FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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FILER

COMPUTER ACCESS TECHNOLOGY CORP

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[x] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2002

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Transition Period From ____________ To __________________

COMPUTER ACCESS TECHNOLOGY CORPORATION
(exact name of registrant as specified in its charter)

Delaware	77-0302527
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2403 Walsh Avenue, Santa Clara	
California	95051
(Address of principal executive offices)	(Zip Code)

(408) 727-6600
(Registrant' s telephone number, including area code)

Common Stock, $0.001 par value
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [_]

As of May 1, 2002, there were 18,966,440 shares of the registrant' s Common Stock outstanding.

Part I – FINANCIAL INFORMATION

Item 1. Financial Statements

COMPUTER ACCESS TECHNOLOGY CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited in thousands)

	December 31, 2001	March 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 42,941	$ 41,190
Short-term investments	4,620	6,651
Trade accounts receivable, net	1,370	1,468
Related party receivable	747	504
Inventories	805	965
Deferred tax assets	512	707
Other current assets	1,435	1,213
Total current assets	52,430	52,698
Property and equipment, net	1,357	1,521
Other assets	101	210
	$ 53,888	$ 54,429
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 602	$ 881
Accrued expenses	1,046	1,647
Deferred revenue	220	297
Total current liabilities	1,868	2,825
Deferred rent	4	5
Total liabilities	1,872	2,830
Stockholders' equity:		
Common stock	19	19
Additional paid-in capital	53,093	52,966
Deferred stock-based compensation	(2,492)	(1,775)
Retained earnings	1,396	389
Total stockholders' equity	52,016	51,599
	$ 53,888	$ 54,429

See accompanying notes.

COMPUTER ACCESS TECHNOLOGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited in thousands, except per share amounts)

	Three Month Period Ended March 31,	
	2001	**2002**
Revenue	$ 5,675	$ 3,422
Cost of revenue (inclusive of amortization of deferred stock-based compensation of $176 and $49 in 2001 and 2002, respectively)	1,265	684
Gross profit	4,410	2,738
Operating expenses:		
Research and development (exclusive of amortization of deferred stock-based compensation of $726 and $299 in 2001 and 2002, respectively)	1,916	1,913
Sales and marketing (exclusive of amortization of deferred stock-based compensation of $215 and $(123) in 2001 and 2002, respectively)	603	1,265
General and administrative (exclusive of amortization of deferred stock-based compensation of $411 and $132 in 2001 and 2002, respectively)	807	1,122
Amortization of deferred stock-based compensation	1,352	308
Total operating expenses	4,678	4,608
Loss from operations	(268)	(1,870)
Other income, net	642	173
Income (loss) before provision for income taxes	374	(1,697)
Provision (benefit) for income taxes	744	(690)
Net loss	$ (370)	$ (1,007)
Net loss per share:		
Basic	$ (0.02)	$ (0.05)
Diluted	$ (0.02)	$ (0.05)
Weighted average shares outstanding		
Basic	18,602	18,911
Diluted	18,602	18,911

See accompanying notes.

COMPUTER ACCESS TECHNOLOGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited in thousands)

	Three Month Period Ended March 31,	
	2001	**2002**
Cash flows from operating activities:		
Net loss	$ (370)	$ (1,007)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	88	141
Provision for doubtful accounts	4	–
Amortization of deferred stock-based compensation	1,528	357
Fair value of stock options in exchange for services	8	–
Changes in assets and liabilities:		
Accounts receivable	54	145
Inventories	(306)	(160)
Deferred tax assets	162	(195)
Other assets	(27)	213
Accounts payable	195	279
Accrued expenses	(2,046)	601
Deferred revenue	–	77
Deferred rent	(11)	1
Net cash provided by (used in) operating activities	(721)	452
Cash flows from investing activities:		
Acquisition of property and equipment	(276)	(305)
Purchase of other long-term assets	–	(100)
Purchase of short-term investments	–	(2,901)
Sale of short-term investments	285	870
Net cash provided by (used in) investing activities	9	(2,436)
Cash flows from financing activities:		
Proceeds from exercise of stock options	63	116
Proceeds from employee stock purchase plan	–	117
Net cash provided by financing activities	63	233
Net decrease in cash and cash equivalents	(649)	(1,751)
Cash and cash equivalents at beginning of period	47,411	42,941
Cash and cash equivalents at end of period	$ 46,762	$ 41,190
Supplemental information:		
Cash paid for (refunded from) income taxes	$ 2,858	$ (718)

See accompanying notes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1−BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

Computer Access Technology Corporation is a provider of advanced verification systems and connectivity products for existing and emerging digital communications standards. Our products are used by semiconductor, device, system and software companies at each phase of their products' lifecycles from development through production and market deployment.

We have expertise in the USB, USB 2.0, IEEE 1394, Bluetooth, InfiniBand, Serial ATA and Ethernet standards and are actively engaged with our customers throughout their development and production processes. Utilizing our easy to use, color-coded software, the CATC Trace, our development products generate, capture, filter and analyze high speed communications traffic, allowing our customers to quickly discover and correct persistent and intermittent errors and flaws in their product design. Our production products are used in manufacturing to ensure that products comply with standards and operate with other devices as well as to assist system manufacturers in downloading software onto new computers. Our connectivity products are devices that translate communications traffic between USB and Ethernet and enable reliable, uninterrupted service for broadband Internet access. These connectivity products also allow for simple installation and incorporate an application specific integrated circuit, or ASIC, and our proprietary embedded software and software drivers.

Interim Financial Information and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements as of March 31, 2002, and for the three month periods ended March 31, 2002 and 2001, have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and include the accounts of Computer Access Technology Corporation and its wholly-owned subsidiaries (collectively, "Computer Access Technology Corporation" or the "Company"). Intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to SEC rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the consolidated financial position at March 31, 2002, the consolidated operating results for the three month periods ended March 31, 2002 and 2001, and consolidated cash flows for the three month period ended March 31, 2002 and 2001. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes for the year ended December 31, 2001.

The unaudited condensed consolidated balance sheet at December 31, 2001 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles in the United States of America for complete financial statements.

Concentrations of credit risk

Revenue and accounts receivable of the customers comprising more than 10% of revenue or receivables are summarized as follows:

	Three Month Period Ended March 31,	
	2001	2002
Revenue:		
Company A	32%	22%

	December 31, 2001	March 31, 2002
Accounts receivable:		
Company A	32%	22%
Company B	13%	− %

NOTE 2 – COMPREHENSIVE INCOME

Comprehensive income is defined as changes in equity of a company from transactions, other events and circumstances, excluding transactions resulting from investments by owners and distributions to owners. There is no difference between net income and comprehensive income for the Company in any of the periods presented.

NOTE 3−STOCK-BASED COMPENSATION

In connection with certain stock option grants in 2000, 1999 and 1998, the Company recorded deferred stock-based compensation totaling $14,393,000 which represents the difference between the exercise price and the deemed fair value at the date of grant, which is being recognized over the vesting period of the related options. Amortization of deferred stock-based compensation was $357,000 in the quarter ended March 31, 2002, of which $49,000 was included in cost of revenue. Amortization of deferred stock-based compensation was $1,528,000 in the quarter ended March 31, 2001, of which $176,000 was included in cost of revenue. Amortization of deferred stock-based compensation on grants prior to December 31, 2000 is estimated to be approximately $1.1 million for the remainder of the year ending December 31, 2002 and $635,000 and $80,000 in the years ending December 31, 2003 and 2004 respectively, and may change due to the granting of additional options or the cancellation of existing grants in future periods.

NOTE 4−NET INCOME (LOSS) PER SHARE

The Company computes net income (loss) per share in accordance with SFAS No. 128, Earnings per Share, and SEC Staff Accounting Bulletin (“SAB”) No. 98. Under the provisions of SFAS No. 128 and SAB No. 98, basic net income (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of shares of common stock outstanding during the period. The calculation of diluted net (loss) income per share excludes potential common stock if their effect is antidilutive. Potential common stock consists of incremental common shares issuable upon the exercise of stock options.

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated (in thousands except per share data):

	Three Month Period Ended March 31,	
	2001	2002
Numerator:		
Net loss	$ (370)	$ (1,007)
Denominator:		
Weighted average shares outstanding	18,602	18,911
Denominator for basic calculation	18,602	18,911
Dilutive effect of stock options	−	−
Denominator for diluted calculation	18,602	18,911
Net loss per share:		
Basic	$ (0.02)	$ (0.05)
Diluted	$ (0.02)	$ (0.05)
Total common stock equivalents, related to options outstanding, excluded from the computation of earnings per share as their effect is antidilutive	662	3,449

NOTE 5–INVENTORIES

Inventories consist of the following (in thousands):

	December 31, 2001	March 31, 2002
Raw materials	$ 451	$ 547
Work in progress	141	276
Finished goods	213	142
	$ 805	$ 965

NOTE 6 – INCOME TAXES

The reconciliation between the effective tax rates and statutory federal income tax rate is shown in the following table:

	Three Month Period Ended March 31, 2001	2002
Statutory federal income tax rate	35.0%	34.0%
State taxes, net of federal income tax benefit	25.7	5.7
Amortization of deferred stock-based compensation	143.1	(7.2)
Research and development credit	(7.5)	4.4
Other	2.6	3.8
Effective tax rate	198.9%	40.7%

NOTE 7−REPORTABLE SEGMENTS AND GEOGRAPHIC INFORMATION

The Company has three reportable segments categorized by product type: development products, production products and connectivity products. The development products are advanced verification systems that assist hardware and software manufacturers in the efficient design of reliable and interoperable systems and devices. Production products are production verification systems and connectivity solutions designed to assist hardware and software manufacturers in volume production of reliable devices and systems. Connectivity products are designed to assist broadband Internet service providers in delivering convenient and dependable service and device manufacturers in producing reliable products. The Company has no inter-segment revenue.

The Company analyzes segment revenue and cost of revenue, but does not allocate operating expenses, including stock-based compensation, or assets to segments. Accordingly, the Company has presented only revenue and gross profit by segment.

Segment information (in thousands):

	Development Products	Production Products	Connectivity Products	Unallocated Stock-based Compensation Expense	Total
Three Month Period Ended March 31, 2001					
Segment revenue from external customers	$ 4,325	$ 503	$ 847	$ −	$5,675
Segment gross profit	$ 3,844	$ 414	$ 328	$ (176)	$4,410
Three Month Period Ended March 31, 2002					
Segment revenue from external customers	$ 2,877	$ 461	$ 84	$ −	$3,422
Segment gross profit	$ 2,447	$ 300	$ 40	$ (49)	$2,738

Geographic information (in thousands):

	Revenue	Long-Lived Assets
Three Month Period Ended March 31, 2001		
North America	$ 2,322	
Europe	845	
Asia	2,462	
Rest of world	46	

Total	$ 5,675

COMPUTER ACCESS TECHNOLOGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS −(Continued)

Three Month Period Ended March 31, 2002		
North America	$ 1,400	$ 1,312
Europe	499	209
Asia	1,495	−
Rest of world	28	−
Total	$ 3,422	$ 1,521

Revenues are attributed to countries based on delivery locations. Sales to foreign customers accounted for 59.1% of revenue during the quarters ended March 31, 2001 and 2002.

NOTE 8−SUBSEQUENT EVENTS

On May 9, 2002, the Company entered into a definitive agreement to purchase Verisys. Verisys, founded in 1992, is a leader in SCSI Bus Analyzers for the Storage Area Network marketplace. The Company will pay the Verisys shareholders $1 million in cash and up to 360,000 shares of the Company' s common stock. The parties anticipate that the transaction will close prior to June 1, 2002.

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

The following information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Item 1 of this report and "Management' s Discussion and Analysis of Financial Condition and Results of Operations" contained in our Form 10-K as filed with the Securities and Exchange Commission on March 28, 2002.

This report contains forward-looking statements within the meaning of the federal securities laws. These statements may contain words such as "expects," "anticipates," "intends," "plans," "believes," "estimates," or other wording indicating future results. Forward-looking statements are subject to risks and uncertainties. Actual results may differ materially from the results discussed in forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, those discussed under "Risk Factors" following "Recent Accounting Pronouncements" below, and elsewhere in this report. We undertake no obligation to revise or update any forward-looking statements to reflect any event or circumstance that may arise after the date of this report.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our consolidated financial statements in conformity with generally accepted accounting principles requires our 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 consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We believe the following critical accounting policies, among others, affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

We report our revenue and gross profit in three business segments: development, production and connectivity products. We have adopted Statement of Position, or SOP, 97-2, *Software Revenue Recognition*. Under SOP 97-2, we recognize revenue to distributors, resellers and end users upon shipment provided that there is persuasive evidence of an arrangement, the product has been delivered, the fee is fixed and determinable and collection of the resulting receivable is reasonably assured. We do not provide distributors, resellers or customers price protection, return or exchange rights. Generally, our distributors do not maintain inventory, however, they do have the right to return inventory upon termination of their distribution agreement. We review inventory levels held by distributors, if any, quarterly to ensure that any potential returns in the event of termination are not material. When we have shipped products but some elements essential to the functionality of the products have not been completed, revenue and associated cost of revenue are deferred until all remaining elements have been delivered. Software maintenance support revenue is deferred and recognized ratably over the maintenance support period. Provisions for warranty costs are recorded at the time products are shipped.

Our cash equivalents and short-term investments are placed in portfolios managed by two professional money management firms under the investment guidelines we have established. These guidelines address the critical objectives of preservation of principal, avoiding inappropriate concentrations, meeting liquidity requirements, and delivering maximum after-tax returns. We classify all highly liquid investments purchased with an original maturity of 90 days or less to be cash equivalents and those with a maturity greater than 91 days but less than one year to be short-term investments. Cash equivalents and short-term investments consist principally of investments in commercial paper, investment quality corporate and municipal bonds, collateralized mortgage obligations, U.S. government agency securities and money market funds.

We account for income taxes under the liability method, which requires, among other things, that deferred income taxes be provided for temporary differences between the tax bases of the Company' s assets and liabilities and their financial statement reported amounts. In addition, deferred tax assets are recorded for the future benefit of utilizing net operating losses and research and development credit carryforwards. The preparation of our tax provision and deferred tax assets requires us to make estimates and assumptions including areas such as the calculation of research and development credits, and future taxable income. If these estimates change in the future, we may be required to record additional valuation allowances against deferred tax assets, and our future tax provisions may result in different effective tax rates. A valuation allowance is provided against deferred tax assets unless it is more likely than not that they will be realized.

Overview

We are a provider of advanced verification systems and connectivity products for existing and emerging digital communications standards such as USB, IEEE 1394, Bluetooth wireless technology, InfiniBand, Serial ATA and Ethernet. Our products are used by semiconductor, device, system and software companies at each phase of their products' lifecycles from development through production and market deployment. Our verification systems consist of development and production products that accurately monitor communications traffic and diagnose operational problems to ensure that products comply with standards and operate with other devices as well as to assist system manufacturers in downloading software onto new computers. Our connectivity products enable reliable, uninterrupted service for broadband Internet access. We currently outsource most of the manufacturing of our verification systems and connectivity products so that we may concentrate our resources on the design, development and marketing of our existing and new products.

We report our revenue and gross profit in three business segments: development, production and connectivity products. In the quarter ended March 31, 2002, our revenue from our development products was $2.9 million, from production products was $461,000 and from connectivity products was $84,000. Historically, we have generated a majority of our revenue across all segments from products for the USB standard. Revenue from our USB products accounted for approximately 71.4% of our revenue in the quarter ended March 31, 2002, of which 44.3% was from our USB 2.0 products.

We sell our products to technology, infrastructure and application companies through our direct sales force and indirectly through our distributors and manufacturer's representatives. Historically, a substantial portion of our revenue has been derived from customers outside of the United States. In the quarter ended March 31, 2002, 59.1% of our revenue was derived from international customers, of which 21.7% was derived from customers based in Japan, 22.0% was derived from customers based in other parts of Asia, and 14.6% was derived from customers based in Europe. International revenue as a percentage of total revenue for the quarter ended March 31, 2002 was consistent with the quarter ended March 31, 2001. All of our revenue and accounts receivable are denominated in U.S. dollars. Although seasonality affects many of our target markets, to date our revenues and financial condition as a whole have not been materially impacted by seasonality.

The development of emerging communications standards and technological change have influenced and are likely to continue to influence our quarterly and annual revenue and results of operations. Our product development and marketing strategies are focused on working closely with the promoter companies and communications standards groups to gain early access to new communications standards and technologies. We have invested significantly in the research, development and marketing of our products for emerging communications standards, often before these standards have gained widespread industry acceptance and in advance of generating substantial revenue related to these investments. Additionally, the rate and timing of customer orders may vary significantly from month to month. Accordingly, if sales of our products do not occur when we expect and we are unable to predict or adjust our estimates on a timely basis, our expenses may increase as a percentage of revenue.

The overall economic environment continues to create uncertainties for us and our customers. We have experienced continuing weakness in each of our business segments over the last year as a result of slowing growth in the global economy and delays in orders as a result of reduced spending by many of our customers, which has been exacerbated by the September 11, 2001 terrorist attack. Our near term financial results have been and may continue to be affected by our decision in 2001 to invest in our sales, marketing and research and development infrastructure.

Results of Operations

The following table presents selected consolidated financial data for the periods indicated as a percentage of revenue:

	Three Month Period Ended March 31,	
	2001	2002
Consolidated Statement of Income Data:		
Revenue	100.0%	100.0%
Cost of Revenue	22.3	20.0
Gross profit	77.7	80.0
Operating expenses:		
Research and development	33.8	55.9
Sales and marketing	10.6	37.0
General and administrative	14.2	32.8
Amortization of deferred stock-based compensation	23.8	9.0
Total operating expenses	82.4	134.7
Loss from operations	(4.7)	(54.7)
Other income, net	11.3	5.1
Income (loss) before provision for income taxes	6.6	(49.6)
Provision (benefit) for income taxes	13.1	(20.2)
Net Loss	(6.5)%	(29.4)%

Comparisons of Quarters Ended March 31, 2001 and 2002

Revenue. Our revenue was $3.4 million in the quarter ended March 31, 2002 and $5.7 million in the quarter ended March 31, 2001. This represents a decrease of 39.7% from the quarter ended March 31, 2001 to the quarter ended March 31, 2002. The decrease in revenue was due primarily to decreases in sales of certain development products, production products and connectivity products of $2.6 million, $312,000 and $787,000, respectively, offset by increases in sales of new and other development products and production products, which represented $1.2 million and $200,000, respectively. The decrease in sales of existing development and production products was the result of the slowdown in the Bluetooth market and the general economic slowdown, primarily in the United States, and the decrease in sales of connectivity products was primarily the result of softness in the broadband Internet access market and additional competitive pressure due to improved availability of next generation cable and DSL modems with integrated USB support. Beginning in the quarter ended March 31, 2002, we converted our resellers to manufacturer' s representatives. This change resulted in an estimated amount of additional revenue for the quarter ended March 31, 2002 of $100,000 as we sold directly to our end customers without discount. However, this estimated additional revenue was offset by an increase in sales and marketing expense relating to manufacturer' s representatives' commissions. Revenue from international customers represented 59.1% of our revenue in the quarters ended March 31, 2002 and March 31, 2001.

Cost of Revenue and Gross Profit. Our gross profit was $2.7 million in the quarter ended March 31, 2002 and $4.4 million in the quarter ended March 31, 2001. This represents a decrease of 37.9% from the quarter ended March 31, 2001 to the quarter ended March 31, 2002. The dollar decrease in gross margin was primarily the result of a decrease in unit sales of development, production and connectivity products, offset by a decrease in amortization of deferred stock-based compensation of $127,000. Our gross margin percentage was 80.0% in the quarter ended March 31, 2002 and 77.7% in the quarter ended March 31, 2001. The increase in gross margin percentage was primarily due to increased development product sales as a percentage of revenue offset by reduced margins for our production products, due to higher costs associated with lower volume manufacturing. Our higher margin business segment, development products, increased as a percentage of revenue by 7.9%, our lower margin business segment, production products, increased as a percentage of revenue by 4.6% and our lowest margin business segment, connectivity products, decreased as a percentage of revenue by 12.5%. Beginning in the quarter ended March 31, 2002, we converted our resellers to manufacturer' s representatives. This change improved gross margins by 0.6%, as we sell directly to our end customers without discount. Excluding amortization of deferred stock-based compensation, our gross margin would have been 81.4% for the quarter ended March 31, 2002 and 80.8% for the quarter ended March 31, 2001.

Research and Development. Our research and development expenses were $1.9 million in the quarters ended March 31, 2002 and March 31, 2001. Increases in direct personnel and related costs of approximately $118,000 were offset by decreases in other research and development costs of approximately $122,000 for the quarter ended March 31, 2002. Research and development expenses represented 55.9% of revenue in the quarter ended March 31, 2002 and 33.8% of revenue in the quarter ended March 31, 2001. The percentage of revenue increase for the quarter ended March 31, 2002 was primarily due to the impact of the decrease in revenue from the quarter ended March 31, 2001.

Sales and Marketing. Our sales and marketing expenses were $1.3 million in the quarter ended March 31, 2002 and $603,000 in the quarter ended March 31, 2001. This represents an increase of 109.8% from the quarter ended March 31, 2001 to the quarter ended March 31, 2002. Sales and marketing expenses represented 37.0% of revenue in the quarter ended March 31, 2002 and 10.6% of revenue in the quarter ended March 31, 2001. The dollar increase was primarily due to increases in personnel and related costs of approximately $280,000 as we continued to invest in our sales and marketing infrastructure for the future, commissions earned by our manufacturer' s representatives of $164,000 and increases in marketing programs of $72,000. The percentage of revenue increase for the quarter ended March 31, 2002 was primarily due to the impact of the decrease in revenue from the quarter ended March 31, 2001 and the increase in costs noted above.

General and Administrative. Our general and administrative expenses were $1.1 million in the quarter ended March 31, 2002 and $807,000 in the quarter ended March 31, 2001. This represents an increase of 39.0% from the quarter ended March 31, 2001 to the quarter ended March 31, 2002. General and administrative expenses represented 32.8% of revenue in the quarter ended March 31, 2002 and 14.2% of revenue in the quarter ended March 31, 2001. The dollar increase was primarily due to an increase in professional services of $217,000, primarily legal fees, and the addition of management and administrative personnel and related costs of $76,000. The percentage of revenue increase for the quarter ended March 31, 2002 was due to a dollar increase in expenses and a decrease in revenue for the period.

Amortization of Deferred Stock-based Compensation. Amortization of deferred stock-based compensation represents the difference between the exercise price and the deemed fair value at the date of grant, in connection with certain stock option grants in 2000, 1999 and 1998, which is being recognized over the vesting period of the related options. Amortization of deferred stock-based compensation was $357,000 in the quarter ended March 31, 2002, of which $49,000 was included in cost of revenue. This amount reflects the impact of option cancellations of approximately $241,000 due to employee terminations. Amortization of deferred stock-based compensation was $1.5 million in the quarter ended March 31, 2001, of which $176,000 was included in cost of revenue. Amortization of deferred stock-based compensation on grants prior to December 31, 2000 is estimated to be approximately $1.1 million for the remainder of the year ending December 31, 2002 and $635,000 and $80,000 in the years ending December 31, 2003 and 2004 respectively, and may change due to the granting of additional options or the cancellation of existing grants in future periods.

Other Income. Other income was $173,000 in the quarter ended March 31, 2002 and $642,000 in the quarter ended March 31, 2001. This represents a decrease of 73.1% from the quarter ended March 31, 2001 to the quarter ended March 31, 2002. These decreases resulted from declining interest income earned on the investment of the additional excess cash balances and the proceeds from our initial public offering in November 2000. During September 2001, we transferred the majority of our excess cash balances from money market funds to tax-exempt and tax-advantaged cash equivalents and short-term investments in commercial paper, investment quality corporate bonds, collateralized mortgage obligations, and U.S. government agency securities.

Provision (benefit) for Income Taxes. Benefit for income taxes was $690,000 in the quarter ended March 31, 2002 and provision for income taxes was $744,000 in the quarter ended March 31. This represents a decrease of 192.7% from the quarter ended March 31, 2001 to the quarter ended March 31, 2002. Our effective tax rate decreased from 198.9% in the quarter ended March 31, 2001 to 40.7% in the quarter ended March 31, 2002 due primarily to a decrease in the amortization of deferred stock-based compensation. Our effective tax rate after excluding the effect of amortization of deferred stock-based compensation was 51.5% in the quarter ended March 31, 2002 and 39.1% in the quarter ended March 31, 2001.

Net loss. Our net loss was $1.0 million in the quarter ended March 31, 2002 and $370,000 in the quarter ended March 31, 2001. This represents an increase of 172.2% from the quarter ended March 31, 2001 to the quarter ended March 31, 2002. Our net loss represented (29.4%) of revenue in the quarter ended March 31, 2002 and (6.5%) of revenue in the quarter ended March 31, 2001. The dollar and percentage of revenue increases in net loss were primarily the result of reduced revenue, increased operating costs and reduced interest income, offset by the benefit for income taxes. Net loss before the effect of the amortization of deferred stock-based compensation was $650,000 in the quarter ended March 31, 2002 and our net income before the effect of the amortization of deferred stock-based compensation was $1.2 million in the quarter ended March 31, 2001.

The following table sets forth net income (loss) and net income (loss) per share, excluding the amortization of deferred stock-based compensation (in thousands, except per share amounts).

	Three Month Period Ended March 31,	
	2001	**2002**
Net income (loss), excluding amortization of deferred compensation	$ 1,158	$ (650)
Net income (loss) per share, excluding amortization of deferred compensation		
Basic	$ 0.06	$ (0.03)
Diluted	$ 0.06	$ (0.03)
Weighted average shares outstanding		
Basic	18,602	18,911
Diluted	19,768	18,911

Liquidity and Capital Resources

Our operating cash flow requirements have generally increased reflecting the expanding scope and level of our activities. Since our inception, we have financed our operations primarily through cash flows from operating activities. In November 2000, we received net proceeds of $38.3 million from the initial public offering of our common stock.

In the quarter ended March 31, 2002, cash provided by operating activities of $452,000 was primarily a result of net loss of $1.0 million, offset by amortization of deferred stock-based compensation of $357,000, depreciation expenses of $141,000 and an increase in related assets and liabilities for working capital purposes of $961,000. Cash used in investing activities was $2.4 million, related to capital expenditures of $305,000, purchase of other long-term assets of $100,000 and the purchase of short-term investments of $2.9 million, offset by the proceeds from the sale of short-term investments of $870,000. Cash provided by financing activities was $233,000, related to the proceeds from the exercise of stock options of $116,000 and to the sale of stock pursuant to our employee stock purchase plan of $117,000.

In the quarter ended March 31, 2001, cash used in operating activities of $721,000 was primarily a result of net loss of $370,000, offset by amortization of deferred stock-based compensation of $1.5 million, depreciation expenses of $88,000 and a decrease in related assets and liabilities for working capital purposes of $2.0 million.

Cash provided by investing activities was $9,000, related to the proceeds from the sale of short-term investments of $285,000 offset by capital expenditures of $276,000. Cash provided by financing activities of $63,000 related to the proceeds from the exercise of stock options.

As of March 31, 2002, we had cash, cash equivalents and short-term investments of $47.8 million, working capital of $49.9 million and no debt.

We believe that the net proceeds from our initial public offering in November 2000, together with funds generated from operations, will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. Thereafter, we may find it necessary to obtain additional equity or debt financing. If we are required to raise additional funds, we may not be able to do so on acceptable terms or at all. In addition, if we issue new securities, stockholders might experience dilution or the holders of the new securities might have rights, preferences or privileges senior to those of existing stockholders.

RISK FACTORS

We continue to face uncertainty relating to economic conditions affecting our customers.

We face uncertainty in the degree to which the current economic slowdown will continue to negatively affect growth and capital spending by our existing and potential customers. We continue to experience instances of customers delaying or deferring orders for our products, and longer lead times needed to close our customer sales. If global economic conditions do not improve, or if there is a worsening in the global economic slowdown, we may continue to experience adverse impacts on our business, operating results and financial condition. Any adverse developments relating to the economic slowdown may make the occurrence of one or more of the factors discussed under "Risk Factors" in this report more likely to occur.

The recent terrorist attacks are unprecedented events that have created many economic and political uncertainties, some of which may harm our business and prospects and our ability in general to conduct business in the ordinary course.

Terrorist attacks in New York and Washington, D.C. in September 2001 have disrupted commerce throughout the world. The continued threat of terrorism and the resulting military, economic and political response and heightened security measures may cause significant disruption to commerce throughout the world. To the extent that this disruption results in a general decrease in our customers' spending, our business and results of operations could be materially and adversely affected. We are unable to predict whether the threat of terrorism or the responses thereto will result in any long-term commercial disruptions or if such activities or responses will have a long-term adverse effect on our business, results of operations or financial condition. These and other developments arising out of the attacks may make the occurrence of one or more of the factors discussed under "Risk Factors" in this report more likely to occur.

Our future operating results are unpredictable and are likely to fluctuate from quarter to quarter and, if we fail to meet the expectations of securities analysts or investors, our stock price would likely decline significantly.

Our quarterly and annual operating results have fluctuated in the past and are likely to fluctuate significantly in the future due to a number of factors, some of which are wholly or partially outside of our control. Many of these risks are described in the following risk factors. Accordingly, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indications of future performance. Some of the factors that could cause our quarterly or annual operating results to fluctuate include:

- the amount and timing of our operating expenses and capital expenditures;
- changes in the volume of our product sales and pricing concessions on volume sales;
- the timing, reduction, deferral or cancellation of customer orders or purchases;

seasonality in some of our target markets;
the effectiveness of our product cost reduction efforts;
variability of our customers' product lifecycles;
changes in the average selling prices of our products; and
cancellations, changes or delays of deliveries to us by our manufacturers and suppliers.

If our operating results fall below the expectations of securities analysts or investors, the trading price of our common stock would likely decline significantly.

If we fail to keep up with rapid technological change and evolving industry standards, our products could become less competitive or obsolete.

The markets for our products are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Our products may cease to be competitive if we fail to introduce new products or product enhancements that address these changes, meet new customer requirements and support new standards. To continue to introduce new products or product enhancements on a timely basis, we must:

identify emerging technological trends in our target markets, including new communications standards;
accurately define and design new products or product enhancements to meet market needs;
develop or license the underlying core technologies necessary to create new products and product enhancements; and
respond effectively to technological changes and product introductions by others.

If we are unable to identify, develop, manufacture, market or support new or enhanced products successfully or on a timely basis, our competitors could gain market share or our new products or product enhancements might not gain market acceptance. Further, we might not be able to respond effectively to product announcements by competitors, technological changes or emerging industry standards.

We depend upon widespread market acceptance of our USB products, and our revenue will decline if the market does not continue to accept these products.

We currently derive a substantial majority of our revenue from sales of our USB products. Revenue from sales of our USB products accounted for approximately 71.4% of our revenue in the quarter ended March 31, 2002. We expect that revenue from these products will continue to account for a substantial portion of our revenue for the foreseeable future. If the market does not continue to accept our USB products, our revenue will decline significantly. Factors that may affect the market acceptance of our current USB products include the continued growth of the markets for USB compliant devices as well as the performance and pricing of our USB products and the availability, functionality and price of competing products. Companies must also modify their products to support new versions of USB as they are developed, such as USB 2.0. Many of these factors are beyond our control. In addition, in order to maintain widespread market acceptance, we must continue to differentiate ourselves from the competition through our technical expertise, product offerings and brand name recognition. Failure of our USB products to maintain market acceptance would adversely impact our revenue.

If we devote resources to developing products for communications standards that ultimately are not widely accepted, our business could be harmed.

We may incur significant expenses and dedicate significant time and resources in developing products for emerging communications standards that may not gain broad acceptance. For example, we spent four years from 1992 to 1995 developing products for the ACCESS.bus technology, a standard designed to connect peripheral devices to computers, which did not gain market acceptance. The failure of a standard for which we devote resources to gain widespread acceptance, or our failure to be first to market with products that address a particular standard, would likely harm our business.

If we fail to maintain and expand our relationships with the core or promoter companies in our target markets, we may have difficulty developing and marketing our products.

It is important to our success to maintain and expand our relationships with companies that are leaders in developing new communications standards in our target markets. We believe that we need to work closely with these core or promoter companies to gain valuable insights into the market demands for new products, to obtain early access to new communications standards as they are developed and to help us design new products. We will need to maintain our relationships with leading technology and infrastructure companies, as well as expand our relationships with leaders in markets that are new for us. Generally, we do not enter into formal contracts that obligate these companies to work or share their technology with us. Industry leaders could choose to work with other companies as they develop new communications standards in the future. If we fail to maintain and expand our industry relationships, we could lose the opportunity for first-mover advantage with respect to emerging standards and it would be more difficult for us to develop and market products that address these standards.

If our target markets do not accept our products for emerging communications standards, our revenue growth could suffer.

Our future growth depends upon our ability to sell advanced verification systems and connectivity products for emerging communications standards such as Bluetooth wireless technology, InfiniBand and Series ATA. However, our products may not gain widespread acceptance by customers. The success of our products depends upon volume production of computer, communications and consumer electronic products that use a particular standard and the acceptance of these products by consumers. The markets for emerging standards products have only recently begun to develop and are rapidly evolving. As a result, it is difficult to predict their potential size or future growth rate. There is significant uncertainty as to whether these markets ultimately will develop at all or, if they do develop, whether they will develop rapidly. If the markets for a particular emerging communications standard fail to develop or develop more slowly than expected, or if our products do not achieve widespread market acceptance by customers in these markets, our business would be significantly harmed.

Delays in the development of new products or product enhancements could harm our operating results and our competitive position.

The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation and highly skilled engineering and development personnel, as well as accurate anticipation of technological and market trends. Although we have not experienced any material product development delays in the past, these types of delays could occur in the future. To the extent that we do not introduce the first product for an emerging standard or customers defer or cancel orders with the expectation of a new product or product enhancement release, our operating results could suffer. Product development delays may result from numerous factors, including:

- changing product specifications and customer requirements;
- difficulties in hiring and retaining necessary technical personnel;
- difficulties in allocating engineering resources and overcoming resource limitations;
- difficulties with contract manufacturers or suppliers of key components;
- changing market or competitive product requirements; and
- unanticipated engineering complexities.

If we are unable to meet the design and market introduction schedules for our new products or product enhancements, our operating results and competitive position may suffer.

Variations in our revenue may cause fluctuations in our operating results.

We may experience a delay in generating or recognizing revenue for a number of reasons. Historically, we have had little backlog and our revenue in any quarter has depended upon orders booked and shipped in that quarter. Furthermore, our customers may delay scheduled delivery dates and cancel orders without significant penalty. In addition, even if we ship orders, generally accepted accounting principles may require us to defer recognition of revenue from those orders until a later date. Because we budget our operating expenses on anticipated revenue trends and a high percentage of our expenses is fixed in the short term, any delay in generating forecasted revenue could have a significant negative impact on our operating results.

Shifts in our product mix may result in declines in gross margins.

Our gross margins vary among our products, with our gross margins generally being higher on our advanced verification systems than on our connectivity products. Our overall gross margins might fluctuate from period to period as a result of shifts in product mix, the channels through which we sell our products, the introduction of new products and product costs.

Decreases in average selling prices of our products may reduce gross margins and revenue.

The average selling prices of our products may decrease in the future in response to product introductions or enhancements by us or our competitors, or as a result of other factors, including discounts given on volume purchase orders or pricing pressures. For example, we recently reduced the prices of certain of our connectivity products in response to competitive pricing pressure. We anticipate that we will need to continue to develop and introduce on a timely basis new products that incorporate features that can be sold at higher average selling prices. Failure to do so would likely cause our revenue and gross margins to decline.

Continued competition in our markets may lead to a reduction in our prices, revenue and market share.

The markets for advanced verification and connectivity products for emerging communications standards are highly competitive. We compete with multiple companies in various markets, including Yokagawa in the markets for products for the 1394 standard, Tektronix in the markets for products for the Bluetooth wireless technology and Finisar in the markets for products for the InfiniBand standard. Any of our competitors may develop technologies that address our targeted markets more effectively and at a lower cost. In addition, these competitors may enter into strategic alliances or business combinations that increase their ability to innovate and address our markets.

We may also face competition from other equipment manufacturers, such as Agilent, National Instruments and Rhode & Schwartz. Many of these companies have substantially greater financial, technical, marketing and distribution resources and brand name recognition than we have. We expect that more companies, including some of our customers, will enter our markets. If these companies develop products that compete with our products or form alliances with or acquire companies offering competing products, even if those products do not have capabilities comparable to our products, they would be significant competitors and their activities could cause us to reduce our prices. Increased competition could result in significant price erosion, reduced revenue, lower margins and loss of market share, any of which would significantly harm our business.

We depend on contract manufacturers for substantially all of our manufacturing requirements and if these manufacturers fail to provide us with adequate supplies of high-quality products, our competitive position, reputation and business could be harmed.

We currently rely on four contract manufacturers for all of our manufacturing requirements except for the final assembly, testing and quality assurance on our lower volume, higher margin products. We do not have long-term contracts with any of these manufacturers. As a result, our manufacturers could refuse to continue to manufacture all or some of our products that we require or change the terms under which they manufacture our products. We have experienced delays in product shipments from some of our contract manufacturers in the past, which in turn forced us to delay product shipments to our customers. We may in the future experience similar delays or other problems, such as inferior quality and insufficient quantity of products, any of which could significantly harm our business. Our contract manufacturers may not be able to meet our future requirements for timely delivery of products of sufficient quality and quantity. We intend to introduce new products and product enhancements regularly, which will require that we rapidly achieve volume production by coordinating our efforts with those of our suppliers and contract manufacturers. The inability of our contract manufacturers to provide us with adequate supplies of high quality products or the loss of any of our contract manufacturers would cause a delay in our ability to fulfill orders while we obtain a replacement manufacturer.

If we are unable to forecast our supply needs accurately, our costs may increase or we may not be able to ship products in a timely manner.

We purchase components used in the manufacture of our products from several key sources. We depend on these sources to deliver necessary components in a timely manner based on twelve-month rolling forecasts that we provide. Lead times for materials and components that we order vary significantly and depend on factors such as specific supplier requirements, contract terms and current market demand for particular components. If we overestimate our component requirements, we may develop excess inventory, which would increase our costs. If we underestimate our component requirements, we may not be able to fulfill customer orders.

We depend on sole source suppliers for several key components of our products, and we may lose sales if they fail to meet our needs.

We obtain some parts, components and packaging used in our products from sole sources of supply. For example, we obtain field programmable gate array integrated circuits from Altera, ASICs from LSI Logic through Wyle Electronics, certain Bluetooth components from Ericsson, semiconductor devices from Agilent, and micro-controllers from Intel, SMSC and Cypress Semiconductor. If suppliers are unable to meet our demand for sole source components at reasonable costs and if we are unable to obtain an alternative source or the price for an alternative source is prohibitive, our ability to maintain timely and cost-effective production of our products would be harmed. In addition, because we rely on purchase orders rather than long-term contracts with our suppliers, including our sole source suppliers, we cannot predict with certainty our ability to obtain components in the longer term. If we are unable to obtain components or receive a smaller allocation of components than is necessary to manufacture products in quantities sufficient to meet demand, customers could choose to purchase competing products.

If our distributors and manufacturer’ s representatives do not actively sell our products, our product sales may decline.

We sell a substantial portion of our products through distributors and manufacturer’ s representatives, including Toyo, our distributor in Japan, which accounted for approximately 21.7% of our revenue in the quarter ended March 31, 2002. Our distributors and manufacturer’ s representatives generally offer products from multiple manufacturers. Accordingly, there is a risk that these distributors and manufacturer’ s representatives may give higher priority to selling products from other suppliers and reduce their efforts to sell our products. Our distributors and manufacturer’ s representatives may not market our products effectively or continue to devote the resources necessary to provide us with effective sales, marketing and technical support. Our distributors may on occasion build inventories in anticipation of substantial growth in sales and, if growth does not occur as rapidly as anticipated, may decrease the quantity of products ordered from us in subsequent quarters. A slowdown in orders from our distributors could reduce our revenue in any given quarter and give rise to fluctuations in our operating results.

In addition, our sales to Toyo and our other distributors are made on the basis of purchase orders rather than a long-term commitment. The loss of any one of our major distributors, or the delay of significant orders from these distributors, could result in decreased revenue.

If we are unable to hire and retain additional sales, marketing, engineering, operations and finance personnel, our growth will be impaired.

To grow our business successfully and maintain a high level of quality, we will need to recruit, retain and motivate additional highly skilled sales, marketing, engineering, operations and finance personnel. If we are not able to hire and retain a sufficient number of qualified employees, our growth will be impaired. In particular, as a company focused on the development of complex products, we will need to hire additional hardware and software developers and engineers and project managers of various experience levels in order to keep pace with technological change and develop products that meet the needs of rapidly evolving markets. Competition for skilled employees, particularly in the San Francisco Bay Area, is intense. We may have even greater difficulty recruiting potential employees if prospective employees perceive the equity component of our compensation package to be less valuable as a result of market fluctuations in the price of our common stock.

The loss of key management personnel, on whose knowledge, leadership and technical expertise we rely, would harm our ability to execute our business plan.

Our success depends heavily upon the continued contributions of our key management personnel, whose knowledge, leadership and technical expertise would be difficult to replace. All of our executive officers and key personnel are employees at will. We maintain no key person insurance on any of our personnel. If we were to lose the services of any of our key personnel and were unable to hire qualified replacements, our ability to execute our business plan would be harmed. In addition, employees who leave our company may subsequently compete against us.

If we fail to manage our growth effectively, our business could suffer.

Our ability to offer products and implement our business plan successfully in a rapidly evolving market requires an effective planning and management process. We increased our headcount by 8.3% in the quarter ended March 31, 2002. We expect that our headcount will continue to increase in future periods and that we will need to continue to improve our financial and managerial controls, reporting systems and procedures. For example, we are in the process of migrating our operations to a new enterprise resource planning system that affects almost every facet of our business operations. Typically, these conversions negatively affect a company' s near-term ability to conduct business due to problems such as historical data conversion errors, personnel training time associated with the new system, delays in implementation or unforeseen technical problems during conversion. If problems arise during this transition, we could experience delays in or lack of shipping, an inability to support our existing customer base, delays in paying vendors, delays in collecting from customers, an inability to place or receive product orders or other operational problems. If this were to occur, our profitability or financial position could be negatively impacted. If we are not able to manage our growth effectively and efficiently, the quality of our products, our ability to retain key personnel and our operating results could suffer.

Our products may contain defects that cause us to incur significant costs, divert our attention from product development efforts and result in a loss of customers.

Highly complex products such as our verification systems and connectivity products frequently contain defects when they are first introduced or as new versions are released. Although none of our products has contained any material defects in the past, our products may contain defects of this nature in the future. If any of our products contains defects or have reliability, quality or compatibility problems, our reputation may be damaged and customers may be reluctant to buy our products. As a result, our ability to retain existing customers or attract new customers could be harmed. In addition, these defects could interrupt or delay sales to our customers. We may have to invest significant capital and other resources to alleviate these problems. If any of these problems remains undiscovered until after we have commenced commercial production of a new product, we may be required to incur additional development costs and product recall, repair or replacement costs. These problems may also result in claims against us by our customers or others. In addition, these problems may divert our technical and other resources from other development efforts.

If we are unable to expand our direct sales operations and our distributor and manufacturer' s representatives channels or successfully manage our expanded sales organization, our ability to increase our revenue will be harmed.

Historically, we have relied on a limited direct sales organization, supported by third-party manufacturer' s representatives, to sell our products domestically and on third-party distributors to sell our products internationally. We intend to develop and expand our direct sales organization in North America and our indirect distribution channels internationally. We may not be able to expand our direct sales organization successfully, and the cost of any expansion may exceed the revenue generated from expansion. In addition, if we fail to develop relationships with significant distributors or manufacturer' s representatives, or if our current distributors or manufacturer' s representatives are not successful in their sales or marketing efforts, sales of our products may decrease.

Any acquisitions that we undertake could be difficult to integrate, disrupt our business, dilute stockholder value and harm our operating results.

We expect to review opportunities to buy other businesses or technologies that would complement our current products, expand the breadth of our markets or enhance our technical capabilities or that might otherwise offer growth opportunities. If we make any future acquisitions, we could issue stock that would dilute the percentage ownership of our existing stockholders, incur substantial debt or assume contingent liabilities. To date, we have not acquired any other business or technologies. Potential acquisitions also involve numerous risks, including:

- problems in assimilating the purchased operations, technologies or products;
- costs or accounting charges associated with the acquisition;
- diversion of management' s attention from our existing business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have little or no prior experience; and
- potential loss of key employees of purchased businesses.

Economic, political and other risks associated with international sales and operations could adversely affect our sales.

Because we sell our products worldwide and have a research and development facility in Israel, our business is subject to risks associated with doing business internationally. We recognized 59.1% of our revenue from sales to international customers in the quarter ended March 31, 2002. We anticipate that revenue from international operations will continue to represent a substantial portion of our revenue. In addition, several of our manufacturers' facilities and suppliers are located outside the United States. Accordingly, our future results could be harmed by a variety of factors, including:

- changes in foreign currency exchange rates;
- changes in a specific country' s or region' s political or economic conditions, particularly in emerging markets;
- trade protection measures and import or export licensing requirements;
- potentially negative consequences from changes in tax laws;
- difficulty in staffing and managing widespread operations;

differing labor regulations;

differing protection of intellectual property; and

unexpected changes in regulatory requirements.

Our headquarters and our contract manufacturers are located in Northern California, Asia and other areas where natural disasters may occur.

Currently, our corporate headquarters and some of our contract manufacturers are located in Northern California and our other contract manufacturers are located in Asia. Northern California and Asia historically have been vulnerable to natural disasters and other risks, such as earthquakes, fires, floods, power loss and telecommunication failure, which at times have disrupted the local economy and posed physical risks to our and our manufacturers' properties. We also maintain facilities in San Diego, California and Netanya, Israel. We do not have redundant, multiple site capacity in the event of a natural disaster.

Any failure to protect our intellectual property adequately may significantly harm our business.

To date, we protect our proprietary processes, software, know-how and other intellectual property and related rights through copyrights, trademarks and maintenance of trade secrets, including entering into confidentiality agreements. Our success and ability to compete depend in part on our proprietary technology. We currently do not have any patents. Although we have six patents pending, patents may not issue as a result of these or other patent applications. Any patents that ultimately issue may be successfully challenged by others or invalidated, or may not provide us with a significant competitive advantage. Third parties may breach confidentiality agreements or other protective contracts into which we have entered, and we may not be able to enforce our rights in the event of these breaches. We may be required to spend significant resources to monitor and police our intellectual property rights, including pursuing remedies in court. We may become involved in legal proceedings against other parties, which may also cause other parties to assert claims against us. We report material pending legal proceedings, if any, under the separate caption "Item 1. Legal Proceedings" elsewhere in this report. However, in the future, we may not be able to detect infringement and may lose competitive position in our markets before we do so. In addition, competitors may design around our technologies or develop competing technologies. The laws of other countries in which we market our products might offer little or no effective protection of our proprietary technology. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it, which could significantly harm our business.

Claims that we infringe third-party intellectual property rights could result in significant expenses or restrictions on our ability to sell our products.

Our industry is characterized by uncertain and conflicting intellectual property claims and frequent intellectual property litigation, especially regarding patent rights. We cannot be certain that our products do not and will not infringe issued patents or other intellectual property rights of others. Historically, patent applications in the United States have not been publicly disclosed until the patent is issued, and we may not be aware of filed patent applications that relate to our products or technology. If patents are later issued in connection with these applications, we may be liable for infringement. From time to time, other parties may assert patent, copyright and other intellectual property rights to technologies and in various jurisdictions that are important to our business. Any claims asserting that our products infringe or may infringe proprietary rights of third parties, including claims arising through our contractual indemnification of our customers, regardless of their merit or resolution, would likely be costly and time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays or require us to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us, or at all.

Changes in current laws or regulations or the imposition of new laws or regulations could impede the sale of our products.

In the United States, substantial portions of the telecommunications industry, we and many of our customers and their products are subject to regulations and standards set by the Federal Communications Commission, or FCC. Internationally, many of our customers and their products may also be required to comply with regulations established by authorities in various countries. We are required to determine to what extent our products may be subject to FCC standards and regulations and to what extent we are required to obtain authorizations from the FCC directly or from a third-party authorized by the FCC to issue such authorizations. We are also required to maintain in good standing any equipment authorization we receive from the FCC or an FCC-approved party. In addition, the regulations in force both in the United States and in foreign jurisdictions may change. Failure to comply with regulations established by regulatory authorities or to obtain timely domestic or foreign regulatory approvals or certificates could significantly harm our business.

An energy crisis in California may cause our operating results to suffer.

California has encountered, and may again encounter, an energy crisis that could disrupt our operations and increase our expenses. Suppliers of electric power have on some occasions implemented, and may in the future continue to implement, rolling blackouts throughout California. We currently do not have backup generators or alternate sources of power in the event of a blackout, and our current insurance does not provide coverage for any damages our customers or we may suffer as a result of any interruption in the power supply. If blackouts interrupt our power supply, we would be temporarily unable to continue operations at our facilities in California. Any such interruption in our ability to continue operations at our facilities could damage our reputation, harm our ability to retain existing customers and to obtain new customers, and result in lost revenue, any of which could substantially harm our business and results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with an interest rate fixed at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. As of March 31, 2002, cash equivalents and short-term investments consist principally of investments in commercial paper, investment quality corporate and municipal bonds, collateralized mortgage obligations, U.S. government agency securities and money market funds.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings

On December 29, 2000, we filed in the United States District Court for the Northern District of California a complaint against Catalyst Enterprises, Inc., alleging trademark and trade dress infringement, copyright infringement and unfair competition and seeking damages and attorneys' fees. The case is referred to as Computer Access Technology Corporation v. Catalyst Enterprises, Inc., Case No. C 00 4852 DLJ. Catalyst responded to the complaint on April 6, 2001 by denying each of the substantive claims and asserting federal and state unfair competition counterclaims, and requesting an award of attorneys' fees. We answered the counterclaims on September 27, 2001, and denied all the substantive claims of Catalyst's counterclaims.

On March 28, 2001, we filed a motion for preliminary injunction against Catalyst. The Court denied this motion by order entered June 13, 2001. We filed a notice of appeal to the 9th Circuit Court of Appeals on July 12, 2001, and we filed a motion to voluntarily withdraw the appeal on November 28, 2001. The appeal was dismissed by order dated December 4, 2001.

On December 11, 2001, Catalyst filed a motion for partial summary judgment on the issue of trade dress functionality. On January 25, 2002, we filed a motion for judgment on the pleadings or, in the alternative, a special motion to strike Catalyst's counterclaims. The Court denied Catalyst's motion and granted our motion for judgment on the pleadings by order entered March 29, 2002, and dismissed each of Catalyst's counterclaims with prejudice.

Discovery in the case is ongoing, and expert designations are due July 29, 2002. The case is set for trial on October 23, 2002.

We cannot predict the outcome of this matter at this time.

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits.

Exhibit No.	Document Name
3.1*	Amended and Restated Certificate of Incorporation of the Company.
3.2*	Bylaws of the Company.
4.1*	Specimen Certificate of the Company' s common stock.
*	Previously filed as an exhibit to the Company' s Registration Statement on Form S-1 (Registration No. 333-43866) as filed with the SEC on August 16, 2000, as subsequently amended, and incorporated in this quarterly report by reference.

b. Reports on Form 8-K

On January 11, 2002, the Company filed a Form 8-K to announce, on January 7, 2002, Jean-Louis Gassée was named President and Chief Executive Officer of the Company.

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.

Date May 14, 2002		**Computer Access Technology Corporation**
	By:	/s/ Dennis W. Evans
		Dennis W. Evans Executive Vice President, Chief Financial Officer and Secretary (Principal Financial Officer and Principal Accounting Officer)