

DIODES INC /DEL/  
Form 10-K  
March 01, 2007

**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 ended **December 31, 2006**.

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.  
**Commission file number: 1-5740**

**DIODES INCORPORATED**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or  
organization)

**95-2039518**

(I.R.S. Employer Identification  
Number)

**3050 East Hillcrest Drive, Westlake Village,  
California**

(Address of principal executive offices)

**91362**

(Zip Code)

**Registrant's telephone number, including area code: (805) 446-4800**

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

Title of Each Class

Common Stock, Par Value \$0.66 2/3

Name of Each Exchange on Which Registered

The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Security 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 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:

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 19,269,401 shares of Common Stock held by non-affiliates of the registrant, based on the closing price of \$41.44 per share of the Common Stock on the Nasdaq Global Select Market on June 30, 2006, the last business day of the registrant’s most recently completed second quarter, was approximately \$798,523,977. The number of shares of the registrant’s Common Stock outstanding as of February 26, 2007 was 26,036,304.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant’s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2007 annual meeting of stockholders are incorporated by reference into Part III of this Report. The proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the registrant’s fiscal year ended December 31, 2006.

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## PART I

### Item 1. Business

#### GENERAL

We are global supplier of low pin-count standard semiconductor products. These products have 8 pins or less and include small signal transistors, MOSFETs, thyristor surge protection devices, transient voltage protection devices, Hall sensors, power management products, programmable logic arrays, diodes, rectifiers, bridges, and silicon wafer. We design, manufacture and market these semiconductors focused on diverse end-use applications in the consumer electronics, computing, industrial, communications and automotive sectors. Semiconductors, which provide electronic signal amplification and switching functions, are basic building-block electronic components that are incorporated into almost every electronic device. We believe that our focus on Standard Semiconductor products provides us with a meaningful competitive advantage relative to other semiconductor companies that provide a wider range of semiconductor products.

Our portfolio of discrete and analog semiconductors addresses the design needs of many advanced electronic devices including high-volume consumer devices such as digital audio players, notebook computers, flat-panel displays, mobile handsets, digital cameras and set-top boxes. We believe that we have particular strength in designing innovative surface-mount semiconductors for applications with critical need to minimize product size while maximizing power efficiency and overall performance, and at a lower cost than alternative solutions. Our product portfolio includes over 4,000 products, and we shipped approximately 7.5 billion units, 10.2 billion units, and 14.5 billion units in 2004, 2005, and 2006, respectively. From 2001 to 2006, our net sales grew from \$93.2 million to \$343.3million, representing a compound annual growth rate of 29.2%.

We serve over 150 direct customers worldwide, which consist of original equipment manufacturers (OEMs) and electronic manufacturing services (EMS) providers. Additionally, we have approximately 60 distributor customers worldwide, through which we indirectly serve over 10,000 customers. Our customers include: (i) industry leading OEMs, in a broad range of industries, such as Bose Corporation, Honeywell International, Inc., LG Electronics, Inc., Logitech, Inc., Motorola, Inc., Quanta Computer, Inc., Sagem Communication, Samsung Electronics Co., Ltd. and Thompson, Inc.; (ii) leading EMS providers such as Celestica, Inc., Flextronics International, Ltd., Hon Hai Precision Industry Co., Ltd., Inventec Corporation, Jabil Circuit, Inc., Sanmina-SCI Corporation and Solectron Corporation who build end-market products incorporating our semiconductors for companies such as Apple Computer, Inc., Cisco Systems, Inc., Dell, Inc., EMC Corporation, Intel Corporation, Microsoft Corporation and Roche Diagnostics; and (iii) leading distributors, such as Arrow Electronics, Inc., Avnet, Inc., Future Electronics and Yosun Industrial Corp. For 2005 and 2006, our OEM and EMS customers together accounted for 69.5% and 54.2%, respectively, of our net sales.

We were incorporated in 1959 in California and reincorporated in Delaware in 1969. We are headquartered in Westlake Village, California, near Los Angeles. We have two manufacturing facilities located in Shanghai, China, one analog design and testing facility located in Hsinchu, Taiwan, and our wafer fabrication facility is in Kansas City, Missouri. Our sales, marketing and logistical centers are located in Taipei, Taiwan; Shanghai and Shenzhen, China; and Hong Kong. In 2006, we strengthened our product design centers in Dallas, San Jose, Shanghai and Taiwan to position our design engineers to work more closely with our customers and enable us to deliver a stream of innovative solutions in our targeted product categories. We also have regional sales offices and/or representatives in: Derbyshire, England; Toulouse, France; Frankfurt, Germany; and in various cities throughout the United States.

The following diagram shows the entities through which we conduct our business and the principal services provided by each entity.

As part of our growth strategy, in December 2005, we announced the acquisition of Anachip Corporation, a fabless Taiwanese semiconductor company focused on analog ICs designed for specific applications, and in November 2006, we acquired the net assets of APD Semiconductor, Inc., a privately held U.S.-based fabless semiconductor company. See “Our Strategy” for more discussion of these acquisitions.

## **SEGMENT REPORTING AND FINANCIAL INFORMATION**

An operating segment is defined as a component of an enterprise about which separate financial information is available that is evaluated regularly by the chief decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief decision-making group consists of the President and Chief Executive Officer, Chief Financial Officer, Senior Vice President of Operations, Senior Vice President of Sales and Marketing, Vice President of Asia Sales, and Senior Vice President of Finance. For financial reporting purposes, we operate in a single segment, standard semiconductor products, through our various manufacturing and distribution facilities. We aggregated our standard products since the products are similar and have similar economic characteristics, and the products are similar in production process and share the same customer type.

Our operations include the domestic operations (Diodes Incorporated and Diodes-FabTech) located in the United States and the Asian operations (Diodes-Taiwan, located in Taipei, Taiwan, and Diodes-Anachip located in Hsinchu, Taiwan, Diodes-China and Diodes-Shanghai both located in Shanghai, China, and Diodes-Hong Kong located in Hong Kong, China). For reporting purposes, European operations are consolidated into the domestic (North America) operations. Information about our net revenues, assets and property, plant and equipment is described in our notes to the consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

## **OUR INDUSTRY**

Semiconductors are critical components used in the manufacture of an increasing variety of electronic products and systems. Since the invention of the transistor in 1948, continuous improvements in semiconductor processes and design technologies have led to smaller, more complex and more reliable devices at a lower cost per function. The availability of low-cost semiconductors, together with increased customer demand for sophisticated electronic systems, has led to the proliferation of semiconductors in diverse end-use applications in the consumer electronics, computing, industrial, communications and automotive sectors. These factors have also led to an increase in the total number of semiconductor components in individual electronic systems and an increase in value of these components as a percentage of the total cost of the electronic systems in which they are incorporated.

## OUR COMPETITIVE STRENGTHS

We believe our competitive strengths include the following:

**Flexible, scalable and cost-effective manufacturing** - Our manufacturing operations are a core element of our success and we have designed our manufacturing base to allow us to respond quickly to changes in demand trends in the end-markets we serve. For example, we have structured our Shanghai assembly, test and packaging facilities to enable us to rapidly and efficiently add capacity and adjust product mix to meet shifts in customer demand and overall market trends. As a result, for the past several years we have operated our Shanghai facilities at near full capacity, while at the same time significantly expanding that capacity. Additionally, the Shanghai location of our manufacturing operations provides us with access to a highly-skilled workforce at a low overall cost base while enabling us to better serve our leading customers, many of which are located in Asia.

**Integrated packaging expertise** - We believe that we have particular expertise in designing and manufacturing innovative and proprietary packaging solutions that integrate multiple separate discrete elements into a single semiconductor product called an array. Our ability to design and manufacture highly integrated semiconductor solutions provides our customers with products of equivalent functionality with fewer individual parts, and at lower overall cost, than alternative products. For example, one of our leading diode array products integrates eight discrete elements into a single highly miniaturized package that provides four times the functionality, with less than 20% of the space requirements of the previous solution. This combination of integration, functionality and miniaturization makes our products well suited for high-volume consumer applications such as digital audio players, notebook computers and digital cameras.

**Broad customer base and diverse end-markets** - Our customers include leading OEMs such as Bose Corporation, Honeywell International, Inc., LG Electronics, Inc., Logitech, Inc., Motorola, Inc., Quanta Computer, Inc., Sagem Communication, Samsung Electronics Co., Ltd. and Thompson, Inc., as well as leading EMS providers such as Celestica, Inc., Flextronics International, Ltd., Hon Hai Precision Industry Co., Ltd., Inventec Corporation, Jabil Circuit, Inc., Sanmina-SCI Corporation and Solectron Corporation. Overall, we serve over 150 direct customers and over 10,000 additional customers through our distributors, including leading distributors such as Arrow Electronics, Inc., Avnet, Inc., Future Electronics and Yosun Industrial Corp. Our products are ultimately used in end-products in a large number of markets served by our broad base of customers, which we believe makes us less dependent on either specific customers or specific end-use applications.

**Customer focused product development** - Effective collaboration with our customers and a high degree of customer service are essential elements of our business. We believe focusing on dependable delivery of semiconductor solutions tailored to specific end-user applications, has fostered deep customer relationships and created a key competitive advantage for us in the highly fragmented discrete semiconductor marketplace. We believe our close relationships with our OEM and EMS customers have provided us with deeper insight into our customers' product needs. This results in differentiation in our product designs and often provides us with insight into additional opportunities for new design wins in our customers' products.

**Management continuity and experience** - We believe that the continuity of our management team is a critical competitive strength. Five members of our executive management team have an average of over 13 years of service at the Company and the length of their service with us has created significant institutional insight into our markets, our customers and our operations.

In June 2005, we appointed Dr. Keh-Shew Lu as President and Chief Executive Officer. Dr. Lu has served as a director of Diodes since 2001 and has 30 years of relevant industry experience. Dr. Lu began his career at Texas Instruments, Inc. in 1974 and retired in 2001 as Senior Vice President and General Manager of Worldwide Analog, Mixed-Signal and Logic Products. Our Chief Financial Officer, Carl Wertz, has been employed by us since 1993 and

has over 20 years of financial experience in manufacturing and distribution industries. Joseph Liu, our Senior Vice President of Operations, joined us in 1990 and has over 30 years of relevant industry experience having started his career in 1971 at Texas Instruments. Similarly, Mark King, our Senior Vice President of Sales and Marketing, has been employed by us since 1991, as has Steven Ho, our Vice President of Asia Sales.

Joining our executive management team in 2006 were: Richard White, Sr. Vice President of Finance, bringing with him 30 years of senior level finance experience, including 25 years at Texas Instruments; Francis Tang, Vice President of Product Development, promoted from Global Product Manager in May of 2006; and Edmund Tang, Vice President of Corporate Administration, with 30 years of managerial and engineering experience.

**OUR STRATEGY** – Our strategy is to continue to enhance our position as a global supplier of standard semiconductor products, and to continue to add other product lines such as power management using our packaging technology capability.

The principal elements of this strategy include the following:

**Continue to rapidly introduce innovative discrete and analog semiconductor products** – We intend to maintain our rapid pace of new product introductions, especially for high-volume, growth applications with short design cycles, such as digital audio players, notebook computers, flat-panel displays, mobile handsets, digital cameras, set-top boxes and other consumer electronics and computing devices. During 2006, we introduced approximately 218 new devices in approximately 30 different product families and achieved new design wins at over 100 OEMs. We believe that continued introduction of new and differentiated product solutions is critically important in maintaining and extending our market share in the highly competitive semiconductor marketplace.

**Expand our available market opportunities** – We intend to aggressively maximize our opportunities in the discrete and analog semiconductor market as well as in related markets where we can apply our semiconductor design and manufacturing expertise. A key element of this is leveraging our highly integrated packaging expertise through our Application Specific Multi-Chip Circuit (ASMCC) product platform, which consists of standard arrays, function specific arrays and end-equipment specific arrays. We intend to achieve this by:

- Ø Continuing to focus on increasing packaging integration, particularly with our existing standard array and customer-specific array products, in order to achieve products with increased circuit density, reduced component count and lower overall product cost;
- Ø Expanding existing products and developing new products in our function specific array lines, which combine multiple discrete semiconductor components to achieve specific common electronic device functionality at a low cost; and
- Ø Developing new product lines, which we refer to as end-equipment specific arrays, which combine discrete components with logic and/or standard analog circuits to provide system-level solutions for high-volume, high-growth applications.

**Maintain intense customer focus** – We intend to strengthen and deepen our customer relationships. We believe that continued focus on customer service would increase our net sales, operating performance and overall market share. To accomplish this, we intend to continue to closely collaborate with our customers to design products that meet their specific needs. A critical element of this strategy is to continue to further reduce our design cycle time in order to quickly provide our customers with innovative products. Additionally, to support our customer-focused strategy, we are continuing to expand our sales force and field application engineers, particularly in Asia and Europe.

**Enhance cost competitiveness** – A key element of our success is our overall low-cost base. While we believe that our Shanghai manufacturing facilities are among the most efficient in the industry, we will continue to refine our proprietary manufacturing processes and technology to achieve additional cost efficiencies. Additionally, we intend to continue to operate our facilities at high utilization rates and to increase product yields in order to achieve meaningful economies of scale.

**Pursue selective strategic acquisitions** – As part of our strategy to expand our standard semiconductor product offerings and to maximize our market opportunities, we may acquire discrete, analog or mixed-signal technologies, product lines or companies in order to support our ASMCC product platform and enhance our standard and new product offerings.

In December 2005, we announced the acquisition of Anachip Corporation, a fabless Taiwanese semiconductor company focused on analog ICs designed for specific applications, and headquartered in the Hsinchu Science Park in Taiwan. This acquisition, which was completed on January 10, 2006, fits in the center of our long-term strategy. Anachip's main product focus is power management ICs. The analog devices they produce are used in LCD monitor/TV's, wireless LAN 802.11 access points, brushless DC motor fans, portable DVD players, datacom devices, ADSL modems, TV/satellite set-top boxes, and power supplies. Anachip brings a design team with strong capabilities in a range of targeted analog and power management technologies.

On November 3, 2006, we purchased the net assets of APD Semiconductor, Inc., a privately held U.S.-based fabless semiconductor company. APD Semiconductor is headquartered in Redwood City, California, with a sales, application, and administration center in Taipei, Taiwan. APD Semiconductor's main product focus is its patented and trademarked Super Barrier Rectifier ("SBR") technology. Utilizing a low cost IC wafer process, the SBR technology uses a MOS cellular design to replace standard traditional Schottky or PN junction diodes. The SBR technology uses an innovative-patented process technique that allows its key parameters to be easily tuned to optimize any customer applications. This adaptive and scalable technology allows for increased power saving with better efficiency and reliability at higher operating temperatures for end user applications like digital audio players, DC/DC converters, AC/DC power supplies, LCD monitors, Power-over-Ethernet (POE), Power Factor Correction (PFC) and TV/satellite set-top boxes. The SBR technology offers industry-leading products like the SBR20U100CT, which has the lowest forward voltage and highest efficiency and power saving in its class. The APD acquisition will further strengthen our technology leadership in the discrete semiconductor market and expand our product capabilities across important segments of our end-markets.



## **FOLLOW-ON PUBLIC OFFERING**

In October 2005, we sold 2,125,000 shares of our Common Stock in a follow-on public offering, raising approximately \$71.7 million (net of commissions and expenses). We used approximately \$31 million and \$8 million of the proceeds in connection with the Anachip and ADP acquisitions, respectively, and we intend to use the remaining net proceeds from this offering for working capital and other general corporate purposes, including additional acquisitions.

## **CONVERTIBLE BONDS OFFERING**

On October 12, 2006, we issued and sold convertible senior notes with an aggregate principal amount of \$230 million due 2026 (“Notes”), which pay 2.25% interest per annum on the principal amount of the notes, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on April 1, 2007.

The Notes will be convertible into cash or, at our option, cash and shares of our Common Stock based on an initial conversion rate, subject to adjustment, of 17.0946 shares per \$1,000 principal amount of Notes (which represents an initial conversion price of \$58.50 per share), in certain circumstances. In addition, following a “make-whole fundamental change” that occurs prior to October 1, 2011, we will, at our option, increase the conversion rate for a holder who elects to convert its Notes in connection with such “make-whole fundamental change,” in certain circumstances.

We intend to use the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments, or purchases of Common Stock.

## **OUR PRODUCTS**

Our product portfolio includes over 4,000 products that are designed for use in high-volume consumer devices such as digital audio players, notebook computers, flat-panel displays, mobile handsets, digital cameras and set-top boxes. We target and serve end-equipment market segments that we believe have higher growth rates than other end-equipment market segments served by the overall semiconductor industry.

Our broad product line includes:

- Ø Discrete semiconductor products, including performance Schottky rectifiers; performance Schottky diodes; Zener diodes and performance Zener diodes, including tight tolerance and low operating current types; standard, fast, super-fast and ultra-fast recovery rectifiers; bridge rectifiers; switching diodes; small signal bipolar transistors; prebiased transistors; MOSFETs; thyristor surge protection devices; and transient voltage suppressors;
- Ø Complex high-density diode, transistor and mixed technology arrays, in multi-pin ultra-miniature surface-mount packages, including customer specific and function specific arrays;
- Ø Silicon wafers used in manufacturing these products; and
- Ø Power management devices, Hall sensors and programmable logic arrays

Our semiconductor products are an essential building-block of electronic circuit design and are available in thousands of permutations varying according to voltage, current, power handling capability and switching speed.

Our complex diode and transistor arrays help bridge the gap between discrete semiconductors and integrated circuits. Arrays consist of multiple discrete semiconductor devices housed in a single package. Our discrete surface-mount devices, which are components that can be attached to the surface of a substrate with solder, target end-equipment categories with critical needs to minimize size while maintaining power efficiency and performance.

The following table lists the end-markets, some of the applications in which our products are used, and the percentage of net sales for each end market for the last three years:

| End Markets          | 2004 | 2005 | 2006 | End product applications   |
|----------------------|------|------|------|--|
| Consumer Electronics | 37%  | 38%  | 36%  | Set-top boxes, game consoles, digital audio players, digital cameras, mobile handsets, flat-panel displays, personal medical devices |
| Computing            | 31%  | 34%  | 36%  | Notebooks, flat-panel monitors, motherboards, PDAs, multi-function printers, servers, network interface cards, hard disk drives      |
| Communications       | 8%   | 17%  | 14%  | Gateways, routers, switches, hubs, fiber optics, DSL, cable and standard modems, networking (wireless, ethernet, power/phone line)   |
| Industrial           | 19%  | 7%   | 12%  | Ballast lighting, power supplies, DC-DC conversion, security/access systems, motor controls, HVAC                                    |
| Automotive           | 5%   | 4%   | 2%   | Comfort controls, audio/video players, GPS navigation, safety, security, satellite radios, engine controls, HID lighting             |

## PRODUCT PACKAGING

Our device packaging technology includes a wide variety of surface-mount and leaded types. Our focus on the development of smaller, more thermally efficient, and increasingly integrated packaging, is an important component of our product development. We provide a comprehensive offering of miniature and sub-miniature packaging, enabling us to fit discrete components into smaller and more efficient packages, while maintaining the same device functionality and power handling capabilities. Smaller packaging provides a reduction in the height, weight and board space required for our components, and is well suited for battery-powered, hand-held and wireless consumer applications such as digital audio players, notebook computers, flat-panel displays, mobile handsets, digital cameras and set-top boxes.

## CUSTOMERS

We serve over 150 direct customers worldwide, which consist of OEMs and EMS providers. Additionally, we have approximately 60 distributor customers worldwide, through which we indirectly serve over 10,000 customers. Our customers include: (i) industry leading OEMs in a broad range of industries, such as Bose Corporation, Honeywell International, Inc., LG Electronics, Inc., Logitech, Inc., Motorola, Inc., Quanta Computer, Inc., Sagem Communication, Samsung Electronics Co., Ltd. and Thompson, Inc.; (ii) leading EMS providers, such as Celestica, Inc., Flextronics International, Ltd., Hon Hai Precision Industry Co., Ltd., Inventec Corporation, Jabil Circuit, Inc., Sanmina-SCI Corporation and Solectron Corporation, who build end-market products incorporating our semiconductors for companies such as Apple Computer, Inc., Cisco Systems, Inc., Dell, Inc., EMC Corporation, Intel Corporation, Microsoft Corporation and Roche Diagnostics; and (iii) leading distributors such as Arrow Electronics, Inc., Avnet, Inc., Future Electronics and Yosun Industrial Corp. For the years of 2004, 2005 and 2006, our OEM and EMS customers together accounted for 66.3%, 69.5% and 54.2%, respectively, of our net sales. The acquisition of Anachip, which sold products predominantly through distributors, is the major contributor to the increase in the percentage of our total net sales sold to distributors.

For the year ended December 31, 2005 and December 31, 2006, Lite-On Semiconductor Corporation (LSC), which is also our largest stockholder, (owning approximately 22.3% of our Common Stock as of December 31, 2006), accounted for approximately 9.6% and 6.5%, respectively, of our net sales. Additionally, other members of The Lite-On Group of companies accounted for 4.2% and 2.3%, respectively, of our net sales in 2005 and 2006. No other customer accounted for 10% or more of our net sales in 2005 and 2006. Also, 14.7% and 13.0% of our net sales were

from the subsequent sale of products we purchased from LSC in 2005 and 2006, respectively. We believe each member of The Lite On Group of companies makes independent purchasing decisions. See “Certain Relationships and Related Party Transactions.”

We believe that our close relationships with our OEM and EMS customers have provided us with deeper insight into our customers’ product needs than other manufacturers who we believe depend to a greater extent on indirect sales through distributors. In addition to seeking to expand relationships with our existing customers, our strategy is to pursue new customers and diversify our customer base by focusing on leading global consumer electronics companies and their EMS providers and distributors.

We generally warrant that products sold to our customers will, at the time of shipment, be free from defects in workmanship and materials and conform to our approved specifications. Subject to certain exceptions, our standard warranty extends for a period of one year from the date of shipment. Warranty expense to date has not been significant. Generally, our customers may cancel orders on short notice without incurring a significant penalty.

Many of our customers are based in Asia. Net sales by country consists of sales to customers assigned to that country based on the country to which the product is shipped. For the year ended December 31, 2006, 34.5%, 28.1%, 22.2%, and 15.2% of our net sales were derived from China, Taiwan, the United States and all other markets, respectively, compared to 31.7%, 27.9%, 25.6% and 14.8%, respectively, for 2005.

## **SALES AND MARKETING**

We market and sell our products worldwide through a combination of direct sales and marketing personnel, independent sales representatives and distributors. We have direct sales personnel in the United States, United Kingdom, France, Germany, Taiwan and China. We also have independent sales representatives in the United States, Japan, Korea, and Europe. We currently have distributors in the United States, Europe and Asia.

As of December 31, 2006, our direct global sales and marketing organization consisted of approximately 160 employees operating out of 18 offices. We have sales and marketing offices or representatives in Taipei, Taiwan; Shanghai and Shenzhen, China; Hong Kong; Derbyshire, England; Toulouse, France; Frankfurt, Germany; and we have five regional sales offices in the United States. As of December 31, 2006, we also had approximately 20 independent sales representative firms marketing our products.

Our marketing group focuses on our product strategy, product development road map, new product introduction process, demand assessment and competitive analysis. Our marketing programs include participation in industry tradeshows, technical conferences and technology seminars, sales training and public relations. The marketing group works closely with our sales and research and development groups to align our product development road map. The marketing group coordinates its efforts with our product development, operations and sales groups, as well as with our customers, sales representatives and distributors. We support our customers through our field application engineering and customer support organizations.

To support our global customer-base, our website is language-selectable into English, Chinese, and Korean, giving us an effective marketing tool for worldwide markets. With its extensive online product catalog with advanced search capabilities, our website facilitates quick and easy product selection. Our website provides easy access to our worldwide sales contacts and customer support, and incorporates a distributor-inventory check to provide component inventory availability and a small order desk for overnight sample fulfillment. Our website, [www.diodes.com](http://www.diodes.com), also provides access to investor financial information and our corporate governance information.

## **MANUFACTURING OPERATIONS AND FACILITIES**

We operate four manufacturing facilities, two of which are located in Shanghai, China. The third is located in Kansas City, Missouri, and the newly acquired Anachip facility is located at Hsinchu, Taiwan. Our facilities in Shanghai perform packaging, assembly and testing functions, and our Kansas City facility is a 5-inch wafer foundry. Anachip's main product focus is power management ICs.

As of December 31, 2006, we had invested approximately \$127.2 million in plant and state-of-the-art equipment in China. Both of our Chinese factories manufacture product for sale by our U.S. and Asian operations, and also sell to external customers. Silicon wafers are received and inspected in a highly controlled "clean room" environment awaiting the assembly operation. At the first step of assembly, the wafers are sawn with very thin, high speed diamond blades into tiny semiconductor "dice", numbering as many as 170,000 per 5-inch diameter wafer. Dice are then loaded onto a

handler, which automatically places the dice, one by one, onto lead frames, which are package specific, where they are bonded to the lead-frame pad. Next, automatic wire bonders make the necessary electrical connections from the die to the leads of the lead-frame, using micro-thin gold wire. Our fully automated assembly machinery then molds the epoxy case around the die and lead-frame to produce the desired semiconductor product. After a trim, form, test, mark and re-test operation, the parts are placed into special carrier housings and a cover tape seals the parts in place. The taped parts are then spooled onto reels or placed into other packaging medium and boxed for shipment.

Our manufacturing processes use many raw materials, including silicon wafers, copper lead frames, gold wire and other metals, molding compounds and various chemicals and gases. We have no material agreements with any of our suppliers that impose minimum or continuing supply obligations. From time to time, suppliers may extend lead times, limit supplies or increase prices due to capacity constraints or other factors. Although we believe that supplies of the raw materials we use are currently and will continue to be available, shortages could occur in various essential materials due to interruption of supply or increased demand in the industry.

In the United States, our corporate headquarters are located in a leased facility in Westlake Village, California, approximately 30 miles northwest of Los Angeles. We also lease or own properties around the world for use as sales offices, research and development labs, warehouses and logistic centers. The size and/or location of these properties change from time to time based on business requirements. In 2006, we purchased a building in Taipei, Taiwan for approximately \$6.0 million (see Item 2 - Properties).

## **BACKLOG**

The amount of backlog to be shipped during any period is dependent upon various factors, and all orders are subject to cancellation or modification, usually with no penalty to the customer. Orders are generally booked from one month to greater than six months in advance of delivery. The rate of booking of new orders can vary significantly from month to month. We, and the industry as a whole, are experiencing a trend towards shorter lead-times. The amount of backlog at any date depends upon various factors, including the timing of the receipt of orders, fluctuations in orders of existing product lines, and the introduction of any new lines. Accordingly, we believe that the amount of our backlog at any date is not a particularly useful measure of our future sales. We strive to maintain proper inventory levels to support our customers' just-in-time order expectations.

## **PATENTS, TRADEMARKS AND LICENSES**

Although patents and trademarks have not been material to our business to date, they may become more significant in the future, particularly as they relate to our packaging and analog technologies.

Through our APD asset acquisition, we acquired the Super Barrier Rectifier technology (less than 500V) and the SBR trademark. SBR is state-of-the-art integrated circuit wafer processing technology that allows the design and manufacture of a device, which is able to integrate and improve the benefits of the two existing rectifier technologies into a single device. The creation of a finite conduction cellular IC, combined with inherent design uniformity has allowed manufacturing costs to be kept competitive with existing power device technology, thus producing breakthrough in rectifier technology.

Currently, our licensing of patents to other companies is not material. We do, however, license certain product technology from other companies, but we do not consider any of the licensed technology to be material in terms of royalties. We believe the duration and other terms of the licenses are appropriate for our current needs.

## **COMPETITION**

Numerous semiconductor manufacturers and distributors serve the discrete semiconductor components market, making competition intense. Some of our larger competitors include Fairchild Semiconductor Corporation, Infineon Technologies A.G., International Rectifier Corporation, ON Semiconductor Corporation, Philips Electronics N.V. (NXP), Rohm Electronics USA, LLC, Toshiba Corporation and Vishay Intertechnology, Inc., many of which have greater financial, marketing, distribution and other resources than us. Accordingly, in response to market conditions, we from time to time may reposition product lines or decrease prices, which may affect our sales of, and profit margins on, such product lines. The price and quality of the product, and our ability to design products and deliver customer service in keeping with the customers' needs, determine the competitiveness of our products. We believe that our product focus and our flexibility and ability to quickly adapt to customer needs affords us competitive advantages.

## **ENGINEERING AND RESEARCH AND DEVELOPMENT**

Our engineering and research and development groups consist of applications, technical marketing, and product development engineers who assist in determining the direction of our future product lines. Their primary function is to work closely with market-leading customers to further refine, expand and improve our product range within our

product types and packages. In addition, customer requirements and acceptance of new package types are assessed and new, higher-density and more energy-efficient packages are developed to satisfy customers' needs. Working with customers to integrate multiple types of technologies within the same package, our applications engineers strive to reduce the required number of components and, thus, circuit board size requirements of a device, while increasing the functionality of the component technology.

Product engineers work directly with our semiconductor wafer design and process engineers who craft die designs needed for products that precisely match our customers' requirements. Direct contact with our manufacturing facilities allows the manufacturing of products that are in line with current technical requirements. We have the capability to capture the customer's electrical and packaging requirements through their product development engineers, and then transfer those requirements to our research and development and engineering department, so that the customer's requirements can be translated, designed, and manufactured with full control, even to the elemental silicon level.



For the years ended December 31, 2004, 2005 and 2006, investment in research and development was \$3.4 million, \$3.7 million and \$8.3 million, respectively. As a percentage of net sales, research and development expense was 1.8%, 1.7% and 2.4% for 2004, 2005 and 2006, respectively. We anticipate research and development to increase in absolute dollars and to be in the range of 2-3% of net sales as we continue to develop proprietary technology.

## **EMPLOYEES**

As of December 31, 2006, we employed a total of 2,268 employees, of which 1,910 of our employees were in Asia, 352 were in the United States and six were in Europe. None of our employees is subject to a collective bargaining agreement. We consider our relations with our employees to be satisfactory.

## **ENVIRONMENTAL MATTERS**

We are subject to a variety of U.S. federal, state, local and foreign governmental laws, rules and regulations related to the use, storage, handling, discharge or disposal of certain toxic, volatile or otherwise hazardous chemicals used in our manufacturing process both in the United States where our wafer fabrication facility is located, and in China where our assembly, test and packaging facilities are located. Any of these regulations could require us to acquire equipment or to incur substantial other expenses to comply with environmental regulations. As of December 31, 2006, there were no known environmental claims or recorded liabilities.

## **CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS**

We conduct business with two related party companies, LSC (and its subsidiaries and affiliates) and Keylink International (formerly Xing International) (and its subsidiaries). LSC is our largest stockholder and owned 22.3% of our outstanding Common Stock as of December 31, 2006. Keylink International is our 5% joint venture partner in Diodes-China and Diodes-Shanghai. C.H. Chen, our former President and Chief Executive Officer, and Vice Chairman of our Board of Directors, is also Vice Chairman of LSC. M.K. Lu, a member of our Board of Directors, is President of LSC. In addition, Raymond Soong, the Chairman of our Board of Directors, is Chairman of LSC, and is the Chairman of Lite-On Technology Corporation, a significant shareholder of LSC. In connection with our 2005 follow-on public offering, LSC sold 750,000 shares (1,125,000 split-adjusted shares at December 1, 2005), reducing its holdings of our Common Stock to approximately 5.8 million shares (split adjusted). We did not receive any of the proceeds from their sale of our Common Stock. LSC shared in the expenses of the offering.

The Audit Committee of our Board of Director reviews all related party transactions for potential conflict of interest situations, and approves all such transactions, in accordance with such procedures as it may adopt from time to time. We believe that all related party transactions are on terms no less favorable to us than would be obtained from unaffiliated third parties.

In 2006, we sold silicon wafers to LSC representing 6.5% (9.6% in 2005 and 11.1% in 2004) of our sales, making LSC our largest customer. Also for 2006, 13.0% (14.7% in 2005 and 17.2% in 2004) of our net sales were from discrete semiconductor products purchased from LSC for subsequent sale by us, making LSC our largest outside supplier. In addition, companies affiliated with LSC, which we refer to collectively as The Lite-On Group, accounted for 3.3%, 4.2% and 2.3% of our net sales, respectively, in 2004, 2005 and 2006. We also rent warehouse space in Hong Kong from a member of The Lite-On Group, which also provides us with warehousing and logistics services at that Hong Kong location. For 2004, 2005 and 2006, we reimbursed this entity in aggregate amounts of \$190,000, \$288,000 and \$474,000, respectively, for these items. Such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties. The Audit Committee of the Board of Directors has approved the arrangements we have with these related party transactions.

In December 2000, we acquired a wafer foundry, FabTech, Inc., from LSC for approximately \$6.0 million cash plus \$19.0 million in assumed debt (the debt was due primarily to LSC). In connection with the acquisition, LSC entered into a volume purchase agreement to purchase wafers from FabTech. In addition, in accordance with the terms of the acquisition, we also entered into management incentive agreements with several members of FabTech's management. The agreements provided members of FabTech's management with guaranteed annual payments as well as contingent bonuses based on the annual profitability of FabTech, subject to a maximum annual amount. LSC reimbursed us for any portion of the guaranteed and contingent liability paid by FabTech. The final year of the management incentive agreements was 2004, with final payment made on March 31, 2005. LSC reimbursed us \$375,000 in each of 2003, 2004, and 2005 for amounts paid by us under these management incentive agreements.

In 2006, we sold silicon wafers to companies owned by Keylink International totaling 0.4% (0.6% in 2005 and 0.9% in 2004) of our net sales. Also for 2006, 2.3% (3.0% in 2005 and 3.5% in 2004) of our sales were from semiconductor products purchased from companies owned by Keylink International. In addition, Diodes-China and Diodes-Shanghai lease their manufacturing facilities from, and subcontract a portion of their manufacturing process (metal plating and environmental waste services) to, Keylink International. We also pay a consulting fee to Keylink International. In 2004, 2005 and 2006, we paid Keylink International an aggregate of \$4.8 million, \$6.6 million and \$7.9 million, respectively, with respect to these items. We believe such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties. The Audit Committee of the Board of Directors has approved the contracts associated with these related party transactions.

On December 20, 2005, we entered into a definitive stock purchase agreement to acquire Anachip Corporation, a Taiwanese fabless analog IC company, and headquartered in the Hsinchu Science Park in Taiwan. The selling shareholders included LSC (which owned approximately 60% of Anachip's outstanding capital stock), and two Taiwanese venture capital firms (together owning approximately 20% of Anachip's stock), as well as current and former Anachip employees. At December 31, 2005, we had purchased an aggregate of 9,433,613 shares (or approximately 18.9%) of the 50,000,000 outstanding shares of the capital stock of Anachip. On January 10, 2006 (the closing date of the acquisition), we purchased an additional 40,470,212 shares and therefore, we now hold approximately 99.81% of the Anachip capital stock.

Concurrent with the acquisition, Anachip entered into a wafer purchase agreement with LSC, pursuant to which LSC will sell to Anachip, according to Anachip's requirements, during the two year period ending on December 31, 2007, wafers of the same or similar type, and meeting the same specifications, as those wafers purchased from LSC by Anachip at the time of the acquisition. Anachip will purchase such wafers on terms (including purchase price, delivery schedule, and payment terms) no less favorable to Anachip than those terms on which Anachip purchased such wafers from LSC at the time of the acquisition provided; however, that the purchase price will be the lower of the current price or the most favorable customer pricing. If the price of raw wafers increases by more than 20% within any six-month period, Anachip and LSC will renegotiate in good faith the price of wafers to reflect the cost increase.

## **FINANCIAL INFORMATION ABOUT GEOGRAPHIC AREAS**

We sell product primarily through our operations in North America, Asia and Europe. See Note 15 of "Notes to Consolidated Financial Statements" for a description of our geographic information.

## **FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES**

With respect to foreign operations, see Notes 1 and 15 of "Notes to Consolidated Financial Statements."

## **AVAILABLE INFORMATION**

Our website address is <http://www.diodes.com>. We make available, free of charge through our website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (the "SEC").

Our filings may also be read and copied at the SEC's Public Reference Room at 100 F Street NE, Room 1580 Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that website is [www.sec.gov](http://www.sec.gov).

To support our global customer base, our website is language-selectable into English, Chinese, and Korean, giving us an effective marketing tool for worldwide markets. With its extensive online Product (Parametric) Catalog with advanced search capabilities, our website facilitates quick and easy product selection. Our website provides easy access to worldwide sales contacts and customer support, and incorporates a distributor-inventory check to provide component inventory availability and a small order desk for overnight sample fulfillment. Our website also provides access to current and complete investor financial information and corporate governance information including our Code of Business Conduct, as well as SEC filings and press releases, and stock quotes.

**Cautionary Statement for Purposes of the ‘‘Safe Harbor’’ Provision of the Private Securities Litigation Reform Act of 1995**

Many of the statements included in this Annual Report on Form 10-K contain forward-looking statements and information relating to our company. We generally identify forward-looking statements by the use of terminology such as ‘‘may,’’ ‘‘will,’’ ‘‘could,’’ ‘‘should,’’ ‘‘potential,’’ ‘‘continue,’’ ‘‘expect,’’ ‘‘intend,’’ ‘‘plan,’’ ‘‘estimate,’’ ‘‘anticipate,’’ ‘‘be,’’ and similar phrases or the negatives of such terms. We base these statements on our beliefs as well as assumptions we made using information currently available to us. Such statements are subject to risks, uncertainties and assumptions, including those identified in ‘‘Risk Factors,’’ as well as other matters not yet known to us or not currently considered material by us. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected. Given these risks and uncertainties, prospective investors are cautioned not to place undue reliance on such forward-looking statements. Forward-looking statements do not guarantee future performance and should not be considered as statements of fact.

You should not unduly rely on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise. The Private Securities Litigation Reform Act of 1995 (the ‘‘Act’’) provides certain ‘‘safe harbor’’ provisions for forward-looking statements. All forward-looking statements made on this Annual Report on Form 10-K are made pursuant to the Act.

**Item 1A. Risk Factors**

Investing in our Common Stock involves a high degree of risk. You should carefully consider the following risks and other information in this report before you decide to buy our Common Stock. Our business, financial condition or operating results may suffer if any of the following risks are realized. Additional risks and uncertainties not currently known to us may also adversely affect our business, financial condition or operating results. If any of these risks or uncertainties occurs, the trading price of our Common Stock could decline and you could lose part or all of your investment.

**RISKS RELATED TO OUR BUSINESS**

*Downturns in the highly cyclical semiconductor industry or changes in end-market demand could affect our operating results and financial condition.*

The semiconductor industry is highly cyclical, and periodically experiences significant economic downturns characterized by diminished product demand, production overcapacity and excess inventory, which can result in rapid erosion in average selling prices. From time to time, the semiconductor industry experiences order cancellations and reduced demand for products, resulting in significant revenue declines, due to excess inventories at computer and telecommunications equipment manufacturers and general economic conditions, especially in the technology sector. The market for semiconductors may experience renewed, and possibly more severe and prolonged downturns in the future, which may harm our results of operations and reduce the value of our business.

In addition, we operate in a narrower market of the broader semiconductor market and, as a result, cyclical fluctuations may affect this segment to a greater extent than they do the broader semiconductor market. This may cause us to experience greater fluctuations in our results of operations than compared to some of our broad line semiconductor manufacturer competitors. In addition, we may experience significant changes in our profitability as a result of variations in sales, changes in product mix, changes in end-user markets and the costs associated with the introduction of new products. The markets for our products depend on continued demand in the consumer electronics, computer, industrial, communications and automotive sectors. These end-user markets also tend to be cyclical and may also experience changes in demand that could adversely affect our operating results and financial condition.



***The semiconductor business is highly competitive, and increased competition may harm our business and our operating results.***

The sectors of the semiconductor industry in which we operate are highly competitive. We expect intensified competition from existing competitors and new entrants. Competition is based on price, product performance, product availability, quality, reliability and customer service. We compete in various markets with companies of various sizes, many of which are larger and have greater resources or capabilities as it relates to financial, marketing, distribution, brand name recognition, research and development, manufacturing and other resources than we have. As a result, they may be better able to develop new products, market their products, pursue acquisition candidates and withstand adverse economic or market conditions. Most of our current major competitors are broad line semiconductor manufacturers who often have a wider range of product types and technologies than we do. In addition, companies not currently in direct competition with us may introduce competing products in the future. Some of our current major competitors are Fairchild Semiconductor Corporation, International Rectifier Corporation, ON Semiconductor Corporation, Philips Electronics N.V., Rohm Electronics USA LLC, and Vishay Intertechnology, Inc. We may not be able to compete successfully in the future, and competitive pressures may harm our financial condition or our operating results.

***We receive a significant portion of our net sales from a single customer. In addition, this customer is also our largest external supplier and is a related party. The loss of this customer or supplier could harm our business and results of operations.***

In 2005 and 2006, LSC, our largest stockholder and our largest customer, accounted for 9.6% and 6.5%, respectively, of our net sales. LSC is also our largest supplier, providing us with discrete semiconductor products for subsequent sale by us, which represented approximately 14.7% and 13.0%, respectively, of our net sales, in 2005 and 2006. The loss of LSC as either a customer or a supplier, or any significant reduction in either the amount of product it supplies to us, or the volume of orders it places with us, could materially harm our business and results of operations.

***Delays in initiation of production at new facilities, implementing new production techniques or resolving problems associated with technical equipment malfunctions could adversely affect our manufacturing efficiencies.***

Our manufacturing efficiency has been and will be an important factor in our future profitability, and we may not be able to maintain or increase our manufacturing efficiency. Our manufacturing and testing processes are complex, require advanced and costly equipment and are continually being modified in our efforts to improve yields and product performance. Difficulties in the manufacturing process can lower yields. Technical or other problems could lead to production delays, order cancellations and lost revenue. In addition, any problems in achieving acceptable yields, construction delays, or other problems in upgrading or expanding existing facilities, building new facilities, problems in bringing other new manufacturing capacity to full production or changing our process technologies, could also result in capacity constraints, production delays and a loss of future revenues and customers. Our operating results also could be adversely affected by any increase in fixed costs and operating expenses related to increases in production capacity if net sales do not increase proportionately, or in the event of a decline in demand for our products.

Our wafer fabrication facility is located in Kansas City, Missouri, while our facilities in Shanghai, China provide assembly, test and packaging capabilities and the Anachip facility in Taiwan produces power management ICs. Any disruption of operations at these facilities could have a material adverse effect on our business, financial condition and results of operations.

***We are and will continue to be under continuous pressure from our customers and competitors to reduce the price of our products, which could adversely affect our growth and profit margins.***

Prices for our products tend to decrease over their life cycle. There is substantial and continuing pressure from customers to reduce the total cost of purchasing our products. To remain competitive and retain our customers and gain new ones, we must continue to reduce our costs through product and manufacturing improvements. We must also strive to minimize our customers' shipping and inventory financing costs and to meet their other goals for rationalization of supply and production. We experienced an annual decrease in average selling prices (ASP) for our products of 3.1% and 15.0% for 2004 and 2005, respectively, and an ASP increase of 12.1%, primarily due to newly acquired product lines, in 2006. Our growth and the profit margins of our products will suffer if we cannot effectively continue to reduce our costs and keep our product prices competitive.



***Our customer orders are subject to cancellation or modification usually with no penalty. High volumes of order cancellation or reductions in quantities ordered could adversely affect our results of operations and financial condition.***

All of our customer orders are subject to cancellation or modification, usually with no penalty to the customer. Orders are generally made on a purchase order basis, rather than pursuant to long-term supply contracts, and are booked from one to twelve months in advance of delivery. The rate of booking new orders can vary significantly from month to month. We, and the semiconductor industry as a whole, are experiencing a trend towards shorter lead-times, which is the amount of time between the date a customer places an order and the date the customer requires shipment. Furthermore, our industry is subject to rapid changes in customer outlook and periods of excess inventory due to changes in demand in the end markets our industry serves. As a result, many of our purchase orders are revised, and may be cancelled, with little or no penalty and with little or no notice. However, we must still commit production and other resources to fulfilling these orders even though they may ultimately be cancelled. If a significant number of orders are cancelled or product quantities ordered are reduced, and we are unable to timely generate replacement orders, we may build up excess inventory and our results of operations and financial condition may suffer.

***New technologies could result in the development of new products by our competitors and a decrease in demand for our products, and we may not be able to develop new products to satisfy changes in demand, which could result in a decrease in net sales and loss of market share.***

Our product range and new product development program is focused on discrete and analog semiconductor products. Our failure to develop new technologies, or anticipate or react to changes in existing technologies, either within or outside of the discrete semiconductor market, could materially delay development of new products, which could result in a decrease in our net sales and a loss of market share to our competitors. The semiconductor industry is characterized by rapidly changing technologies and industry standards, together with frequent new product introductions. This includes the development of new types of technology or the improvement of existing technologies, such as analog and digital technologies that compete with, or seek to replace discrete semiconductor technology. Our financial performance depends on our ability to design, develop, manufacture, assemble, test, market and support new products and product enhancements on a timely and cost-effective basis. New products often command higher prices and, as a result, higher profit margins. We may not successfully identify new product opportunities or develop and bring new products to market or succeed in selling them into new customer applications in a timely and cost-effective manner.

Products or technologies developed by other companies may render our products or technologies obsolete or noncompetitive and, since we operate primarily in a narrower segment of the broader semiconductor industry, this may have a greater effect on us than it would if we were a broad-line semiconductor manufacturer with a wider range of product types and technologies. Many of our competitors are larger and more established international companies with greater engineering and research and development resources than us. Our failure to identify or capitalize on any fundamental shifts in technologies in our product markets, relative to our competitors, could harm our business, have a material adverse effect on our competitive position within our industry and harm our relationships with our customers. In addition, to remain competitive, we must continue to reduce package sizes, improve manufacturing yields and expand our sales. We may not be able to accomplish these goals, which could harm our business.

***We may be subject to claims of infringement of third-party intellectual property rights or demands that we license third-party technology, which could result in significant expense and reduction in our intellectual property rights.***

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights. From time to time, third parties have asserted, and may in the future assert, patent, copyright, trademark and other intellectual property rights to technologies that are important to our business and have demanded, and may in the future demand, that we license their patents and technology. Any litigation to determine the validity of allegations that

our products infringe or may infringe these rights, including claims arising through our contractual indemnification of our customers, or claims challenging the validity of our patents, regardless of its merit or resolution, could be costly and divert the efforts and attention of our management and technical personnel. We may not prevail in litigation given the complex technical issues and inherent uncertainties in intellectual property litigation. If litigation results in an adverse ruling we could be required to:

Ø pay substantial damages for past, present and future use of the infringing technology;

Ø cease the manufacture, use or sale of infringing products;

Ø discontinue the use of infringing technology;

Ø expend significant resources to develop non-infringing technology;

Ø pay substantial damages to our customers or end-users to discontinue use or replace infringing technology with non-infringing technology;

Ø license technology from the third party claiming infringement, which license may not be available on commercially reasonable terms, or at all; or

Ø relinquish intellectual property rights associated with one or more of our patent claims, if such claims are held invalid or otherwise unenforceable.

***We depend on third-party suppliers for timely deliveries of raw materials, parts and equipment, as well as finished products from other manufacturers, and our results of operations could be adversely affected if we are unable to obtain adequate supplies in a timely manner.***

Our manufacturing operations depend upon obtaining adequate supplies of raw materials, parts and equipment on a timely basis from third parties. Our results of operations could be adversely affected if we are unable to obtain adequate supplies of raw materials, parts and equipment in a timely manner or if the costs of raw materials, parts or equipment were to increase significantly. Our business could also be adversely affected if there is a significant degradation in the quality of raw materials used in our products, or if the raw materials give rise to compatibility or performance issues in our products, any of which could lead to an increase in customer returns or product warranty claims. Although we maintain rigorous quality control systems, errors or defects may arise from a supplied raw material and be beyond our detection or control. Any interruption in, or change in quality of, the supply of raw materials, parts or equipment needed to manufacture our products could adversely affect our business and harm our results of operations and our reputation with our customers.

In addition, we sell finished products from other manufacturers. Our business could also be adversely affected if there is a significant degradation in the quality of these products. From time to time, such manufacturers may extend lead-times, limit supplies or increase prices due to capacity constraints or other factors. We have no long-term purchase contracts with any of these manufacturers and, therefore, have no contractual assurances of continued supply, pricing or access to finished products that we sell, and any such manufacturer could discontinue supplying to us at any time. Additionally, some of our suppliers of finished products or wafers compete directly with us and may in the future choose not to supply products to us.

***If we do not succeed in continuing to vertically integrate our business, we will not realize the cost and other efficiencies we anticipate and our ability to compete, profit margins and results of operations may suffer.***

We are continuing to vertically integrate our business. Key elements of this strategy include continuing to expand the reach of our sales organization, expand our manufacturing capacity, expand our wafer foundry and research and development capability and expand our marketing, product development, package development and assembly/testing operations in company-owned facilities or through the acquisition of established contractors. There are certain risks associated with our vertical integration strategy, including:

- Ø difficulties associated with owning a manufacturing business, including, but not limited to, the maintenance and management of manufacturing facilities, equipment, employees and inventories and limitations on the flexibility of controlling overhead;
- Ø difficulties in continuing expansion of our operations in Asia and Europe, because of the distance from our U.S. headquarters and differing regulatory and cultural environments;
  - Ø the need for skills and techniques that are outside our traditional core expertise;
  - Ø less flexibility in shifting manufacturing or supply sources from one region to another;
- Ø even when independent suppliers offer lower prices, we would continue to acquire wafers from our captive manufacturing facility, which may result in us having higher costs than our competitors;
  - Ø difficulties developing and implementing a successful research and development team; and

Ø difficulties developing, protecting, and gaining market acceptance of, our proprietary technology.

The risks of becoming a fully integrated manufacturer are amplified in an industry-wide slowdown because of the fixed costs associated with manufacturing facilities. In addition, we may not realize the cost, operating and other efficiencies that we expect from continued vertical integration. If we fail to successfully vertically integrate our business, our ability to compete, profit margins and results of operations may suffer.

***Part of our growth strategy involves identifying and acquiring companies with complementary product lines or customers. We may be unable to identify suitable acquisition candidates or consummate desired acquisitions and, if we do make any acquisitions, we may be unable to successfully integrate any acquired companies with our operations.***

A significant part of our growth strategy involves acquiring companies with complementary product lines, customers or other capabilities. For example, (i) in fiscal year 2000, we acquired FabTech, a wafer fabrication company, in order to have our own wafer manufacturing capabilities, (ii) in January 2006, we acquired Anachip as an entry into standard logic markets, and (iii) in November 2006, we acquired the assets of APD. While we do not currently have any agreements or commitments in place with respect to any material acquisitions, we are in various stages of preliminary discussions, and we intend to continue to expand and diversify our operations by making further acquisitions. However, we may be unsuccessful in identifying suitable acquisition candidates, or we may be unable to consummate a desired acquisition. To the extent we do make acquisitions, if we are unsuccessful in integrating these companies or their operations or product lines with our operations, or if integration is more difficult than anticipated, we may experience disruptions that could have a material adverse effect on our business, financial condition and results of operations. In addition, we may not realize all of the benefits we anticipate from any such acquisitions. Some of the risks that may affect our ability to integrate or realize any anticipated benefits from acquisitions that we may make include those associated with:

- Ø unexpected losses of key employees or customers of the acquired company;
- Ø bringing the acquired company's standards, processes, procedures and controls into conformance with our operations;
  - Ø coordinating our new product and process development;
  - Ø hiring additional management and other critical personnel;
  - Ø increasing the scope, geographic diversity and complexity of our operations;
- Ø difficulties in consolidating facilities and transferring processes and know-how;
  - Ø difficulties in reducing costs of the acquired entity's business;
- Ø diversion of management's attention from the management of our business; and
  - Ø adverse effects on existing business relationships with customers.

***We are subject to many environmental laws and regulations that could affect our operations or result in significant expenses.***

We are subject to a variety of U.S. federal, state, local and foreign governmental laws, rules and regulations related to the use, storage, handling, discharge or disposal of certain toxic, volatile or otherwise hazardous chemicals used in our manufacturing process both in the United States where our wafer fabrication facility is located, in China where our assembly, test and packaging facilities are located, and in Taiwan where our analog products are produced. Some of these regulations in the United States include the Federal Clean Water Act, Clean Air Act, Resource Conservation and Recovery Act, Comprehensive Environmental Response, Compensation, and Liability Act and similar state statutes and regulations. Any of these regulations could require us to acquire equipment or to incur substantial other expenses to comply with environmental regulations. If we were to incur such additional expenses, our product costs could significantly increase, materially affecting our business, financial condition and results of operations. Any failure to comply with present or future environmental laws, rules and regulations could result in fines, suspension of production or cessation of operations, any of which could have a material adverse effect on our business, financial condition and results of operations. Our operations affected by such requirements include, among others: the disposal of wastewater containing residues from our manufacturing operations through publicly operated treatment works or sewer systems, and which may be subject to volume and chemical discharge limits and may also require discharge permits; and the use, storage and disposal of materials that may be classified as toxic or hazardous. Any of these may result in, or may have resulted in, environmental conditions for which we could be liable.

Some environmental laws impose liability, sometimes without fault, for investigating or cleaning up contamination on, or emanating from, our currently or formerly owned, leased or operated properties, as well as for damages to property or natural resources and for personal injury arising out of such contamination. Such liability may also be joint and several, meaning that we could be held responsible for more than our share of the liability involved, or even the entire share. In addition, the presence of environmental contamination could also interfere with ongoing operations or adversely affect our ability to sell or lease our properties. Environmental requirements may also limit our ability to identify suitable sites for new or expanded plants. Discovery of contamination for which we are responsible, the enactment of new laws and regulations, or changes in how existing requirements are enforced, could require us to incur additional costs for compliance or subject us to unexpected liabilities.

***Our products may be found to be defective and, as a result, product liability claims may be asserted against us, which may harm our business and our reputation with our customers.***

Our products are typically sold at prices that are significantly lower than the cost of the equipment or other goods in which they are incorporated. For example, our products that are incorporated into a personal computer may be sold for several cents, whereas the computer maker might sell the personal computer for several hundred dollars. Although we maintain rigorous quality control systems, we shipped approximately 14.5 billion individual semiconductor devices in 2006 to customers around the world, and in the ordinary course of our business, we receive warranty claims for some of these products that are defective, or that do not perform to published specifications. Since a defect or failure in our products could give rise to failures in the end products that incorporate them (and consequential claims for damages against our customers from their customers), we may face claims for damages that are disproportionate to the revenues and profits we receive from the products involved. In addition, our ability to reduce such liabilities may be limited by the laws or the customary business practices of the countries where we do business. Even in cases where we do not believe we have legal liability for such claims, we may choose to pay for them to retain a customer's business or goodwill or to settle claims to avoid protracted litigation. Our results of operations and business could be adversely affected as a result of a significant quality or performance issue in our products, if we are required or choose to pay for the damages that result. Although we currently have product liability insurance, we may not have sufficient insurance coverage, and we may not have sufficient resources, to satisfy all possible product liability claims. In addition, any perception that our products are defective would likely result in reduced sales of our products, loss of customers and harm to our business and reputation.

***We may fail to attract or retain the qualified technical, sales, marketing and management personnel required to operate our business successfully.***

Our future success depends, in part, upon our ability to attract and retain highly qualified technical, sales, marketing and managerial personnel. Personnel with the necessary expertise are scarce and competition for personnel with these skills is intense. We may not be able to retain existing key technical, sales, marketing and managerial employees or be successful in attracting, assimilating or retaining other highly qualified technical, sales, marketing and managerial personnel in the future. For example, we have faced, and continue to face, intense competition for qualified technical and other personnel in Shanghai, China, where our assembly, test and packaging facilities are located. A number of U.S. and multi-national corporations, both in the semiconductor industry and in other industries, have recently established and are continuing to establish factories and plants in Shanghai, China, and the competition for qualified personnel has increased significantly as a result. If we are unable to retain existing key employees or are unsuccessful in attracting new highly qualified employees, our business, financial condition and results of operations could be materially and adversely affected.

***We may not be able to maintain our growth or achieve future growth and such growth may place a strain on our management and on our systems and resources.***

Our ability to successfully grow our business within the discrete and analog semiconductor markets requires effective planning and management. Our past growth, and our targeted future growth, may place a significant strain on our management and on our systems and resources, including our financial and managerial controls, reporting systems and procedures. In addition, we will need to continue to train and manage our workforce worldwide. If we are unable to effectively plan and manage our growth effectively, our business and prospects will be harmed and we will not be able to maintain our profit growth or achieve future growth.

***Our business may be adversely affected by obsolete inventories as a result of changes in demand for our products and change in life cycles of our products.***

The life cycles of some of our products depend heavily upon the life cycles of the end products into which devices are designed. These types of end-market products with short life cycles require us to manage closely our production and inventory levels. Inventory may also become obsolete because of adverse changes in end-market demand. We may in the future be adversely affected by obsolete or excess inventories which may result from unanticipated changes in the estimated total demand for our products or the estimated life cycles of the end products into which our products are designed. In addition, some customers restrict how far back the date of manufacture for our products can be, and therefore some of our products inventory may become obsolete, and thus, adversely affect our results of operations.

***If OEMs do not design our products into their applications, a portion of our net sales may be adversely affected.***

We expect an increasingly significant portion of net sales will come from products we design specifically for our customers. However, we may be unable to achieve these design wins. In addition, a design win from a customer does not necessarily guarantee future sales to that customer. Without design wins from OEMs, we would only be able to sell our products to these OEMs as a second source, which usually means we are only able to sell a limited amount of product to them. Once an OEM designs another supplier's semiconductors into one of its product platforms, it is more difficult for us to achieve future design wins with that OEM's product platform because changing suppliers involves significant cost, time, effort and risk to an OEM. Achieving a design win with a customer does not ensure that we will receive significant revenues from that customer and we may be unable to convert design into actual sales. Even after a design win, the customer is not obligated to purchase our products and can choose at any time to stop using our products, if, for example, its own products are not commercially successful.





***We rely heavily on our internal electronic information and communications systems, and any system outage could adversely affect our business and results of operations.***

All of our operations, other than FabTech and Anachip, operate on a single technology platform. To manage our international operations efficiently and effectively, we rely heavily on our Enterprise Resource Planning (ERP) system, internal electronic information and communications systems and on systems or support services from third parties. Any of these systems are subject to electrical or telecommunications outages, computer hacking or other general system failure. Difficulties in upgrading or expanding our ERP system or system-wide or local failures that affect our information processing could have material adverse effects on our business, financial condition, results of operations and cash flows.

***We are subject to interest rate risk that could have an adverse effect on our cost of working capital and interest expenses.***

We have credit facilities with U.S. and Asian financial institutions, as well as other debt instruments, with interest rates equal to LIBOR or similar indices plus a negotiated margin. A rise in interest rates could have an adverse impact upon our cost of working capital and our interest expense. As of December 31, 2006, our outstanding interest-bearing debt was \$239.9 million. An increase of 1.0% in interest rates would increase our annual interest rate expense by approximately \$99,000 (our \$230 million in convertible notes have a 2.25% fixed interest rate).

***We had a significant amount of debt following the offering of convertible notes. Our substantial indebtedness could adversely affect our business, financial condition and results of operations and our ability to meet our payment obligations under the notes and or other debt.***

Following the offering of convertible notes in October 2006, we had a significant amount of debt and substantial debt service requirements. As of December 31, 2006, we had \$239.9 million of outstanding debt, including \$230 million senior convertible notes. In addition, \$50.9 million is available for future borrowings under our principal U.S. credit facility, and we are permitted under the terms of our debt agreements to incur substantial additional debt.

This level of debt could have significant consequences on our future operations, including:

- Ø making it more difficult for us to meet our payment and other obligations under the notes and our other outstanding debt;
- Ø resulting in an event of default if we fail to comply with the financial and other restrictive covenants contained in our debt agreements, which event of default could result in all of our debt becoming immediately due and payable and, in the case of an event of default under our secured debt, such as our senior secured credit facility, could permit the lenders to foreclose on our assets securing that debt;
- Ø reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate purposes, and limiting our ability to obtain additional financing for these purposes;
- Ø subjecting us to the risk of increased sensitivity to interest rate increases on our indebtedness with variable interest rates, including borrowings under senior secured credit facility;
- Ø limiting our flexibility in planning for, or reacting to, and increasing our vulnerability to, changes in our business, the industry in which we operate and the general economy; and
- Ø placing us at a competitive disadvantage compared to our competitors that have less debt or are less leveraged.

Any of the above-listed factors could have an adverse effect on our business, financial condition and results of operations and our ability to meet our payment obligations under the notes and our other debt.

***If we fail to maintain an effective system of internal controls or discover material weaknesses in our internal controls over financial reporting, we may not be able to report our financial results accurately or detect fraud, which could harm our business and the trading price of our Common Stock.***

Effective internal controls are necessary for us to produce reliable financial reports and are important in our effort to prevent financial fraud. We are required to periodically evaluate the effectiveness of the design and operation of our internal controls. These evaluations may result in the conclusion that enhancements, modifications or changes to our internal controls are necessary or desirable. While management evaluates the effectiveness of our internal controls on a regular basis, these controls may not always be effective. There are inherent limitations on the effectiveness of internal controls including collusion, management override, and failure of human judgment. Because of this, control procedures are designed to reduce rather than eliminate business risks. If we fail to maintain an effective system of internal controls or if management or our independent registered public accounting firm were to discover material weaknesses in our internal controls, we may be unable to produce reliable financial reports or prevent fraud and it could harm our financial condition and results of operations and result in loss of investor confidence and a decline in our stock price.

***Terrorist attacks, or threats or occurrences of other terrorist activities whether in the United States or internationally may affect the markets in which our Common Stock trades, the markets in which we operate and our profitability.***

Terrorist attacks, or threats or occurrences of other terrorist or related activities, whether in the United States or internationally, may affect the markets in which our Common Stock trades, the markets in which we operate and our profitability. Future terrorist or related activities could affect our domestic and international sales, disrupt our supply chains and impair our ability to produce and deliver our products. Such activities could affect our physical facilities or those of our suppliers or customers. Such terrorist attacks could cause ports or airports to or through which we ship to be shut down, thereby preventing the delivery of raw materials and finished goods to or from our manufacturing facilities in Shanghai, China, Taiwan or Kansas City, Missouri, or to our regional sales offices. Due to the broad and uncertain effects that terrorist attacks have had on financial and economic markets generally, we cannot provide any estimate of how these activities might affect our future results.

### **RISKS RELATED TO OUR INTERNATIONAL OPERATIONS**

***Our international operations subject us to risks that could adversely affect our operations.***

We expect net sales from foreign markets to continue to represent a significant portion of our total net sales. In addition, the majority of our manufacturing facilities are located overseas in China. In 2005 and 2006, net sales to customers outside the United States represented 74.4% and 77.8%, respectively, of our net sales. There are risks inherent in doing business internationally, and any or all of the following factors could cause harm to our business:

- Ø changes in, or impositions of, legislative or regulatory requirements, including tax laws in the United States and in the countries in which we manufacture or sell our products;
- Ø compliance with trade or other laws in a variety of jurisdictions;
- Ø trade restrictions, transportation delays, work stoppages, and economic and political instability;
- Ø changes in import/export regulations, tariffs and freight rates;
- Ø difficulties in collecting receivables and enforcing contracts;
- Ø currency exchange rate fluctuations;
- Ø restrictions on the transfer of funds from foreign subsidiaries to the United States;
- Ø the possibility of international conflict, particularly between or among China and Taiwan and the United States;
- Ø legal regulatory, political and cultural differences among the countries in which we do business;
- Ø longer customer payment terms; and
- Ø changes in U.S. or foreign tax regulations.

***We have significant operations and assets in China, Taiwan and Hong Kong and, as a result, will be subject to risks inherent in doing business in those jurisdictions, which may adversely affect our financial performance.***

We have a significant portion of our assets in mainland China, Taiwan and Hong Kong. Our ability to operate in China, Taiwan and Hong Kong may be adversely affected by changes in those jurisdictions' laws and regulations, including those relating to taxation, import and export tariffs, environmental regulations, land use rights, property and other matters. In addition, our results of operations in China, Taiwan and Hong Kong are subject to the economic and political situation there. We believe that our operations in China, Taiwan and Hong Kong are in compliance with all applicable legal and regulatory requirements. However, the central or local governments of these jurisdictions may impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures and efforts on our part to ensure our compliance with such regulations or interpretations.

Changes in the political environment or government policies in those jurisdictions could result in revisions to laws or regulations or their interpretation and enforcement, increased taxation, restrictions on imports, import duties or currency revaluations. In addition, a significant destabilization of relations between or among China, Taiwan or Hong Kong and the United States could result in restrictions or prohibitions on our operations or the sale of our products or the forfeiture of our assets in these jurisdictions. There can be no certainty as to the application of the laws and regulations of these jurisdictions in particular instances. Enforcement of existing laws or agreements may be sporadic and implementation and interpretation of laws inconsistent. Moreover, there is a high degree of fragmentation among regulatory authorities, resulting in uncertainties as to which authorities have jurisdiction over particular parties or transactions. The possibility of political conflict between these countries or with the United States could have an adverse impact upon our ability to transact business in these jurisdictions and to generate profits.

***We are subject to foreign currency risk as a result of our international operations.***

We face exposure to adverse movements in foreign currency exchange rates, primarily Asian currencies and, to a lesser extent, the Euro. For example, many of our employees who are located in China, are paid in the Chinese Yuan and, accordingly, an increase in the value of the Yuan compared to the U.S. dollar could increase our operating expenses. In addition, we sell our products in various currencies and, accordingly, a decline in the value of any such currency against the U.S. dollar, which is our primary functional currency, could create a decrease in our net sales. Our foreign currency risk may change over time as the level of activity in foreign markets grows and could have an adverse impact upon our financial results. These currencies are principally the Chinese Yuan, the Taiwanese dollar, the Japanese Yen, the Euro and the Hong Kong dollar. The Chinese government has recently taken action to permit the Yuan to U.S. dollar exchange rate to fluctuate, which may exacerbate our exposure to foreign currency risk and harm our results of operations. We do not usually employ hedging techniques designed to mitigate foreign currency exposures and, therefore, we could experience currency losses as these currencies fluctuate against the U.S. dollar.

***We may not continue to receive preferential tax treatment in Asia, thereby increasing our income tax expense and reducing our net income.***

As an incentive for establishing our manufacturing subsidiaries in China, we receive preferential tax treatment. In addition, in conjunction with the acquisition of Anachip, we also receive preferential tax treatment in Taiwan. Governmental changes in foreign tax law may cause us not to be able to continue receiving these preferential tax treatments in the future, which may cause an increase in our income tax expense, thereby reducing our net income.

***The distribution of any earnings of our foreign subsidiaries to the United States may be subject to U.S. income taxes, thus reducing our net income.***

We are currently planning, and may in the future plan, to distribute earnings of our foreign subsidiaries from Asia to the United States. We may be required to pay U.S. income taxes on these earnings to the extent we have not previously recorded deferred U.S. taxes on such earnings. Any such taxes would reduce our net income in the period in which these earnings are distributed.

On October 22, 2004, the American Jobs Creation Act, or AJCA, was signed into law. Among other items, the AJCA establishes a phased repeal of the extraterritorial income exclusion, a new incentive tax deduction for U.S. corporations to repatriate cash from foreign subsidiaries equal to 85% of cash dividends received in the year elected that exceeds a base-period amount, and significantly revises the taxation of U.S. companies doing business abroad.

At December 31, 2004, we made a minimum estimate for repatriating cash from our subsidiaries in China and Hong Kong of \$8.0 million under the AJCA, and recorded an income tax expense of approximately \$1.3 million. Under the guidelines of the AJCA, we developed a required domestic reinvestment plan, covering items such as U.S. bank debt repayment, U.S. capital expenditures and U.S. research and development activities, among others, to cover the dividend repatriation. During 2005, we completed a quantitative analysis of the benefits of the AJCA, the foreign tax credit implications, and state and local tax consequences of the impact of the AJCA on our plans for repatriation. Based on the analysis, we repatriated \$24.0 million from our foreign subsidiaries in 2005.

We are evaluating the need to provide additional deferred taxes for the future earnings of our foreign subsidiaries to the extent such earnings may be appropriated for distribution to our corporate offices in North America, and as further investment strategies with respect to foreign earnings are determined. The distribution of any unappropriated funds from our foreign subsidiaries to the U.S. will require the recording of income tax provisions on the U.S. entity, thus reducing net income. As of December 31, 2006, we have recorded approximately \$3.3 million in deferred taxes for earnings of our foreign subsidiaries.

**RISKS RELATED TO OUR COMMON STOCK**

*Variations in our quarterly operating results may cause our stock price to be volatile.*

We may experience substantial variations in net sales, gross profit margin and operating results from quarter to quarter. We believe that the factors that influence this variability of quarterly results include:

- Ø general economic conditions in the countries where we sell our products;
- Ø seasonality and variability in the computing and communications market and our other end-markets;
- Ø the timing of our and our competitors' new product introductions;
- Ø product obsolescence;

Ø the scheduling, rescheduling and cancellation of large orders by our customers;

Ø the cyclical nature of demand for our customers' products;

Ø our ability to develop new process technologies and achieve volume production at our fabrication facilities;

Ø changes in manufacturing yields;

Ø changes in gross profit margins due to the Anachip or APD acquisitions;

Ø adverse movements in exchange rates, interest rates or tax rates; and

Ø the availability of adequate supply commitments from our outside suppliers or subcontractors.

Accordingly, a comparison of our results of operations from period to period is not necessarily meaningful to investors and our results of operations for any period do not necessarily indicate future performance. Variations in our quarterly results may trigger volatile changes in our stock price.

***We may enter into future acquisitions and take certain actions in connection with such acquisitions that could affect the price of our Common Stock.***

As part of our growth strategy, we expect to review acquisition prospects that would implement our vertical integration strategy or offer other growth opportunities. While we do not currently have any agreements or commitments in place with respect to any material acquisitions, we are in various stages of preliminary discussions, and we may acquire businesses, products or technologies in the future. In the event of future acquisitions, we could:

Ø use a significant portion of our available cash;

Ø issue equity securities, which would dilute current stockholders' percentage ownership;

Ø incur substantial debt;

Ø incur or assume contingent liabilities, known or unknown;

Ø incur amortization expenses related to intangibles; and

Ø incur large, immediate accounting write-offs.

Such actions by us could harm our results from operations and adversely affect the price of our Common Stock.

***Our directors, executive officers and significant stockholders hold a substantial portion of our Common Stock, which may lead to conflicts with other stockholders over corporate transactions and other corporate matters.***

Our directors, executive officers and our affiliate, LSC, beneficially own approximately 29.7% of our outstanding Common Stock, including options to purchase shares of our Common Stock that are exercisable within 60 days of December 31, 2006. These stockholders, acting together, will be able to influence significantly all matters requiring stockholder approval, including the election of directors and significant corporate transactions such as mergers or other business combinations. This control may delay, deter or prevent a third party from acquiring or merging with us, which could adversely affect the market price of our Common Stock.

LSC, our largest stockholder, owns approximately 22.3% (5.8 million shares) of our Common Stock. Some of our directors and executive officers may have potential conflicts of interest because of their positions with LSC or their ownership of LSC Common Stock. Some of our directors are LSC directors and officers, and our non-employee Chairman of our Board of Directors is Chairman of the board of LSC. Several of our directors and executive officers own LSC Common Stock and hold options to purchase LSC Common Stock. Service on our Board of Directors and as a director or officer of LSC, or ownership of LSC Common Stock by our directors and executive officers, could create, or appear to create, actual or potential conflicts of interest when directors and officers are faced with decisions that could have different implications for LSC and us. For example, potential conflicts could arise in connection with decisions involving the Common Stock owned by LSC, or under the other agreements we may enter into with LSC. LSC was our largest external supplier of discrete semiconductor products for subsequent sale by us. In 2005 and 2006, approximately 14.7% and 13.0%, respectively, of our net sales were from products manufactured by LSC. In addition to being our largest external supplier of finished products in each of these periods, we sold silicon wafers to LSC totaling 9.6% and 6.5%, respectively, of our net sales during such periods, making LSC our largest customer.

We may have difficulty resolving any potential conflicts of interest with LSC, and even if we do, the resolution may be less favorable than if we were dealing with an entirely unrelated third party.



***We were formed in 1959, and our early corporate records are incomplete. As a result, we may have difficulty in assessing and defending against claims relating to rights to our Common Stock purporting to arise during periods for which our records are incomplete.***

We were formed in 1959 under the laws of California and reincorporated in Delaware in 1969. We have had several transfer agents over the past 47 years. In addition, our early corporate records, including our stock ledger, are incomplete. As a result, we may have difficulty in assessing and defending against claims relating to rights to our Common Stock purporting to arise during periods for which our records are incomplete.

***Conversion of our convertible senior notes will dilute the ownership interest of existing stockholders, including holders who had previously converted their notes.***

To the extent we issue Common Stock upon conversion of the notes, the conversion of some or all of the notes will dilute the ownership interests of existing stockholders, including holders who have received Common Stock upon prior conversion of the notes. Any sales in the public market of the Common Stock issuable upon such conversion could adversely affect prevailing market prices of our Common Stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could depress the price of our Common Stock.

***The repurchase rights and the increased conversion rate triggered by a make-whole fundamental change could discourage a potential acquirer.***

If a “fundamental change” in accordance with the terms of the senior convertible notes were to occur, the holders of the notes have the right to require us to repurchase the notes. A fundamental change would include a change in control of the Company. In addition, if a make-whole fundamental change were to occur, which may include an acquisition of the Company, the conversion rate for the senior convertible notes will increase. The repurchase rights in our senior convertible notes triggered by a fundamental change and the increased conversion rate triggered by a make-whole fundamental change could discourage a potential acquirer.

***Anti-takeover effects of certain provisions of Delaware law and our Certificate of Incorporation and By-laws.***

Some provisions of Delaware law, our certificate of incorporation and by-laws may be deemed to have an anti-takeover effect and may delay or prevent a tender offer to takeover attempt that a stockholder might consider in its best interest, including those attempts that might result in a premium over the market price for the shares held by stockholders.

#### ***Section 203 of Delaware General Corporation Law***

Section 203 of the Delaware General Corporation Law prohibits transactions between a Delaware corporation and an “interested stockholder,” which is defined as a person who, together with any affiliates or associates, beneficially owns, directly or indirectly, 15.0% or more of the outstanding voting shares of a Delaware corporation. This provision prohibits certain business combinations between an interested stockholder and a Delaware corporation for a period of three years after the date the stockholder becomes an interested stockholder, unless:

- (i) either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder is approved by the corporation’s board of directors prior to the date the interested stockholder becomes an interested stockholder;
- (ii) the interested stockholder acquired at least 85.0% of the voting stock of the corporation (other than stock held by directors who are also officers or be certain employee stock plans) in the transaction in which the stockholder became

an interested stockholder; or

(iii) the business combination is approved by a majority of the board of directors and by the affirmative vote of 66.66% of the outstanding voting stock that is not owned by the interested stockholder.

For this purpose, business combinations include mergers, consolidations, sales or other dispositions of assets having an aggregate value in excess of 10.0% of the aggregate market value of the consolidated assets or outstanding stock of the corporation, and certain transactions that would increase the interested stockholder's proportionate share ownership in the corporation.

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***Certificate of Incorporation and Bylaw Provisions***

Provisions of our certificate of incorporation and bylaws may have the effect of making it more difficult for a third party to acquire control of our company. In particular, our bylaws authorize our Board of Directors to issue, without further action by the stockholders, up to 1,000,000 shares of undesignated preferred stock with rights and preferences, including voting rights, designated from time to time by the board of directors. The existence of authorized but unissued shares of preferred stock enables our board of directors to render more difficult or to discourage an attempt to obtain control of us by means of a merger, tender offer, proxy contest or otherwise.

**Item 1B. Unresolved Staff Comments**

None

**Item 2. Properties**

Our primary physical properties at December 31, 2006, were as follows:

| Use                                  | Address   | Owned /<br>Leased<br>Expiration | Approximate<br>size<br>(sq. ft.) | Approximate<br>Rental / Mo |
|--------------------------------------|---|---------------------------------|----------------------------------|----------------------------|
| Headquarters and distribution center | 3050 East Hillcrest Drive, Suite 200,<br>Westlake Village, California, USA<br>91362 | Leased<br>Dec, 2009             | 31,000                           | \$ 29,000                  |
| Sales office, R&D center             | 780 Montague Express Way, Suite 201,<br>San Jose, CA 95131                          | Leased<br>Jan, 2010             | 4,000                            | \$ 5,000                   |
| R&D center                           | 15660 N. Dallas Parkway, Suite 850,<br>Dallas, TX 75248                             | Leased<br>Dec, 2011             | 6,000                            | \$ 8,000                   |
| Sales office                         | One Overlook Drive, Suite 8,<br>Amherst, NH 03031                                   | Leased<br>Monthly               | *                                | *                          |
| Sales office                         | 160-D Ease Wend, Lemont, IL<br>60439  | Leased<br>Monthly               | *                                | *                          |
| Sales office                         | 18430 Brookhurst Street, Suite 201A,<br>Fountain Valley, CA 92708                   | Leased<br>Monthly               | *                                | *                          |
| Sales office                         | 199 Route 13, Brookline, NH<br>03033  | Leased<br>Monthly               | *                                | *                          |
| Sales office                         | 22 Avenue Paul Sejourne F-31000<br>Toulouse, France                                 | Leased<br>Monthly               | *                                | *                          |
| Manufacturing facility               | 777 N. Blue Parkway Suite 350,<br>Lee's   | Leased<br>Jun, 2013             | 70,000                           | \$ 117,000                 |

## Summit, MO 64086

|                        |   |              |               |   |
|------------------------|---|--------------|---------------|---|
| Warehouse              | 2nd Flr, 501-15, Chung-Cheng,<br>Hsin-Tien City,<br>Taipei, Taiwan, ROC | <b>Owned</b> | <b>5,000</b>  | - |
| Warehouse              | 5th Flr, 501-16, Chung-Cheng,<br>Hsin-Tien City,<br>Taipei, Taiwan, ROC | <b>Owned</b> | <b>7,000</b>  | - |
| Sales office           | 7F, No. 50, Min-Quan Road,<br>Hsin-Tien City,<br>Taipei, Taiwan         | <b>Owned</b> | <b>11,000</b> | - |
| Administrative offices | 5F, No.52, Min-Quan Road,<br>Hsin-Tien City,<br>Taipei, Taiwan          | <b>Owned</b> | <b>12,000</b> | - |
| Administrative offices | 7F, No. 52, Min-Quan Road,<br>Hsin-Tien City,<br>Taipei, Taiwan         | <b>Owned</b> | <b>12,000</b> | - |

*Continued*

*Properties continued*

| Use   | Address  | Owned /<br>Leased<br>Expiration | Approximate<br>size<br>(sq. ft.) | Approximate<br>Rental / Mo |
|---|--|---------------------------------|----------------------------------|----------------------------|
| Warehouse                                     | Room B, 3F, Chuan Hing Building, No. 14 Wang Tai Road, Kowloon Bay, Hong Kong    | Leased<br>May, 2008             | 10,000                           | \$ 9,000                   |
| Manufacturing facility                        | 2F, 24-2 Gongyedong 4th Road, Hsinchu Science Park, Hsin Chu 230077, Taiwan ROC  | Leased<br>Jul, 2007             | 31,000                           | \$ 20,000                  |
| Manufacturing facility                        | 5F, No. 2 Gongyedong 4th Road, Hsinchu Science Park, Hsin Chu 230077, Taiwan ROC | Leased<br>Jul, 2007             | 19,000                           | \$ 12,000                  |
| Office  | F Room, 15F, No. 30 Chung Cheng 2nd Road, Kaoshung City                          | Leased<br>Dec, 2007             | 1,000                            | *                          |
| Manufacturing facility, products distribution | 999 ChenChun Road, Xinqiao Town, SonJiang County, Shanghai, China                | Leased<br>Jan, 2017             | 145,000                          | \$ 67,000                  |
| Manufacturing facility, products distribution | 1F, 18 Lane, SanZhuang Road, SongJiang export zone, Shanghai, China              | Leased<br>Jun, 2009             | 112,000                          | \$ 37,000                  |
| Shanghai sales office                         | Room 606, No. 1158, Changning Road, Shanghai, China                              | Leased<br>Aug, 2008             | 4,000                            | \$ 4,300                   |
| ShenZhen sales office                         | Room A1103-04, Anlian Plaza # 2222, Jintian Road, Futian CBD, ShenZhen, China    | Leased<br>Apr, 2012             | 5,000                            | \$ 6,000                   |

\* Size is less than 1,000 square feet and/or monthly rental is less than \$1,000.

We believe our current facilities are adequate for the foreseeable future. See “Property, Plant and Equipment” and “Commitments and Contingencies” in “Notes to Consolidated Financial Statements.”

### **Item 3. Legal Proceedings**

We are, from time to time, involved in litigation incidental to the conduct of our business. We do not believe we are currently a party to any material pending litigation.

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

No matter was submitted by us to a vote of security holders during the fourth quarter of 2006.

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## PART II

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

Our Common Stock is traded on the Nasdaq Global Select Market ("NasdaqGS") under the symbol "DIOD." Until June 19, 2000, our Common Stock was traded on the American Stock Exchange ("AMEX") under the symbol "DIO." In July 2000, November 2003, and December 2005, we effected 50% stock dividends in the form of three-for-two stock splits. The following table shows the range of high and low closing sales prices per share, adjusted for the three-for-two stock splits, for our Common Stock for each fiscal quarter from January 1, 2005 as reported by Nasdaq.

| Calendar Quarter Ended                    | Closing Sales Price of Common Stock |          |
|---|-------------------------------------|----------|
|   | High                                | Low      |
| First quarter (through February 26, 2007) | \$ 40.41                            | \$ 32.83 |
| Fourth quarter 2006                       | 45.35                               | 35.48    |
| Third quarter 2006                        | 45.99                               | 32.56    |
| Second quarter 2006                       | 43.62                               | 32.54    |
| First quarter 2006                        | 41.50                               | 32.46    |
| Fourth quarter 2005                       | 34.94                               | 23.09    |
| Third quarter 2005                        | 25.93                               | 20.63    |
| Second quarter 2005                       | 22.34                               | 16.79    |
| First quarter 2005                        | 18.31                               | 13.05    |

On February 26, 2007, the closing sales price of our Common Stock as reported by NasdaqGS was \$39.37, and there were approximately 600 holders of record of our Common Stock.

We have never declared or paid cash dividends on our Common Stock. Our credit agreement permits us to pay dividends to our stockholders to the extent that any such dividends declared or paid in any fiscal year do not exceed an amount equal to 50% of our net profit after taxes for such fiscal year. The payment of dividends is within the discretion of our Board of Directors, and will depend upon, among other things, our earnings, financial condition, capital requirements, and general business conditions. There have been no stock repurchases in our history.

## Performance Graph

Set forth below is a line graph comparing the yearly percentage change in the cumulative total stockholder return of our Common Stock against the cumulative total return of the Nasdaq Composite and the Nasdaq Industrial Index for the five calendar years ending December 31, 2006. The graph is not necessarily indicative of future price performance.

*The graph shall not be deemed incorporated by reference by any general statement incorporating by reference this Annual Report into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such Acts.*

Source: CTA Integrated Communications. Data from ReutersBRIDGE Data Networks

The graph assumes \$100 invested on December 31, 2001 in our Common Stock, the stock of the companies in the Nasdaq Composite Index and the Nasdaq Industrial Index, and that all dividends received within a quarter, if any, were reinvested in that quarter.



**Item 6. Selected Financial Data**

The following selected consolidated financial data for the fiscal years ended December 31, 2002 through 2006 is qualified in its entirety by, and should be read in conjunction with, the other information and consolidated financial statements, including the notes thereto, appearing elsewhere herein. Certain amounts as presented in the accompanying consolidated financial statements have been reclassified to conform to 2006 financial statement presentation. These reclassifications had no impact on previously reported net income or stockholders' equity.

| (In thousands, except per share data)<br><i>Income Statement Data</i> | <b>Year Ended December 31,</b> |             |             |             |                   |
|---|--------------------------------|-------------|-------------|-------------|-------------------|
|   | <b>2002</b>                    | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b>       |
| Net sales   | \$ 115,821                     | \$ 136,905  | \$ 185,703  | \$ 214,765  | \$ <b>343,308</b> |
| Gross profit  | 26,710                         | 36,528      | 60,735      | 74,377      | <b>113,892</b>    |
| Selling, general and administrative expenses                          | 16,228                         | 19,586      | 23,503      | 30,285      | <b>47,945</b>     |
| Research and development expenses                                     | 1,472                          | 2,049       | 3,422       | 3,713       | <b>8,317</b>      |
| Loss (gain) on sales and impairment of fixed assets                   | 43                             | 1,037       | 14          | (102)       | <b>152</b>        |
| Income from operations  | 8,967                          | 13,856      | 33,796      | 40,481      | <b>57,478</b>     |
| Interest income (expense), net  | (1,183)                        | (860)       | (637)       | 221         | <b>5,117</b>      |
| Other income (expense)  | 67                             | (5)         | (418)       | 406         | <b>(1,474)</b>    |
| Income before taxes and minority interest                             | 7,851                          | 12,991      | 32,741      | 41,108      | <b>61,121</b>     |
| Income tax provision  | 1,729                          | 2,460       | 6,514       | 6,685       | <b>11,689</b>     |
| Minority interest in joint venture                                    | (320)                          | (436)       | (676)       | (1,094)     | <b>(1,289)</b>    |
| Net income  | 5,802                          | 10,095      | 25,551      | 33,329      | <b>48,143</b>     |
| Earnings per share: <sup>(1)</sup>                                    |                                |             |             |             |                   |
| Basic   | \$ 0.32                        | \$ 0.53     | \$ 1.27     | \$ 1.44     | \$ <b>1.88</b>    |
| Diluted   | \$ 0.29                        | \$ 0.47     | \$ 1.10     | \$ 1.29     | \$ <b>1.74</b>    |
| Number of shares used in computation <sup>(1)</sup>                   |                                |             |             |             |                   |
| Basic   | 18,415                         | 19,096      | 20,106      | 23,168      | <b>25,628</b>     |
| Diluted   | 19,946                         | 21,609      | 23,207      | 25,894      | <b>27,668</b>     |

| <i>Balance Sheet Data</i> | As of December 31, |            |            |            |            |
|---------------------------|--------------------|------------|------------|------------|------------|
|                           | 2002               | 2003       | 2004       | 2005       | 2006       |
| Total assets              | \$ 105,010         | \$ 123,795 | \$ 167,801 | \$ 289,515 | \$ 622,139 |
| Working capital           | 20,831             | 27,154     | 49,571     | 146,651    | 395,354    |
| Long-term debt            | 18,417             | 12,583     | 11,347     | 9,486      | 239,917    |
| Stockholders' equity      | 57,678             | 71,450     | 112,148    | 225,474    | 294,167    |

<sup>(1)</sup> Adjusted for the effect of 3-for-2 stock splits in July 2000, November 2003, and December 2005.

2006 data includes \$5.3 million, or \$0.15 per diluted share, of non-cash, stock option compensation expense as per SFAS No. 123R.

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

*The following discussion of the Company's financial condition and results of operations should be read together with the consolidated financial statements and the notes to consolidated financial statements included elsewhere in this Form 10-K.*

*The following discussion contains forward-looking statements and information relating to our Company. We generally identify forward-looking statements by the use of terminology such as "may," "will," "could," "should," "potential," "continue," "expect," "intend," "plan," "estimate," "anticipate," "believe," "project," or similar phrases or the negatives of such terms. We base these statements on our beliefs as well as assumptions we made using information currently available to us. Such statements are subject to risks, uncertainties and assumptions, including those identified in "Item 1A. Risk Factors," as well as other matters not yet known to us or not currently considered material by us. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected. Given these risks and uncertainties, prospective investors are cautioned not to place undue reliance on such forward-looking statements. Forward-looking statements do not guarantee future performance and should not be considered as statements of fact.*

*You should not unduly rely on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise. The Private Securities Litigation Reform Act of 1995 (the "Act") provides certain "safe harbor" provisions for forward-looking statements. All forward-looking statements made on this Annual Report on Form 10-K are made pursuant to the Act.*

### **Overview**

We are global supplier of low pin-count standard semiconductor products. These products have 8 pins or less and include small signal transistors, MOSFETs, thyristor surge protection devices, transient voltage protection devices, Hall sensors, power management products, programmable logic arrays, diodes, rectifiers, bridges, and silicon wafer. We design, manufacture and market discrete semiconductors focused on diverse end-use applications in the consumer electronics, computing, industrial, communications and automotive sectors. Semiconductors, which provide electronic signal amplification and switching functions, are basic building-block electronic components that are incorporated into almost every electronic device. We believe that our product focus provides us with a meaningful competitive advantage relative to broad line semiconductor companies that provide a wider range of semiconductor products.

We are headquartered in Westlake Village, California, near Los Angeles. We have two manufacturing facilities located in Shanghai, China, one manufacturing facility located in Taipei, Taiwan and a wafer fabrication facility in Kansas City, Missouri; and our sales and marketing and logistical centers are located in Taipei, Taiwan; Shanghai and Shenzhen, China; and Hong Kong. We also have regional sales offices or representatives in: Derbyshire, England; Toulouse, France; Frankfurt, Germany; and various cities in the United States.

In 1998, we began to transform our business from the distribution of discrete semiconductors manufactured by others to the design, manufacture and marketing of discrete semiconductor products using our internal manufacturing capabilities. The key elements of our strategy of transforming our business from a distribution-based model to one primarily based on the design and manufacture of proprietary products are:

Ø expanding our manufacturing capacity, including establishing integrated state-of-the-art packaging and testing facilities in Asia, in 1998 and 2004, and acquiring a wafer foundry in the United States in 2000.

Ø

expanding our sales and marketing organization in Asia in order to address the shift of manufacturing of electronics products from the United States to Asia.

Ø establishing our sales and marketing organization in Europe commencing in 2002.

Ø expanding the number of our field application engineers to design our products into specific end-user applications.

In implementing this strategy, the following factors have affected, and, we believe, will continue to affect, our results of operations:

Ø Since 1998, we have experienced increases in the demand for our products, and substantial pressure from our customers and competitors to reduce the selling price of our products. We expect future increases in net income to result primarily from increases in sales volume and improvements in product mix in order to offset reduced average selling prices of our products.

- Ø In 2005 and 2006, 15.3% and 27.3%, respectively, of our net sales were derived from products introduced within the last three years, which we term “new products,” compared to 14.3% in 2004. New products generally have gross profit margins that are significantly higher than the margins of our standard products. We expect net sales derived from new products to increase in absolute terms, although our net sales of new products as a percentage of our net sales will depend on the demand for our standard products, as well as our product mix.
- Ø Our gross profit margin was 33.2% in 2006, compared to 34.6% in 2005 and 32.7% in 2004. Our gross profit margin decrease in 2006 was due to the lower gross margin (approximately 25%) related to the acquisition of the analog product line. We will continue to move the analog product to our China manufacturing facilities to increase the gross margin on this product line. Future gross profit margins will depend primarily on our product mix, cost savings, and the demand for our products.
  - Ø As of December 31, 2006, we had invested approximately \$127.2 million in our Asian manufacturing facilities. During 2006, we invested approximately \$33.6 million in our Asian manufacturing facilities and we expect to continue to invest in our manufacturing facilities, although the amount to be invested will depend on product demand and new product developments.
- Ø During 2006, the percentage of our net sales derived from our Asian subsidiaries was 71.9%, compared to 65.4% in 2005 and 55.5% in 2004. We expect our net sales to the Asian market to continue to increase as a percentage of our total net sales for 2007 and beyond as a result of the continuing shift of the manufacture of electronic products from the United States to Asia.
- Ø We have increased our investment in research and development from \$3.7 million in 2005 to \$8.3 million in 2006. We continue to seek to hire qualified engineers who fit our focus on proprietary semiconductor processes and packaging technologies. Our goal is to expand research and development expenses to approximately 2-3% of net sales, which will enable us to bring additional proprietary devices to the market.

During 2005, we sold 2,125,000 shares of our Common Stock in a follow-on public offering, raising approximately \$71.7 million (net of commissions and expenses). We used approximately \$31 million of the net proceeds in connection with the Anachip acquisition and we intend to use the remaining net proceeds from this offering for working capital and other general corporate purposes, including acquisitions.

On October 12, 2006, we issued and sold convertible senior notes with an aggregate principal amount of \$230 million due 2026 (“Notes”), which pay 2.25% interest per annum on the principal amount of the Notes, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on April 1, 2007. The Notes will be convertible into cash or, at our option, cash and shares of our Common Stock based on an initial conversion rate, subject to adjustment, of 17.0946 shares per \$1,000 principal amount of Notes (which represents an initial conversion price of \$58.50 per share), in certain circumstances. In addition, following a “make-whole fundamental change” that occurs prior to October 1, 2011, we will, at our option, increase the conversion rate for a holder who elects to convert its Notes in connection with such “make-whole fundamental change,” in certain circumstances. We intend to use the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments, or additional purchases of Common Stock.

As part of our growth strategy, in December 2005, we announced the acquisition of Anachip, a fabless Taiwanese semiconductor company focused on analog ICs designed for specific applications. The acquisition, which closed on January 10, 2006, fits in the center of our long-term strategy. Anachip’s main product focus is Power Management ICs. The analog devices they produce are used in LCD monitor/TVs, wireless LAN 802.11 access points, brushless DC motor fans, portable DVD players, datacom devices, ADSL modems, TV/satellite set-top boxes, and power supplies. Anachip brings a design team with strong capabilities in a range of targeted analog and power management technologies. This acquisition also shows our disciplined approach to making acquisitions. We paid \$30.8 million to

acquire Anachip and the acquisition was accretive to our 2006 earnings.

On November 3, 2006, we completed the purchase of the assets of APD Semiconductor, a privately held U.S.-based fabless semiconductor company. Headquartered in Redwood City, California, APD's main product focus is its patented and trademarked Super Barrier Rectifier™ (SBR™) technology. The purchase price of the acquisition was \$8.4 million in addition to a potential earn-out provision with respect to pre-defined covered products. Revenue generated from APD technologies was approximately \$500,000 for year 2006. For 2007, we project the revenue generated from the APD product line to exceed the purchase price and that the acquisition will be accretive. The APD acquisition is aligned with our strategy of strengthening our technology leadership in the standard semiconductor market and expanding our product capabilities across important segments of our end-markets.

## Net Sales

We generate a substantial portion of our net sales through the sale of semiconductor products that are designed and manufactured by third parties or us. We also generate a portion of our net sales from outsourcing our manufacturing capacity to third parties and from the sale of silicon wafers to manufacturers of discrete semiconductor components. We serve customers across diversified industries, including the consumer electronics, computing, industrial, communications and automotive markets.

We recognize revenue from product sales when title to and risk of loss of the product have passed to the customer, there is persuasive evidence of an arrangement, the sale price is fixed or determinable and collection of the related receivable is reasonably assured. These criteria are generally met upon shipment to our customers. Net sales are stated net of reserves for pricing adjustments, discounts, rebates and returns.

The principal factors that have affected or could affect our net sales from period to period are:

- Ø the condition of the economy in general and of the semiconductor industry in particular,
  - Ø our customers' adjustments in their order levels,
  - Ø changes in our pricing policies or the pricing policies of our competitors or suppliers,
    - Ø the termination of key supplier relationships,
    - Ø the rate of introduction to, and acceptance of new products by, our customers,
    - Ø our ability to compete effectively with our current and future competitors,
- Ø our ability to enter into and renew key corporate and strategic relationships with our customers, vendors and strategic alliances,
  - Ø changes in foreign currency exchange rates,
  - Ø a major disruption of our information technology infrastructure; and
- Ø unforeseen catastrophic events, such as armed conflict, terrorism, fires, typhoons and earthquakes.

## Cost of goods sold

Cost of goods sold includes manufacturing costs for our semiconductors and our wafers. These costs include raw materials used in our manufacturing processes as well as the labor costs and overhead expenses. Cost of goods sold is also impacted by yield improvements, capacity utilization and manufacturing efficiencies. In addition, cost of goods sold includes the cost of products that we purchase from other manufacturers and sell to our customers. Cost of goods sold is also affected by inventory obsolescence if our inventory management is not efficient.

## Selling, general and administrative expenses

Selling, general and administrative expenses relate primarily to compensation and associated expenses for personnel in general management, sales and marketing, information technology, engineering, human resources, procurement, planning and finance, and sales commissions, as well as outside legal, accounting and consulting expenses, and other operating expenses. We expect our selling, general and administrative expenses to increase in absolute dollars as we

hire additional personnel and expand our sales, marketing and engineering efforts and information technology infrastructure.

**Research and development expenses**

Research and development expenses consist of compensation and associated costs of employees engaged in research and development projects, as well as materials and equipment used for these projects. Research and development expenses are primarily associated with our wafer facility in Kansas City, Missouri and our manufacturing facilities in China and Taiwan, as well as with our engineers in the U.S. All research and development expenses are expensed as incurred, and we expect our research and development expenses to increase in absolute dollars as we invest in new technologies and product lines.

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### **Interest income/expense**

Interest income consists of interest earned on our cash and investment balances. Interest expense consists of interest payable on our outstanding credit facilities and other debt instruments including the convertible bond.

### **Income tax provision**

Our global presence requires us to pay income taxes in a number of jurisdictions. In general, earnings in the U.S. and Taiwan are currently subject to tax rates of 39.0% and 35.0%, respectively. Earnings of Diodes-Hong Kong are subject to a 17.5% tax for local sales or local source sales; all other Hong Kong sales are not subject to foreign income taxes. Earnings at Diodes-Taiwan and Diodes-Hong Kong are also subject to U.S. taxes with respect to those earnings that are derived from product manufactured by our China subsidiaries and sold to customers outside of Taiwan and Hong Kong, respectively. The U.S. tax rate on these earnings is computed as the difference between the foreign effective tax rates and the U.S. tax rate. In accordance with U.S. tax law, we receive credit against our U.S. federal tax liability for income taxes paid by our foreign subsidiaries. Funds repatriated from foreign subsidiaries to the U.S. may be subject to Federal and state income taxes.

Diodes-China is located in the Songjiang district, where the standard central government tax rate is 24.0%. However, as an incentive for establishing Diodes-China, the earnings of Diodes-China were subject to a 0% tax rate by the central government from 1996 through 2000, and to a 12.0% tax rate from 2001 through 2006. In addition, due to an \$18.5 million permanent re-investment of Diodes-China earnings in 2004, Diodes-China has re-applied to the Chinese government for additional preferential tax treatment on earnings that are generated by this \$18.5 million investment. If approved, those earnings will be exempted from central government income tax for two years, and then subject to a 12.0% tax rate for the following three years.

In addition, the earnings of Diodes-China would ordinarily be subject to a standard local government tax rate of 3.0%. However, as an incentive for establishing Diodes-China, the local government waived this tax from 1996 through 2005. Management expects this tax to be waived for 2006; however, the local government can re-impose this tax at its discretion at any time.

In 2004, we established our second Shanghai-based manufacturing facility, Diodes-Shanghai, located in the Songjiang Export Zone of Shanghai, China. In the Songjiang Export Zone, the central government standard tax rate is 15.0%. From 2010 onward, Diodes-Shanghai earnings might not continue to be subject to the 15% tax rate as a proposed income tax reform is expected to be taking effect in 2007 which could terminate some existing tax incentive for foreign enterprise doing business in China. There is no local government tax. During 2004, Diodes-Shanghai earnings were subject to the standard 15.0% central government tax rate. As an incentive for establishing Diodes-Shanghai, the 2005 and 2006 earnings of Diodes-Shanghai were exempted from central government income tax, and for the years 2007 through 2009 its earnings will be subject to a 7.5% tax rate. From 2010 onward, Diodes-Shanghai earnings might not continue to be subject to the 15% tax rate as a proposed income tax reform is expected to be taking effect in 2007 which could terminate some existing tax incentive for foreign enterprise doing business in China.

With the recently proposed China government income tax reform, which could terminate some existing tax incentives for foreign enterprises doing business in China, it is unclear to what extent our China subsidiaries will continue to receive preferential tax treatment.

As an incentive for the formation of Anachip, earnings of Anachip are subject to a five-year tax holiday (subject to certain qualifications of Taiwanese tax law). In the third quarter of 2006, we elected to begin this five-year tax holiday as of January 1, 2006.

As of December 31, 2006, accumulated and undistributed earnings of Diodes-China and Diodes-Shanghai are approximately \$67.0 million, including \$28.5 million of restricted earnings (which are not available for dividends). Through March 31, 2002, we had not recorded deferred U.S. Federal or state tax liabilities (estimated to be \$8.9 million as of March 31, 2002) on these cumulative earnings since we, at that time, considered this investment to be permanent, and had no plans or obligation to distribute all or part of that amount from China to the U.S. Beginning in April 2002, we began to record deferred taxes on a portion of the China earnings in preparation of a dividend distribution. In the year ended December 31, 2004, we received a dividend of approximately \$5.7 million from our Diodes-China subsidiary, for which the tax effect is included in U.S. Federal and state taxable income.

On October 22, 2004, the President of the United States signed the American Jobs Creation Act (AJCA) into law. Originally intended to repeal the extraterritorial income (ETI) exclusion, which had triggered tariffs by the European Union, the AJCA expanded to cover a wide range of business tax issues. Among other items, the AJCA establishes a phased repeal of the ETI, a new incentive tax deduction for U.S. corporations to repatriate cash from foreign subsidiaries at a reduced tax rate (a deduction equal to 85% of cash dividends received in the year elected that exceeds a base-period amount) and significantly revises the taxation of U.S. companies doing business abroad.

At December 31, 2004, we made a minimum estimate for repatriating cash from our subsidiaries in China and Hong Kong of \$8.0 million under the AJCA, and recorded an income tax expense of approximately \$1.3 million. Under the guidelines of the AJCA, we developed a required domestic reinvestment plan, covering items such as U.S. bank debt repayment, U.S. capital expenditures and U.S. research and development activities, among others, to cover the dividend repatriation. During 2005, we completed a quantitative analysis of the benefits of the AJCA, the foreign tax credit implications, and state and local tax consequences of the impact of the AJCA on our plans for repatriation. Based on the analysis, we repatriated \$24.0 million from our foreign subsidiaries in 2005.

We are evaluating the need to provide additional deferred taxes for the future earnings of our foreign subsidiaries to the extent such earnings may be appropriated for distribution to our corporate office in North America, and as further investment strategies with respect to foreign earnings are determined. The distribution of any unappropriated funds from our foreign subsidiaries to the U.S. will require the recording of income tax provisions on the U.S. entity, thus reducing net income. As of December 31, 2006, we have recorded approximately \$3.3 million in deferred taxes for earnings of our foreign subsidiaries, primarily Diodes-Hong Kong.

## **CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in accordance with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, inventory reserves and income taxes, among others. Our estimates are based upon historical experiences, market trends and financial forecasts and projections, and upon various other assumptions that management believes to be reasonable under the circumstances and at that certain point in time. Actual results may differ, significantly at times, from these estimates under different assumptions or conditions.

We believe the following critical accounting policies and estimates affect the significant estimates and judgments we use in the preparation of our consolidated financial statements, and may involve a higher degree of judgment and complexity than others.

### **Revenue recognition**

We recognize revenue when there is persuasive evidence that an arrangement exists, when delivery has occurred, when our price to the buyer is fixed or determinable and when collectibility of the receivable is reasonably assured. These elements are met when title to the products is passed to the buyers, which is generally when our product is shipped.

We reduce revenue in the period of sale for estimates of product returns, distributor price adjustments and other allowances, the majority of which are related to our North American operations. Our reserve estimates are based upon historical data as well as projections of revenues, distributor inventories, price adjustments, average selling prices and market conditions. Actual returns and adjustments could be significantly different from our estimates and provisions, resulting in an adjustment to revenues.

### **Inventory reserves**

Inventories are stated at the lower of cost or market value. Cost is determined principally by the first-in, first-out method. On an on-going basis, we evaluate our inventory, both finished goods and raw material, for obsolescence and slow-moving items. This evaluation includes analysis of sales levels, sales projections, and purchases by item, as well as raw material usage related to our manufacturing facilities. Based upon this analysis, as well as an inventory aging

analysis, we accrue a reserve for obsolete and slow-moving inventory. If future demand or market conditions are different than our current estimates, an inventory adjustment may be required, and would be reflected in cost of goods sold in the period the revision is made.

**Accounting for income taxes**

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the tax jurisdictions in which we operate. This process involves using an asset and liability approach whereby deferred tax assets and liabilities are recorded for differences in the financial reporting bases and tax bases of our assets and liabilities. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities. We continually evaluate our deferred tax asset as to whether it is likely that the deferred tax assets will be realized. If management ever determined that our deferred tax asset was not likely to be realized, a write-down of the asset would be required and would be reflected as an expense in the accompanying period.

### **Allowance for doubtful accounts**

Management evaluates the collectability of our accounts receivable based upon a combination of factors, including the current business environment and historical experience. If we are aware of a customer's inability to meet its financial obligations to us, we record an allowance to reduce the receivable to the amount we reasonably believe we will be able to collect from the customer. For all other customers, we record an allowance based upon the amount of time the receivables are past due. If actual accounts receivable collections differ from these estimates, an adjustment to the allowance may be necessary with a resulting effect on operating expense.

### **Impairment of long-lived assets**

As of December 31, 2006, goodwill was \$25.0 million (\$4.2 million related to the FabTech acquisition, \$0.9 million related to Diodes-China and \$19.9 million related to Anachip). We account for goodwill in accordance with SFAS No. 142 ("Goodwill and Other Intangible Assets"), for which goodwill is tested for impairment at least annually. We performed the required impairment tests of goodwill and have determined that the goodwill is fully recoverable.

We assess the impairment of long-lived assets, including goodwill, on an on-going basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Our impairment review process is based upon (i) an income approach from a discounted cash flow analysis, which uses our estimates of revenues, costs and expenses, as well as market growth rates, and (ii) a market multiples approach which measures the value of an asset through an analysis of recent sales or offerings or comparable public entities. If ever the carrying value of the goodwill is determined to be less than the fair value of the underlying asset, a write-down of the asset will be required, with the resulting expense charged in the period that the impairment was determined.

### **Share-Based Compensation**

Effective in January 1, 2006, we adopted SFAS No. 123R, "Share-Based Payments," using the modified prospective method. Under SFAS 123R, we are required to select a valuation technique or option-pricing model that meets the criteria as stated in the standard, which includes a binomial model and the Black-Scholes model. At the present time, the Company is continuing to use the Black-Scholes model, consistent with prior period valuations under SFAS 123. No modifications were made to any outstanding share-options prior to the adoption of SFAS 123R.

The adoption of SFAS 123R, applying the "modified prospective method," as elected by us, requires us to value stock options prior to our adoption of SFAS 123 under the fair value method and expense these amounts over the stock options' remaining vesting period. This resulted in the expensing of \$6.5 million in the year ended December 31, 2006, which was recorded within the cost of goods sold expense, general and administrative expense and research and development expense on our condensed consolidated income statement. In addition, SFAS 123R requires us to reflect any tax savings resulting from tax deductions in excess of expense reflected in our financial statements as a financing cash inflow in our statement of cash flows rather than as an operating cash flow as in prior periods (See "Note 13 - Share-based Compensation" for details). We have changed our primary award type to employees from stock options to stock awards as an improved method of employee reward and retention. In general, we increased the vesting period from three years to four years, and reduced the number of shares subject to the award by a factor of three.

We have 567,748 restricted stock grants outstanding as of December 31, 2006. The restricted stock grants will be recorded each quarter as a non-cash operating expense item. As of December 31, 2006, there was \$10.2 million of total unrecognized compensation cost related to non-vested share-based compensation. This cost is expected to be recognized over a weighted-average period of 3.0 years. In the year ended December 31, 2006, an expense of \$1.8 million was recorded. In addition to the expense, the effects of the restricted stock grants are included in the diluted shares outstanding calculation.



## Results of Operations

The following table sets forth, for the periods indicated, the percentage that certain items in the statement of income bear to net sales and the percentage dollar increase (decrease) of such items from period to period.

|   | Percent of Net sales<br>Year Ended December 31, |        |        |        |               | Percentage Dollar Increase (Decrease)<br>Year Ended December 31, |              |             |             |
|---|---|--------|--------|--------|---------------|--|--------------|-------------|-------------|
|   | 2002  | 2003   | 2004   | 2005   | 2006          | '02 to '03   | '03 to '04   | '04 to '05  | '05 to '06  |
| Net sales                                 | 100%  | 100%   | 100%   | 100%   | <b>100%</b>   | 18.2%  | 35.6%        | 15.6%       | 59.9%       |
| Cost of goods sold                        | (76.9)  | (73.3) | (67.3) | (65.4) | <b>(66.8)</b> | 12.6   | 24.5         | 12.3        | 63.4        |
| Gross profit                              | 23.1  | 26.7   | 32.7   | 34.6   | <b>33.2</b>   | 36.8   | 66.3         | 22.5        | 53.1        |
| Operating expenses                        | (15.4)  | (16.6) | (14.5) | (15.8) | <b>(16.4)</b> | 27.8   | 18.8         | 25.8        | 66.4        |
| Income from operations                    | 7.7   | 10.1   | 18.2   | 18.8   | <b>16.7</b>   | 54.5   | 143.9        | 19.8        | 42.0        |
| Interest income (expense)                 | (1.0)   | (0.6)  | (0.3)  | 0.1    | <b>1.5</b>    | (27.3)   | (25.9)       | (134.7)     | 2215.4      |
| Other income (expense)                    | 0.1   | (0.0)  | (0.2)  | 0.2    | <b>(0.4)</b>  | (107.5)  | (8260.0)     | 197.1       | 463.1       |
| Income before taxes and minority interest | 6.8   | 9.5    | 17.6   | 19.1   | <b>17.8</b>   | 65.5   | 152.0        | 25.6        | 48.7        |
| Income tax provision                      | (1.5)   | (1.8)  | (3.5)  | (3.1)  | <b>(3.4)</b>  | 42.3   | 164.8        | 2.6         | 74.9        |
| Minority interest                         | (0.3)   | (0.3)  | (0.4)  | (0.5)  | <b>(0.4)</b>  | 36.3   | 54.9         | 61.8        | 17.8        |
| Net income                                | 5.0   | 7.4    | 13.8   | 15.5   | <b>14.0</b>   | <b>74.0</b>  | <b>153.1</b> | <b>30.4</b> | <b>44.4</b> |

The following discussion explains in greater detail the consolidated financial condition of the Company. This discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere herein. All per share amounts have been adjusted to reflect the three-for-two stock split in December 2005.

### *Year 2006 Compared to Year 2005*

#### Net sales

Net sales for 2006 increase \$128.5 million to \$343.3 million from \$214.8 million for 2005. The 59.9% increase was due primarily to a 42.6% increase in units sold combined with a 12.1% increase in average selling prices (ASP). The

increase in ASP was due to the product lines related to the Anachip and APD acquisitions. The following table sets forth the geographic breakdown of our net sales for the periods indicated based on the country to which the product is shipped:

|               | Net sales for the year<br>ended December 31 |                   | Percentage of<br>Net sales |               |
|---------------|---|-------------------|----------------------------|---------------|
|               | 2005  | 2006              | 2005                       | 2006          |
| China         | \$ 68,050                                   | \$ 118,303        | 31.7%                      | 34.5%         |
| Taiwan        | 59,838                                      | 96,401            | 27.9%                      | 28.1%         |
| United States | 54,981                                      | 76,357            | 25.6%                      | 22.2%         |
| All Others    | 31,896                                      | 52,247            | 14.9%                      | 15.2%         |
| <b>Total</b>  | <b>\$ 214,765</b>                           | <b>\$ 343,308</b> | <b>100.0%</b>              | <b>100.0%</b> |

### Cost of goods sold

Cost of goods sold increased \$89.0 million, or 63.4%, for 2006 compared to \$140.4 million in 2005. As a percent of sales, cost of goods sold increased from 65.4% for 2005 to 66.8% for 2006. Our average unit cost (AUP) for discrete devices decreased approximately 4.4% from 2005, and AUPs for wafer products increased approximately 6.0%. As per SFAS 123R, included in cost of goods sold for 2006 was \$469,000 of non-cash, stock option compensation expense related to our manufacturing facilities.



## **Gross profit**

Gross profit for 2006 increased 53.1% to \$113.9 million from \$74.4 million for 2005. Gross margin as a percentage of net sales was at 33.2% for the year of 2006, down from 34.6% for the year of 2005. The decreased gross margin was primarily due to the lower margin product line related to the Anachip acquisition.

## **Selling, general and administrative expenses**

Selling, general and administrative expenses (SG&A) for 2006 increased approximately \$17.7 million, or 58.3%, compared to \$30.3 million in 2005, due primarily to (i) an approximately \$5.4 million increase associated with non-cash, share-based compensation expense due to our adoption of SFAS 123R, (ii) higher sales commissions, wages and marketing expenses associated with the acquisition of Anachip, and (iii) audit and legal expenses associated with Sarbanes-Oxley Act compliance. SG&A, as a percentage of net sales, was 14.0% in 2006, compared to 14.1% in 2005. Included in SG&A for the year ended December 31, 2006 was an approximate \$620,000 adjustment due to an overstatement of restricted share grant expense recorded in 2005. For comparable purposes, excluding the \$5.4 million of share-based compensation, SG&A for the year ended December 31, 2006 would have improved to 12.4% of total sales.

## **Research and development expenses**

Research and development expenses (R&D) in 2006 increased \$4.6 million to \$8.3 million, or 2.4% of net sales from \$3.7 million, or 1.7% of net sales, in 2005. R&D expenses are primarily related to new product development at the silicon wafer level, and, to a lesser extent, at the packaging level. We continue to seek to hire qualified engineers who fit our focus on next-generation processes and packaging technologies. Our current goal is to maintain R&D at 2-3% of revenue as we continue to bring proprietary technology and advanced devices to the market.

## **Interest income/expense**

Net interest income for 2006 was \$5.1 million compared to net interest income of \$221,000 in 2005, due primarily to interest income earned on proceeds from the offering of convertible notes, as well as to a reduction in our bank loans from \$10.7 million at December 31, 2005 to \$8.5 million at December 31, 2006. Our interest income is generated from interest earned on our \$48.9 million cash balances and \$291.0 million short-term investments. Our interest expense is primarily the \$1.1 million interest payable for \$230 million convertible notes.

## **Other income/loss**

Other loss for the year ended December 31, 2006 was \$1.5 million, compared to other income \$406,000 for the same period of 2005. Included in other expense for the year ended December 31, 2006, was an approximate \$1.1 million one-time, non-cash, prior periods adjustment due to the understatement of intercompany currency exchange losses at our Taiwan subsidiary.

## **Income tax provision**

We recognized income tax expense of \$11.7 million for 2006, resulting in an effective tax rate of 19.1%, as compared to \$6.7 million or 16.3% for the same period in 2005, due primarily to higher income in the U.S. at higher tax rates and accrued dividend related taxes for our foreign subsidiaries.

## **Minority interest in joint venture earnings**

Minority interest in joint venture earnings primarily represented the minority investor's share of the earnings of our China subsidiaries for the period. The joint venture investments were eliminated in the consolidations of our financial statements, and the activities of Diodes-China, Diodes-Shanghai and Diodes-Anachip were included therein. As of December 31, 2006, we had 95% controlling interests in Diodes-China and Diodes-Shanghai, and a 99.81% controlling interest in Diodes-Anachip.

**Net income**

We generated net income of \$48.1 million (or \$1.88 basic earnings per share and \$1.74 diluted earnings per share) for the twelve months ended December 31, 2006. For comparison purposes, excluding \$5.3 million net of tax stock option expenses, pro forma net income was \$53.4 million (or \$2.09 basic earnings per share and \$1.89 diluted earnings per share) for the twelve months ended December 31, 2006, as compared to \$33.3 million (or \$1.44 basic earnings per share and \$1.29 diluted earnings per share) for the same period in 2005.

**Year 2005 Compared to Year 2004****Net sales**

Net sales for 2005 increased \$29.1 million to \$214.8 million from \$185.7 million for 2004. The 15.6% increase was due primarily to an approximately 36.0% increase in units sold as a result of increased end-market demand for our products, partly offset by a 15.0% decrease in ASPs. ASPs for discrete products decreased by 10.7% while ASPs for wafers fell 17.3%. The following table sets forth the geographic breakdown of our net sales for the periods indicated based on the country to which the product is shipped:

|               | Net sales for the year<br>ended December 31 |                   | Percentage of<br>Net sales |               |
|---------------|---|-------------------|----------------------------|---------------|
|               | 2004  | 2005              | 2004                       | 2005          |
| China         | \$ 44,311                                   | \$ 68,050         | 23.9%                      | 31.7%         |
| Taiwan        | 50,716                                      | 59,838            | 27.3%                      | 27.9%         |
| United States | 53,204                                      | 54,981            | 28.7%                      | 25.6%         |
| All Others    | 37,472                                      | 31,896            | 20.2%                      | 14.9%         |
| <b>Total</b>  | <b>\$ 185,703</b>                           | <b>\$ 214,765</b> | <b>100.0%</b>              | <b>100.0%</b> |

**Cost of goods sold**

Cost of goods sold increased \$15.4 million, or 12.3%, for 2005 compared to \$125.0 million in 2004. As a percent of sales, cost of goods sold decreased from 67.3% for 2004 to 65.4% for 2005. Our AUP for discrete devices decreased approximately 14.3% from 2004, and AUPs for wafer products decreased approximately 14.9%. These cost decreases were due primarily to improved manufacturing efficiencies.

**Gross profit**

Gross profit for 2005 increased 22.5% to \$74.4 million from \$60.7 million for 2004. Of the \$13.7 million increase, \$9.6 million was due to the 190 basis point increase in gross profit margin from 32.7% in 2004 to 34.6% in 2005, while \$4.1 million was due to the 22.5% increase in net sales. Gross profit increases in Asia were the primary contributor to the gross profit increase in 2005. The higher gross margin percentage was due primarily to improved product sales mix, increased capacity utilization and manufacturing efficiencies, partially offset by pricing pressure on our wafer products.

**Selling, general and administrative expenses**

SG&A for 2005 increased approximately \$6.8 million, or 28.9%, compared to \$23.5 million 2004, due primarily to (i) a \$1.8 million expense relating to share inducement grants made to our President and Chief Executive Officer, and our Vice Chairman, (ii) higher sales commissions, wages and marketing expenses associated with increased sales and, (iii) consulting, legal and accounting fees primarily associated with Sarbanes-Oxley compliance. SG&A, as a percentage of net sales, was 14.1% in 2005, compared to 12.7% in 2004.

**Research and development expenses**

R&D increased to \$3.7 million, or 1.7% of net sales, in 2005 from \$3.4 million, or 1.8% of net sales, in 2004. R&D expenses are primarily related to new product development at the silicon wafer level, and, to a lesser extent, at the packaging level.



### **Gain on sale of fixed assets**

Gain on sale of fixed assets of \$102,000 for 2005 was due primarily to a gain on the termination of two capital leases in China.

### **Interest income / expense**

Net interest income for 2005 was \$221,000 compared to net interest expense of \$620,000 in 2004, due primarily to interest income earned on proceeds from our public offering of equity securities in 2005, as well as to a reduction in our total debt from \$17.5 million at December 31, 2004 to \$12.5 million at December 31, 2005. Our interest income is generated from interest earned on our cash balances and short-term investments. Our interest expense has been primarily the result of borrowings to finance the FabTech acquisition in 2000, as well as our ongoing investment in, and expansion of, our Diodes-China and Diodes-Shanghai manufacturing facilities.

### **Other income**

Other income for 2005 increased \$824,000 from 2004, due primarily to lower currency exchange losses in Taiwan as well as the expiration of management incentive agreements associated with the FabTech acquisition.

### **Income tax provision**

We recognized income tax expense of \$6.7 million for 2005, resulting in an effective tax rate of 16.3%, as compared to \$6.5 million or 19.9% for the same period in 2004, due primarily to an increase in profits earned in lower tax rate jurisdictions.

### **Minority interest in joint venture earnings**

Minority interest in joint venture earnings represents the minority investor's share of the income of Diodes-China and Diodes-Shanghai (established in 2004). The increase in these subsidiaries' income for the twelve months ended December 31, 2005 is primarily the result of increased sales and manufacturing efficiencies. As of December 31, 2005, we had a 95% controlling interest in each of these subsidiaries.

### **Net income**

We generated net income of \$33.3 million (or \$1.44 basic earnings per share and \$1.29 diluted earnings per share) for the twelve months ended December 31, 2005, as compared to \$25.6 million (or \$1.27 basic earnings per share and \$1.10 diluted earnings per share) for the same period in 2004. This 30.4% increase in net income is due primarily to the 15.6% net sales increase at a gross profit margin of 34.6% for 2005, compared to a gross profit margin of 32.7% in 2004.

### **Financial Condition**

#### ***Liquidity and Capital Resources***

Our primary sources of liquidity are cash, funds from operations and borrowings under our credit facilities. Our primary liquidity requirements have been to meet our inventory and capital expenditure needs. For 2004, 2005 and 2006, our working capital was \$49.6 million, \$146.7 million, and \$395.4 million, respectively. We anticipate our working capital position will be sufficient for at least the next 12 months.

During 2005, we sold 3.2 million (stock split adjusted) shares of our Common Stock in a follow-on public offering, raising approximately \$72 million (net of commissions and expenses). We used approximately \$31 million of the net proceeds in connection with the Anachip acquisition, and we intend to use the remaining net proceeds from this offering for working capital and other general corporate purposes, including additional acquisitions.

On October 12, 2006, we issued and sold convertible senior notes with an aggregate principal amount of \$230 million due 2026 (“Notes”), which pay 2.25% interest per annum on the principal amount of the Notes, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on April 1, 2007. We intend to use the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments, or additional purchases of Common Stock.

In connection with the issuance of the Notes, we incurred approximately \$6.2 million of issuance costs, which primarily consisted of investment banker fees, legal and accounting fees. These costs are classified within Other Assets and are being amortized as a component of interest expense using the straight-line method over the life of the Notes from issuance through October 12, 2011.

In 2004, 2005 and 2006, our capital expenditures were \$26.5 million, \$24.7 million and \$45.1 million, respectively. Our capital expenditures for these periods were primarily related to manufacturing expansion in our facilities in China and, to a lesser extent, our wafer fabrication facility in the United States, and an office building in Taiwan. Excluding this non-production related \$6 million building purchase in Taiwan, the capital expenditures for 2006 were approximately 11.4% of revenue, which is in the range of our 10-12% full-year estimate.

### ***Discussion of cash flows***

Cash and short-term investments have increased from \$19.0 million at December 31, 2004, to \$113.6 million at December 31, 2005, to \$339.9 million at December 31, 2006. The increase from 2004 to 2005 was primarily due to the proceeds from the follow-on offering. During 2006, we increased short-term investments to \$339.9 million from the proceeds of the convertible note offering.

### ***Operating activities***

Net cash provided by operating activities during 2006 was \$72.1 million, resulting primarily from \$48.1 million of net income in this period. Net cash provided by operating activities was \$47.7 million for 2005 and \$20.8 million for 2004. Net cash provided by operations increased by \$24.4 million from 2005 to 2006. This increase resulted primarily from a \$14.8 million increase in our net income (from \$33.3 million in 2005 to \$48.1 million in 2006), \$6.5 million increase in non-cash, share-based compensation expense, and \$4.8 million increase in depreciation and amortization expense, partially offset by increases in inventories, resulting from slower inventory turns, and increases in accounts receivable and prepaid expenses and other assets. We continue to closely monitor our credit terms with our customers, while at times providing extended terms, primarily required by our customers in Asia and Europe.

### ***Investing activities***

Net cash used by investing activities for 2006 was \$325.7 million resulting from capital expenditures of \$45.7 million, including the \$6 million office building purchase in Taiwan, \$250.7 million short-term investments of municipal bonds and \$29.4 million used for acquisitions including the final acquisition payment for Anachip of \$21.0 million (net of cash acquired) and the \$8.4 million APD acquisition payment.

### ***Financing activities***

Net cash provided by financing activities for 2006 was \$229.0 million, resulting primarily from \$224.0 million in net proceeds from the offering of convertible notes and \$4.8 million loan proceeds in Taiwan secured by land and building, offset by \$10.4 million debt repayment. In addition, we received \$4.3 million from stock option exercises in 2006 and \$6.7 million in excess tax benefits related to stock option exercise. Net cash provided by financing activities was \$73.7 million for 2005 and \$10.7 million for 2004. Net cash provided by financing activities for 2005 was \$73.7 million, resulting primarily from \$71.7 million in net proceeds from the offering of equity securities, offset by \$10.9 million in debt repayment. In addition, we received \$4.2 million from stock option exercises in 2005 and \$2.9 million in excess tax benefits related to stock option exercise. Net cash provided by financing activities for 2004 was primarily due to \$5.6 million received in connection with the exercise of stock options and excess tax benefits of \$8.5 million related to stock option exercise, partially offset by \$7.1 million repaid under our debt instruments.

### ***Debt instruments***

On October 12, 2006, we issued \$230 million in aggregate principal convertible senior notes due on October 1, 2026, which pay interest semiannually at a rate of 2.25% per annum. The notes will be convertible, in certain circumstances, into cash up to the principal amount, and any conversion value above the principal amount will be convertible, at our option, into cash or shares of Common Stock, at an initial conversion rate of 17.0946 shares per \$1,000 principal

amount of notes (which represents an initial conversion price of \$58.50 per share). The initial conversion price represents a 39.68% conversion premium, based on the last reported sale price of \$41.88 of our Common Stock on October 5, 2006.

On August 29, 2005, we amended our U.S. credit arrangements with Union Bank of California, N.A. (Union Bank). Under the second amendment to our amended and restated credit agreement, we now have available a revolving credit commitment of up to \$20.0 million, including a \$5.0 million letter of credit sub-facility. In addition, and in connection with this amendment, one of our subsidiaries, FabTech, also amended and restated a term note and related agreement with respect to an existing term loan arrangement, which we refer to as the FabTech term loan. After giving effect to this amendment, the principal amount under the FabTech term loan was increased to \$5.0 million.



The revolving credit commitment expires on August 29, 2008. The FabTech term loan, which amortizes monthly, matures on August 29, 2010. As of December 31, 2006, we had no amounts outstanding under our revolving credit facility, and \$3.7 million was outstanding under the FabTech term loan. Loans to us under our credit facility are guaranteed by FabTech, and in turn, the FabTech term loan is guaranteed by us. The purpose of the revolving credit facility is to provide cash for domestic working capital purposes, and to fund permitted acquisitions.

All loans under the credit facility and the FabTech term loan are collateralized by all of our U.S. accounts, instruments, chattel paper, documents, general intangibles, inventory, equipment, furniture and fixtures, pursuant to security agreements entered into by us in connection with these credit arrangements.

Any amounts borrowed under the revolving credit facility and the FabTech term loan bear interest at LIBOR plus 1.15%. At December 31, 2006, the effective rate under both the credit agreement and the FabTech term loan was LIBOR plus 1.15%, or approximately 6.51%.

The credit agreement contains covenants that require us to maintain a leverage ratio not greater than 2.25 to 1.0, an interest expense coverage ratio of not less than 2.0 to 1.0 and a current ratio of not less than 1.0 to 1.0. It also requires us to achieve a net profit before taxes, as of the last day of each fiscal quarter, for the two consecutive fiscal quarters ending on that date of not less than \$1. The credit agreement permits us to pay dividends to our stockholders to the extent that any such dividends declared or paid in any fiscal year do not exceed an amount equal to 50% of our net profit after taxes for such fiscal year. However, it limits our ability to dispose of assets, incur additional indebtedness, engage in liquidation or merger, acquisition, partnership or other combination (except permitted acquisitions). The credit agreement also contains customary representations, warranties, affirmative and negative covenants and events of default.

The agreements governing the FabTech term loan do not contain any financial or negative covenants. However, they provide that a default under our credit agreement will cause a cross-default under the FabTech term loan.

As of December 31, 2005, FabTech had paid down \$3.75 million, to pay in full a note in favor of LSC, which debt was incurred in connection with our acquisition of FabTech from LSC in 2000. This note matured on June 30, 2006 and amortized monthly. The obligations under this note were subordinated to the obligations under our U.S. credit agreement with Union Bank.

As of December 31, 2006, our Asia subsidiaries have available lines of credit of up to an aggregate of \$34.8 million with a number of Chinese and Taiwanese financial institutions. These lines of credit, except for one Taiwanese credit facility, are collateralized by its premises, are unsecured, uncommitted and, in some instances, may be repayable on demand. Loans under these lines of credit bear interest at LIBOR or similar indices plus a specified margin.

As of December 31, 2006, Diodes-China owed \$1.4 million under a note to one of our customers, which debt was incurred in connection with our investing in manufacturing equipment. We repay this unsecured and interest-free note in quarterly price concession installments, with any remaining balance due in July 2008.

### **Off-Balance Sheet Arrangements**

We do not have any transactions, arrangements and other relationships with unconsolidated entities that will affect our liquidity or capital resources. We have no special purpose entities that provided off-balance sheet financing, liquidity or market or credit risk support, nor do we engage in leasing, hedging or research and development services, that could expose us to liability that is not reflected on the face of our financial statements.

## Contractual Obligations

The following table represents our contractual obligations as of December 31, 2006:

### Payments due by period (in thousands)

| Contractual Obligations  | Total             | Less than        |                 |                 | More than         |
|--------------------------|-------------------|------------------|-----------------|-----------------|-------------------|
|                          |                   | 1 year           | 1-3 years       | 3-5 years       | 5 years           |
| Long-term debt           | \$ 239,917        | \$ 2,802         | \$ 2,695        | \$ 1,388        | \$ 233,032        |
| Capital leases           | 1,868             | 185              | 370             | 370             | 943               |
| Operating leases         | 16,169            | 4,096            | 5,870           | 6,176           | 27                |
| Purchase obligations     | 7,466             | 7,466            | 0               | 0               | 0                 |
| <b>Total obligations</b> | <b>\$ 265,420</b> | <b>\$ 15,549</b> | <b>\$ 8,935</b> | <b>\$ 7,934</b> | <b>\$ 234,002</b> |

Inflation did not have a material effect on net sales or net income in fiscal years 2004 through 2006. A significant increase in inflation could affect future performance.

## Recently Issued Accounting Pronouncements and Proposed Accounting Changes

In February 2007, the FASB issued FAS 159, The Fair Value Option for financial assets and financial liabilities - including an amendment of FASB statement No. 115 ("FAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. FAS 159 is expected to expand the use of fair value measurement, which is consistent with the long-term measurement objectives for accounting for financial instruments. FAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 with early adoption permitted. No entity is permitted to apply this Statement retrospectively to fiscal years preceding the effective date unless the entity chooses early adoption. The Company has not yet determined the effect, if any, that the implementation of FAS 159 will have on our results of operations or financial condition.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Staff Position (FSP) AIG AIR-1, "Accounting for Planned Major Maintenance Activities" ("FSP AUG AIR-1"). FSP AUG AIR-1 addresses the accounting for planned major maintenance activities. Specifically, the FSP prohibits the practice of the accrue-in-advance method of accounting for planned major maintenance activities. FSP AUG AIR-1 is effective for the first fiscal year beginning after December 15, 2006. Retrospective application is required unless impracticable. We do not believe the adoption of FSP AUG AIR-1 will have a material impact on our consolidated financial statements.

In September 2006, FASB issued FAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an Amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("FAS 158"). FAS 158 requires an employer that is a business entity and sponsors one or more single employer benefit plans to (1) recognize the funded status of the benefit in its statement of financial position, (2) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period, but are not recognized as components of net periodic benefit cost, (3) measure defined benefit plan assets and obligations as of the date of the employer's fiscal year end statement of financial position and (4) disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs on credits, and transition asset or obligations. We do not expect FAS 158 to have a material impact on our consolidated financial statements.

In September 2006, the FASB issued FAS 157, "Fair Value Measurements" ("FAS 157"). SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with early adoption permitted. The Company has not yet determined the effect, if any, that the implementation of FAS 157 will have on our results of operations or financial condition.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the Company's fiscal year ending December 31, 2007. We do not expect SAB 108 to have a material impact on our consolidated financial statements.

In July 2006, the FASB issued FASB interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes" which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular rollforward of unrecognized tax benefits. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effects, if any, of adopting FIN 48 will be recorded as an adjustment to retained earnings as of the beginning of the period of adoption. We continue to evaluate the impact of FIN 48 on our consolidated financial statements, and at this time, we do not know the impact upon adoption of this standard.

In March 2006, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (that is, Gross versus Net Presentation)." Taxes within the scope of EITF Issue No. 06-3 include any taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, sales taxes, use taxes, value-added taxes, and some excise taxes. The EITF concluded that the presentation of these taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. For any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements. The Company's policy is to exclude all such taxes, if any, from revenue. The provisions of EITF 06-3 are effective for interim and annual reporting periods beginning after December 15, 2006. The adoption of EITF 06-3 will not have any material effect on our consolidated financial statements.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

**Foreign Currency Risk.** We face exposure to adverse movements in foreign currency exchange rates, primarily in Asia. Our foreign currency risk may change over time as the level of activity in foreign markets grows and could have an adverse impact upon our financial results. Certain of our assets, including certain bank accounts and accounts receivable, and liabilities exist in non-U.S. dollar denominated currencies, which are sensitive to foreign currency exchange fluctuations. These currencies are principally the Chinese Yuan and the Taiwanese dollar and, to a lesser extent, the Japanese Yen, the Euro and the Hong Kong dollar. Because of the relatively small size and nature of each individual currency exposure, we do not regularly employ hedging techniques designed to mitigate foreign currency exposures. Therefore, we do experience currency gains and losses. If the Chinese Yuan and the Taiwanese dollar were to strengthen or weaken by 1.0% against the U.S. dollar, we would experience currency losses of approximately \$115,000 and \$387,000, respectively. In the future, we may enter into hedging arrangements designed to mitigate foreign currency fluctuations.

The Chinese government does not permit the Chinese Yuan to float and be traded freely compared to other world currencies. Should the Chinese government allow a significant Chinese Yuan appreciation, and we do not take appropriate means to offset this exposure, the effect could have an adverse impact upon our financial results.

**Interest Rate Risk.** We have credit facilities with U.S. and Asian financial institutions as well as other debt instruments with interest rates equal to LIBOR or similar indices plus a negotiated margin. A rise in interest rates could have an adverse impact upon our cost of working capital and our interest expense. In July 2001, we entered into an interest rate swap agreement to hedge our exposure to variability in expected future cash flows resulting from interest rate risk related to a portion of our long-term debt. The interest rate under the swap agreement was fixed at 6.8% and was based on the notional amount of U.S. \$2.3 million as of December 31, 2003. The swap contract was

inversely correlated to the related hedged long-term debt and was therefore considered an effective cash flow hedge of the underlying long-term debt. The level of effectiveness of the hedge was measured by the changes in the market value of the hedged long-term debt resulting from fluctuation in interest rates. At November 30, 2004 the interest rate swap agreement on our long-term debt expired. As a matter of policy, we do not enter into derivative transactions for trading or speculative purposes. As of December 31, 2006, our outstanding debt under our interest-bearing credit agreements was \$239.9 million, including \$230 million convertible notes with a fixed interest rate of 2.25%. Based on an increase or decrease in interest rates by 1.0% for the year, our annual interest rate expense would increase or decrease by approximately \$99,000.

**Political Risk.** We have a significant portion of our assets in mainland China and Taiwan. The possibility of political conflict between the two countries or with the United States could have an adverse impact upon our ability to transact business through these important business segments and to generate profits. See “Risk Factors - Foreign Operations.”

**Item 8. Financial Statements and Supplementary Data**

See “Item 15. Exhibits and Financial Statement Schedules” for the Company’s Consolidated Financial Statements and the notes and schedules thereto filed as part of this Annual Report on Form 10-K.

**Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure**

Not Applicable.

**Item 9A. Controls and Procedures**

**Disclosure Controls and Procedures**

The Company's Chief Executive Officer, Dr. Keh-Shew Lu, and Chief Financial Officer, Carl C. Wertz, with the participation of the Company's management, carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer believe that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information relating to the Company (including its consolidated subsidiaries) required to be included in this report is made known to them.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity's disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established processes.

**Management’s Annual Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, the Company's Chief Executive Officer and the Chief Financial Officer and implemented by the Company's Board of Directors, management and other personnel, 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 in the United States of America.

The 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 in the United States of America, 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.

Under the supervision and with the participation from management, including our Chief Executive Officer and the Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework and criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This evaluation included review of the documentation of controls, testing of operating effectiveness of controls and a conclusion on this evaluation. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2006. Management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by Moss Adams LLP, an independent registered public accounting firm, who has expressed unqualified opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 as stated in their report which is included in Item 8 of this Report.

## **Changes in Internal Control**

There was no change in our internal control over financial reporting, known to the Chief Executive Officer or the Chief Financial Officer, that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders  
Diodes Incorporated and Subsidiaries

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting that Diodes Incorporated and Subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Diodes Incorporated and Subsidiaries' 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 capitalize 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 accounting principles generally accepted in the United States of America. 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 Diodes Incorporated and Subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Also in our opinion, Diodes Incorporated and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework.



We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule of Diodes Incorporated and Subsidiaries as of and for the year ended December 31, 2006, and our report dated February 28, 2007 expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

/s/ Moss Adams LLP  
**Moss Adams LLP**  
Los Angeles, California  
February 28, 2007

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information concerning the directors, executive officers and corporate governance of the Company is incorporated herein by reference from the section entitled "Proposal One - Election of Directors" contained in the definitive proxy statement of the Company to be filed pursuant to Regulation 14A within 120 days after the Company's fiscal year end of December 31, 2006, for its annual stockholders' meeting for 2007 (the "Proxy Statement").

We have adopted a code of ethics that applies to our Chief Executive Officer and senior financial officers. The code of ethics has been posted on our website under the Corporate Governance portion of the Investor Relations section at [www.diodes.com](http://www.diodes.com). We intend to satisfy disclosure requirements regarding amendments to, or waivers from, any provisions of our code of ethics on our website.

**Item 11. Executive Compensation**

The information concerning executive compensation is incorporated herein by reference from the section entitled "Proposal One - Election of Directors" contained in the Proxy Statement.

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

The information concerning the security ownership of certain beneficial owners and management and related stockholder matters is incorporated herein by reference from the section entitled "General Information - Security Ownership of Certain Beneficial Owners and Management" and "Proposal One - Election of Directors" contained in the Proxy Statement.

**Item 13. Certain Relationships, Related Transactions and Director Independence**

The information concerning certain relationships, related transactions and director independence is incorporated herein by reference from the section entitled "Proposal One - Election of Directors - Certain Relationships, Related Transactions and Director Independence" and "Proposal One - Elections of Directors" contained in the Proxy Statement.

**Item 14. Principal Accountant Fees and Services**

The information concerning the Company's principal accountant's fees and services is incorporated herein by reference from the section entitled "Ratification of the Appointment of Independent Registered Public Accounting Firm" in the Proxy Statement.

**PART IV****Item 15. Exhibits and Financial Statement Schedules****(a) Financial Statements and Schedules**

| (1) Financial statements:  | <u>Page</u> |
|--|-------------|
| Report of Independent Registered Public Accounting Firm  | 46          |
| Consolidated Balance Sheet at December 31, 2005 and 2006   | 47 to 48    |
| Consolidated Statement of Income for the Years Ended December 31, 2004, 2005, and 2006               | 49          |
| Consolidated Statement of Stockholders' Equity for the Years Ended December 31, 2004, 2005, and 2006 | 50          |
| Consolidated Statement of Cash Flows for the Years Ended December 31, 2004, 2005, and 2006           | 51 to 52    |
| Notes to Consolidated Financial Statements   | 53 to 83    |
| <br>(2) Schedules:   |             |
| Report of Independent Registered Public Accounting Firm on Financial Statement Schedule              | 84          |
| Schedule II – Valuation and Qualifying Accounts  | 85          |

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements and note thereto.

**(b) Exhibits**

The exhibits listed on the Index to Exhibits at page 86 are filed as exhibits or incorporated by reference to this Annual Report on Form 10-K.

**(c) Financial Statements of Unconsolidated Subsidiaries and Affiliates**

Not Applicable.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders  
Diodes Incorporated and Subsidiaries

We have audited the accompanying consolidated balance sheets of Diodes Incorporated and Subsidiaries as of December 31, 2006 and 2005 and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Diodes Incorporated and Subsidiaries as of December 31, 2006 and 2005, and the consolidated results of its operations and cash flows for each of the years in the three year period ended December 31, 2006, in conformity with accepted accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 13 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of accounting for share-based payment arrangements to conform to Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Diodes Incorporated and Subsidiaries' internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 28, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Moss Adams LLP  
**MOSS ADAMS LLP**

Los Angeles, California  
February 28, 2007

**DIODES INCORPORATED AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

| December 31,                              | 2005                  | 2006                  |
|---|-----------------------|-----------------------|
| <i>ASSETS</i>                             |                       |                       |
| <b>CURRENT ASSETS</b>                     |                       |                       |
| Cash and cash equivalents                 | \$ 73,288,000         | \$ 48,888,000         |
| Short-term investments                    | 40,348,000            | 291,008,000           |
| Total cash and short-term investments     | 113,636,000           | 339,896,000           |
| Accounts receivable                       |                       |                       |
| Trade customers                           | 48,348,000            | 72,175,000            |
| Related parties                           | 6,804,000             | 6,147,000             |
|   | 55,152,000            | 78,322,000            |
| Allowance for doubtful accounts           | (534,000)             | (617,000)             |
| Accounts receivable, net of allowances    | 54,618,000            | 77,705,000            |
| Inventories                               | 24,611,000            | 48,202,000            |
| Deferred income taxes, current            | 2,541,000             | 4,650,000             |
| Prepaid expenses and other                | 5,326,000             | 8,393,000             |
| <b>Total current assets</b>               | <b>200,732,000</b>    | <b>478,846,000</b>    |
| <b>PROPERTY, PLANT AND EQUIPMENT, net</b> | <b>68,930,000</b>     | <b>95,469,000</b>     |
| <b>DEFERRED INCOME TAXES, non-current</b> | <b>8,466,000</b>      | <b>5,428,000</b>      |
| <b>OTHER ASSETS</b>                       |                       |                       |
| Equity investment                         | 5,872,000             | -                     |
| Intangible assets, net                    | -                     | 10,669,000            |
| Goodwill                                  | 5,090,000             | 25,030,000            |
| Other                                     | 425,000               | 6,697,000             |
| <b>Total assets</b>                       | <b>\$ 289,515,000</b> | <b>\$ 622,139,000</b> |

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

**DIODES INCORPORATED AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (Continued)**

| December 31,   | 2005                  | 2006                  |
|--|-----------------------|-----------------------|
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                       |
| <b>CURRENT LIABILITIES</b>   |                       |                       |
| Line of credit   | \$ 3,000,000          | \$ -                  |
| Accounts payable   |                       |                       |
| Trade  | 18,619,000            | 40,029,000            |
| Related parties  | 7,921,000             | 12,120,000            |
| Accrued liabilities  | 18,312,000            | 24,967,000            |
| Income tax payable   | 1,470,000             | 3,433,000             |
| Current portion of long-term debt  | 4,621,000             | 2,802,000             |
| Current portion of capital lease obligations   | 138,000               | 141,000               |
| <b>Total current liabilities</b>   | <b>54,081,000</b>     | <b>83,492,000</b>     |
| <b>LONG-TERM DEBT</b> , net of current portion   |                       |                       |
| 2.25% convertible senior notes due 2026  | -                     | 230,000,000           |
| Others   | 4,865,000             | 7,115,000             |
| <b>CAPITAL LEASE OBLIGATIONS</b> , net of current portion  | <b>1,618,000</b>      | <b>1,477,000</b>      |
| <b>OTHER LONG TERM LIABILITIES</b>   | <b>-</b>              | <b>1,101,000</b>      |
| <b>MINORITY INTEREST IN JOINT VENTURE</b>  | <b>3,477,000</b>      | <b>4,787,000</b>      |
| <b>Total Liabilities</b>   | <b>64,041,000</b>     | <b>327,972,000</b>    |
| <b>STOCKHOLDERS' EQUITY</b>  |                       |                       |
| Preferred stock - par value \$1.00 per share;<br>1,000,000 shares authorized; no shares issued or outstanding                                      | -                     | -                     |
| Common stock - par value \$0.66 2/3 per share;<br>70,000,000 shares authorized; 25,258,119 and 25,961,267<br>issued at 2005 and 2006, respectively | 16,839,000            | 17,308,000            |
| Additional paid-in capital   | 94,664,000            | 113,449,000           |
| Retained earnings  | 114,659,000           | 162,802,000           |
| Accumulated other comprehensive gain (loss)  | (688,000)             | 608,000               |
| <b>Total stockholders' equity</b>  | <b>225,474,000</b>    | <b>294,167,000</b>    |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 289,515,000</b> | <b>\$ 622,139,000</b> |

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

**DIODES INCORPORATED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

| Years ended December 31,                         | 2004           | 2005           | 2006           |
|--|----------------|----------------|----------------|
| <b>NET SALES</b>                                 | \$ 185,703,000 | \$ 214,765,000 | \$ 343,308,000 |
| <b>COST OF GOODS SOLD</b>                        | 124,968,000    | 140,388,000    | 229,416,000    |
| Gross profit                                     | 60,735,000     | 74,377,000     | 113,892,000    |
| <b>OPERATING EXPENSES</b>                        |                |                |                |
| Selling, general and administrative              | 23,503,000     | 30,285,000     | 47,945,000     |
| Research and development                         | 3,422,000      | 3,713,000      | 8,317,000      |
| Loss (gain) on fixed assets                      | 14,000         | (102,000)      | 152,000        |
| Total operating expenses                         | 26,939,000     | 33,896,000     | 56,414,000     |
| Income from operations                           | 33,796,000     | 40,481,000     | 57,478,000     |
| <b>OTHER INCOME (EXPENSES)</b>                   |                |                |                |
| Interest income (expense), net                   | (637,000)      | 221,000        | 5,117,000      |
| Other  | (418,000)      | 406,000        | (1,474,000)    |
| Total other income (expenses)                    | (1,055,000)    | 627,000        | 3,643,000      |
| Income before income taxes and minority interest | 32,741,000     | 41,108,000     | 61,121,000     |
| <b>INCOME TAX PROVISION</b>                      | (6,514,000)    | (6,685,000)    | (11,689,000)   |
| Income before minority interest                  | 26,227,000     | 34,423,000     | 49,432,000     |
| Minority interest in earnings of joint venture   | (676,000)      | (1,094,000)    | (1,289,000)    |
| <b>NET INCOME</b>                                | \$ 25,551,000  | \$ 33,329,000  | \$ 48,143,000  |
| <b>EARNINGS PER SHARE</b>                        |                |                |                |
| Basic  | \$ 1.27        | \$ 1.44        | \$ 1.88        |
| Diluted  | \$ 1.10        | \$ 1.29        | \$ 1.74        |
| Number of shares used in computation             |                |                |                |
| Basic  | 20,106,413     | 23,168,180     | 25,628,419     |
| Diluted  | 23,207,156     | 25,894,384     | 27,667,755     |

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





**DIODES INCORPORATED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

Years ended December 31, 2004, 2005, and 2006

Common stock

|  | Shares     | Shares in Treasury | Amount        | Common stock in treasury | Additional paid-in capital | Retained earnings | Accumulated other comprehensive gain (loss) | Total          |
|--|------------|--------------------|---------------|--------------------------|----------------------------|-------------------|---|----------------|
| <b>BALANCE,</b><br>December 31,<br>2003                                    | 21,940,925 | 2,420,262          | \$ 14,627,000 | \$ (1,782,000)           | \$ 3,067,000               | \$ 55,779,000     | \$ (241,000)                                | \$ 71,450,000  |
| Comprehensive income, net of tax:  |            |                    |               |                          |                            |                   |   |                |
| Net income for the yearended December 31, 2004                             |            |                    |               |                          |                            | 25,551,000        |   | 25,551,000     |
| Translation adjustments  |            |                    |               |                          |                            |                   | 793,000                                     | 793,000        |
| Change in unrealized loss on derivative instruments, net of tax of \$9,000 |            |                    |               |                          |                            |                   | 23,000                                      | 23,000         |
| Total comprehensive income   |            |                    |               |                          |                            |                   |   | 26,367,000     |
| Management fee from LSC  |            |                    |               |                          | 180,000                    |                   |   | 180,000        |
| Exercise of stock options including \$8,514,000 incometax benefit          | 1,703,976  | -                  | 1,136,000     | -                        | 13,015,000                 | -                 | -   | 14,151,000     |
| <b>BALANCE,</b><br>December 31,<br>2004                                    | 23,644,901 | 2,420,262          | \$ 15,763,000 | \$ (1,782,000)           | \$ 16,262,000              | \$ 81,330,000     | \$ 575,000                                  | \$ 112,148,000 |

|  |             |             |                 |           |  |                 |                |              |                |
|--|-------------|-------------|-----------------|-----------|--|-----------------|----------------|--------------|----------------|
| Comprehensive income, net of tax:                                  |             |             |                 |           |  |                 |                |              |                |
| Net income for the year ended December 31, 2005                    |             |             |                 |           |  |                 |                |              |                |
|  |             |             |                 |           |  |                 |                | 33,329,000   | 33,329,000     |
| Translation adjustments  |             |             |                 |           |  |                 |                |              |                |
|  |             |             |                 |           |  |                 |                | (1,263,000)  | (1,263,000)    |
| Total comprehensive income   |             |             |                 |           |  |                 |                |              |                |
|  |             |             |                 |           |  |                 |                |              | 32,066,000     |
| Management fee from LSC  |             |             |                 |           |  |                 |                |              |                |
|  |             |             |                 |           |  |                 |                | 180,000      | 180,000        |
| Exercise of stock options including \$2,898,000 income tax benefit |             |             |                 |           |  |                 |                |              |                |
|  | 787,545     |             | 525,000         |           |  |                 |                | 7,023,000    | 7,548,000      |
| Share-based compensation   |             |             |                 |           |  |                 |                |              |                |
|  | 58,435      |             | 39,000          |           |  |                 |                | 1,775,000    | 1,814,000      |
| Follow-on offering   |             |             |                 |           |  |                 |                |              |                |
|  | 3,187,500   |             | 2,126,000       |           |  |                 |                | 69,592,000   | 71,718,000     |
| Treasury share retirement  |             |             |                 |           |  |                 |                |              |                |
|  | (2,420,262) | (2,420,262) | (1,614,000)     | 1,782,000 |  | (168,000)       |                | -            | -              |
| <b>BALANCE, December 31, 2005</b>                                  |             |             |                 |           |  |                 |                |              |                |
|  | 25,258,119  |             | - \$ 16,839,000 | \$        |  | - \$ 94,664,000 | \$ 114,659,000 | \$ (688,000) | \$ 225,474,000 |
| Comprehensive income, net of tax:                                  |             |             |                 |           |  |                 |                |              |                |
| Net income for the year ended December 31, 2006                    |             |             |                 |           |  |                 |                |              |                |
|  |             |             |                 |           |  |                 |                | 48,143,000   | 48,143,000     |
| Translation adjustments  |             |             |                 |           |  |                 |                |              |                |
|  |             |             |                 |           |  |                 |                | 1,296,000    | 1,296,000      |

|                                   |                   |                           |                         |                          |                               |
|-----------------------------------|-------------------|---------------------------|-------------------------|--------------------------|-------------------------------|
| Total comprehensive income        |                   |                           |                         |                          | 49,439,000                    |
| Exercise of stock options         | 703,148           | 469,000                   | 3,858,000               |                          | 4,327,000                     |
| Excess tax pools                  |                   |                           | 6,655,000               |                          | 6,655,000                     |
| Share-based compensation          |                   |                           | 8,272,000               |                          | 8,272,000                     |
| <b>BALANCE, December 31, 2006</b> | <b>25,961,267</b> | <b>- \$ 17,308,000 \$</b> | <b>- \$ 113,449,000</b> | <b>\$ 162,802,000 \$</b> | <b>608,000 \$ 294,167,000</b> |

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

**DIODES INCORPORATED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| <b>Years ended December 31,</b>   | <b>2004</b>   | <b>2005</b>   | <b>2006</b>   |
|---|---------------|---------------|---------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |               |               |               |
| Net income  | \$ 25,551,000 | \$ 33,329,000 | \$ 48,143,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: |               |               |               |
| Depreciation and amortization   | 13,173,000    | 16,228,000    | 21,065,000    |
| Minority interest earnings  | 676,000       | 1,094,000     | 1,289,000     |
| Share-based compensation  | -             | 1,814,000     | 8,272,000     |
| Loss (gain) on disposal of property, plant and equipment                          | 14,000        | (102,000)     | 152,000       |
| Adjustment of other comprehensive income  | -             | -             | 1,071,000     |
| Changes in operating assets:  |               |               |               |
| Accounts receivable   | (13,203,000)  | (11,037,000)  | (11,320,000)  |
| Inventories   | (6,074,000)   | (2,373,000)   | (16,283,000)  |
| Prepaid expenses and other current assets   | (2,474,000)   | 696,000       | (2,792,000)   |
| Deferred income taxes   | (3,051,000)   | (3,482,000)   | 929,000       |
| Changes in operating liabilities:   |               |               |               |
| Accounts payable  | 3,728,000     | 5,330,000     | 14,534,000    |
| Accrued liabilities   | 1,468,000     | 2,770,000     | 4,957,000     |
| Other liabilities   | -             | -             | 101,000       |
| Income taxes payable  | 978,000       | 3,390,000     | 1,963,000     |
| Net cash provided by operating activities   | 20,786,000    | 47,657,000    | 72,081,000    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |               |               |               |
| Purchases of property, plant and equipment  | (26,201,000)  | (19,583,000)  | (45,656,000)  |
| Purchases of short-term investments   | -             | (40,348,000)  | (250,660,000) |
| Acquisitions, net of cash acquired  | -             | (5,872,000)   | (29,433,000)  |
| Proceeds from sales of property, plant and equipment                              | 68,000        | -             | 54,000        |
| Net cash used by investing activities   | (26,133,000)  | (65,803,000)  | (325,695,000) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |               |               |               |
| Repayments on line of credit, net   | (2,321,000)   | (3,167,000)   | (5,758,000)   |
| Net proceeds from the issuance of common stock                                    | 5,628,000     | 76,367,000    | 4,327,000     |
| Excess tax benefits   | 8,514,000     | 2,898,000     | 6,655,000     |
| Management incentive reimbursement from LSC                                       | 375,000       | 375,000       | -             |
| Proceeds from long-term debt  | 3,583,000     | 5,890,000     | 228,569,000   |
| Repayments of long-term debt  | (4,819,000)   | (7,750,000)   | (4,666,000)   |
| Minority shareholder investment in subsidiary                                     | 175,000       | -             | -             |
| Repayments of capital lease obligations   | (158,000)     | (136,000)     | (138,000)     |
| Dividend to minority shareholder  | (300,000)     | (750,000)     | -             |
| Net cash provided by financing activities   | 10,677,000    | 73,727,000    | 228,989,000   |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>               |               |               |               |
|   | 793,000       | (1,263,000)   | 225,000       |

|  |               |               |                      |
|--|---------------|---------------|----------------------|
| <b>INCREASE IN CASH</b>                              | 6,123,000     | 54,318,000    | <b>(24,400,000)</b>  |
| <b>CASH AND CASH EQUIVALENTS</b> , beginning of year | 12,847,000    | 18,970,000    | <b>73,288,000</b>    |
| <b>CASH AND CASH EQUIVALENTS</b> , end of year       | \$ 18,970,000 | \$ 73,288,000 | \$ <b>48,888,000</b> |

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

**DIODES INCORPORATED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

**Years ended December 31,** **2004** **2005** **2006**

**SUPPLEMENTAL DISCLOSURE OF CASH  
FLOW INFORMATION**

Cash paid during the year for:

|              |              |              |                     |
|--------------|--------------|--------------|---------------------|
| Interest     | \$ 683,000   | \$ 633,000   | \$ <b>1,771,000</b> |
| Income taxes | \$ 2,504,000 | \$ 3,443,000 | \$ <b>3,377,000</b> |

Non-cash activities:

|  |              |              |                     |
|--|--------------|--------------|---------------------|
| Tax benefit related to stock options credited to paid-in capital | \$ 8,514,000 | \$ 2,898,000 | \$ <b>6,655,000</b> |
|--|--------------|--------------|---------------------|

|   |            |              |                   |
|---|------------|--------------|-------------------|
| Property, plant and equipment purchased on accounts payable | \$ 321,000 | \$ 5,061,000 | \$ <b>878,000</b> |
|---|------------|--------------|-------------------|

The Company purchased 99.81% of the capital stock of Anachip Corporation and purchased the net assets of APD semiconductor for total \$35.2 million, net of \$3.9 million cash acquired (\$5.8 million was paid in 2005). In conjunction with the acquisition, liabilities were assumed as follows:

|                                |                     |
|--------------------------------|---------------------|
| Fair value of assets acquired  | <b>56,896,000</b>   |
| Liabilities assumed            | <b>(17,737,000)</b> |
| Cash acquired                  | <b>(3,888,000)</b>  |
| Cash paid for the acquisitions | <b>35,271,000</b>   |

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

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1 – SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES**

**Nature of operations** – Diodes Incorporated and its subsidiaries manufacture and distribute low pin-count standard semiconductor products to manufacturers in the consumer electronic, computer, communications, industrial and automotive markets. These products have 8 pins or less and include small signal transistors, MOSFETs, thyristor surge protection devices, transient voltage protection devices, Hall sensors, power management IC's programmable logic arrays, diodes, rectifiers, bridges, and silicon wafers. The products are sold primarily throughout North America, Asia and Europe.

**Principles of consolidation** –The consolidated financial statements include Diodes-North America and its subsidiaries:

Diodes Taiwan Corporation, Ltd. (“Diodes-Taiwan”) - 100% owned  
Diodes Hong Kong Ltd. (“Diodes-Hong Kong”) - 100% owned  
Anachip Corporation (“Anachip” or “Diodes-Anachip”) - 99.81% owned  
Shanghai KaiHong Electronics Co., Ltd. (“Diodes-China”) - 95% owned  
Shanghai KaiHong Technology Co., Ltd. (“Diodes-Shanghai”) - 95% owned  
FabTech Incorporated (“FabTech” or “Diodes-FabTech”) - 100% owned

All significant intercompany balances and transactions have been eliminated.

**Revenue recognition** – Revenue is recognized when there is persuasive evidence that an arrangement exists, when delivery has occurred, when our price to the buyer is fixed or determinable and when collectibility of the receivable is reasonably assured. These elements are met when title to the products is passed to the buyers, which is generally when our product is shipped to both original equipment manufacturers (OEMs) and electronics component distributors. We reduce revenue in the period of sale for estimates of product returns and other allowances.

**Product warranty** – We generally warrant our products for a period of one year from the date of sale. Historically, warranty expense has not been significant.

**Cash and cash equivalents** – We consider all highly liquid investments with maturity of three months or less at the date of purchase to be cash equivalents. We currently maintain substantially all of our day-to-day operating cash balances with major financial institutions. Cash balances are usually in excess of Federal and/or foreign deposit insurance limits. We have not experienced any losses related to these balances, and management believes its credit risk to be minimal.

**Short-term investments** – Our short-term investments consist primarily of municipal bonds, all of which are classified as available-for-sale. Available-for-sale securities are recorded at fair value, and unrealized holding gains and losses are recorded, net of tax, as a separate component of accumulated other comprehensive income. Available-for-sale securities with remaining maturities of less than one year, and those identified by management at time of purchase for funding operations in less than one year are classified as short-term. Unrealized losses are charged against net earnings when a decline in fair value is determined to be other than temporary. Realized gains and losses are accounted for on the specific identification method (see Note 3).

**Allowance for doubtful accounts** – Management evaluates the collectability of our accounts receivable based upon a combination of factors, including the current business environment and historical experience. If we are aware of a customer's inability to meet its financial obligations to us, we record an allowance to reduce the receivable to the

amount we reasonably believe we will be able to collect from the customer. For all other customers, we record an allowance based upon the amount of time the receivables are past due. If actual accounts receivable collections differ from these estimates, an adjustment to the allowance may be necessary with a resulting effect on operating expense.



**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1 – SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Inventories** – Inventories are stated at the lower of cost or market value. Cost is determined principally by the first-in, first-out method. On an on-going basis, both finished goods inventory and raw material inventory is evaluated for obsolescence and slow-moving items. This evaluation includes analysis of sales levels, sales projections, and purchases by item, as well as raw material usage related to our manufacturing facilities. Based upon this analysis, as well as an inventory aging analysis, a reserve for obsolete and slow-moving inventory is accrued (see Note 4).

**Property, plant and equipment** – Property, plant and equipment are depreciated using straight-line methods over the estimated useful lives, which range from 20 to 55 years for buildings and 3 to 10 years for machinery and equipment. The estimated lives of leasehold improvements range from 3 to 5 years, and are amortized over the shorter of the remaining lease term or their estimated useful lives (see Note 5).

**Goodwill and other intangible assets** – We account for goodwill in accordance with Statement of Financial Accounting Standards (SFAS) No. 142 (“Goodwill and Other Intangible Assets”), under which goodwill is tested for impairment at least annually.

Under SFAS No. 142, goodwill is evaluated for potential impairment on an annual basis or whenever events or circumstances indicate that an impairment may have occurred. SFAS No. 142 requires that goodwill be tested for impairment using a two-step process. The first step of the goodwill impairment test, used to identify potential impairment, compares the estimated fair value of the reporting unit containing goodwill with the related carrying amount. If the estimated fair value of the reporting unit exceeds its carrying amount, the reporting unit’s goodwill is not considered to be impaired and the second step of the impairment test is unnecessary. If the reporting unit’s carrying amount exceeds its estimated fair value, the second step test must be performed to measure the amount of the goodwill impairment loss, if any. The second step test compares the implied fair value of the reporting unit’s goodwill, determined in the same manner as the amount of goodwill recognized in a business combination, with the carrying amount of such goodwill. If the carrying amount of the reporting unit’s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

An independent appraiser performed the required impairment tests of goodwill as of January 1, 2006 and 2007, and has determined that the goodwill is fully recoverable. No goodwill was impaired during the years ended December 31, 2004, 2005 and 2006. As of December 31, 2006, goodwill for Diodes-FabTech, Diodes-China and Diodes-Anachip was \$4.2 million, \$0.9 million and \$19.9 million, respectively (see Note 7).

We also acquired other intangible assets through our Anachip Corporation acquisition in January 2006 and our APD acquisition in November 2006, which were being amortized on a straight-line basis over its estimated useful life. As of December 31, 2006, the net intangible assets were \$10.7 million, including \$8.5 million for APD patents and \$2.2 million for Anachip patents and trademarks (see Note 6).

**Debt issuance costs** – Debt issuance costs of \$6.2 million related to the convertible bond were capitalized and are amortized over 5 years using the straight-line method. Amortization of debt issuance costs is included in other interest expense while the un-amortized balance is included in other assets. Un-amortized debt issuance costs were \$6.0 million at December 31, 2006.

**Impairment on long-lived assets** – Certain of our long-lived assets are reviewed at least annually as to whether their carrying values have become impaired in accordance with SFAS No. 144, (“Accounting for the Impairment or Disposal

of Long-Lived Assets”). Management considers assets to be impaired if the carrying value exceeds the undiscounted projected cash flows from operations. If impairment exists, the assets are written down to fair value or the projected discounted cash flows from related operations. As of December 31, 2006, we expect the remaining carrying value of assets to be recoverable.

**Income taxes** – Income taxes are accounted for using an asset and liability approach whereby deferred tax assets and liabilities are recorded for differences in the financial reporting bases and tax bases of our assets and liabilities (see Note 11).

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1 – SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Concentration of credit risk** – Financial instruments, which potentially subject us to concentrations of credit risk, include trade accounts receivable. Credit risk is limited by the dispersion of our customers over various geographic areas, operating primarily in the electronics manufacturing and distribution industries. We perform on-going credit evaluations of our customers, and generally require no collateral. Historically, credit losses have not been significant.

We currently maintain substantially all of our day-to-day cash balances with major financial institutions. Cash balances are usually in excess of Federal and/or foreign deposit insurance limits.

**Valuation of financial instruments** – The carrying value of our financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, working capital line of credit, and long-term debt approximate fair value due to their current market conditions, maturity dates and other factors. Short-term investments classified as available-for-sale are recorded at market value with unrealized gains or losses reflected in other accumulated comprehensive income or loss.

**Treasury shares** – In December 2005, the Board of Directors canceled the 2,420,262 shares held in treasury. The cancellation has no net impact on stockholders' equity, shares outstanding, or shares used to compute earnings per share.

**Equity investment** – On December 20, 2005, we acquired an 18.87% equity interest of Anachip Corporation, a private-held Taiwanese fabless analog IC company, for approximately \$5.9 million. The investment is being accounted for under the equity method as required by APB No. 18, (*The Equity Method of Accounting for Investments in Common Stock*). However, we did not record income from the investment on the consolidated financial statements for the ten days ending December 31, 2005, as the amount was not material. In January 2006, we increased our equity ownership of Anachip Corporation to 99.81%. As a result, Anachip was consolidated beginning the first fiscal quarter of 2006.

**Stock split** – On December 1, 2005, we affected a three-for-two stock split for shareholders of record as of November 18, 2005 in the form of a 50% stock dividend. All share and per share amounts in the accompanying consolidated financial statements and footnotes disclosures have been retroactively adjusted to reflect the effect of this stock split.

**Use of estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires that management make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Earnings per share** – Earnings per share is based upon the weighted average number of shares of common stock and common stock equivalents outstanding, including those related to share-based compensation and convertible notes. Earnings per share are computed using the “treasury stock method” under Financial Accounting Standards Board (FASB) Statement No. 128. The convertible note includes a net share settlement feature which requires the company to redeem the par amount of the bond in cash and any remaining value, assuming the bond is in the money, in incremental shares, cash or a combination thereof. The net share settled convertible as structured is defined in EITF 90-19, instrument C, which allows us to use treasury stock method of calculating the diluted earnings per share. The incremental value of the shares will be determined based on the average price of our common stock over the reporting period. There are no shares in the earnings per share denominator as our stock price does not exceed the conversion price and there is no conversion spread.

For the years ended December 31, 2004, 2005 and 2006, options outstanding for 0 shares, 682,000 shares and 165,000 shares, respectively, of common stock have been excluded from the computation of diluted earnings per share because their effect was anti-dilutive.

|   | <b>Years Ended December 31</b> |               |               |
|---|--------------------------------|---------------|---------------|
|   | <b>2004</b>                    | <b>2005</b>   | <b>2006</b>   |
| Net income for earnings per share computation   | \$ 25,551,000                  | \$ 33,329,000 | \$ 48,143,000 |
| <b>Basic</b>  |                                |               |               |
| Weighted average number of common shares outstanding during the year                              | 20,106,413                     | 23,168,180    | 25,628,419    |
| <b>Basic earnings per share</b>   | \$ 1.27                        | \$ 1.44       | \$ 1.88       |
| <b>Diluted</b>  |                                |               |               |
| Weighted average number of common shares outstanding used in calculating basic earnings per share | 20,106,413                     | 23,168,180    | 25,628,419    |
| Add: additional shares issuable upon exercise of stock options                                    | 3,100,744                      | 2,726,204     | 2,039,336     |
| Weighted average number of common shares used in calculating diluted earnings per share           | 23,207,157                     | 25,894,384    | 27,667,755    |
| <b>Diluted earnings per share</b>   | \$ 1.10                        | \$ 1.29       | \$ 1.74       |

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1 – SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Stock-based compensation** – Effective in January 1, 2006, we adopted SFAS No. 123R, (“Share-Based Payments”), using the modified prospective method. We are required to select a valuation technique or option-pricing model that meets the criteria as stated in the standard, which includes a binomial model and the Black-Scholes model. At the present time, we continue to use the Black-Scholes model, consistent with prior period valuations under SFAS 123. No modifications were made to any outstanding share-options prior to the adoption of SFAS 123R.

The adoption of SFAS 123R, applying the “modified prospective method,” as elected by the Company, requires us to value stock options prior to its adoption of SFAS 123 under the fair value method and expense these amounts over the stock options' remaining vesting period. This resulted in the Company expensing \$6.5 million in the year ended December 31, 2006, which was recorded within cost of goods sold, general and administrative expense, and research and development expense on our condensed consolidated income statement. In addition, SFAS 123R requires us to reflect any tax savings resulting from tax deductions in excess of expense reflected in our financial statements as a financing cash inflow in its statement of cash flows rather than as an operating cash flow as in prior periods (See “Note 13 - Share-based Compensation” for details). We have changed our primary award type from stock options to stock awards as an improved method of reward and retention. In general, for new grants, we also extended the vesting period from three years to four years, and reduced the number of shares subject to the award by a factor of three.

We have 567,748 restricted stock grants outstanding as of December 31, 2006. The restricted stock grants are recorded each quarter as a non-cash operating expense item. As of December 31, 2006, there was \$10.2 million of total unrecognized compensation cost related to non-vested share-based compensation. This cost is expected to be recognized over a weighted-average period of 3.0 years. In addition to the expense, the effect of the restricted stock grants are included in the diluted shares outstanding calculation (See “Note 13 - Share-based Compensation”).

**Adjustments to share-based and other expense** – Management believed two errors existed in our accounting treatment for certain transactions related to prior reporting periods. In consideration of Staff Accounting Bulletin No. 108, management assessed the impact of the following errors and determined the errors were immaterial, and did not, individually and in the aggregate, materially impact the financial position, net income or earnings per share for any of the affected annual and quarterly results: (i) an overstatement of operating expense for the year ended December 31, 2005 in the amount of \$0.8 million relating to the expensing of restricted share grants resulted when we incorrectly marked-to-market the quarterly share grant expense rather than fixing the expense based on the market price of our common stock on the date the award was granted, and (ii) an understatement of other expense in the amounts of \$0.1 million, \$0.1 million, \$0.2 million, and \$0.7 million for the years ended December 31, 2002, 2003, 2004, and 2005, respectively, which arose when we incorrectly assessed the long-term nature of our intercompany accounts, and eliminated intercompany foreign currency exchange losses by recording the losses directly to shareholders' equity via other comprehensive loss, rather than recording to shareholders' equity through the income statement. In the quarter ended September 30, 2006, we made a one-time adjustment to the relevant accounts, and the tax adjusted net result was a decrease to net income of approximately \$0.6 million

**Functional currencies and foreign currency translation** – Through our subsidiaries, we maintain foreign operations in Taiwan, Hong Kong and China. We believe the New Taiwan (“NT”) dollar as the functional currency at Diodes-Taiwan and Diodes-Anachip most appropriately reflects the current economic facts and circumstances of the operations. Assets and liabilities recorded in NT dollar are translated at the exchange rate on the balance sheet date. Income and expense accounts are translated at the average monthly exchange rate during the year. Resulting translation adjustments are recorded as a separate component of accumulated other comprehensive income or loss.

We use the U.S. dollar as the functional currency in Diodes-China, Diodes-Shanghai and Diodes-Hong Kong, as substantially all monetary transactions are made in that currency, and other significant economic facts and circumstances currently support that position. As these factors may change in the future, we will periodically assess our position with respect to the functional currency of our foreign subsidiaries. Included in net income are foreign currency exchange losses of approximately \$424,000 for the year ended December 31, 2004, exchange gains of \$79,000 for the year ended December 31, 2005, and exchange losses of \$1.8 million for the year ended December 31, 2006.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1 – SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Comprehensive income** – Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities are reported as a separate component of stockholders' equity, such items, along with net income, are components of comprehensive income. The components of other comprehensive income include foreign currency translation adjustments. Accumulated other comprehensive loss was \$688,000 and accumulated other comprehensive gain was \$608,000 at December 31, 2005 and December 31, 2006, respectively. The \$1.3 million change was primarily a result of a \$1.1 million one-time, non-cash adjustment to other expense for inter-company foreign currency exchange losses that were incorrectly recorded directly to shareholders' equity via other comprehensive loss, rather than by recording to shareholders' equity through the income statement.

**Recently issued accounting pronouncements and proposed accounting changes** – In February 2007, the FASB issued FAS 159, The Fair Value Option for financial assets and financial liabilities - including an amendment of FASB statement No. 115 (“FAS 159”). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. FAS 159 is expected to expand the use of fair value measurement, which is consistent with the long-term measurement objectives for accounting for financial instruments. FAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 with early adoption permitted. No entity is permitted to apply this Statement retrospectively to fiscal years preceding the effective date unless the entity chooses early adoption. The Company has not yet determined the effect, if any, that the implementation of FAS 159 will have on our results of operations or financial condition.

In September 2006, the FASB issued Staff Position (FSP) AIG AIR-1, “Accounting for Planned Major Maintenance Activities” (“FSP AUG AIR-1”). FSP AUG AIR-1 addresses the accounting for planned major maintenance activities. Specifically, the FSP prohibits the practice of the accrue-in-advance method of accounting for planned major maintenance activities. FSP AUG AIR-1 is effective for the first fiscal year beginning after December 15, 2006. Retrospective application is required unless impracticable. We do not believe the adoption of FSP AUG AIR-1 will have a material impact on our consolidated financial statements.

In September 2006, the FASB issued FAS 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans - an Amendment of FASB Statements No. 87, 88, 106 and 132(R)” (“FAS 158”). FAS 158 requires an employer that is a business entity and sponsors one or more single employer benefit plans to (1) recognize the funded status of the benefit in its statement of financial position, (2) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period, but are not recognized as components of net periodic benefit cost, (3) measure defined benefit plan assets and obligations as of the date of the employer's fiscal year end statement of financial position and (4) disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs on credits, and transition asset or obligations. We do not expect FAS 158 to have a material impact on our consolidated financial statements.

In September 2006, the FASB issued FAS 157, Fair Value Measurements (“FAS 157”). SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. FAS 157 is

effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with early adoption permitted. We have not yet determined the effect, if any, that the implementation of FAS 157 will have on our results of operations or financial condition.

In September 2006, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the fiscal years beginning after November 15, 2006. We do not expect SAB 108 to have a material impact on our consolidated financial statements.



**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1 – SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

In July 2006, the FASB issued FASB interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes" which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular rollforward of unrecognized tax benefits. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effects, if any, of adopting FIN 48 will be recorded as an adjustment to retained earnings as of the beginning of the period of adoption. We are currently evaluating the impact of adopting FIN 48 and its impact on our consolidated financial statements.

In March 2006, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (that is, Gross versus Net Presentation)." Taxes within the cope of EITF Issue No. 06-3 include any taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, sales taxes, use taxes, value-added taxes, and some excise taxes. The EITF concluded that the presentation of these taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. For any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements. Our policy is to exclude all such taxes, if any, from revenue. The provisions of EITF 06-3 are effective for interim and annual reporting periods beginning after December 15, 2006. The adoption of EITF 06-3 will not have any effect on our consolidated financial statements.

**Reclassifications** – In the first quarter of 2006, we adopted SFAS No. 123R, "Share-Based Payments," using the modified prospective method. SFAS 123R requires that the excess tax benefit associated with an individual share-based payment award be included in the statement of cash flows as a cash inflow from financing activities and a cash outflow from operating activities. The amounts presented in the accompanying financial statements for year 2004 and 2005 have been reclassified to conform to year 2006 financial statement presentation. These reclassifications had no impact on previously reported net income or stockholders' equity.

**NOTE 2 -BUSINESS ACQUISITIONS**

**Anachip acquisition** – On December 20, 2005, we announced the signing of a definitive stock purchase agreement to acquire Anachip Corporation, a Taiwanese fabless analog IC company.

Headquartered in the Hsinchu Science Park in Taiwan, Anachip's main product focus is power management ICs. Anachip's products are widely used in LCD monitor/TV's, wireless 802.11 LAN access points, brushless DC motor fans, portable DVD players, datacom devices, ADSL modems, TV/satellite set-top boxes, and power supplies.

The selling shareholders of Anachip stock included LSC (which owned approximately 60% of Anachip's outstanding capital stock), and two Taiwanese venture capital firms (together owning approximately 20% of Anachip's stock), as

well as current and former Anachip employees.

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**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 2 –BUSINESS ACQUISITIONS** (Continued)

At December 31, 2005, we had purchased an aggregate of 9,433,613 shares (or approximately 18.9%) of the 50,000,000 outstanding shares of the capital stock of Anachip. On January 10, 2006, (the closing date of the acquisition) we purchased an additional 40,470,212 shares and therefore, we hold approximately 99.81% of the Anachip capital stock. At December 31, 2005, the investment in Anachip is recorded under the equity method; however, we did not record income from the investment on the consolidated financial statements for the ten days ending December 31, 2005, as the amount was not material. As of result of the additional Anachip interest acquired during 2006, Anachip was consolidated beginning the first fiscal quarter of 2006.

The purchase price of the acquisition was NT\$20 per share (approximately US\$31 million). The following table summarizes management's fair value of the assets acquired and liabilities assumed at the date of acquisition.

|                           | Original Amount<br>Disclosed in 2005<br>Form 10-K<br>(unaudited) | Purchase<br>Adjustments | Total Allocation |
|---------------------------|--|-------------------------|------------------|
| Current assets            | \$ 23,752,000  | \$ (1,254,000)          | \$ 22,498,000    |
| Fixed assets/non-current  | 2,291,000  | (11,000)                | 2,280,000        |
| Patents and trademarks    | 2,269,000  | 161,000                 | 2,430,000        |
| Goodwill                  | 19,541,000   | 399,000                 | 19,940,000       |
| Total assets acquired     | 47,853,000   | (705,000)               | 47,148,000       |
| Current liabilities       | (16,829,000)   | 1,132,000               | (15,697,000)     |
| Non-current liabilities   | (655,000)  | (45,000)                | (700,000)        |
| Total liabilities assumed | (17,484,000)   | 1,087,000               | (16,397,000)     |
| Total purchase price      | \$ 30,369,000  | \$ 382,000              | \$ 30,751,000    |

Purchase adjustments primarily relate to acquisition costs and refinement to estimated fair values of assets acquired and liabilities assumed.

The acquired intangible assets include patents and trademarks of \$2.4 million with an approximately 10-year weighted-average useful life.

The following unaudited table summarizes the supplemental pro forma information for the year ended December 31, 2005 as though the acquisition had been completed as of the beginning of that reporting period. The pro forma information is presented for illustrative purposes and is not indicative of future performance.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 2 –BUSINESS ACQUISITIONS** (Continued)

|                           | <b>Twelve months ended December 31, 2005</b> |                  |
|---------------------------|--|------------------|
|                           | <b>As reported</b>                           | <b>Pro forma</b> |
| <b>Revenue</b>            | \$ 214,765,000                               | \$ 265,083,000   |
| <b>Net income</b>         | 33,329,000                                   | 32,934,000       |
| <b>Earnings per share</b> |  |                  |
| <b>Basic</b>              | \$ 1.44                                      | \$ 1.42          |
| <b>Diluted</b>            | \$ 1.29                                      | \$ 1.27          |

**APD acquisition** – On October 24, 2006, we signed an agreement to purchase the net assets of APD Semiconductor, a privately held U.S.-based fabless discrete semiconductor company. The assets related to the business of manufacturing, marketing, selling and distribution of discrete semiconductor products. The initial purchase price of the acquisition was \$8.4 million in addition to a potential earn-out provision with respect to pre-defined covered products. The acquisition was completed on November 3, 2006.

The contingent consideration had been recorded as a liability at the date of acquisition. When the contingency is resolved and the consideration is distributable, any excess of the fair value of the contingent consideration payable over the amount that was recognized as a liability shall be recognized as an additional cost of the acquired entity. If the amount initially recognized as a liability exceeds the consideration payable, that excess shall be allocated as a pro rata reduction of the amounts assigned to assets acquired. Any amount that remains after reducing those assets to zero shall be recognized as an extraordinary gain.

The following table summarizes management's preliminary estimates of the fair values of the assets acquired and liabilities assumed at the date of acquisition. The allocation of the purchase price is subject to refinement for final determination of fair value and the contingent consideration.

|                               | <b>Total Allocation</b> |
|-------------------------------|-------------------------|
| <b>Assets acquired</b>        |                         |
| Accounts receivable           | \$ 299,000              |
| Inventory                     | 754,000                 |
| Fixed assets                  | 125,000                 |
| Patents                       | 8,569,000               |
| <b>Liabilities assumed</b>    |                         |
| Accounts payable              | (339,000)               |
| Accrued long term liabilities | (1,000,000)             |
| <b>Net assets acquired</b>    | <b>\$ 8,408,000</b>     |

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 3 – SHORT-TERM INVESTMENTS**

Short-term investments at December 31, 2006, were as follows:

|  | Cost Basis     | Unrealized<br>Gains | Unrealized<br>Losses | Recorded Basis |
|--|----------------|---------------------|----------------------|----------------|
| State and local government obligations | \$ 290,796,000 | \$ -                | \$ -                 | \$ 290,796,000 |
| Money market mutual funds              | 212,000        | -                   | -                    | 212,000        |
| Total short-term investments           | \$ 291,008,000 | \$ -                | \$ -                 | \$ 291,008,000 |

The estimated fair value of the investments is \$290.8 million, and is based on publicly available market information or other estimates determined by management. Although the maturities of the securities are over 10 years, management intends to use the funds within one year and does not anticipate holding the investments until maturity; therefore, the securities are classified as short-term.

**NOTE 4 – INVENTORIES**

Inventories, stated at the lower of cost or market value, at December 31 were:

|                  | 2005          | 2006          |
|------------------|---------------|---------------|
| Finished goods   | \$ 14,722,000 | \$ 30,626,000 |
| Work-in-progress | 3,002,000     | 10,265,000    |
| Raw materials    | 9,534,000     | 13,464,000    |
|                  | 27,258,000    | 54,355,000    |
| Less: reserves   | (2,647,000)   | (6,153,000)   |
|                  | \$ 24,611,000 | \$ 48,202,000 |

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 5 – PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment at December 31 were:

|   | 2005          | 2006          |
|---|---------------|---------------|
| Buildings and leasehold improvements            | \$ 7,511,000  | \$ 8,117,000  |
| Construction in-progress                        | 7,201,000     | 6,619,000     |
| Machinery and equipment                         | 106,175,000   | 148,716,000   |
|   | 120,887,000   | 163,452,000   |
| Less: Accumulated depreciation and amortization | (52,219,000)  | (72,612,000)  |
|   | 68,668,000    | 90,840,000    |
| Land  | 262,000       | 4,629,000     |
| Total   | \$ 68,930,000 | \$ 95,469,000 |

**NOTE 6 – INTANGIBLE ASSETS SUBJECT TO AMORTIZATION**

Intangible assets subject to amortization at December 31, 2006 was:

| Amortized Intangible Assets | Useful life | Gross Carrying Amount | Accumulated Amortization | Currency exchange and other | Net           |
|-----------------------------|-------------|-----------------------|--------------------------|-----------------------------|---------------|
| <b>APD:</b>                 |             |                       |                          |                             |               |
| Patents                     | 15 years    | \$ 8,569,000          | \$ 79,000                | -                           | \$ 8,490,000  |
| <b>Anachip:</b>             |             |                       |                          |                             |               |
| Patents and trademarks      | 3-10 years  | 2,430,000             | 281,000                  | 30,000                      | 2,179,000     |
| Total                       |             | \$ 10,999,000         | \$ 360,000               | \$ 30,000                   | \$ 10,669,000 |

Amortization expense related to intangible assets subject to amortization was \$0 and \$360,000 for the years ended December 31, 2005 and 2006, respectively.

Amortization of intangible assets through 2011 is as follows:

| Years | Anachip    | APD        | Total amortization of Intangible assets |
|-------|------------|------------|---|
| 2007  | \$ 280,000 | \$ 571,000 | \$ 851,000                              |
| 2008  | 280,000    | 571,000    | 851,000                                 |
| 2009  | 280,000    | 571,000    | 851,000                                 |
| 2010  | 280,000    | 571,000    | 851,000                                 |

|      |         |         |         |
|------|---------|---------|---------|
| 2011 | 243,000 | 571,000 | 814,000 |
|------|---------|---------|---------|

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 7 – GOODWILL**

Changes in goodwill for the years ended December 31 are as follows:

|                  | 2005             |                        |                               | 2006                 |                    |                        |                             |                      |
|------------------|------------------|------------------------|-------------------------------|----------------------|--------------------|------------------------|-----------------------------|----------------------|
|                  | Balance, January | Acquisitions/purchases | Currency exchange adjustments | Balance, December 31 | Balance, January 1 | Acquisitions/purchases | Currency exchange and other | Balance, December 31 |
| Goodwill-China   | \$ 881,000       | \$ -                   | \$ -                          | \$ 881,000           | \$ 881,000         | \$ -                   | \$ -                        | \$ 881,000           |
| Goodwill-FabTech | 4,209,000        | -                      | -                             | 4,209,000            | 4,209,000          | -                      | -                           | 4,209,000            |
| Goodwill-Anachip | -                | -                      | -                             | -                    | -                  | 19,675,000             | 265,000                     | 19,940,000           |
| Total            | \$ 5,090,000     | \$ -                   | \$ -                          | \$ 5,090,000         | \$ 5,090,000       | \$ 19,675,000          | \$ 265,000                  | \$ 25,030,000        |

**NOTE 8 – BANK CREDIT AGREEMENTS AND LONG-TERM DEBT**

**Line of credit** - We maintain credit facilities with several financial institutions through our entities in the United States and Asia. The credit unused and available under the various facilities as of December 31, 2006, totals \$50.9 million, as follows:

| 2006<br>Credit Facility | Terms   | Outstanding at December 31, |           |
|-------------------------|---|-----------------------------|-----------|
|                         |   | 2005                        | 2006      |
| \$<br>20,000,000        | Revolving, collateralized by all assets, variable interest, LIBOR plus variable margin, due monthly   | \$ -                        | \$ -      |
| \$ 5,000,000            | Term loan, collateralized by all assets, variable interest, LIBOR plus variable margin, (approximately 6.5% at December 31, 2006) due monthly | 4,687,000                   | 3,686,000 |
| \$<br>20,000,000        | Unsecured, interest at LIBOR plus margin, due quarterly   | 6,000,000                   | -         |
| \$<br>19,693,000        | Unsecured, variable interest plus margin due monthly  | -                           | 4,790,000 |
| \$<br>64,693,000        |   | 10,687,000                  | 8,476,000 |



|   |              |             |
|---|--------------|-------------|
| Less: Long term debt, net of Related Party (Including in the following table) | (7,687,000)  | (8,476,000) |
| <b>Line of credit</b>   | \$ 3,000,000 | \$ -        |

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**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 8 -BANK CREDIT AGREEMENTS AND LONG-TERM DEBT** (Continued)

**Long-term debt** – The balances as of December 31, consist of the following:

|   | 2005         | 2006           |
|---|--------------|----------------|
| <b>Convertible bond</b> with aggregate principal amount \$230,000,000 of convertible senior notes due 2026. The notes will mature on October 1, 2026. Interest, at 2.25%, is payable semi-annually in arrears on April 1 and October 1 of each year, beginning on April 1, 2007 | \$ -         | \$ 230,000,000 |
| <b>Term note portion</b> of China credit facility due in 2006.  | 3,000,000    | -              |
| <b>Notes payable</b> to a commercial bank in Taiwan, principal amount of TWD 158,000,000, the interest rate was 1.9% as of December 31, 2006. TWD 132,000,000 will mature on July 6, 2021. TWD 26,000,000 will mature on July 6, 2013, secured by land and building.            | -            | 4,790,000      |
| <b>Term note portion</b> due to unrelated customer, unsecured and interest-free in quarterly price concession, balance due in July 2008.  | 1,800,000    | 1,441,000      |
| <b>Note payable</b> to U.S. bank, collateralized by all assets, due in aggregate monthly principal payments of \$83,000 plus interest (approximately 6.5% at December 31, 2006).  | 4,686,000    | 3,686,000      |
|   | 9,486,000    | 239,917,000    |
| Less: Current portion   | (4,621,000)  | (2,802,000)    |
| <b>Long-term debt</b> , net of current portion  | \$ 4,865,000 | \$ 237,115,000 |

The U.S. credit facility includes a revolving credit commitment of up to \$20.0 million, including a \$5.0 million letter of credit sub-facility. As of December 31, 2006, there was no amount outstanding under the letter of credit sub-facility. The credit facilities contain certain covenants and restrictions, which, among other matters, require the maintenance of certain financial ratios and attainment of certain financial results.

The annual contractual maturities of long-term debt at December 31, 2006 are as follows:

|                             |                       |
|-----------------------------|-----------------------|
| 2007                        | \$ 2,802,000          |
| 2008                        | 1,345,000             |
| 2009                        | 1,350,000             |
| 2010                        | 1,023,000             |
| 2011                        | 365,000               |
| Thereafter                  | 233,032,000           |
| <b>Total Long term debt</b> | <b>\$ 239,917,000</b> |

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 8 -BANK CREDIT AGREEMENTS AND LONG-TERM DEBT** (Continued)

**Convertible bond** – On October 12, 2006, we issued and sold convertible senior notes with an aggregate principal amount of \$230 million due 2026 (“Notes”), which pay 2.25% interest per annum on the principal amount of the notes, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on April 1, 2007. Interest will accrue on the notes from and including October 12, 2006 or from and including the last date in respect of which interest has been paid or provided for, as the case may be, to, but excluding, the next interest payment date or maturity date, as the case may be. Commencing with the six-month period beginning October 1, 2011, and for each six-month period thereafter, we will, on the interest payment date for such interest period, pay contingent interest to the holders of the notes under certain circumstances and in amounts described in the indenture. For U.S. federal income tax purposes, we will treat, and each holder of the notes will agree under the indenture to treat, the notes as contingent payment debt instruments governed by special tax rules and to be bound by our application of those rules to the notes.

The notes will be convertible into cash or, at our option, cash and shares of our common stock based on an initial conversion rate, subject to adjustment, of 17.0946 shares per \$1,000 principal amount of notes (which represents an initial conversion price of \$58.50 per share), in certain circumstances. In addition, following a “make-whole fundamental change” that occurs prior to October 1, 2011, we will, at our option, increase the conversion rate for a holder who elects to convert its notes in connection with such “make-whole fundamental change,” in certain circumstances.

Note holders may convert their notes prior to stated maturity only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending December 31, 2006, if the closing sale price of our common stock for each of 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 120% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading day period (we refer to this five consecutive trading day period as the “note measurement period”) in which the average trading price per \$1,000 principal amount of notes was equal to or less than 98% of the average conversion value of the notes during the note measurement period; (3) upon the occurrence of specified corporate transactions; (4) if we have called the notes for redemption; and (5) at any time from, and including, September 1, 2011 to, and including, October 1, 2011 and at any time on or after October 1, 2024. Upon conversion, we will deliver cash equal to the lesser of the aggregate principal amount of the notes to be converted and the total conversion obligation. We will deliver, at our option, cash, or shares of our common stock or a combination of cash and shares of our Common Stock for the remainder, if any, of the conversion obligation. The conversion obligation is based on the sum of the “daily settlement amounts” described in this prospectus for the 20 consecutive trading days that begin on, and include, the second trading day after the day the notes are tendered for conversion.

On or after October 1, 2011, we may from time to time at our option redeem the notes, in whole or in part, for cash, at a redemption price equal to 100% of the principal amount of the notes we redeem, plus any accrued and unpaid interest to, but excluding, the redemption date.

On each of October 1, 2011, October 1, 2016 and October 1, 2021, holders may require us to purchase all or a portion of their notes at a purchase price in cash equal to 100% of the principal amount of the notes to be purchased, plus any accrued and unpaid interest to, but excluding, the purchase date.

Note holders may require us to repurchase all or a portion of their notes upon a fundamental change, as described in this prospectus, at a repurchase price in cash equal to 100% of the principal amount of the notes to be repurchased,

plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date. Future minimum interest payments related to the Notes as of December 31, 2006 are \$5.2 million for each year from 2007 through 2011. Future minimum payments related to the Notes as of December 31, 2006 for 2011 and thereafter include \$77.5 million in interest and \$230 million in principal for a total of \$307.5 million.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 8 –BANK CREDIT AGREEMENTS AND LONG-TERM DEBT** (Continued)

We have evaluated the terms of the call feature, redemption feature, and the conversion feature under applicable accounting literature, including SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” and EITF 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock,” and concluded that none of these features should be separately accounted for as derivatives.

We intend to use the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments, or purchases of Common Stock.

In connection with the issuance of the Notes, we incurred approximately \$6.2 million of issuance costs, which primarily consisted of investment banker fees, legal and accounting fees. These costs are classified within Other Assets and are amortized as a component of interest expense using the straight-line method over the life of the Notes from issuance through October 12, 2011.

**NOTE 9 –CAPITAL LEASE OBLIGATIONS**

Future minimum lease payments under capital lease agreements are summarized as follows:

**For years ending December 31,**

|   |    |           |
|---|----|-----------|
| 2007                                    | \$ | 185,000   |
| 2008                                    |    | 185,000   |
| 2009                                    |    | 185,000   |
| 2010                                    |    | 185,000   |
| 2011                                    |    | 185,000   |
| Thereafter                              |    | 943,000   |
|   |    | 1,868,000 |
| Less: Interest                          |    | (250,000) |
| Present value of minimum lease payments |    | 1,618,000 |
| Less: Current portion                   |    | (141,000) |
| Long-term portion                       | \$ | 1,477,000 |

At December 31, 2006, property under capital leases had a cost of \$2.4 million, and the related accumulated depreciation was \$797,000. Depreciation of assets held under capital lease is included in depreciation expenses.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 10 – ACCRUED LIABILITIES**

Accrued liabilities at December 31 were:

|   | <b>2005</b>   | <b>2006</b>   |
|---|---------------|---------------|
| Employee compensation and payroll taxes | \$ 6,094,000  | \$ 9,746,000  |
| Equipment purchases                     | 7,073,000     | 6,195,000     |
| Accrued interest on convertible notes   | -             | 1,121,000     |
| Sales commissions                       | 629,000       | 699,000       |
| Other                                   | 4,516,000     | 7,206,000     |
|   | \$ 18,312,000 | \$ 24,967,000 |

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 11 – INCOME TAXES**

The components of the income tax provision are as follows:

|                            | <b>2004</b>       | <b>2005</b>      | <b>2006</b>          |
|----------------------------|-------------------|------------------|----------------------|
| Current tax provision      |                   |                  |                      |
| Federal                    | \$ 4,922,000      | \$ 3,013,000     | \$ <b>9,106,000</b>  |
| Foreign                    | 4,745,000         | 4,546,000        | <b>6,555,000</b>     |
| State                      | 461,000           | 547,000          | <b>641,000</b>       |
|                            | <b>10,128,000</b> | <b>8,106,000</b> | <b>16,302,000</b>    |
| Deferred tax benefit       | (3,614,000)       | (1,421,000)      | <b>(4,613,000)</b>   |
| Total income tax provision | \$ 6,514,000      | \$ 6,685,000     | \$ <b>11,689,000</b> |

Reconciliation between the effective tax rate and the statutory tax rates for the years ended December 31, 2004, 2005, and 2006 is as follows:

|  | <b>2004</b>   |                                  | <b>2005</b>   |                                  | <b>2006</b>          |                                  |
|--|---------------|----------------------------------|---------------|----------------------------------|----------------------|----------------------------------|
|  | Amount        | Percent<br>of pretax<br>earnings | Amount        | Percent<br>of pretax<br>earnings | Amount               | Percent<br>of pretax<br>earnings |
| Federal tax                                    | \$ 11,132,000 | 34.0                             | \$ 13,977,000 | 34.0                             | \$ <b>20,781,000</b> | <b>34.0</b>                      |
| State franchise tax,<br>net of Federal benefit | 1,572,000     | 4.8                              | 1,891,000     | 4.6                              | <b>2,506,000</b>     | <b>4.1</b>                       |
| Foreign income tax rate<br>difference          | (6,629,000)   | (20.2)                           | (11,079,000)  | (27.0)                           | <b>(16,993,000)</b>  | <b>(27.8)</b>                    |
| Subpart F income                               | 1,016,000     | 3.1                              | 1,520,000     | 3.7                              | <b>2,614,000</b>     | <b>4.3</b>                       |
| Foreign dividend                               | (497,000)     | (1.5)                            | 1,116,000     | 2.7                              | <b>2,270,000</b>     | <b>3.7</b>                       |
| Other  | (80,000)      | (0.3)                            | (740,000)     | (1.7)                            | <b>511,000</b>       | <b>0.8</b>                       |
| Income tax provision                           | \$ 6,514,000  | 19.9                             | \$ 6,685,000  | 16.3                             | \$ <b>11,689,000</b> | <b>19.1</b>                      |

Our global presence requires us to pay income taxes in a number of jurisdictions. In general, earnings in the U.S. and Taiwan are currently subject to tax rates of 39.0% and 35.0%, respectively. Earnings of Diodes-Hong Kong are subject to a 17.5% tax for local sales or local source sales; all other Hong Kong sales are not subject to foreign income taxes. Earnings at Diodes-Taiwan and Diodes-Hong Kong are also subject to U.S. taxes with respect to those earnings that are derived from product manufactured by our China subsidiaries and sold to customers outside of Taiwan and Hong Kong, respectively. The U.S. tax rate on these earnings is computed as the difference between the foreign effective tax rates and the U.S. tax rate. In accordance with U.S. tax law, we receive credit against our U.S. federal tax liability for income taxes paid by our foreign subsidiaries. Funds repatriated from foreign subsidiaries to the U.S. may be subject to Federal and state income taxes.

Diodes-China is located in the Songjiang district, where the standard central government tax rate is 24.0%. However, as an incentive for establishing Diodes-China, the earnings of Diodes-China were subject to a 0% tax rate by the central government from 1996 through 2000, and to a 12.0% tax rate from 2001 through 2006. In addition, due to an \$18.5 million permanent re-investment of Diodes-China earnings in 2004, Diodes-China has re-applied to the Chinese government for additional preferential tax





**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 11 – INCOME TAXES (Continued)**

treatment on earnings that are generated by this \$18.5 million investment. If approved, those earnings will be exempted from central government income tax for two years, and then subject to a 12.0% tax rate for the following three years.

In addition, the earnings of Diodes-China would ordinarily be subject to a standard local government tax rate of 3.0%. However, as an incentive for establishing Diodes-China, the local government waived this tax from 1996 through 2005. Management expects this tax to be waived for 2006; however, the local government can re-impose this tax at its discretion at any time.

In 2004, we established our second Shanghai-based manufacturing facility, Diodes-Shanghai, located in the Songjiang Export Zone of Shanghai, China. In the Songjiang Export Zone, the central government standard tax rate is 15.0%. From 2010 onward, Diodes-Shanghai earnings might not continue to be subject to the 15% tax rate as a proposed income tax reform is expected to be taking effect in 2007 which could terminate some existing tax incentive for foreign enterprise doing business in China. There is no local government tax. During 2004, Diodes-Shanghai earnings were subject to the standard 15.0% central government tax rate. As an incentive for establishing Diodes-Shanghai, the 2005 and 2006 earnings of Diodes-Shanghai were exempted from central government income tax, and for the years 2007 through 2009 its earnings will be subject to a 7.5% tax rate. From 2010 onward, Diodes-Shanghai earnings might not continue to be subject to the 15% tax rate as a proposed income tax reform is expected to be taking effect in 2007 which could terminate some existing tax incentive for foreign enterprise doing business in China.

With the recently proposed China government income tax reform, which could terminate some existing tax incentives for foreign enterprises doing business in China, it is unclear to what extent our China subsidiaries will continue to receive preferential tax treatment.

As an incentive for the formation of Anachip, earnings of Anachip are subject to a five-year tax holiday (subject to certain qualifications of Taiwanese tax law). In the third quarter of 2006, we elected to begin this five-year tax holiday as of January 1, 2006.

As of December 31, 2006, accumulated and undistributed earnings of Diodes-China and Diodes-Shanghai are approximately \$67.0 million, including \$28.5 million of restricted earnings (which are not available for dividends). Through March 31, 2002, we had not recorded deferred U.S. Federal or state tax liabilities (estimated to be \$8.9 million as of March 31, 2002) on these cumulative earnings since we, at that time, considered this investment to be permanent, and had no plans or obligation to distribute all or part of that amount from China to the U.S. Beginning in April 2002, we began to record deferred taxes on a portion of the China earnings in preparation of a dividend distribution. In the year ended December 31, 2004, we received a dividend of approximately \$5.7 million from our Diodes-China subsidiary, for which the tax effect is included in U.S. Federal and state taxable income.

On October 22, 2004, the President of the United States signed the American Jobs Creation Act (AJCA) into law. Originally intended to repeal the extraterritorial income (ETI) exclusion, which had triggered tariffs by the European Union, the AJCA expanded to cover a wide range of business tax issues. Among other items, the AJCA establishes a phased repeal of the ETI, a new incentive tax deduction for U.S. corporations to repatriate cash from foreign subsidiaries at a reduced tax rate (a deduction equal to 85% of cash dividends received in the year elected that exceeds a base-period amount) and significantly revises the taxation of U.S. companies doing business abroad.

At December 31, 2004, we made a minimum estimate for repatriating cash from our subsidiaries in China and Hong Kong of \$8.0 million under the AJCA, and recorded an income tax expense of approximately \$1.3 million. Under the guidelines of the AJCA, we developed a required domestic reinvestment plan, covering items such as U.S. bank debt repayment, U.S. capital expenditures and U.S. research and development activities, among others, to cover the dividend repatriation. During 2005, we completed a quantitative analysis of the benefits of the AJCA, the foreign tax credit implications, and state and local tax consequences of the impact of the AJCA on our plans for repatriation. Based on the analysis, we repatriated \$24.0 million from our foreign subsidiaries in 2005.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 11 –INCOME TAXES (Continued)**

We are evaluating the need to provide additional deferred taxes for the future earnings of our foreign subsidiaries to the extent such earnings may be appropriated for distribution to our corporate office in North America, and as further investment strategies with respect to foreign earnings are determined. The distribution of any unappropriated funds from our foreign subsidiaries to the U.S. will require the recording of income tax provisions on the U.S. entity, thus reducing net income. As of December 31, 2006, we have recorded approximately \$3.3 million in deferred taxes for earnings of our foreign subsidiaries, primarily Diodes-Hong Kong.

At December 31, 2005 and 2006, our deferred tax assets and liabilities are comprised of the following items:

|  | 2005           | 2006           |
|--|----------------|----------------|
| <b>Deferred tax assets, current</b>        |                |                |
| Inventory cost                             | \$ 672,000     | \$ 728,000     |
| Accrued expenses and accounts receivable   | 1,692,000      | 1,074,000      |
| Foreign tax credit                         | 1,100,000      | 1,100,000      |
| Net operating loss carryforwards and other | (923,000)      | 1,748,000      |
|  | \$ 2,541,000   | \$ 4,650,000   |
| <b>Deferred tax assets, non-current</b>    |                |                |
| Plant, equipment and intangible assets     | \$ (1,181,000) | \$ (2,050,000) |
| Foreign tax credit                         | 5,882,000      | 6,506,000      |
| Net operating loss carryforwards and other | 3,765,000      | 972,000        |
|  | \$ 8,466,000   | \$ 5,428,000   |

For the years ended December 31, 2004, 2005 and 2006, we recorded tax benefits related to the exercise of non-qualified stock options and the disqualified disposition of incentive stock options which were recorded as a credit to additional paid-in capital in the amount of \$8.5 million, \$2.9 million and \$6.7 million, respectively.

At December 31, 2006, we had Federal and state NOL carryforwards of approximately \$11.3 million and \$9.5 million, respectively, available to offset future regular and alternative minimum taxable income. The Federal NOL carryforwards will begin to expire in 2017 and the state NOL carryforwards will begin to expire in 2013. The benefit of a \$1.3 million NOL related to a deferred tax asset for stock options will be credited to additional paid-in capital when realized.

At December 31, 2006, we had Federal and state tax credit carryforwards of approximately \$8.8 million and \$0.2 million, respectively, available to offset future regular income and partially offset alternative minimum taxable income. The Federal credit carryforwards will begin to expire in 2009 and the state credit carryforwards will begin to expire in 2020.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 12 – EMPLOYEE BENEFIT PLANS**

We maintain a 401(k) retirement plan (the Plan) for the benefit of qualified employees at our North American locations. Employees who participate may elect to make salary deferral contributions to the Plan up to 100% of the employees' eligible payroll subject to annual Internal Revenue Code maximum limitations. We make a matching contribution of \$1 for every \$2 contributed by the participant up to 6% (3% maximum matching) of the participant's eligible payroll. In addition, we may make a discretionary contribution to the entire qualified employee pool, in accordance with the Plan.

As stipulated by the regulations of the People's Republic of China, we maintain a retirement plan pursuant to the local Municipal Government for the employees in China. We are required to make contributions to the retirement plan at a rate of 22.5% of the employee's eligible payroll.

Pursuant to the Taiwan Labor Standard Law and Factory Law, we maintain a retirement plan for the employees in Taiwan. We make contributions at a rate of 6% of the employee's eligible payroll.

For the years ended December 31, 2004, 2005, and 2006, total amounts expensed under these plans were approximately \$1.4 million, \$1.8 million and \$2.6 million, respectively.

**NOTE 13 – SHARE-BASED COMPENSATION**

We maintain share-based compensation plans for our Board of Directors ("Directors"), officers, and key employees, which provide for stock options and stock awards under our 1993 ISO Plan, 1993 NQO Plan, and 2001 Omnibus Equity Incentive Plan.

**Stock Options** - Through March 31, 2006, substantially all stock options granted vest in equal annual installments over a three-year period and expire ten years after the grant date. Beginning April 1, 2006, substantially all stock options granted vest in equal annual installments over a four-year period and expire ten years after the grant date.

Beginning in fiscal year 2006, we adopted SFAS No. 123R, "Share-Based Payments" (SFAS 123R), on a modified prospective transition method to account for our employee stock options. Under the modified prospective transition method, fair value of new and previously granted but unvested stock options are recognized as compensation expense in the income statement, and prior period results are not restated, and thus do not include the additional compensation expense. In the year ended December 31, 2006, operating income decreased by \$6.5 million, net income decreased by \$5.4 million (net of tax benefits recognized \$1.1 million), and diluted earnings per share were reduced by approximately \$0.15. For the year ended December 31, 2006, share-based compensation expense associated with our stock options recognized in the Consolidated Statement of Income is as follows:

|  | <b>Year 2006</b>    |
|--|---------------------|
| Selling and administrative expense     | \$ 5,394,000        |
| Research and development expense       | 603,000             |
| Cost of sales                          | 469,000             |
| Total share-based compensation expense | <b>\$ 6,466,000</b> |



**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 13 – SHARE-BASED COMPENSATION (Continued)**

Share-based compensation expense for stock options granted during 2004, 2005 and 2006 were calculated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

|                         | <b>2004</b> | <b>2005</b> | <b>2006</b>   |
|-------------------------|-------------|-------------|---------------|
| Expected volatility     | 68.36%      | 60.00%      | <b>54.34%</b> |
| Expected term (years)   | 5.00        | 5.00        | <b>5.88</b>   |
| Risk free interest rate | 3.64%       | 3.85%       | <b>4.73%</b>  |
| Forfeiture rate         | 2.64%       | 2.54%       | <b>2.56%</b>  |
| Dividend yield          | 0%          | 0%          | <b>0%</b>     |

**Expected volatility.** We estimate expected volatility using historical volatility. Public trading volume on options in our stock is not material. As a result, we determined that utilizing an implied volatility factor would not be appropriate. We calculate historical volatility for the period that is commensurate with the option's expected term assumption.

**Expected term.** We have evaluated expected term based on history and exercise patterns across its demographic population. We believe that this historical data is the best estimate of the expected term of a new option. The expected term for officers and Directors is 6.57 years, while the expected term for all other employees is 4.83 years.

**Risk free interest rate.** We estimate the risk-free interest rate based on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term assumption.

**Forfeiture rate.** The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest as SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term “forfeitures” is distinguished from “cancellations” or “expirations” and represents only the unvested portion of the surrendered option. We have applied an annual forfeiture rate of 2.56% to all unvested options as of December 31, 2006. This analysis will be re-evaluated at least annually, and the forfeiture rate will be adjusted as necessary.

**Dividend yield.** We historically have not paid a cash dividend; therefore this input is not applicable.

**Discount for post vesting restrictions.** This input is not applicable.

For the year ended December 31, 2006, we granted stock options to purchase 243,080 shares of our Common Stock, which vest in equal annual installments over a three or four-year period and expire ten years from the date of grant. The weighted-average grant-date fair value of options granted during the years 2004, 2005 and 2006 were \$10.9 million, \$12.2 million, and \$19.5 million, respectively. The total intrinsic value (actual gain) of options exercised during the years 2004, 2005 and 2006 were approximately \$23.6 million, \$ 11.9 million, and \$23.2 million, respectively.

At December 31, 2006, un-amortized compensation expense related to unvested options, net of forfeitures, was approximately \$9.3 million. The weighted average period over which share-based compensation expense related to

these options will be recognized is 2.1 years.

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**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 13 – SHARE-BASED COMPENSATION (Continued)**

A summary of the stock option plans as of December 31 is as follows:

| Stock options                           | Shares (000) | Weighted<br>Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual<br>Term (yrs) | Aggregate<br>Intrinsic Value<br>(\$000) |
|---|--------------|---------------------------------------|--|---|
| Outstanding at December 31, 2003        | 5,077        | \$ 5.04                               |  | 38,722                                  |
| Granted                                 | 790          | 12.23                                 |  |   |
| Exercised                               | (1705)       | 3.31                                  |  | 23,641                                  |
| Forfeited or expired                    | (53)         | 9.09                                  |  |   |
| Outstanding at December 31, 2004        | 4,109        | 7.09                                  | 6.70   | 20,727                                  |
| Outstanding at December 31, 2004        | 4,109        | 7.09                                  |  |   |
| Granted                                 | 833          | 22.34                                 |  |   |
| Exercised                               | (788)        | 5.26                                  |  | 11,902                                  |
| Forfeited or expired                    | (61)         | 13.11                                 |  |   |
| Outstanding at December 31, 2005        | 4,092        | 10.45                                 | 6.74   | 84,277                                  |
| Outstanding at January 1, 2006          | 4,092        | 10.45                                 |  |   |
| Granted                                 | 243          | 34.57                                 |  |   |
| Exercised                               | (703)        | 6.21                                  |  | 23,164                                  |
| Forfeited or expired                    | (54)         | 24.04                                 |  |   |
| <b>Outstanding at December 31, 2006</b> | <b>3,579</b> | <b>12.73</b>                          | <b>6.36</b>  | <b>81,396</b>                           |
| <b>Exercisable at December 31, 2006</b> | <b>2,607</b> | <b>8.95</b>                           | <b>5.57</b>  | <b>69,161</b>                           |

Prior to our adoption of SFAS 123R, SFAS No. 123, “Accounting for Stock-Based Compensation” (SFAS 123) provided an alternative to APB Opinion No. 25, “Accounting for Stock Issued to Employees” (APB 25), in accounting for stock-based compensation issued to employees. SFAS 123 provided for a fair value based method of accounting for employee stock options and similar equity instruments. However, companies that continued to account for stock-based compensation arrangements under APB 25 were required by SFAS 123 to disclose, in the notes to financial statements, the pro forma effects on net income and net income per share as if the fair value based method prescribed by SFAS 123 had been applied. Prior to our adoption of SFAS 123R, we accounted for stock-based compensation using the provisions of APB 25 and presented the pro forma information required by SFAS 123 as amended by SFAS No. 148, “Accounting for Stock-Based Compensation-Transition and Disclosure” (SFAS 148).



**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**NOTE 13 – SHARE-BASED COMPENSATION (Continued)**

Had we accounted for stock-based compensation plans using the fair value based accounting method described by SFAS 123R for the periods prior to fiscal year 2006, our earnings per share for the years 2004 and 2005, would have approximated the following:

|   | <b>2004</b>   | <b>2005</b>   |
|---|---------------|---------------|
| <b>Net income, as reported</b>  | \$ 25,551,000 | \$ 33,329,000 |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax benefits | (1,642,000)   | (2,805,000)   |
| <b>Pro forma net income</b>   | \$ 23,909,000 | \$ 30,524,000 |
| <b>Earnings per share:</b>  |               |               |
| <b>Basic</b>  |               |               |
| - as reported   | \$ 1.27       | \$ 1.44       |
| - pro forma   | \$ 1.19       | \$ 1.32       |
| <b>Diluted</b>  |               |               |
| - as reported   | \$ 1.10       | \$ 1.29       |
| - pro forma   | \$ 1.03       | \$ 1.18       |

As of December 31, 2006, approximately 2.6 million of the 3.6 million stock options were exercisable. The following summarizes information about stock options outstanding at December 31, 2006:

|          | Range of exercise prices | Number outstanding (000) | Weighted average remaining contractual life (yrs) | Weighted average exercise price |
|----------|--------------------------|--------------------------|---|---------------------------------|
| '93 NQQ  | \$ 2.00-10.63            | 627                      | 3.32  | \$ 7.39                         |
| '93 ISO  | 2.22-10.63               | 322                      | 3.99  | 6.13                            |
| '01 Plan | 3.70-42.67               | 2,630                    | 7.37  | 14.82                           |
| Total    | \$ 2.00-42.67            | 3,579                    | 6.36  | \$ 12.73                        |

The following summarizes information about stock options exercisable at December 31, 2006:

|          | Range of exercise prices | Number outstanding (000) | Weighted average remaining contractual life (yrs) | Weighted average exercise price |
|----------|--------------------------|--------------------------|---|---------------------------------|
| '93 NQQ  | \$ 2.00-10.63            | 627                      | 3.32  | \$ 7.39                         |
| '93 ISO  | 2.22-10.63               | 322                      | 3.99  | 6.13                            |
| '01 Plan | 3.70-32.60               | 1,658                    | 6.72  | 10.08                           |
| Total    | \$ 2.00-32.60            | 2,607                    | 5.57  | \$ 8.95                         |

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 13 – SHARE-BASED COMPENSATION** (Continued)

**Share Grants** – Restricted stock awards and restricted stock units generally vest in equal annual installments over a four-year period. A summary of the status of our non-vested share grants in 2005 and 2006 are presented below:

| Nonvested Shares                      | Shares (000) | Weighted-Average<br>Grant-Date<br>Fair Value |
|---------------------------------------|--------------|--|
| Nonvested at January 1, 2005          | -            | \$ -   |
| Granted                               | 330          | 17.30  |
| Vested                                | -            | -  |
| Forfeited                             | -            | -  |
| Nonvested at December 31, 2005        | 330          | 17.30  |
| Nonvested at January 1, 2006          | 330          | 17.30  |
| Granted                               | 242          | 34.90  |
| Vested                                | -            | -  |
| Forfeited                             | (4)          | 34.96  |
| <b>Nonvested at December 31, 2006</b> | <b>568</b>   | <b>\$ 24.67</b>                              |

For each of the years ended December 31, 2005 and 2006, there were \$1.8 million of total recognized share-based compensation expense related to non-vested stock award arrangements granted under the plans. The total of unrecognized share-based compensation expense as of December 31, 2005 and December 31, 2006 was \$3.9 million and \$10.2 million, respectively. This cost is expected to be recognized over a weighted average period of 3.0 years.

**NOTE 14 – RELATED PARTY TRANSACTIONS**

We conduct business with two related party companies, Lite-On Semiconductor Corporation (“LSC”) (and its subsidiaries and affiliates) and Keylink International (formerly Xing International) (and its subsidiaries). LSC is our largest stockholder and owns 22.3% of our outstanding Common Stock as of December 31, 2006. Keylink International is our 5% joint venture partner in Diodes-China and Diodes-Shanghai. C.H. Chen, our previous President and Chief Executive Officer, and Vice Chairman of our Board of Directors, is also Vice Chairman of LSC. M.K. Lu, a member of our Board of Directors, is President of LSC, while Raymond Soong, the Chairman of our Board of Directors, is the Chairman of Lite-On Technology Corporation, a significant shareholder of LSC, as well as Chairman of LSC.

The Audit Committee of our Board of Directors reviews all related party transactions for potential conflict of interest situations, and approves all such transactions, in accordance with such procedures as it may adopt from time to time. We believe that all related party transactions are on terms no less favorable to us than would be obtained from unaffiliated third parties.

**Lite-On Semiconductor Corporation (LSC)** - In July 1997, Vishay Intertechnology, Inc. (Vishay) and the Lite-On Group, a Taiwanese consortium, formed a joint venture - Vishay/Lite-On Power Semiconductor Pte., LTD. (Vishay/LPSC) - to acquire Lite-On Power Semiconductor Corp. (LPSC), a then 37% shareholder of the Company and a member of the Lite-On Group of the Republic of China. The Lite-On Group is a leading manufacturer of power

semiconductors, computer peripherals, and communication products.

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**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 14 –RELATED PARTY TRANSACTIONS (Continued)**

In March 2001, Vishay agreed to sell its 65% interest in the Vishay/LPSC joint venture to the Lite-On Group, the 35% joint venture partner. Because of this transaction, the Lite-On Group, through LPSC, its wholly owned subsidiary, indirectly owned approximately 37% of our common stock. In December 2001, LPSC merged with Dyna Image Corporation of Taipei, Taiwan. Dyna Image is the world's largest manufacturer of Contact Image Sensors (CIS), which are used in fax machines, scanners, and copy machines. The combined company is called Lite-On Semiconductor Corporation (LSC). As of December 31, 2006, LSC owned approximately 22.3% of our common stock. We consider our relationship with LSC to be mutually beneficial and we plan to continue our strategic alliance together as we have since 1991.

We sold silicon wafers to LSC totaling 6.5% during 2006 (9.6% in 2005 and 11.1% in 2004) of our net sales, respectively, making LSC our largest customer. Also for the year ended December 31, 2006, 13.0% (14.7% in 2005 and 17.2% in 2004) of our net sales were from discrete semiconductor products purchased from LSC for subsequent sale by us, making LSC our largest outside supplier. In addition, companies affiliated with LSC, which we refer to collectively as The Lite-On Group, accounted for 3.3%, 4.2% and 2.3% of our net sales, respectively, in 2004, 2005 and 2006. We also rent warehouse space in Hong Kong from a member of The Lite-On Group, which also provides us with warehousing services at that location. For 2004, 2005 and 2006, we reimbursed this entity in aggregate amounts of \$190,000, \$288,000 and \$474,000, respectively, for these items. We believe such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties. The Audit Committee of our Board of Directors has approved the contracts associated with these related party transactions.

Net sales to, and purchases from, LSC were as follows for years ended December 31:

|           | 2004          | 2005          | 2006          |
|-----------|---------------|---------------|---------------|
| Net sales | \$ 20,675,000 | \$ 20,608,000 | \$ 22,374,000 |
| Purchases | \$ 22,368,000 | \$ 22,289,000 | \$ 48,778,000 |

In December 2000, we acquired a wafer foundry, FabTech, Inc., from LSC for approximately \$6.0 million cash plus \$19.0 million in assumed debt (the debt was due primarily to LSC). In connection with the acquisition, LSC entered into a volume purchase agreement to purchase wafers from FabTech. In addition, in accordance with the terms of the acquisition, we also entered into several management incentive agreements with members of FabTech's management, which provided FabTech's management with guaranteed annual payments as well as contingent bonuses based on the annual profitability of FabTech, subject to a maximum annual amount. Any portion of the guaranteed and contingent liability paid by FabTech was reimbursed by LSC. The final year of the management incentive agreements was 2004, with final payment made on March 31, 2005. LSC reimbursed us \$375,000 in 2003, 2004, and 2005 for each of 2002, 2003 and 2004, for amounts paid by us under these management incentive agreements.

**Keylink International** – We sell product to, and purchase inventory from, companies owned by our 5% minority shareholder, Keylink International (formerly Xing International), in Diodes-China and Diodes-Shanghai. During 2006, we sold silicon wafers to companies owned by Keylink International totaling 0.4%, respectively, (0.6% in 2005 and 0.9% in 2004) of our net sales. Also for the year ended December 31, 2006, 2.3% (3.0% in 2005 and 3.5% in 2004) of our net sales were from discrete semiconductor products purchased from companies owned by Keylink International, respectively. In addition, Diodes-China and Diodes-Shanghai lease their manufacturing facilities from, and

subcontract a portion of their manufacturing process (metal plating and environmental services) to, Keylink International. We also pay a consulting fee to Keylink International. The aggregate amounts for these services for the year ended December 31, 2004, 2005 and 2006 were \$4.8 million, \$6.6 million and \$7.9 million, respectively. We believe such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties. The Audit Committee of our Board of Directors has approved the contracts associated with these related party transactions.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 14 –RELATED PARTY TRANSACTIONS (Continued)**

Net sales to, and purchases from, companies owned by Keylink International were as follows for years ended December 31:

|           | 2004         | 2005         | 2006                |
|-----------|--------------|--------------|---------------------|
| Net sales | \$ 1,677,000 | \$ 1,336,000 | \$ <b>1,481,000</b> |
| Purchases | \$ 4,789,000 | \$ 3,882,000 | \$ <b>5,973,000</b> |

Accounts receivable from, and accounts payable to, related parties were as follows as of December 31:

|                       | 2005         | 2006                 |
|-----------------------|--------------|----------------------|
| Accounts receivable   |              |                      |
| LSC                   | \$ 5,800,000 | \$ <b>4,848,000</b>  |
| Keylink International | 1,004,000    | <b>1,299,000</b>     |
|                       | \$ 6,804,000 | \$ <b>6,147,000</b>  |
| Accounts payable      |              |                      |
| LSC                   | \$ 5,150,000 | \$ <b>8,646,000</b>  |
| Keylink International | 2,771,000    | <b>3,474,000</b>     |
|                       | \$ 7,921,000 | \$ <b>12,120,000</b> |

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 15 ~~SEGMENT~~ INFORMATION**

An operating segment is defined as a component of an enterprise about which separate financial information is available that is evaluated regularly by the chief decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief decision-making group consists of the President and Chief Executive Officer, Chief Financial Officer, Senior Vice President of Operations, Senior Vice President of Sales and Marketing, Vice President of Asia Sales, and Senior Vice President of Finance. For financial reporting purposes, we operate in a single segment, semiconductor related devices, through our various manufacturing and distribution facilities. We aggregated our products since the products are similar and have similar economic characteristics, and the products are similar in production process and share the same customer type.

Our operations include the domestic operations (Diodes, Inc. and FabTech) located in the United States and the Asian operations (Diodes-Taiwan located in Taipei, Taiwan, Diodes-Anachip located in Hsinchu, Taiwan, Diodes-China and Diodes-Shanghai both located in Shanghai, China, and Diodes-Hong Kong located in Hong Kong, China). For reporting purposes, European operations, which accounted for approximately 2.6%, 2.6% and 3.3% of total sales for the years ended December 31, 2004, 2005 and 2006, respectively, are consolidated into the domestic (North America) operations.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**


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**NOTE 15 -SEGMENT INFORMATION** (Continued)

The accounting policies of the operating entities are the same as those described in the summary of significant accounting policies. Revenues are attributed to geographic areas based on the location of the market producing the revenues.

|                               |    | Asia                 |    | U.S.A.              |    | Consolidated         |
|-------------------------------|----|----------------------|----|---------------------|----|----------------------|
| <b>2006</b>                   |    |                      |    |                     |    |                      |
| <b>Total Sales</b>            | \$ | <b>405,002,000</b>   | \$ | <b>117,867,000</b>  | \$ | <b>522,869,000</b>   |
| <b>Inter-company sales</b>    |    | <b>(158,131,000)</b> |    | <b>(21,430,000)</b> |    | <b>(179,561,000)</b> |
| <b>Net sales</b>              | \$ | <b>246,871,000</b>   | \$ | <b>96,437,000</b>   | \$ | <b>343,308,000</b>   |
| <b>Long-lived assets, net</b> | \$ | <b>105,020,000</b>   | \$ | <b>26,148,000</b>   | \$ | <b>131,168,000</b>   |
| <b>Assets</b>                 | \$ | <b>241,979,000</b>   | \$ | <b>380,160,000</b>  | \$ | <b>622,139,000</b>   |
| <b>2005</b>                   |    |                      |    |                     |    |                      |
|                               |    | Asia                 |    | U.S.A.              |    | Consolidated         |
| <b>Total Sales</b>            | \$ | 238,825,000          | \$ | 90,707,000          | \$ | 329,532,000          |
| <b>Inter-company sales</b>    |    | (98,427,000)         |    | (16,340,000)        |    | (114,767,000)        |
| <b>Net sales</b>              | \$ | 140,398,000          | \$ | 74,367,000          | \$ | 214,765,000          |
| <b>Long-lived assets, net</b> | \$ | 58,283,000           | \$ | 15,737,000          | \$ | 74,020,000           |
| <b>Assets</b>                 | \$ | 139,863,000          | \$ | 149,652,000         | \$ | 289,515,000          |
| <b>2004</b>                   |    |                      |    |                     |    |                      |
|                               |    | Asia                 |    | U.S.A.              |    | Consolidated         |
| <b>Total Sales</b>            | \$ | 185,308,000          | \$ | 92,634,000          | \$ | 277,942,000          |
| <b>Inter-company sales</b>    |    | (75,527,000)         |    | (16,712,000)        |    | (92,239,000)         |
| <b>Net sales</b>              | \$ | 109,781,000          | \$ | 75,922,000          | \$ | 185,703,000          |
| <b>Long-lived assets, net</b> | \$ | 49,470,000           | \$ | 16,477,000          | \$ | 65,947,000           |
| <b>Assets</b>                 | \$ | 116,729,000          | \$ | 51,072,000          | \$ | 167,801,000          |



**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 15 -SEGMENT INFORMATION (Continued)**

**Geographic Information**

Revenues were derived from invoiced to the following countries (All Others represents countries with less than 10% of total revenues each):

|                      | <b>2006</b> | <b>Revenue</b>     | <b>% of Total<br/>Revenue</b> |
|----------------------|-------------|--------------------|-------------------------------|
| <b>China</b>         | <b>\$</b>   | <b>118,303,000</b> | <b>34.5%</b>                  |
| <b>Taiwan</b>        |             | <b>96,401,000</b>  | <b>28.1%</b>                  |
| <b>United States</b> |             | <b>76,357,000</b>  | <b>22.2%</b>                  |
| <b>All Others</b>    |             | <b>52,247,000</b>  | <b>15.2%</b>                  |
| <b>Total</b>         | <b>\$</b>   | <b>343,308,000</b> | <b>100.0%</b>                 |

|                      | <b>2005</b> | <b>Revenue</b>     | <b>% of Total<br/>Revenue</b> |
|----------------------|-------------|--------------------|-------------------------------|
| <b>China</b>         | <b>\$</b>   | <b>68,050,000</b>  | <b>31.7%</b>                  |
| <b>Taiwan</b>        |             | <b>59,838,000</b>  | <b>27.9%</b>                  |
| <b>United States</b> |             | <b>54,981,000</b>  | <b>25.6%</b>                  |
| <b>All Others</b>    |             | <b>31,896,000</b>  | <b>14.8%</b>                  |
| <b>Total</b>         | <b>\$</b>   | <b>214,765,000</b> | <b>100.0%</b>                 |

|                      | <b>2004</b> | <b>Revenue</b>     | <b>% of Total<br/>Revenue</b> |
|----------------------|-------------|--------------------|-------------------------------|
| <b>United States</b> | <b>\$</b>   | <b>53,204,000</b>  | <b>28.7%</b>                  |
| <b>Taiwan</b>        |             | <b>50,716,000</b>  | <b>27.3%</b>                  |
| <b>China</b>         |             | <b>44,311,000</b>  | <b>23.9%</b>                  |
| <b>All Others</b>    |             | <b>37,472,000</b>  | <b>20.1%</b>                  |
| <b>Total</b>         | <b>\$</b>   | <b>185,703,000</b> | <b>100.0%</b>                 |

**Major customers** –In 2006, we sold silicon wafers to LSC totaling 6.5% (9.6% in 2005 and 11.1% in 2004) of our total net sales, making LSC our largest customer. No other customer accounted for 10% or greater of our total net sales.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 16 – COMMITMENTS AND CONTINGENCIES**

**Operating leases** – We lease offices, manufacturing plants and warehouses under operating lease agreements expiring through December 2011. Rent expense amounted to approximately \$2.9 million, \$3.7 million and \$4.0 million for the years ended December 31, 2004, 2005, and 2006, respectively.

Future minimum lease payments under non-cancelable operating leases at December 31, 2006 are:

|                |               |
|----------------|---------------|
| 2007           | \$ 4,096,000  |
| 2008           | 3,347,000     |
| 2009           | 2,523,000     |
| 2010           | 1,620,000     |
| 2011 and later | 4,584,000     |
|                | \$ 16,170,000 |

**Purchase commitments** - We have non-cancelable purchase contracts for capital expenditures, primarily for manufacturing equipment in China, for approximately \$7.5 million at December 31, 2006.

**DIODES INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**NOTE 17 – SELECTED QUARTERLY FINANCIAL DATA (Unaudited)**

|                    | Quarter Ended |               |               |               |
|--------------------|---------------|---------------|---------------|---------------|
|                    | March 31      | June 30       | Sept. 30      | Dec. 31       |
| <b>Fiscal 2006</b> |               |               |               |               |
| Net sales          | \$ 73,589,000 | \$ 82,712,000 | \$ 92,575,000 | \$ 94,432,000 |
| Gross profit       | 24,214,000    | 27,433,000    | 30,696,000    | 31,549,000    |
| Net income         | 9,312,000     | 11,385,000    | 12,770,000    | 14,675,000    |
| Earnings per share |               |               |               |               |
| Basic              | \$ 0.37       | \$ 0.45       | \$ 0.50       | \$ 0.57       |
| Diluted            | 0.34          | 0.41          | 0.45          | 0.53          |

|                    | Quarter Ended |               |               |               |
|--------------------|---------------|---------------|---------------|---------------|
|                    | March 31      | June 30       | Sept. 30      | Dec. 31       |
| <b>Fiscal 2005</b> |               |               |               |               |
| Net sales          | \$ 48,600,000 | \$ 50,598,000 | \$ 54,200,000 | \$ 61,367,000 |
| Gross profit       | 16,596,000    | 17,496,000    | 18,877,000    | 21,407,000    |
| Net income         | 7,240,000     | 7,665,000     | 8,383,000     | 10,041,000    |
| Earnings per share |               |               |               |               |
| Basic              | \$ 0.34       | \$ 0.35       | \$ 0.38       | \$ 0.40       |
| Diluted            | 0.31          | 0.32          | 0.34          | 0.36          |

|                    | Quarter Ended |               |               |               |
|--------------------|---------------|---------------|---------------|---------------|
|                    | March 31      | June 30       | Sept. 30      | Dec. 31       |
| <b>Fiscal 2004</b> |               |               |               |               |
| Net sales          | \$ 41,435,000 | \$ 47,017,000 | \$ 49,364,000 | \$ 47,887,000 |
| Gross profit       | 12,750,000    | 15,028,000    | 16,746,000    | 16,211,000    |
| Net income         | 4,856,000     | 6,123,000     | 7,242,000     | 7,330,000     |
| Earnings per share |               |               |               |               |
| Basic              | \$ 0.25       | \$ 0.31       | \$ 0.36       | \$ 0.35       |
| Diluted            | 0.21          | 0.27          | 0.31          | 0.31          |

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENT SCHEDULE**

To the Board of Directors and Stockholders  
Diodes Incorporated and Subsidiaries

Our audits of the consolidated financial statements of Diodes Incorporated and Subsidiaries referred to in our report dated February 28, 2007 appearing in item 8 in this Annual Report on Form 10-K also included an audit of the financial statement schedule listed in item 15(a) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ Moss Adams LLP

**MOSS ADAMS LLP**  
Los Angeles, California  
February 28, 2007

**DIODES INCORPORATED AND SUBSIDIARIES****SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS**

| Description                                    | Balance at the<br>beginning of<br>period | Additions charged<br>to costs and<br>expenses | Deductions | Balance at the<br>end of period |
|--|--|---|------------|---------------------------------|
| Year ended December 31,                        |  |   |            |                                 |
| <b>2004</b>                                    |  |   |            |                                 |
| Allowance for doubtful accounts                | \$ 375,000                               | \$ 68,000                                     | \$ 11,000  | \$ 432,000                      |
| Reserve for slow moving and obsolete inventory | 2,093,000                                | 982,000                                       | 930,000    | 2,145,000                       |
| <b>2005</b>                                    |  |   |            |                                 |
| Allowance for doubtful accounts                | \$ 432,000                               | \$ 190,000                                    | \$ 88,000  | \$ 534,000                      |
| Reserve for slow moving and obsolete inventory | 2,145,000                                | 982,000                                       | 480,000    | 2,647,000                       |
| <b>2006</b>                                    |  |   |            |                                 |
| Allowance for doubtful accounts                | * \$ 534,000                             | \$ 263,000                                    | \$ 180,000 | \$ 617,000                      |
| Reserve for slow moving and obsolete inventory | 2,647,000                                | 3,843,000 **                                  | 337,000    | 6,153,000                       |

\* 2006 includes the beginning balance of \$205,000 allowance for doubtful accounts acquired from Anachip

\*\* 2006 includes the beginning balance of \$1,052,000 and \$500,000 reserve for slow moving and obsolete inventory acquired from Anachip and APD, respectively.

**SIGNATURES**

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

DIODES INCORPORATED (Registrant)

By: /s/ Keh-Shew, Lu  
KEH-SHEW LU  
President and Chief Executive Officer  
(Principal Executive Officer)

March 1, 2007

By: /s/ Carl C. Wertz  
CARL C. WERTZ  
Chief Financial Officer, Treasurer, and Secretary  
(Principal Financial and Accounting Officer)

March 1, 2007

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints Dr. Keh-Shew Lu, President and Chief Financial Officer and Carl C. Wertz, Chief Financial Officer, Treasurer, and Secretary, his true and lawful attorneys-in-fact and agents, with full power of substitution, to sign and execute on behalf of the undersigned and any and all amendments to this report, and to perform any acts necessary in order to file the same, with all exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requested 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 agents, or their or his or her substitutes, shall 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 indicated on March 1, 2007.

/s/ Keh-Shew, Lu  
KEH-SHEW LU  
President and Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Carl C. Wertz  
CARL C. WERTZ  
Chief Financial Officer, Treasurer, and Secretary  
(Principal Financial and Accounting Officer)

/s/ Raymond Soong  
RAYMOND SOONG  
Chairman of the Board of Directors

/s/ C.H. Chen  
C.H. CHEN  
Director

/s/ Michael R. Giordano  
MICHAEL R. GIORDANO  
Director

/s/ M.K. Lu  
M.K. LU  
Director

/s/ Keh-Shew Lu

/s/ John M. Stich

KEH-SHEW LU  
Director

JOHN M. STICH  
Director

/s/ Shing Mao  
SHING MAO  
Director

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## INDEX TO EXHIBITS

**Number Description**

- 2.1 Stock Purchase Agreement dated as of December 20, 2005, by and among DII Taiwan Corporation Ltd., Anachip Corporation, Lite-On Semiconductor Corporation, Shin Sheng Investment Limited and Sun Shining Investment Corp.<sup>(1)</sup>
- 2.2 Asset Purchase Agreement dated as of October 18, 2006, by and among DII Taiwan Corporation Ltd., APD Semiconductor, Inc. and Certain Shareholders Thereof, and entered into by the parties on October 19, 2006<sup>(2)</sup>
- 2.3 Amendment to the Asset Purchase Agreement, dated October 18, 2006, by and among Diodes Incorporated, DII Taiwan Corporation Ltd., APD Semiconductor, Inc. and APD Semiconductor (Asia) Inc., and entered into by the parties on October 19, 2006<sup>(3)</sup>
- 2.4 Second Amendment to Asset Purchase Agreement dated as of October 31, 2006, by and among Diodes Incorporated, DII Taiwan Corporation Ltd., APD Semiconductor, Inc. and APD Semiconductor (Asia) Inc<sup>(4)</sup>
- 3.1 Certificate of Incorporation, as amended<sup>(5)</sup>
- 3.2 Amended By-laws of the Company dated August 14, 1987<sup>(6)</sup>
- 4.1 Form of Certificate for Common Stock, par value \$0.66 2/3 per share<sup>(7)</sup>
- 4.2 Form of Convertible Senior Notes due 2026<sup>(8)</sup>
- 4.3 Form of Indenture for the Convertible Senior Notes due 2026<sup>(9)</sup>
- 10.1 \* Company's 401(k) Plan - Adoption Agreement<sup>(10)</sup>
- 10.2 \* Company's 401(k) Plan - Basic Plan Documentation #03<sup>(10)</sup>
- 10.3 \* Company's Incentive Bonus Plan<sup>(11)</sup>
- 10.4 \* Company's 1993 Non-Qualified Stock Option Plan<sup>(11)</sup>
- 10.5 \* Company's 1993 Incentive Stock Option Plan<sup>(10)</sup>
- 10.6 KaiHong Compensation Trade Agreement for SOT-23 Product<sup>(12)</sup>
- 10.7 KaiHong Compensation Trade Agreement for MELF Product<sup>(13)</sup>
- 10.8 Lite-On Power Semiconductor Corporation Distributorship Agreement<sup>(14)</sup>
- 10.9 Loan Agreement between the Company and FabTech Incorporated<sup>(15)</sup>
- 10.10 KaiHong Joint Venture Agreement between the Company and Mrs. J.H. Xing<sup>(15)</sup>
- 10.11 Quality Assurance Consulting Agreement between LPSC and Shanghai KaiHong Electronics Company, Ltd.<sup>(16)</sup>
- 10.12 Guaranty Agreement between the Company and Shanghai KaiHong Electronics Co., Ltd.<sup>(17)</sup>
- 10.13 Guaranty Agreement between the Company and Xing International, Inc.<sup>(17)</sup>
- 10.14 Bank Guaranty for Shanghai KaiHong Electronics Co., LTD<sup>(18)</sup>
- 10.15 Consulting Agreement between the Company and J.Y. Xing<sup>(19)</sup>
- 10.16 Diodes-Taiwan Relationship Agreement for FabTech Wafer Sales<sup>(20)</sup>
- 10.17 Volume Purchase Agreement dated as of October 25, 2000, between FabTech, Inc. and Lite-On Power Semiconductor Corporation<sup>(21)</sup>
- 10.18 Diodes Incorporated Building Lease - Third Amendment<sup>(22)</sup>
- 10.19\* 2001 Omnibus Equity Incentive Plan<sup>(23)</sup>
- 10.20 Sale and Leaseback Agreement between the Company and Shanghai Ding Hong Company, Ltd.<sup>(24)</sup>
- 10.21 Lease Agreement between the Company and Shanghai Ding Hong Company, Ltd.<sup>(24)</sup>
- 10.22 Lease Agreement for Plant #2 between the Company and Shanghai Ding Hong Electronic Equipment Limited<sup>(25)</sup>
- 10.23 \$5 Million Term Note with Union Bank<sup>(25)</sup>
- 10.24 First Amendment To Amended And Restated Credit Agreement<sup>(25)</sup>
- 10.25 Covenant Agreement between Union Bank and FabTech, Inc.<sup>(25)</sup>



- 10.26 Amendment to The Sale and Lease Agreement dated as January 31, 2002 with Shanghai Ding Hong Electronic Co., Ltd. <sup>(25)</sup>
- 10.27 Lease Agreement between Diodes Shanghai and Shanghai Yuan Hao Electronic Co., Ltd. <sup>(25)</sup>
- 10.28 Supplementary to the Lease agreement dated as September 30, 2003 with Shanghai Ding Hong Electronic Co., Ltd. <sup>(25)</sup>
- 10.29 Second Amendment to Amended and Restated Credit Agreement dated as of August 29, 2005, between Diodes Incorporated and Union Bank of California, N.A. <sup>(26)</sup>
- 10.30 Covenant Agreement dated as of August 29, 2005, between FabTech, Inc. and Union Bank of California, N.A. <sup>(26)</sup>
- 10.31 Revolving Note dated as of August 29, 2005, of Diodes Incorporated payable to Union Bank of California, N.A. <sup>(26)</sup>
- 10.32 Term Note dated as of August 29, 2005, of FabTech, Inc. payable to Union Bank of California, N.A. <sup>(26)</sup>
- 10.33 Security Agreement dated as of February 27, 2003, between the Company and Union Bank of California, N.A. <sup>(26)</sup>
- 10.34 Security Agreement dated as of February 27, 2003, between FabTech, Inc. and Union Bank of California, N.A. <sup>(26)</sup>
- 10.35 Continuing Guaranty dated as of December 1, 2000, between the Company and Union Bank of California, N.A. <sup>(26)</sup>
- 10.36 Continuing Guaranty dated as of December 1, 2000, between FabTech, Inc. and Union Bank of California, N.A. <sup>(26)</sup>

- 10.37\* Employment agreement between Diodes Incorporated and Dr. Keh-Shew Lu dated August 29, 2005<sup>(27)</sup>
- 10.38\* Employment agreement between Diodes Incorporated and Joseph Liu, dated August 29, 2005. <sup>(27)</sup>
- 10.39\* Employment agreement between Diodes Incorporated and Mark King, dated August 29, 2005. <sup>(27)</sup>
- 10.40\* Employment agreement between Diodes Incorporated and Carl Wertz, dated August 29, 2005. <sup>(27)</sup>
- 10.41\* Form of Indemnification Agreement between Diodes and its directors and executive officers. <sup>(27)</sup>
- 10.42 Wafer purchase Agreement dated January 10, 2006 between Diodes Incorporated Taiwan Co., Ltd and Lite-on Semiconductor Corporation<sup>(28)</sup>
- 10.43 Supplementary to the Lease Agreement dated on September 5, 2004 with Shanghai Ding Hong Electronic Co., Ltd. <sup>(29)</sup>
- 10.44 Supplementary to the Lease Agreement dated on June 28, 2004 with Shanghai Yuan Hao Electronic Co., Ltd. <sup>(29)</sup>
- 10.45 Agreement on Application, Construction and Transfer of Power Facilities, dated as of March 15, 2006, between the Company and Shanghai Yahong Electronic Co., Ltd <sup>(29)</sup>
- 10.46\* Amendment of 1993 Non-Qualified Stock Option Plan, the 1993 Incentive Stock Option Plan and the 2001 Equity Incentive Plan of the Company dated as of September 22, 2006<sup>(30)</sup>
- 10.47 Amended and Restated Lease Agreement dated as of September 1, 2006, between Diodes FabTech, Inc. with Townsend Summit, LLC<sup>(31)</sup>
- 10.48 Agreement on purchase of office building located in Taiwan dated April 14, 2006, between Diodes Taiwan and First International Computer, Inc. <sup>(31)</sup>
- 10.49\* Deferred Compensation Plan effective January 1, 2007 <sup>(32)</sup>
- 14 Code of Ethics for Chief Executive Officer and Senior Financial Officers <sup>(33)</sup>
- 21 Subsidiaries of the Registrant
- 23.1 Consent of Independent Registered Public Accounting Firm
- 31.1 Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1943, adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1943, adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification Pursuant to 18 U.S.C. adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification Pursuant to 18 U.S.C. adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- (1) Previously filed with Company's Form 8-K, filed with the Commission on December 21, 2005, which is hereby incorporated by reference.
- (2) Previously filed with Company's Form 8-K, filed with the Commission on October 24, 2006 which is hereby incorporated by reference.
- (3) Previously filed with Company's Form 8-K, filed with the Commission on October 24, 2006 which is hereby incorporated by reference.
- (4) Previously filed with Company's Form 8-K, filed with the Commission on November 7, 2006 which is hereby incorporated by reference.
- (5) Previously filed as Exhibit 3.1 of Amendment No. 1 to the Company's Registration Statement on Form S-3 (File No. 333-127833) filed on September 8, 2005, which is hereby incorporated by reference.
- (6) Previously filed as Exhibit 3 to Form 10-K filed with the Commission for fiscal year ended April 30, 1988, which is hereby incorporated by reference.

- (7) Previously filed as Exhibit 4.1 of the Company's Registration Statement on Form S-3 (Registration No. 333-127833 filed on August 25, 2005, which is hereby incorporated by reference.
- (8) Previously filed as Exhibit 4.1 of the Company's Registration Statement on Form S-3 (Registration No. 333-137803) filed on October 4, 2006, which is hereby incorporated by reference.
- (9) Previously filed as Exhibit 4.3 of the Company's Registration Statement on Form S-3 (Registration No. 333-137803) filed on October 4, 2006, which is hereby incorporated by reference.
- (10) Previously filed with Company's Form 10-K, filed with the Commission on March 31, 1995, which is hereby incorporated by reference.
- (11) Previously filed with Company's Form S-8, filed with the Commission on May 9, 1994, which is hereby incorporated by reference.
- (12) Previously filed as Exhibit 10.2 to Form 10-Q/A, filed with the Commission on October 27, 1995, which is hereby incorporated by reference.
- (13) Previously filed as Exhibit 10.3 to Form 10-Q/A, filed with the Commission on October 27, 1995, which is hereby incorporated by reference.
- (14) Previously filed as Exhibit 10.4 to Form 10-Q, filed with the Commission on July 27, 1995, which is hereby incorporated by reference.
- (15) Previously filed with Company's Form 10-K, filed with the Commission on April 1, 1996, which is hereby incorporated by reference.

- (16) Previously filed with Company's Form 10-Q, filed with the Commission on May 15, 1996, which is hereby incorporated by reference.
- (17) Previously filed with Company's Form 10-K, filed with the Commission on March 26, 1997, which is hereby incorporated by reference.
- (18) Previously filed with Company's Form 10-Q, filed with the Commission on August 11, 1998, which is hereby incorporated by reference.
- (19) Previously filed with Company's Form 10-Q, filed with the Commission on November 11, 1998, which is hereby incorporated by reference.
- (20) Previously filed with Company's Form 10-Q, filed with the Commission on August 10, 1999, which is hereby incorporated by reference.
- (21) Previously filed with Company's Form 8-K, filed with the Commission on December 14, 2000, which is hereby incorporated by reference.
- (22) Previously filed with Company's Form 10-Q, filed with the Commission on November 2, 2001, which is hereby incorporated by reference.
- (23) Previously filed with Company's Definitive Proxy Statement, filed with the Commission on April 27, 2001, which is hereby incorporated by reference.
- (24) Previously filed with Company's Form 10-Q, filed with the Commission on May 15, 2002, which is hereby incorporated by reference.
- (25) Previously filed with Company's Form 10-Q, filed with the Commission on August 9, 2004, which is hereby incorporated by reference.
- (26) Previously filed with Company's Form 8-K, filed with the Commission on September 2, 2005, which is hereby incorporated by reference.
- (27) Previously filed with Company's Form 8-K, filed with the Commission on September 2, 2005, which is hereby incorporated by reference.
- (28) Previously filed with Company's Form 8-K, filed with the Commission on January 12, 2006.
- (29) Previously filed with Company's Form 10-Q, filed with the Commission on May 10, 2006 which is hereby incorporated by reference.
- (30) Previously filed with Company's Form 8-K, filed with the Commission on September 26, 2006 which is hereby incorporated by reference.
- (31) Previously filed with Company's Form 8-K, filed with the Commission on October 11, 2006 which is hereby incorporated by reference.
- (32) Previously filed with Company's Form 8-K, filed with the Commission on January 8, 2007.
- (33) Provided in the Corporate Governance portion of the Investor Relations section of the Company's website at <http://www.diodes.com>.

\* Constitute management contracts, or compensatory plans or arrangements, which are required to be filed pursuant to Item 601 of Regulation S-K.