule shall be deemed approval.

(b) **Preparation of Final Plans**. Based on the approved Space Plans, and in accordance with the Work Schedule, Tenant's architect will prepare complete architectural plans, drawings and specifications and complete engineered mechanical, structural and electrical working drawings for all of the Tenant Improvements for the Premises (collectively, the "Final Plans"). The Final Plans will show (a) the subdivision (including partitions and walls), layout, lighting, finish and decoration work (including carpeting and other floor coverings) for the Premises; (b) all internal and external communications and utility facilities which will require conduiting or other improvements from the base Building shell work and/or within common areas; and (c) all other specifications for the Tenant Improvements. The Final Plans will be submitted to Landlord for signature to confirm that they are consistent with the Space Plans. At the time Landlord approves the Final Plans, Landlord shall inform Tenant in writing of any tenant improvements which Landlord will require Tenant to remove upon the expiration or earlier termination of this Lease. If Landlord reasonably disapproves any aspect of the Final Plans based on any inconsistency with the Space Plans, Landlord agrees to advise Tenant in writing of such disapproval and the reasons therefor within the time frame set forth in the Work Schedule. Landlord's failure to deliver written notice of disapproval within the time frame set forth in the Work Schedule shall be deemed approval. In accordance with the Work Schedule, Tenant will then cause Tenant's architect to redesign the Final Plans incorporating the revisions reasonably requested by Landlord so as to make the Final Plans consistent with the Space Plans.

(c) **Requirements of Tenant's Final Plans**. Tenant's Final Plans will include locations and complete dimensions, and the Tenant Improvements, as shown on the Final Plans, will: (i) be compatible with the Building shell and with the design, construction and equipment of the Building; (ii) if not comprised of the Building standards set forth in the written description thereof (the "Standards"), then compatible with and of at least equal quality as the Standards and approved by

Landlord; (iii) comply with all applicable laws, ordinances, rules and regulations of all governmental authorities having jurisdiction, and all applicable insurance regulations; (iv) not require Building service beyond the level normally provided to other tenants in the Building and will not overload the Building floors; and (v) be of a nature and quality consistent with the overall objectives of Landlord for the Building, as determined by Landlord in its reasonable but subjective discretion.

(d) **Submittal of Final Plans**. Once approved by Landlord and Tenant, Tenant's architect will submit the Final Plans to the appropriate governmental agencies for plan checking and the issuance of a building permit. Tenant's architect, with Landlord's cooperation, will make any changes to the Final Plans which are requested by the applicable governmental authorities to obtain the building permit. After approval of the Final Plans no further changes may be made without the prior written approval of both Landlord and Tenant, and then only after agreement by Tenant to pay any excess costs resulting from the design and/or construction of such changes.

(e) **Changes to Shell of Building**. If the Final Plans or any amendment thereof or supplement thereto shall require changes in the Building shell, the increased cost of the Building shell work caused by such changes will be paid for by Tenant or charged against the "Allowance" described in Section 5 below.

(f) **Work Cost Estimate and Statement**. Prior to the commencement of construction of any of the Tenant Improvements shown on the Final Plans, Tenant will submit to Landlord a written estimate of the cost to complete the Tenant Improvement Work, which written estimate will be based on the Final Plans taking into account any modifications which may be required to reflect changes in the Final Plans required by the City or County in which the Premises are located (the "Work Cost Estimate"). Landlord will either approve the Work Cost Estimate or disapprove specific items and submit to Tenant revisions to the Final Plans to reflect deletions of and/or substitutions for such disapproved items; provided that Landlord's approval shall not be unreasonably withheld or conditioned. Submission and approval of the Work Cost Estimate will proceed in accordance with the Work Schedule. Landlord's failure to disapprove the Work Cost Estimate within the time frame required by the Work Schedule shall be deemed approval. Upon Landlord's approval or deemed approval of the Work Cost Estimate (such approved Work Cost Estimate to be hereinafter known as the "Work Cost Statement"), Tenant will have the right to purchase materials and to commence the construction of the items included in the Work Cost Statement pursuant to Section 6 hereof. If the total costs reflected in the Work Cost Statement exceed the Allowance described in Section 5 below, Tenant agrees to pay such excess.

5. **PAYMENT FOR THE TENANT IMPROVEMENTS**.

(a) **Allowance**. Landlord hereby grants to Tenant a tenant improvement allowance of Twelve Dollars ($12.00) per Rentable Square Foot of the Premises, i.e., Three Hundred Fifteen Thousand Dollars ($315,000) (the "Allowance"). The Allowance is to be used only for:

(i) Payment of the cost of preparing the Space Plans and the Final Plans, including mechanical, electrical, plumbing and structural drawings and of all other aspects necessary to complete the Final Plans.

(ii) The payment of plan check, permit and license fees relating to construction of the Tenant Improvements.

(iii) Construction of the Tenant Improvements, including, without limitation, the following:

(aa) Installation within the Premises of all partitioning, doors, floor coverings, ceilings, wall coverings and painting, millwork and similar items;

(bb) All electrical wiring, lighting fixtures, outlets and switches, and other electrical work necessary for the Premises;

(cc) The furnishing and installation of all duct work, terminal boxes, diffusers and accessories necessary for the heating, ventilation and air conditioning systems within the Premises, including the cost of meter and key control for after−hour air conditioning;

(dd) Any additional improvements to the Premises required for Tenant's use of the Premises including, but not limited to, odor control, special heating, ventilation and air conditioning, noise or vibration control or other special systems or improvements;

(ee) All fire and life safety control systems such as fire walls, sprinklers, halon, fire alarms, including piping, wiring and accessories, necessary for the Premises;

(ff) All plumbing, fixtures, pipes and accessories necessary for the Premises; and

(gg) Testing and inspection costs.

(iv) All costs incurred by Landlord for construction or planning of the Tenant Improvements in the Premises.

In the event that Tenant does not use or apply the entire Allowance for the items set forth in clauses (i) through (iv) above, then Tenant shall be entitled to apply such unused portion of the Allowance, not to exceed One Hundred Twenty−Five Thousand Dollars ($125,000), for reimbursement of Tenant's reasonable and properly documented moving expenses and cabling, fixtures, furnishings, telephone and security systems and equipment installed by Tenant in the Premises.

(b) **Excess Costs**. The cost of each item referenced in Section 5(a) above shall be charged against the Allowance. If the work cost exceeds the Allowance, Tenant shall be solely responsible for payment of all excess costs, which shall be paid to Landlord within five (5) business days after invoice therefor. Except to the extent provided in the last paragraph of Section 5(a) above, in no event will the Allowance be used to pay for Tenant's furniture, artifacts, equipment, telephone systems or any other item of personal property which is not affixed to the Premises.

(c) **Changes**. Any changes to the Final Plans will be approved by Landlord and Tenant in the manner set forth in Section 4 above. Tenant shall be solely responsible for any additional costs associated with such changes Landlord will have the right to decline Tenant's request for a change to the Final Plans if such changes are inconsistent with the provisions of Section 4 above.

(d) **Governmental Cost Increases**. If increases in the cost of the Tenant Improvements as set forth in the Work Cost Statement are due to requirements of any governmental agency, Tenant shall be solely responsible for such additional costs; provided, however, that Landlord will first apply toward any such increase any remaining balance of the Allowance.

(e) **Disbursement of the Allowance**. Provided Tenant is not in default following the giving of notice and passage of any applicable cure period under the Lease or this Work Letter Agreement, Landlord shall disburse the Allowance to Tenant to reimburse Tenant for the actual construction costs which Tenant incurs in connection with the construction of the Tenant Improvements in accordance with the following:

(i) Twenty−five percent (25%) of the Allowance shall be disbursed to Tenant when Landlord shall have received "Evidence of Completion and Payment" as to fifty percent (50%) of Tenant's Work having been completed and paid for by Tenant as described hereinbelow;

(ii) An additional Fifty percent (50%) of the Allowance shall be disbursed to Tenant when Landlord shall have received "Evidence of Completion and Payment" as to seventy−five percent (75%) of Tenant's Work having been completed and paid for by Tenant as described hereinbelow;

(iii) Fifteen percent (15%) of the Allowance shall be disbursed to Tenant when Landlord shall have received "Evidence of Completion and Payment" as to ninety percent (90%) of Tenant's Work having been completed and paid for by Tenant as described hereinbelow; and

(iv) The final ten percent (10%) of the Allowance shall be disbursed to Tenant when Landlord shall have received "Evidence of Completion and Payment" as to one hundred percent (100%) of Tenant's Work having been completed and paid for by Tenant as described hereinbelow and satisfaction of the items described in subparagraph (vi) below.

(v) As to each phase of completion of Tenant's Work described in subparagraphs (i) through (iii) above, the appropriate portion of the Allowance shall be disbursed to Tenant only when Landlord has received the following "Evidence of Completion and Payment":

(A) Tenant has delivered to Landlord a draw request ("Draw Request") in a form satisfactory to Landlord with respect to the Improvements specifying that the requisite portion of Tenant's Work has been completed, together with invoices, receipts and bills evidencing the costs and expenses set forth in such Draw Request and evidence of payment by Tenant for all costs which are payable in connection with such Tenant's Work covered by the Draw Request. The Draw Request shall constitute a representation by Tenant that the Tenant's Work identified therein has been completed in a good and workmanlike manner and in accordance with the Final Plans and the Work Schedule and has been paid for;

(B) The architect for the Tenant Improvements has certified to Landlord that the Tenant Improvements have been completed to the level indicated in the Draw Request in accordance with the Final Plans;

(C) Tenant has delivered to Landlord such other evidence of Tenant's payment of the general contractor and subcontractors for the portions of Tenant's Work covered by the Draw Request and the absence of any liens generated by such portions of the Tenant's Work as may be required by Landlord (i.e., either unconditional lien releases in accordance with California Civil Code Section 3262 or release bond(s) in accordance with California Civil Code Sections 3143 and 3171);

(D) Landlord or Landlord's architect or construction representative has inspected the Tenant Improvements and determined that the portion of Tenant's Work covered by the Draw Request has been completed in a good and workmanlike manner;

(vi) The final disbursement of the balance of the Allowance under subparagraph (iv) above shall be disbursed to Tenant only when Landlord has received Evidence of Completion and Payment as to all of Tenant's Work as provided hereinabove and the following conditions have been satisfied:

(A) Thirty−five (35) days shall have elapsed following the filing of a valid notice of completion by Tenant for the Tenant Improvements;

(B) A certificate of occupancy for the Tenant Improvements and the Premises has been issued by the appropriate governmental body; and

(C) The satisfaction of any other requirements or conditions which may be required or imposed by Landlord's lender with respect to the construction of the Tenant Improvements.

(vii) All construction costs in excess of the Allowance shall have been paid by Tenant.

(g) **Books and Records**. At its option, Landlord, at any time within twelve (12) months after final disbursement of the Allowance to Tenant, and upon at least ten (10) days prior written notice to Tenant, may cause an audit to be made of Tenant's books and records relating to Tenant's expenditures in connection with the construction of the Tenant Improvements. Tenant shall maintain complete and accurate books and records in accordance with generally accepted accounting principles of these expenditures for at least twelve (12). Tenant shall make available to Landlord's auditor at the Premises within ten (10) business days following Landlord's notice requiring the audit, all books and records maintained by Tenant pertaining to the construction and completion of the Tenant Improvements. In addition to all other remedies which Landlord may have pursuant to the Lease, Landlord may recover from Tenant the reasonable cost of its audit if the audit discloses that Tenant falsely reported to Landlord expenditures which were not in fact made or falsely reported a material amount of any expenditure or the aggregate expenditures.

6. **CONSTRUCTION OF TENANT IMPROVEMENTS**. Following Landlord's approval of the Final Plans and the Work Cost Statement described in Section 4(f) above, Tenant's contractor (selected as provided in Paragraph 9(n)) will commence and diligently proceed with the construction of the Tenant Improvements. Tenant shall use diligent efforts to cause its contractor to complete the Tenant Improvements in a good and workmanlike manner in accordance with the Final Plans and the Work Schedule. Tenant agrees to use diligent efforts to cause construction of the Tenant Improvements to commence promptly following the issuance of a building permit for the Tenant Improvements. Landlord shall have the right to enter upon the Premises to inspect Tenant's construction activities following reasonable advance notice to Tenant.

7. **MISCELLANEOUS CONSTRUCTION COVENANTS**.

(a) **No Liens**. Tenant shall not allow the Tenant Improvements or the Building or any portion thereof to be subjected to any mechanic's, materialmen's or other liens or encumbrances arising out of the construction of the Tenant Improvements.

(b) **Diligent Construction**. Tenant will promptly, diligently and continuously pursue construction of the Tenant Improvements to successful completion in full compliance with the Final Plans, the Work Schedule and this Work Letter Agreement. Landlord and Tenant shall cooperate with one another during the performance of Tenant's Work to effectuate such work in a timely and compatible manner.

(c) **Compliance with Laws**. Tenant will construct the Tenant Improvements in a safe and lawful manner. Tenant shall, at its sole cost and expense, comply with all applicable laws and all regulations and requirements of, and all licenses and permits issued by, all municipal or other

governmental bodies with jurisdiction which pertain to the installation of the Tenant Improvements. Copies of all filed documents and all permits and licenses shall be provided to Landlord. Any portion of the Tenant Improvements which is not acceptable to any applicable governmental body, agency or department, or not reasonably satisfactory to Landlord, shall be promptly repaired or replaced by Tenant at Tenant's expense. Notwithstanding any failure by Landlord to object to any such Tenant Improvements, Landlord shall have no responsibility therefor.

(d) **Indemnification**. Subject to the terms of the Lease regarding insurance and waiver of subrogation by the parties, Tenant hereby indemnifies and agrees to defend and hold Landlord, the Premises and the Building harmless from and against any and all suits, claims, actions, losses, costs or expenses (including, without limitation, claims for workers' compensation) of any nature whatsoever, together with reasonable attorneys' fees for counsel of Landlord's choice, arising out of or in connection with the Tenant Improvements or the performance of Tenant's Work (including, but not limited to, claims for breach of warranty, personal injury or property damage).

(e) **Insurance**. Construction of the Tenant Improvements shall not proceed without Tenant first acquiring workers' compensation and comprehensive general public liability insurance and property damage insurance as well as "All Risks" builders' risk insurance, with minimum coverage of $2,000,000 or such other amount as may be approved by Landlord in writing and issued by an insurance company reasonably satisfactory to Landlord. Not less than thirty (30) days before commencing the construction of the Tenant Improvements, certificates of such insurance shall be furnished to Landlord or, if requested, the original policies thereof shall be submitted for Landlord's approval. All such policies shall provide that thirty (30) days prior notice must be given to Landlord before modification, termination or cancellation. All insurance policies maintained by Tenant pursuant to this Exhibit B shall name Landlord and any lender with an interest in the Premises as additional insureds and comply with all of the applicable terms and provisions of the Lease relating to insurance. Tenant's contractor shall be required to maintain the same insurance policies as Tenant, and such policies shall name Tenant, Landlord and any lender with an interest in the Premises as additional insureds.

(f) **Construction Defects**. Landlord shall have no responsibility for the Tenant Improvements and Tenant will remedy, at Tenant's own expense, and be responsible for any and all defects in the Tenant Improvements that may appear during or after the completion thereof whether the same shall affect the Tenant Improvements in particular or any parts of the Premises in general.

(g) **Additional Services**. If the construction of the Tenant Improvements shall require that additional services or facilities (including, but not limited to, hoisting, cleanup or other cleaning services, trash removal, field supervision, or ordering of materials) be provided by Landlord, then Tenant shall pay Landlord for such items at Landlord's cost or at a reasonable charge if the item involves time of Landlord's personnel only. Electrical power and heating, ventilation and air conditioning shall be available to Tenant during normal business hours for construction purposes at no charge to Tenant.

(h) **Coordination of Labor**. All of Tenant's contractors, subcontractors, employees, servants and agents must work in harmony with and shall not interfere with any labor employed by Landlord, or Landlord's contractors or by any other tenant or its contractors with respect to the any portion of the Project. Nothing in this Work Letter shall, however, require Tenant to use union labor.

(i) **Work in Adjacent Areas**. Any work to be performed in areas adjacent to the Premises shall be performed only after obtaining Landlord's express written permission, which shall not be unreasonably withheld, conditioned or delayed, and shall be done only if an agent or employee of Landlord is present; Tenant will reimburse Landlord for the expense of any such employee or agent.

(j) **HVAC Systems**. Tenant agrees to be entirely responsible for the maintenance or the balancing of any heating, ventilating or air conditioning system installed by Tenant and/or maintenance of the electrical or plumbing work installed by Tenant and/or for maintenance of lighting fixtures, partitions, doors, hardware or any other installations made by Tenant.

(k) **Coordination with Lease**. Nothing herein contained shall be construed as (i) constituting Tenant as Landlord's agent for any purpose whatsoever, or (ii) a waiver by Landlord or Tenant of any of the terms or provisions of the Lease. Any default by Tenant following the giving of notice and the passage of any applicable cure period with respect to any portion of this Exhibit B shall be deemed a breach of the Lease for which Landlord shall have all the rights and remedies as in the case of a breach of said Lease.

(l) **Approval of Plans**. Landlord will not check Tenant drawings for building code compliance. Approval of the Final Plans by Landlord is not a representation that the drawings are in compliance with the requirements of governing authorities, and it shall be Tenant's responsibility to meet and

comply with all federal, state, and local code requirements. Approval of the Final Plans does not constitute assumption of responsibility by Landlord or its architect for their accuracy, sufficiency or efficiency, and Tenant shall be solely responsible for such matters.

(m) **Tenant's Deliveries**. Tenant shall deliver to Landlord, at least five (5) days prior to the commencement of construction of Tenant's Work, the following information:

(i) The names, addresses, telephone numbers, and primary contacts for the general, mechanical and electrical contractors Tenant intends to engage in the performance of Tenant's Work; and

(ii) The date on which Tenant's Work will commence, together with the estimated dates of completion of Tenant's construction and fixturing work.

(n) **Qualification of Contractors**. Once the Final Plans have been proposed and approved, Tenant shall select and retain a contractor and subcontractors from a list of contractors and subcontractors approved by Landlord for the construction of the Tenant Improvement Work in accordance with the Final Plans. All contractors engaged by Tenant shall be bondable, licensed contractors, possessing good labor relations, capable of performing quality workmanship and working in harmony with Landlord's general contractor and other contractors on the job, if any, all as reasonably determined by Landlord. All work shall be coordinated with general construction work on the Site, if any.

(o) **Warranties**. Tenant shall cause its contractor to provide warranties for not less than one (1) year (or such shorter time as may be customary and available without additional expense to Tenant) against defects in workmanship, materials and equipment, which warranties shall run to the benefit of Landlord or shall be assignable to Landlord to the extent that Landlord is obligated to maintain any of the improvements covered by such warranties.

(p) **Landlord's Performance of Work**. Within ten (10) working days after receipt of Landlord's written notice of Tenant's failure to perform its obligations under this Exhibit B, if Tenant shall fail to commence to cure such failure, Landlord shall have the right, but not the obligation, to perform, on behalf of and for the account of Tenant, subject to reimbursement of the cost thereof by Tenant, any and all of Tenant's Work which Landlord determines, in its reasonable discretion, should be performed immediately and on an emergency basis for the best interest of the Premises including, without limitation, work which pertains to structural components, mechanical, sprinkler and general utility systems, roofing and removal of unduly accumulated construction material and debris; provided, however, Landlord shall use reasonable efforts to give Tenant at least ten (10) days prior written notice to the performance of any of Tenant's Work.

(q) **As−Built Drawings**. Tenant shall cause "As−Built Drawings" (excluding furniture, fixtures and equipment) to be delivered to Landlord and/or Landlord's representative no later than sixty (60) days after the completion of Tenant's Work. In the event these drawings are not received by such date, Landlord may, at its election, cause said drawings to be obtained and Tenant shall pay to Landlord, as additional rent, the cost of producing these drawings.

8. LANDLORD'S FURNITURE. Tenant is hereby given the right to use all of Landlord's office furniture, cubicles, cabling, telephones and related furnishings located in the Premises as of the date of this Lease, without additional charge, including any such furniture or furnishings located elsewhere in the Building and not currently being used by any other tenant. Tenant shall be responsible for insuring all such furniture and furnishings under its "All Risks" policy required under Section 19(a)(i) of the Lease. Landlord and Tenant shall jointly prepare and sign an inventory of all such furnishings to be located within the Premises and used by Tenant during the term of this Lease on or before Tenant's occupancy of the Premises. In the event Tenant leases the Premises throughout the initial term and option terms of this Lease, Tenant shall be allowed, but not required, to assume ownership of such furnishings at the end of the final option term, and Landlord shall convey such furnishings to Tenant by bill of sale at the end of the final option term without representation or warranty by Landlord of any nature whatsoever. If Tenant does not lease the Premises for such period, the furnishings as set forth on the inventory shall remain the property of Landlord and shall be surrendered to Landlord by Tenant upon Lease expiration in the same condition as received, reasonable wear and tear excepted.

DEFINITION OF OPERATING EXPENSES

1. **Items Included in Operating Expenses**. The term "Operating Expenses" as used in the Lease to which this Exhibit "C" is attached means: all costs and expenses of operation and maintenance of the Building and the Common Areas (as such terms are defined in the Lease), as determined by standard accounting practices, including the following costs by way of illustration but not limitation, but excluding those items specifically set forth in Paragraph 3 below:

(a) Real Property Taxes and Assessments (as defined in Paragraph 2 below) and any taxes or assessments imposed in lieu thereof;

(b) any and all assessments imposed with respect to the Building pursuant to any covenants, conditions and restrictions affecting the Project, the Common Areas or the Building;

(c) water and sewer charges and the costs of electricity, heating, ventilating, air conditioning and other utilities;

(d) utilities surcharges and any other costs, levies or assessments resulting from statutes or regulations promulgated by any government or quasi−government authority in connection with the use, occupancy or alteration of the Building or the Premises or the parking facilities serving the Building or the Premises;

(e) costs of insurance obtained by Landlord;

(f) waste disposal and janitorial services;

(g) labor;

(h) costs incurred in the management of the Building, including, without limitation: (i) supplies, (ii) wages and salaries (and payroll taxes and similar governmental charges related thereto) of employees used in the management, operation and maintenance of the Building (with wages and salaries of any employees employed at the Building only on a part−time basis being equitably allocated by Landlord), (iii) Building management office rental, supplies, equipment and related operating expenses, and (iv) a management/administrative fee in an amount not to exceed three percent (3%) of the monthly base rent.

(i) supplies, materials, equipment and tools including rental of personal property used for maintenance;

(j) repair and maintenance of the elevators and the structural portions of the Building, including the plumbing, heating, ventilating, air−conditioning and electrical systems installed or furnished by Landlord;

(k) maintenance, costs and upkeep of all parking and Project Common Areas;

(l) depreciation on a straight line basis and rental of personal property used in maintenance;

(m) amortization on a straight line basis over the useful life [together with interest at the Interest Rate on the unamortized balance] of all capitalized expenditures which are: (i) reasonably intended to produce a reduction in operating charges or energy consumption; or (ii) required under any governmental law or regulation that was not applicable to the Building at the time it was originally constructed; or (iii) for replacement of any Building equipment needed to operate the Building at the same quality levels as prior to the replacement;

(n) costs and expenses of gardening and landscaping;

(o) maintenance of signs (other than signs of tenants of the Building);

(p) personal property taxes levied on or attributable to personal property used in connection with the Building or the Common Areas;

(q) reasonable accounting, audit, verification, legal and other consulting fees; and

(r) costs and expenses of repairs, resurfacing, repairing, maintenance, painting, lighting, cleaning, refuse removal, security and similar items, including appropriate reserves.

2. **Real Property Taxes and Assessments**. The term "Real Property Taxes and Assessments", as used in this Exhibit "C", means: any form of assessment, license fee, license tax, business license

fee, commercial rental tax, levy, charge, improvement bond, tax or similar imposition imposed by any authority having the direct power to tax, including any city, county, state or federal government, or any school, agricultural, lighting, drainage or other improvement or special assessment district thereof, as against any legal or equitable interest of Landlord in the Premises, Building, Common Areas or the Project (as such terms are defined in the Lease), including the following by way of illustration but not limitation:

(a) any tax on Landlord's "right" to rent or "right" to other income from the Premises or as against Landlord's business of leasing the Premises;

(b) any assessment, tax, fee, levy or charge in substitution, partially or totally, of any assessment, tax, fee, levy or charge previously included within the definition of real property tax, it being acknowledged by Tenant and Landlord that Proposition 13 was adopted by the voters of the State of California in the June, 1978 election and that assessments, taxes, fees, levies and charges may be imposed by governmental agencies for such services as fire protection, street, sidewalk and road maintenance, refuse removal and for other governmental services formerly provided without charge to property owners or occupants. It is the intention of Tenant and Landlord that all such new and increased assessments, taxes, fees, levies and charges be included within the definition of "real property taxes" for the purposes of this Lease;

(c) any assessment, tax, fee, levy or charge allocable to or measured by the area of the Premises or other premises in the Building or the rent payable by Tenant hereunder or other tenants of the Building, including, without limitation, any gross receipts tax or excise tax levied by state, city or federal government, or any political subdivision thereof, with respect to the receipt of such rent, or upon or with respect to the possession, leasing, operation, management, maintenance, alteration, repair, use or occupancy by Tenant of the Premises, or any portion thereof but not on Landlord's other operations;

(d) any assessment, tax, fee, levy or charge upon this transaction or any document to which Tenant is a party, creating or transferring an interest or an estate in the Premises; and/or

(e) any assessment, tax, fee, levy or charge by any governmental agency related to any transportation plan, fund or system (including assessment districts) instituted within the geographic area of which the Building is a part.

3. **Items Excluded From Operating Expenses**. Notwithstanding the provisions of Paragraphs 1 and 2 above to the contrary, "Operating Expenses" will not include:

(a) Landlord's federal or state or local income, franchise, inheritance or estate taxes and transfer taxes;

(b) any ground lease rental;

(c) costs incurred by Landlord for the repair of damage to the Building to the extent that Landlord is reimbursed by insurance or condemnation proceeds or by tenants, warrantors or other third persons;

(d) depreciation, amortization and interest payments, except as specifically provided herein, and except on materials, tools, supplies and vendor−type equipment purchased by Landlord to enable Landlord to supply services Landlord might otherwise contract for with a third party, where such depreciation, amortization and interest payments would otherwise have been included in the charge for such third party's services, all as determined in accordance with standard accounting practices;

(e) brokerage commissions, finders' fees, attorneys' fees, space planning costs, marketing costs and other costs incurred by Landlord in leasing or attempting to lease space in the Building;

(f) costs of a capital nature, including, without limitation, capital improvements, capital replacements, capital repairs, capital equipment and capital tools, all as determined in accordance with standard accounting practices; except for the capital expenditures set forth in Subparagraph 1(m) above;

(g) interest, principal, points and fees on debt or amortization on any mortgage, deed of trust or other debt encumbering the Building or the Project;

(h) costs, including permit, license and inspection costs, incurred with respect to the installation of tenant improvements for tenants in the Building (including the original Tenant Improvements for the Premises), or incurred in renovating or otherwise improving, decorating, painting or redecorating space for tenants or other occupants of the Building, including space planning and interior design costs and fees;

(i) attorneys' fees and other costs and expenses incurred in connection with negotiations or disputes with present or prospective tenants or other occupants of the Building; provided, however, that Operating Expenses will include those attorneys' fees and other costs and expenses incurred in connection with negotiations, disputes or claims relating to items of Operating Expenses, enforcement of rules and regulations of the Building, and such other matters relating to the maintenance of standards required of Landlord under the Lease;

(j) except for the administrative/management fees described in Subparagraph 1(h) above, costs of Landlord's general corporate overhead;

(k) all items and services for which Tenant or any other tenant in the Building reimburses Landlord (other than through operating expense pass−through provisions);

(l) electric power costs for which any tenant directly contracts with the local public service company;

(m) costs arising from Landlord's charitable or political contributions;

(n) costs incurred in connection with the original construction of the Building;

(o) expenses directly resulting from the gross negligence and/or intentional misconduct of Landlord, its agents, contractors or employees;

(p) any bad debt loss, rent loss, or reserves for bad debts or rent loss;

(q) the wages of any employee who does not devote substantially all of his or her time to the Building shall be equitably allocated to the Building;

(r) fines, penalties and interest;

(s) costs incurred by Landlord with respect to goods and services (including utilities sold and supplied to tenants and occupants of the Building) to the extent that Landlord is reimbursed such costs other than through operating expense payments; and

(t) rentals and other related expenses incurred in leasing air conditioning systems, elevators or other equipment ordinarily considered to be of a capital nature, except equipment not affixed to the Building which is used while repairs are being undertaken or in providing janitorial or similar services.

STANDARDS FOR UTILITIES AND SERVICES

The following standards for utilities and services are in effect. Landlord reserves the right to adopt nondiscriminatory modifications and additions hereto.

Subject to the terms and conditions of the Lease and provided Tenant remains in occupancy of the Premises, Landlord will provide or make available the following utilities and services:

1. Provide non−attended automatic elevator available for Tenant's nonexclusive use at all times.

2. On Monday through Friday, except holidays, from 8 a.m. to 6 p.m. (and other times for a reasonable additional charge to be fixed by Landlord), ventilate the Premises and furnish air conditioning or heating on such days and hours, when in the reasonable judgment of Landlord it may be required for the comfortable occupancy of the Premises. "Holidays" shall mean New Year's Day, President's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, the day after Thanksgiving and Christmas Day and such other national holidays as are adopted by Landlord as holidays for the Building. The air conditioning system achieves maximum cooling when the window coverings are extended to the full length of the window opening and adjusted to a 45° angle upwards. Landlord will not be responsible for room temperatures if Tenant does not keep all window coverings in the Premises extended to the full length of the window opening and adjusted to a 45° angle upwards whenever the system is in operation. Tenant agrees to cooperate fully at all times with Landlord, and to abide by all reasonable regulations and requirements which Landlord may prescribe for the proper function and protection of said air conditioning system. Tenant agrees not to connect any apparatus, device, conduit or pipe to the chilled and hot water air conditioning supply lines of the Building. Tenant further agrees that neither Tenant nor its servants, employees, agents, visitors, licensees or contractors shall at any time enter the mechanical installations or facilities of the Building or the Project or adjust, tamper with, touch or otherwise in any manner affect said installations or facilities. The cost of maintenance and service calls to adjust and regulate the air conditioning system will be charged to Tenant if the need for maintenance work results from either Tenant's adjustment of room thermostats or Tenant's failure to comply with its obligations under this Exhibit, including keeping window coverings extended to the full length of the window opening and adjusted to a 45° angle upwards. Initially, Tenant shall pay for after−hours HVAC services at the rate of Thirty−Five Dollars ($35.00) per hour.

3. Landlord will make available to the Premises, 24 hours per day, seven days a week, electric current as required by the Building standard office lighting and fractional horsepower office business machines including copiers, personal computers and word processing equipment in an amount not to exceed five (5) watts per square foot per normal business day. Tenant agrees, should its electrical installation or electrical consumption be in excess of the aforesaid quantity or extend beyond normal business hours, to reimburse Landlord monthly for the measured consumption at the average cost per kilowatt hour charged to the Building during the period. If a separate meter is not installed at Tenant's cost, such excess cost will be established by an estimate agreed upon by Landlord and Tenant, and if the parties fail to agree, such cost will be established by an independent licensed engineer selected in Landlord's reasonable discretion, whose fee shall be shared equally by Landlord and Tenant. Tenant agrees not to use any apparatus or device in, upon or about the Premises (other than standard office business machines, personal computers and word processing equipment) which may in any way increase the amount of such services usually furnished or supplied to said Premises, and Tenant further agrees not to connect any apparatus or device with wires, conduits or pipes, or other means by which such services are supplied, for the purpose of using additional or unusual amounts of such services without the written consent of Landlord. Should Tenant use the same to excess, the refusal on the part of Tenant to pay upon demand of Landlord the amount established by Landlord for such excess charge will constitute a breach of the obligation to pay rent under this Lease and will entitle Landlord to the rights therein granted for such breach. Tenant's use of electric current will never exceed the capacity of the feeders to the Building, or the risers or wiring installation and Tenants will not install or use or permit the installation or use of any computer or electronic data processing equipment in the Premises (except standard office business machines, personal computers and word processing equipment) without the prior written consent of Landlord.

4. Water will be available in public areas for drinking and lavatory purposes only, but if Tenant requires, uses or consumes water for any purpose in addition to ordinary drinking and lavatory purposes, of which fact Tenant constitutes Landlord to be the sole judge so long as Landlord is reasonable, Landlord may install a water meter and thereby measure Tenant's water consumption for all purposes. Tenant agrees to pay Landlord for the cost of the meter and the cost of the installation thereof and throughout the duration of Tenant's occupancy Tenant will keep said meter and installation equipment in good working order and repair at Tenant's own cost and expense, in default of which Landlord may cause such meter and equipment to be replaced or repaired and collect the cost thereof from Tenant. Tenant agrees to pay for water consumed, as shown on such meter, as

and when bills are rendered, and on default in making such payment, Landlord may pay such charges and collect the same from Tenant. Any such costs or expenses incurred, or payments made by Landlord for any of the reasons or purposes hereinabove stated will be deemed to be additional rent payable by Tenant and collectible by Landlord as such.

5. Landlord will provide janitorial service to the Premises at least five (5) days per week on each business day, provided the same are used exclusively as permitted in this Lease, and are kept reasonably in order by Tenant, and unless otherwise agreed to by Landlord and Tenant no one other than persons approved by Landlord shall be permitted to enter the Premises for such purposes. If the Premises are not used exclusively as permitted in this Lease, they will be kept clean and in order by Tenant, at Tenant's expense, and to the satisfaction of Landlord, and by persons approved by Landlord. Tenant agrees to pay to Landlord the cost of removal of any of Tenant's refuse and rubbish to the extent that the same exceeds the refuse and rubbish usually attendant upon the use of the Premises as offices.

6. Landlord reserves the right to stop service of the elevator, plumbing, ventilation, air conditioning and electrical systems, when necessary, by reason of accident or emergency or for repairs, alterations or improvements, when in the judgment of Landlord such actions are desirable or necessary to be made, until said repairs, alterations or improvements shall have been completed, and Landlord will have no responsibility or liability for failure to supply elevator facilities, plumbing, ventilating, air conditioning or electric service, when prevented from so doing by strike or accident or by any cause beyond Landlord's reasonable control, or by laws, rules, orders, ordinances, directions, regulations or by reason of the requirements of any federal, state, county or municipal authority or failure of gas, oil or other suitable fuel supply or inability by exercise of reasonable diligence to obtain gas, oil or other suitable fuel supply. It is expressly understood and agreed that any covenants on Landlord's part to furnish any services pursuant to any of the terms, covenants, conditions, provisions or agreements of this Lease, or to perform any act or thing for the benefit of Tenant, will not be deemed breached if Landlord is unable to furnish or perform the same by virtue of a strike or labor trouble or any other cause whatsoever beyond Landlord's control.

7. As part of Operating Expenses, Landlord shall provide security services for the Building and the Project, including, without limitation, equipment, personnel, systems and procedures as reasonably determined by Landlord in its sole discretion.

RULES AND REGULATIONS

A. **General Rules and Regulations**. The following rules and regulations govern the use of the Building and the Project Common Areas. Tenant will be bound by such rules and regulations and agrees to cause Tenant's Authorized Users, its employees, subtenants, assignees, contractors, suppliers, customers and invitees to observe the same.

1. Except as specifically provided in the Lease to which these Rules and Regulations are attached, no sign, placard, picture, advertisement, name or notice may be installed or displayed on any part of the outside or inside of the Building or the Project (but not including decorations placed within the Premises) without the prior written consent of Landlord. Landlord will have the right to remove, at Tenant's expense and without notice, any sign installed or displayed in violation of this rule. All approved signs or lettering on doors and walls are to be printed, painted, affixed or inscribed at the expense of Tenant and under the direction of Landlord by a person or company designated or approved by Landlord.

2. If Landlord objects in writing to any curtains, blinds, shades, screens or hanging plants or other similar objects attached to or used in connection with any window or door of the Premises, or placed on any windowsill, which is visible from the exterior of the Premises, Tenant will immediately discontinue such use. Tenant agrees not to place anything against or near glass partitions or doors or windows which may appear unsightly from outside the Premises including from within any interior common areas.

3. Tenant will not obstruct any sidewalks, halls, passages, exits, entrances, elevators, escalators, or stairways of the Project. The halls, passages, exits, entrances, elevators and stairways are not open to the general public, but are open, subject to reasonable regulations, to Tenant's business invitees. Landlord will in all cases retain the right to control and prevent access thereto of all persons whose presence in the reasonable judgment of Landlord would be prejudicial to the safety, character, reputation and interest of the Project and its tenants, provided that nothing herein contained will be construed to prevent such access to persons with whom any tenant normally deals in the ordinary course of its business, unless such persons are engaged in illegal or unlawful activities. No tenant and no employee or invitee of any tenant will go upon the roof of the Building.

4. Tenant will not obtain for use on the Premises ice, food vendors, towel or other similar services or accept barbering or bootblacking service upon the Premises, except at such reasonable hours and under such reasonable regulations as may be fixed by Landlord. Tenant shall have the right to obtain food and beverage service to serve its employees, agents, contractors, clients and invitees. Landlord expressly reserves the right to absolutely prohibit solicitation, canvassing, distribution of handbills or any other written material, peddling, sales and displays of products, goods and wares in all portions of the Project except as may be expressly permitted under the Lease. Landlord reserves the right to restrict and regulate the use of the common areas of the Project and Building by invitees of tenants providing services to tenants on a periodic or daily basis including food and beverage vendors. Such restrictions may include limitations on time, place, manner and duration of access to a tenant's premises for such purposes. Without limiting the foregoing, Landlord may require that such parties use service elevators, halls, passageways and stairways for such purposes to preserve access within the Building for tenants and the general public.

5. Landlord reserves the right to require tenants to periodically provide Landlord with a written list of any and all business invitees which periodically or regularly provide goods and services to such tenants at the premises. Landlord reserves the right to preclude all vendors from entering or conducting business within the Building and the Project if such vendors are not listed on a tenant's list of requested vendors.

6. Landlord reserves the right to exclude from the Building between the hours of 6 p.m. and 8 a.m. the following business day, or such other hours as may be established from time to time by Landlord, and on Sundays and legal holidays, any person unless that person is known to the person or employee in charge of the Building or has a pass or is properly identified. Tenant will be responsible for all persons for whom it requests passes and will be liable to Landlord for all acts of such persons. Landlord will not be liable for damages for any error with regard to the admission to or exclusion from the Building of any person. Landlord reserves the right to prevent access to the Building in case of invasion, mob, riot, public excitement or other commotion by closing the doors or by other appropriate action.

EXHIBIT "E"

7. The directory of the Building or the Project will be provided exclusively for the display of the name and location of tenants only and Landlord reserves the right to exclude any other names therefrom.

8. All cleaning and janitorial services for the Project and the Premises will be provided exclusively through Landlord, and except with the written consent of Landlord, no person or persons other than those approved by Landlord will be employed by Tenant or permitted to enter the Project for the purpose of cleaning the same. Tenant will not cause any unnecessary labor by carelessness or indifference to the good order and cleanliness of the Premises.

9. Landlord will furnish Tenant, free of charge, with two keys to each entry door lock in the Premises. Landlord may make a reasonable charge for any additional keys. Tenant shall not make or have made additional keys, and Tenant shall not alter any lock or install any new additional lock or bolt on any door of the Premises. Tenant, upon the termination of its tenancy, will deliver to Landlord the keys to all doors which have been furnished to Tenant, and in the event of loss of any keys so furnished, will pay Landlord therefor.

10. If Tenant requires telegraphic, burglar alarm, satellite dishes, antennae or similar services, it will first obtain Landlord's approval, which approval shall not be unreasonably withheld, conditioned or delayed, and comply with, Landlord's reasonable rules and requirements applicable to such services, which may include separate licensing by, Landlord.

11. The elevator will be available for use by all tenants in the Building, subject to such reasonable scheduling as Landlord, in its discretion, deems appropriate. No equipment, materials, furniture, packages, supplies, merchandise or other property will be received in the Building or carried in the elevators except between such hours and in such elevators as may be reasonably designated by Landlord. Tenant's initial move in and subsequent deliveries of bulky items, such as furniture, safes and similar items will, unless otherwise agreed in writing by Landlord, be made during the hours of 6:00 p.m. to 6:00 a.m. or on Saturday or Sunday. Deliveries during normal office hours shall be limited to normal office supplies and other small items, unless Tenant gives prior notice to Landlord of other deliveries. No deliveries will be made which unreasonably impede or interfere with other tenants or the operation of the Building.

12. Tenant will not place a load upon any floor of the Premises which exceeds the load per square foot which such floor was designed to carry and which is allowed by law. Landlord will have the right to reasonably prescribe the weight, size and position of all safes, heavy equipment, files, materials, furniture or other property brought into the Building. Heavy objects will, if considered necessary by Landlord, stand on such platforms as determined by Landlord to be necessary to properly distribute the weight, which platforms will be provided at Tenant's expense. Business machines and mechanical equipment belonging to Tenant, which cause noise or vibration that may be transmitted to the structure of the Building or to any space therein to such a degree as to be objectionable to any tenants in the Building or Landlord, are to be placed and maintained by Tenant, at Tenant's expense, on vibration eliminators or other devises sufficient to eliminate noise or vibration. Tenant will be responsible for all structural engineering required to determine structural load, as well as the expense thereof. The persons employed to move such equipment in or out of the Building must be reasonably acceptable to Landlord. Landlord will not be responsible for loss of, or damage to, any such equipment or other property from any cause, and all damage done to the Building by maintaining or moving such equipment or other property will be repaired at the expense of Tenant.

13. Tenant will not use or keep in the Premises any kerosene, gasoline or inflammable or combustible fluid or material other than those limited quantities necessary for the operation or maintenance of office equipment. Tenant will not use or permit to be used in the Premises any foul or noxious gas or substance, or permit or allow the Premises to be occupied or used in a manner offensive or objectionable to Landlord or other occupants of the Building by reason of noise, odors or vibrations, nor will Tenant bring into or keep in or about the Premises any birds or animals.

14. Tenant will not use any method of heating or air conditioning other than that supplied by Landlord without Landlord's prior written consent.

15. Tenant will not waste electricity, water or air conditioning and agrees to cooperate fully with Landlord to assure the most effective operation of the Building's heating and air conditioning and to comply with any governmental energy−saving rules, laws or regulations of which Tenant has actual notice, and will refrain from attempting to adjust controls. Tenant will keep corridor doors closed, and shall keep all window coverings pulled down.

16. Landlord reserves the right, exercisable without notice and without liability to Tenant, to change the name and street address of the Building. Without the prior written consent of Landlord, which Landlord will not unreasonably withhold or delay, Tenant will not use the name, photograph or likeness of the Building or the Project except in connection with or in promoting or advertising the business of Tenant.

17. Tenant will close and lock the doors of its Premises and entirely shut off all water faucets or other water apparatus, and lighting or gas before Tenant and its employees leave the Premises. Tenant will be responsible for any damage or injuries sustained by other tenants or occupants of the Building or by Landlord for noncompliance with this rule.

18. The toilet rooms, toilets, urinals, wash bowls and other apparatus will not be used for any purpose other than that for which they were constructed and no foreign substance of any kind whatsoever shall be thrown therein. The expense of any breakage, stoppage or damage resulting from any violation of this rule will be borne by the tenant who, or whose employees or invitees, break this rule. Cleaning of equipment of any type is prohibited. Shaving is prohibited.

19. Tenant will not sell, or permit the sale at retail of newspapers, magazines, periodicals, theater tickets or any other goods or merchandise to the general public in or on the Premises. Tenant will not use the Premises for any business or activity other than that specifically provided for in this Lease. Tenant will not conduct, nor permit to be conducted, either voluntarily or involuntarily, any auction upon the Premises without first having obtained Landlord's prior written consent, which consent Landlord may withhold in its sole and absolute discretion.

20. Tenant will not install any radio or television antenna, loudspeaker, satellite dishes or other devices on the roof(s) or exterior walls of the Building or the Project. Tenant will not interfere with satellite dish, radio or television broadcasting or transmission or reception from or in the Project or elsewhere.

21. Except for the ordinary hanging of pictures and wall decorations, Tenant will not mark, drive nails, screw or drill into the partitions, woodwork or plaster or in any way deface the Premises or any part thereof, except in accordance with the provisions of the Lease pertaining to alterations. Landlord reserves the right to direct electricians as to where and how telephone and telegraph wires are to be introduced to the Premises. Tenant will not cut or bore holes for wires. Tenant will not affix any floor covering to the floor of the Premises in any manner except as approved by Landlord. Tenant shall repair any damage resulting from noncompliance with this rule.

22. Tenant will not install, maintain or operate upon the Premises any vending machines without the written consent of Landlord, except for food and beverage vending machines intended to serve Tenant's employees.

23. Landlord reserves the right to exclude or expel from the Project any person who, in Landlord's judgment, is intoxicated or under the influence of liquor or drugs or who is in violation of any of the Rules and Regulations of the Building.

24. Tenant will store all its trash and garbage within its Premises or in other facilities provided by Landlord. Tenant will not place in any trash box or receptacle any material which cannot be disposed of in the ordinary and customary manner of trash and garbage disposal. All garbage and refuse disposal is to be made in accordance with directions issued from time to time by Landlord.

25. The Premises will not be used for lodging or for the storage of merchandise held for sale to the general public, or for lodging or for manufacturing of any kind, nor shall the Premises be used for any improper, immoral or objectionable purpose. No cooking will be done or permitted on the Premises without Landlord's consent, except the use by Tenant of Underwriters' Laboratory approved equipment for brewing coffee, tea, hot chocolate and similar beverages shall be permitted, and the use of a microwave oven for employees use will be permitted, provided that such equipment and use is in accordance with all applicable federal, state, county and city laws, codes, ordinances, rules and regulations.

26. Neither Tenant nor any of its employees, agents, customers and invitees may use in any space or in the public halls of the Building or the Project any hand truck except those equipped with rubber tires and side guards or such other material−handling equipment as Landlord may approve. Tenant will not bring any other vehicles of any kind into the Building.

27. Tenant agrees to comply with all safety, fire protection and evacuation procedures and regulations established by Landlord or any governmental agency.

28. Tenant assumes any and all responsibility for protecting its Premises from theft, robbery and pilferage, which includes keeping doors locked and other means of entry to the Premises closed.

29. To the extent Landlord reasonably deems it necessary to exercise exclusive control over any portions of the Common Areas for the mutual benefit of the tenants in the Building or the Project, Landlord may do so subject to reasonable, non−discriminatory additional rules and regulations which do not deprive Tenant of its quiet enjoyment of the Premises or parking.

30. Landlord may prohibit smoking in the Building and may require Tenant and any of its employees, agents, clients, customers, invitees and guests who desire to smoke, to smoke within designated smoking areas within the Project.

31. Tenant's requirements will be attended to only upon appropriate application to Landlord's asset management office for the Project by an authorized individual of Tenant. Employees of Landlord will not perform any work or do anything outside of their regular duties unless under special instructions from Landlord, and no employee of Landlord will admit any person (Tenant or otherwise) to any office without specific instructions from Landlord.

32. These Rules and Regulations are in addition to, and will not be construed to in any way modify or amend, in whole or in part, the terms, covenants, agreements and conditions of the Lease. Landlord may waive any one or more of these Rules and Regulations for the benefit of Tenant or any other tenant, but no such waiver by Landlord will be construed as a waiver of such Rules and Regulations in favor of Tenant or any other tenant, nor prevent Landlord from thereafter enforcing any such Rules and Regulations against any or all of the tenants of the Project.

33. Landlord reserves the right to make such other reasonable and non−discriminatory Rules and Regulations as, in its judgment, may from time to time be needed for safety and security, for care and cleanliness of the Project and for the preservation of good order therein. Tenant agrees to abide by all such Rules and Regulations herein above stated and any additional reasonable and non−discriminatory rules and regulations which are adopted. Tenant is responsible for the observance of all of the foregoing rules by Tenant's employees, agents, clients, customers, invitees and guests.

B. **Parking Rules and Regulations**. The following rules and regulations govern the use of the parking facilities which serve the Building. Tenant will be bound by such rules and regulations and agrees to cause its employees, subtenants, assignees, contractors, suppliers, customers and invitees to observe the same:

1. Tenant will not permit or allow any vehicles that belong to or are controlled by Tenant or Tenant's employees, subtenants, customers or invitees to be loaded, unloaded or parked in areas other than those designated by Landlord for such activities. No vehicles are to be left in the parking areas overnight and no vehicles are to be parked in the parking areas other than passenger automobiles, vans, sport utility vehicles, motorcycles and pick−up trucks. No extended term storage of vehicles is permitted.

2. Vehicles must be parked entirely within painted stall lines of a single parking stall.

3. All directional signs and arrows must be observed.

4. The speed limit within all parking areas shall be five (5) miles per hour.

5. Parking is prohibited: (a) in areas not striped for parking; (b) in aisles or on ramps; (c) where "no parking" signs are posted; (d) in cross−hatched areas; and (e) in such other areas as may be designated from time to time by Landlord.

6. Landlord reserves the right, without cost or liability to Landlord, to tow any vehicle if such vehicle's audio theft alarm system remains engaged for an unreasonable period of time.

7. Washing, waxing, cleaning or servicing of any vehicle in any area not specifically reserved for such purpose is prohibited.

8. Landlord may refuse to permit any person to park in the parking facilities who violates these rules with unreasonable frequency, and any violation of these rules shall subject the

violator's car to removal, at such car owner's expense. Tenant agrees to use its best efforts to acquaint its employees, subtenants, assignees, contractors, suppliers, customers and invitees with these parking provisions, rules and regulations.

9. Parking stickers, access cards, or any other device or form of identification supplied by Landlord as a condition of use of the parking facilities shall remain the property of Landlord. Parking identification devices, if utilized by Landlord, must be displayed as requested and may not be mutilated in any manner. The serial number of the parking identification device may not be obliterated. Parking identification devices, if any, are not transferable and any device in the possession of an unauthorized holder will be void. Landlord reserves the right to refuse the sale of monthly stickers or other parking identification devices to Tenant or any of its agents, employees or representatives who willfully refuse to comply with these rules and regulations and all unposted city, state or federal ordinances, laws or agreements.

10. Loss or theft of parking identification devices or access cards must be reported to the management office in the Project immediately, and a lost or stolen report must be filed by the Tenant or user of such parking identification device or access card at the time. Landlord has the right to exclude any vehicle from the parking facilities that does not have a parking identification device or valid access card. Any parking identification device or access card which is reported lost or stolen and which is subsequently found in the possession of an unauthorized person will be confiscated and the illegal holder will be subject to prosecution.

11. Landlord reserves the right, without cost or liability to Landlord, to tow any vehicles which are used or parked in violation of these rules and regulations.

12. Landlord reserves the right from time to time to modify and/or adopt such other reasonable and non−discriminatory rules and regulations for the parking facilities as it deems reasonably necessary for the operation of the parking facilities.

EXHIBIT F

RECORDING REQUESTED BY AND)
WHEN RECORDED MAIL TO:)
)
Sunnyvale Mathilda Investors, LLC)
c/o Matteson Real Estate Equities, Inc.)
1991 Broadway, Suite 300)
Redwood City, CA 94063−1994)
Attn: James A. Blake)

MEMORANDUM OF LEASE

THIS MEMORANDUM OF LEASE ("Memorandum") is made and entered into this day of 2005, by and between SUNNYVALE MATHILDA INVESTORS, LLC, a California limited liability company ("Landlord") and MONOLITHIC SYSTEM TECHNOLOGY, INC., dba MOSYS, a Delaware corporation ("Tenant").

1. Terms and Premises. By that certain Office Building Lease dated April , 2005 ("Lease") between Landlord and Tenant, Landlord hereby leases to Tenant, and Tenant hereby hires from Landlord, the premises commonly known as 755 No. Mathilda Avenue, Suite 100, Sunnyvale, California 94086, forming a part of that certain real property located in the City of Sunnyvale, County of Santa Clara, State of California, as shown and described on Exhibit A attached hereto and incorporated herein by this reference (the "Premises"). The term of the Lease is five (5) years with two (2) five (5) year options commencing on [insert actual Commencement Date prior to recording] and ending on [insert actual Expiration Date prior to recording], unless sooner terminated in accordance with the terms of the Lease.

2. Other Terms. All terms and conditions of the Lease are set forth fully in the Lease.

IN WITNESS WHEREOF, Landlord and Tenant have executed this Memorandum as of the date and year first above written.

TENANT:

MONOLITHIC SYSTEM TECHNOLOGY, INC., a Delaware corporation

By: _____
Print Name: _____
Print Title: _____

LANDLORD:

SUNNYVALE MATHILDA INVESTORS, LLC a California limited liability company

By: Matteson Real Estate Equities, Inc.
Manager

By: _____
Its: _____

EXHIBIT "F"

EXHIBIT A
DESCRIPTION OF PREMISES

The ground floor of that certain real property situated in the City of Sunnyvale, County of Santa Clara, State of California, described as follows:

STATE OF CALIFORNIA)
) ss.
COUNTY OF)

On this day of 2005, before me, the undersigned, a Notary Public in and for the State of California, personally appeared , personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument, and acknowledged to me that he executed the same in his authorized capacity; and that by his signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Signature of Notary

[SEAL]

STATE OF CALIFORNIA)
) ss.
COUNTY OF)

On this day of 2005, before me, the undersigned, a Notary Public in and for the State of California, personally appeared , personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument, and acknowledged to me that he executed the same in his authorized capacity; and that by his signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Signature of Notary

[SEAL]

EXHIBIT G

RECORDING REQUESTED BY AND)
WHEN RECORDED MAIL TO:)
)
Sunnyvale Mathilda Investors, LLC)
c/o Matteson Real Estate Equities, Inc.)
1991 Broadway, Suite 300)
Redwood City, CA 94063−1994)
Attn: James A. Blake)

QUITCLAIM

The undersigned, MONOLITHIC SYSTEM TECHNOLOGY, INC., dba MOSYS, a Delaware corporation, hereby irrevocably quitclaims, releases and relinquishes to SUNNYVALE MATHILDA INVESTORS, LLC, a California limited liability company, all of the undersigned's right, title and interest, if any, in, to and under (i) that certain Memorandum of Lease recorded on [insert date of recording] as Instrument No. [insert exact recording information] in the Official Records of Santa Clara County, California (the "Memorandum"), (ii) the Lease (as defined in the Memorandum) and (iii) the Premises (as defined in the Memorandum).

IN WITNESS WHEREOF, this Quitclaim has been executed as of , 2005.

MONOLITHIC SYSTEM TECHNOLOGY, INC., a
Delaware corporation

By: _____
Print Name: _____
Print Title: _____

EXHIBIT "G"

STATE OF CALIFORNIA)
) ss.
COUNTY OF)

On this day of 2005, before me, the undersigned, a Notary Public in and for the State of California, personally appeared , personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument, and acknowledged to me that he executed the same in his authorized capacity; and that by his signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Signature of Notary

[SEAL]

Exhibit 10.17

October 3, 2005

Mr. Dhaval Ajmera
713 Solstice Court
Fremont, CA 94539

Dear Dhaval:

I am pleased to offer you a position with Monolithic System Technology, Inc. ("MoSys" or the "Company") as Vice President of Worldwide Sales and Business Development, an exempt position in which you will report directly to me. Your semimonthly compensation will be $7,916.66 dollars, which is equal to $190,000.00 on an annualized basis. You will also be eligible to receive an incentive bonus based on the following guidelines:

- for the fiscal quarter ending December 31, 2005, you will be eligible to receive a $30,000 non−recoverable, incentive bonus.

- for fiscal year 2006, your targeted incentive bonus will be $30,000 quarterly based on mutually agreed bookings goals with a $30,000 incentive bonus guaranteed in 2006 paid at the end of Q1 as a credit against earned bonuses for the year.

The bookings target and incentive bonus payment will be subject to the Company's sole and absolute discretion. Further, nothing in this offer letter shall alter the "at−will" nature of your employment relationship with the Company, or constitute any promise, express or implied, regarding the duration of your employment with the Company, payment of any specific amount of incentive bonus, or a requirement of any reason or "cause" for termination of your employment with the Company, which shall be terminable at−will, by you or the Company, without any reason or cause or advance notice required.

Upon approval of the Company's Board of Directors, you will be granted an option to purchase 300,000 shares of the Company's common stock. The terms of such option shall be in accordance with the terms of the Company's stock option plan. Accordingly, the options will vest 25% at the end of one year of employment and 2.0833% per month thereafter. The per share exercise price of the option shall be the fair market value of the Company's common stock on the date of grant as determined by the Company's Board of Directors.

If, there is an event of "change of control" of more than 50% of the voting power of the Company resulting from a merger, reorganization, sale of all or substantially all assets or other similar acquisition transaction, and you are terminated involuntarily "without cause," or if you resign for "good reason" in connection with such change in control event, then 50% of the unvested stock options granted to you above shall be immediately accelerated and exercisable.

Should your employment be terminated "without cause," you will receive one quarter (1/4) of the annual salary (three months) in effect at the time of termination as severance pay, and your health benefits will also continue for three months from the Company. In addition, you will receive your earned incentive bonus based on bookings for the quarter in which you are terminated and the subsequent quarter.

In addition, you will be eligible to participate in Monolithic System Technology, Inc. ("MoSys" or the "Company") employee benefit plans including our standard major medical, dental, life, short and long term disability, vision, flexible benefit plan, paid holidays, ESPP (Employee Stock Purchase Plan), personal time off (PTO) and the Company's 401(k) plan.

You also will be eligible for a five hundred dollar ($500.00) monthly car allowance. You will be reimbursed for all reasonable travel and entertainment expenses necessarily and reasonably incurred in conducting the Company's business. You shall submit for reimbursement all direct expenses incurred, including any car allowance on a monthly basis.

The Company will reimburse you the cost of a cellular phone to be primarily used in conducting the Company's business. The Company will also reimburse all reasonable month calling charges billed directly to you and submitted to the Company for payment.

You should be aware that your employment with the Company is for no specified period and constitutes "at will" employment. As a result, you are free to resign at any time, for any reason or for no reason. Similarly, the Company is free to conclude its employment relationship with you at any time, with or without cause.

For purposes of federal immigration law, you will be required to provide to the Company documentary evidence of your identity and eligibility for employment in the United States. Such documentation must be provided to us within three (3) business days of your date of hire, or our employment relationship with you may be terminated.

In the event of any dispute or claim relating to or arising out of our employment relationship, you and the Company agree that all such disputes shall be fully and finally resolved by binding arbitration conducted in Santa Clara County, California under the then−existing rules for resolution of employment disputes adopted by the American Arbitration Association ("AAA") or Judicial Arbitration and Mediation Services ("JAMS"). However, we agree that this mandatory arbitration provision shall not apply to any disputes or claims relating to or arising out of the misuse or misappropriation of the Company's trade secrets or proprietary information.

To indicate your acceptance of the Company's offer, please sign and date this letter in the space provided below and return it to Human Resources. This offer will expire on Tuesday , October 4, 2005 at 5:00 p.m. Please indicate your planned start date. This letter, along with the agreement relating to proprietary rights between you and the Company, set forth the terms of your employment with the Company and supersede any prior representations or agreements, whether written or oral. This letter may not be modified or amended except by a written agreement, signed by the Company and by you.

Dhaval, we believe that you can make a great contribution to MoSys and we all look forward to working with you.

Sincerely,

Chet Silvestri
Chief Executive Officer

ACCEPTED AND AGREED TO
This 3rd day of October, 2005.

Start date 10/3/05

/s/ Dhaval Ajmera
Dhaval Ajmera

EXHIBIT 21.1
Monolithic System Technology, Inc
List of Subsidiaries

MoSys International, Inc.
ATMOS Corporation
MoSys Europe EURL

EXHIBIT 23.1

Consent of Independent Registered Public Accounting Firm

Monolithic System Technology, Inc.
Sunnyvale, California

We hereby consent to the incorporation by reference in the Registration Statements on Form S−8 (Nos. 333−64302, 333−104071, 333−118992, and 333−123364) of Monolithic System Technology, Inc. of our reports dated February 24, 2006, relating to the consolidated financial statements and the financial statement schedule, and the effectiveness of Monolithic System Technology, Inc.'s internal control over financial reporting, which appear in this Form 10−K.

/s/ BDO Seidman, LLP
San Francisco, California

March 13, 2006

EXHIBIT 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement (Form S−8 No. 333−64302, 333−104071, 333−118992, and 333−123364) pertaining to the Amended and Restated 2000 Stock Option and Equity Incentive Plan, 2000 Employee Stock Purchase Plan, 1996 Stock Plan and 1992 Stock Option Plan of Monolithic System Technology, Inc., of our report dated March 15, 2005, with respect to the consolidated financial statements and schedule of Monolithic System Technology, Inc., for the year ended December 31, 2004 included in this Annual Report (Form 10−K) for the year ended December 31, 2005.

/s/ Ernst & Young LLP

San Jose, California
March 13, 2006

Exhibit 31.1

CERTIFICATIONS

RULE 13a−14 THE SECURITIES EXCHANGE ACT OF 1934

I, Chet Silvestri, certify that:

1. I have reviewed this Form 10−K of Monolithic System Technology, Inc. for the year ended December 31, 2005;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a−15(e) and 15d−15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a−15(f) and 15d−15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2006
/s/ CHET SILVESTRI
Chet Silvestri
Chief Executive Officer,
Chief Executive Officer and President (Principal Executive Officer and Principal Financial Officer)

Exhibit 31.2

CERTIFICATIONS

RULE 13a−14 THE SECURITIES EXCHANGE ACT OF 1934

I, Yoshiko Ribar, certify that:

1. I have reviewed this Form 10−K of Monolithic System Technology, Inc. for the year ended December 31, 2005;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a−15(e) and 15d−15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a−15(f) and 15d−15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2006
/s/ YOSHIKO RIBAR
Yoshiko Ribar
Principal Accounting Officer

Exhibit 32

CERTIFICATION OF CEO AND CFO FURNISHED PURSUANT TO
18 U.S.C. § 1350,
AS ADOPTED PURSUANT TO
§ 906 OF THE SARBANES−OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10−K of Monolithic System Technology, Inc. (the "Company") for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Chet Silvestri, Chief Executive Officer, and Interim Chief Financial Officer of the Company, and Yoshiko Ribar, Corporate Controller and Principal Accounting Officer, hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes−Oxley Act of 2002, to the best of his knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ CHET SILVESTRI
Chet Silvestri
Chief Executive Officer and President
(Principal Executive Officer and Principal Financial Officer)
March 16, 2006

/s/ YOSHIKO RIBAR
Yoshiko Ribar
Corporate Controller and Principal Accounting Officer
March 16, 2006

This certification accompanies this Report pursuant to § 906 of the Sarbanes−Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes−Oxley Act of 2002, or otherwise required, be deemed filed by the Company for purposes of § 18 of the Securities Exchange Act of 1934, as amended.