TEXAS CAPITAL BANCSHARES INC/TX
Form 10-Q
May 02, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934.**
For the quarterly period ended March 31, 2008

o **Transition Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934.**
For the transition period from ______________ to ______________

Commission file number 0-30533
TEXAS CAPITAL BANCSHARES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**75-2679109**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2100 McKinney Avenue, Suite 900, Dallas, Texas, U.S.A.	**75201**
(Address of principal executive officers)	(Zip Code)

214/932-6600
(Registrant s telephone number, including area code)

N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 þ No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

On April 30, 2008, the number of shares set forth below was outstanding with respect to each of the issuer s classes of common stock:

Common Stock, par value $0.01 per share 26,651,675

Texas Capital Bancshares, Inc.
Form 10-Q
Quarter Ended March 31, 2008
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Certification of CFO Pursuant to Rule 13a-14(a)
Certification of CEO Pursuant to Rule 13a-14(b)
Certification of CFO Pursuant to Rule 13a-14(b)

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEXAS CAPITAL BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS UNAUDITED

(In thousands except share data)

	Three months ended March 31	
	2008	2007
Interest income		
Interest and fees on loans	$61,897	$61,174
Securities	4,860	5,822
Federal funds sold	40	5
Deposits in other banks	12	15
Total interest income	66,809	67,016
Interest expense		
Deposits	21,724	30,890
Federal funds purchased	2,950	2,153
Repurchase agreements	322	394
Other borrowings	3,327	12
Trust preferred subordinated debentures	1,887	2,047
Total interest expense	30,210	35,496
Net interest income	36,599	31,520
Provision for loan losses	3,750	1,200
Net interest income after provision for loan losses	32,849	30,320
Non-interest income		
Service charges on deposit accounts	1,117	893
Trust fee income	1,216	1,077
Bank owned life insurance (BOLI) income	311	298
Brokered loan fees	473	479
Equipment rental income	1,516	1,459
Other	1,050	1,077
Total non-interest income	5,683	5,283
Non-interest expense		
Salaries and employee benefits	15,342	14,557
Net occupancy expense	2,365	2,020
Leased equipment depreciation	1,193	1,207
Marketing	677	757
Legal and professional	2,016	1,661
Communications and data processing	854	832
Other	3,830	3,061
Total non-interest expense	26,277	24,095

Income from continuing operations before income taxes	12,255	11,508
Income tax expense	4,225	3,922
Income from continuing operations	8,030	7,586
Income (loss) from discontinued operations (after-tax)	(148)	36
Net income	$ 7,882	$ 7,622
Basic earnings per share:		
Income from continuing operations	$ .30	$ .29
Net income	$ .30	$ .29
Diluted earnings per share:		
Income from continuing operations	$ .30	$ .29
Net income	$ .30	$ .29

See accompanying notes to consolidated financial statements.

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TEXAS CAPITAL BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands except share data)

	March 31, 2008	December 31, 2007
	(Unaudited)	
Assets		
Cash and due from banks	$ 78,975	$ 89,463
Securities, available-for-sale	425,513	440,119
Loans held for sale	239,860	174,166
Loans held for sale from discontinued operations	730	731
Loans held for investment (net of unearned income)	3,493,631	3,462,608
Less: Allowance for loan losses	34,021	32,821
Loans held for investment, net	3,459,610	3,429,787
Premises and equipment, net	29,526	31,684
Accrued interest receivable and other assets	110,220	113,648
Goodwill and intangible assets, net	7,810	7,851
Total assets	$4,352,244	$4,287,449
Liabilities and Stockholders Equity		
Liabilities:		
Deposits:		
Non-interest bearing	$ 503,554	$ 529,334
Interest bearing	1,718,339	1,569,546
Interest bearing in foreign branches	933,420	967,497
Total deposits	3,155,313	3,066,377
Accrued interest payable	5,742	5,630
Other liabilities	14,285	23,047
Federal funds purchased	312,212	344,813
Repurchase agreements	8,964	7,148
Other borrowings	430,306	431,890
Trust preferred subordinated debentures	113,406	113,406
Total liabilities	4,040,228	3,992,311
Stockholders equity:		
Common stock, $.01 par value:		
Authorized shares 100,000,000	266	264
Issued shares 26,631,763 and 26,389,548 at March 31, 2008 and December 31, 2007, respectively	266	264
Additional paid-in capital	193,917	190,175
Retained earnings	113,467	105,585

Treasury stock (shares at cost: 84,691 at March 31, 2008 and December 31, 2007)	(581)	(581)
Deferred compensation	573	573
Accumulated other comprehensive income (loss), net of taxes	4,374	(878)
Total stockholders equity	312,016	295,138
Total liabilities and stockholders equity	$4,352,244	$4,287,449

See accompanying notes to consolidated financial statements.

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TEXAS CAPITAL BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(In thousands except share data)

	Common Stock				Treasury Stock				
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Shares	Amount	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2006	26,065,124	$261	182,321	$ 76,163	(84,274)	$(573)	$573	$(5,230)	$253,515
Comprehensive income:									
Net income				29,422					29,422
Change in unrealized gain (loss) on available-for-sale securities, net of taxes of $2,343								4,352	4,352
Total comprehensive income									33,774
Tax benefit related to exercise of stock options			1,164						1,164
Stock-based compensation expense recognized in earnings			4,761						4,761
Issuance of stock related to stock-based awards	324,424	3	1,929						1,932
Purchase of treasury stock					(417)	(8)			(8)
Balance at December 31, 2007	26,389,548	264	190,175	105,585	(84,691)	(581)	573	(878)	295,138
Comprehensive income:									
Net income (unaudited)				7,882					7,882

Change in unrealized gain (loss) on available-for-sale securities, net of taxes of $2,828 (unaudited)								5,252	5,252
Total comprehensive income (unaudited)									13,134
Tax benefit related to exercise of stock options (unaudited)			677						677
Stock-based compensation expense recognized in earnings (unaudited)			1,295						1,295
Issuance of stock related to stock-based awards (unaudited)	242,215	2	1,770						1,772
Balance at March 31, 2008 (unaudited)	26,631,763	$266	$193,917	$113,467	(84,691)	$(581)	$573	$ 4,374	$312,016

See accompanying notes to consolidated financial statements.

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TEXAS CAPITAL BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED
(In thousands)

	Three months ended March 31	
	2008	2007
Operating activities		
Net income	$ 7,882	$ 7,622
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Provision for loan losses	3,750	1,200
Depreciation and amortization	1,878	1,773
Amortization and accretion on securities	73	77
Bank owned life insurance (BOLI) income	(311)	(298)
Stock-based compensation expense	1,295	1,252
Tax benefit from stock option exercises	677	125
Excess tax benefits from stock-based compensation arrangements	(1,935)	(358)
Originations of loans held for sale	(1,330,485)	(994,646)
Proceeds from sales of loans held for sale	1,264,033	985,586
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	3,739	9,665
Accrued interest payable and other liabilities	(11,478)	(3,074)
Net cash (used in) provided by operating activities of continuing operations	(60,882)	8,924
Net cash provided by operating activities of discontinued operations	1,324	8,669
Net cash (used in) provided by operating activities	(59,558)	17,593
Investing activities		
Purchases of available-for-sale securities	(2,580)	(2,568)
Maturities and calls of available-for-sale securities	7,600	4,790
Principal payments received on securities	17,593	20,605
Net increase in loans held for investment	(34,136)	(162,284)
Purchases and sales of premises and equipment, net	319	(2,835)
Net cash used in investing activities of continuing operations	(11,204)	(142,292)
Financing activities		
Net increase in deposits	88,936	17,407
Issuance of stock related to stock-based awards	1,772	340
Net increase (decrease) in other borrowings	232	(3,126)
Excess tax benefits from stock-based compensation arrangements	1,935	358
Net federal funds purchased	(32,601)	122,685
Purchase of treasury stock		(8)
Net cash provided by financing activities of continuing operations	60,274	137,656
Net increase (decrease) in cash and cash equivalents	(10,488)	12,957

Cash and cash equivalents at beginning of period	89,463	93,716
Cash and cash equivalents at end of period	$ 78,975	$ 106,673
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$ 30,098	$ 33,382
Cash paid during the period for income taxes	5,631	11
Non-cash transactions:		
Transfers from loans/leases to other repossessed assets	1,784	
Transfers from loans/leases to premises and equipment		556

See accompanying notes to consolidated financial statements.

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TEXAS CAPITAL BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED
(1) ACCOUNTING POLICIES

Nature of Operations

Texas Capital Bancshares, Inc., a Delaware bank holding company, was incorporated in November 1996 and commenced operations in March 1998. The consolidated financial statements of the Company include the accounts of Texas Capital Bancshares, Inc. and its wholly owned subsidiary, Texas Capital Bank, National Association (the Bank). The Bank currently provides commercial banking services to its customers in Texas and concentrates on middle market commercial and high net worth customers.

Basis of Presentation

The accounting and reporting policies of Texas Capital Bancshares, Inc. conform to accounting principles generally accepted in the United States and to generally accepted practices within the banking industry. Our consolidated financial statements include the accounts of Texas Capital Bancshares, Inc. and its subsidiary, the Bank. Certain prior period balances have been reclassified to conform with the current period presentation.

The consolidated interim financial statements have been prepared without audit. Certain information and footnote disclosures presented in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the interim financial statements include all normal and recurring adjustments and the disclosures made are adequate to make interim financial information not misleading. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2007, included in our Annual Report on Form 10-K filed with the SEC on February 26, 2008 (the 2007 Form 10-K). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Actual results could differ from those estimates. The allowance for possible loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly susceptible to significant change in the near term.

Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on- and off-balance sheet financial instruments do not include the value of anticipated future business or the value of assets and liabilities not considered financial instruments. Effective January 1, 2008, we adopted Statement of Financial Accounting Standard No. 157, Fair Value Measurements (SFAS 157). The adoption of SFAS 157 did not have an impact on our financial statements except for the expanded disclosures noted in Note 10 Fair Value Disclosures.

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(2) EARNINGS PER SHARE

The following table presents the computation of basic and diluted earnings per share (in thousands except per share data):

	Three months ended March 31 2008	Three months ended March 31 2007
Numerator:		
Net income from continuing operations	$ 8,030	$ 7,586
Income (loss) from discontinued operations	(148)	36
Net income	$ 7,882	$ 7,622
Denominator:		
Denominator for basic earnings per share-weighted average shares	26,466,048	26,087,077
Effect of employee stock options [(1)]	61,856	353,478
Denominator for dilutive earnings per share-adjusted weighted average shares and assumed conversions	26,527,904	26,440,555
Basic earnings per share from continuing operations	$ .30	$ .29
Basic earnings per share from discontinued operations		
Basic earnings per share	$ .30	$ .29
Diluted earnings per share from continuing operations	$ .30	$ .29
Diluted earnings per share from discontinued operations		
Diluted earnings per share	$ .30	$ .29

(1) Stock options outstanding of 1,614,748 at March 31, 2008 and 952,170 at March 31, 2007 have not been included in diluted earnings per share because to do so would have been anti-dilutive for the periods

presented. Stock options are anti-dilutive when the exercise price is higher than the average market price of our common stock.

(3) SECURITIES

Securities are identified as either held-to-maturity or available-for-sale based upon various factors, including asset/liability management strategies, liquidity and profitability objectives, and regulatory requirements. Held-to-maturity securities are carried at cost, adjusted for amortization of premiums or accretion of discounts. Available-for-sale securities are securities that may be sold prior to maturity based upon asset/liability management decisions. Securities identified as available-for-sale are carried at fair value. Unrealized gains or losses on available-for-sale securities are recorded as accumulated other comprehensive income in stockholders equity. Amortization of premiums or accretion of discounts on mortgage-backed securities is periodically adjusted for estimated prepayments.

Our unrealized gain on the securities portfolio value increased from a loss of $1.4 million, which represented 0.29% of the amortized cost at December 31, 2007, to a gain of $6.7 million, which represented 1.61% of the amortized cost at March 31, 2008.

The following table discloses, as of March 31, 2008, our investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months (in thousands):

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasuries	$	$	$	$	$	$
Mortgage-backed securities	30,725	(225)	7,883	(15)	38,608	(240)
Corporate securities			4,999	(1)	4,999	(1)
Municipals	2,779	(27)			2,779	(27)
Equity securities						
	$33,504	$(252)	$12,882	$(16)	$46,386	$(268)

At March 31, 2008, the number of investment positions in this unrealized loss position totals 17. We do not

believe these unrealized losses are other than temporary as (1) we have the ability and intent to hold the investments to maturity, or a period of time sufficient to allow for a recovery in market value, and (2) it is not probable that we will be unable to collect the amounts contractually due. The unrealized losses noted are interest rate related due to rising rates in 2006 in relation to previous rates in 2004 and 2005. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

(4) LOANS AND ALLOWANCE FOR LOAN LOSSES

At March 31, 2008 and December 31, 2007, loans were as follows (in thousands):

	March 31, 2008	December 31, 2007
Commercial	$2,021,925	$2,035,049
Construction	620,818	573,459
Real estate	776,460	773,970
Consumer	23,548	28,334
Leases	71,953	74,523
Gross loans held for investment	3,514,704	3,485,335
Deferred income (net of direct origination costs)	(21,073)	(22,727)
Allowance for loan losses	(34,021)	(32,821)
Total loans held for investment, net	$3,459,610	$3,429,787

We continue to lend primarily in Texas. As of March 31, 2008, a substantial majority of the principal amount of the loans in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. We originate substantially all of the loans in our portfolio, except in certain instances we have purchased selected loan participations and interests in certain syndicated credits and United States Department of Agriculture (USDA) government guaranteed loans.

Non-Performing Assets

Total current assets

162,259

172,091

INVESTMENTS HELD TO MATURITY

30,051

34,788

PROPERTY & EQUIPMENT, net of accumulated depreciation and amortization: $55,018 at September 30, 2005; $59,233 at December 31, 2004

39,147

57,707

GOODWILL, net

32,067

33,425

OTHER INTANGIBLE ASSETS, net

21,638

24,657

OTHER ASSETS

2,058

4,385

TOTAL

$

287,220

$

327,053

LIABILITIES & STOCKHOLDERS EQUITY

CURRENT LIABILITIES:

Accounts payable

$

32,290

$

29,613

Restructuring reserve

5,815

2,288

Deferred income taxes

1,465

1,497

Other accrued expenses

23,586

21,986

Total current liabilities

63,156

55,384

DEFERRED INCOME TAXES

412

633

OTHER LIABILITIES

539

999

STOCKHOLDERS EQUITY

Common stock, par value $0.001; 300,000 shares authorized; 85,758 and 84,352 shares issued and outstanding at September 30, 2005 and December 31, 2004, respectively

86

84

Additional paid-in-capital

608,595

602,737

Treasury stock, at cost; 472 and 100 treasury shares at September 30, 2005 and December 31, 2004, respectively

(2,517

)

Deferred compensation

(44

)

Accumulated other comprehensive income

23,418

32,048

Accumulated deficit

(406,469

)

(364,788

)

Total stockholders equity

223,113

270,037

TOTAL

$

287,220

$

327,053

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POWER-ONE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands, unaudited)

	Nine Months Ended September 30, 2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (41,681)	$ (12,104)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	11,473	12,228
Asset impairment(a)	8,018	1,991
Investment write-off(b)	2,496	1,118
Stock compensation	740	1,274
Tax obligations associated with stock compensation plans	(133)	
Exchange gain	(985)	(75)
Deferred income taxes	56	(186)
Net (gain) loss on disposal of property and equipment	27	(199)
Changes in operating assets and liabilities:		
Accounts receivable, net	(3,488)	8,161
Inventories	9,844	(5,646)
Prepaid expenses and other current assets	424	717
Accounts payable	3,610	(7,688)
Restructuring reserve	3,295	(2,977)
Accrued expenses	2,847	2,695
Other liabilities	(395)	164
Net cash used in operating activities	(3,852)	(527)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investments	(209)	
Purchases of held to maturity investments	(3,851)	(51,991)
Proceeds from available-for-sale investments	2,001	
Proceeds from held to maturity investments	7,001	
Acquisition of property & equipment	(5,039)	(6,200)
Proceeds from sale of property and equipment	1,491	1,873
Other assets	5	(278)
Net cash provided by (used in) investing activities	1,399	(56,596)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on bank credit facilities		(792)
Repayments of long-term debt		(9,054)
Issuance of common stock	5,297	1,751
Payments to acquire treasury stock	(2,517)	
Net cash provided by (used in) financing activities	2,780	(8,095)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(2,138)	225
DECREASE IN CASH AND CASH EQUIVALENTS	(1,811)	(64,993)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	35,504	99,507
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 33,693	$ 34,514
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for:		
Interest	$ 4	$ 237
Income taxes	$ 357	$ 266

(a) The asset impairment charges of $8.0 million and $2.0 million for the nine months ended September 30, 2005 and 2004, respectively, related to the impairment of property and equipment calculated in accordance with SFAS No. 144.

(b) The $2.5 million investment write-off for the nine months ended September 30, 2005 related to the write-off of foreign investments and was recorded as other expense.

The $1.1 million investment write-off for the nine months ended September 30, 2004 related to a $1.3 million investment in a privately-held technology company that was written down to a fair value of $0.2 million and was recorded as other expense.

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POWER-ONE, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
NET INCOME (LOSS)	$ 1,529	$ (5,373)	$ (41,681)	$ (12,104)
OTHER COMPREHENSIVE INCOME (LOSS)				
Unrealized loss on investments	(154)	(242)	(267)	(242)
Foreign currency translation adjustment	(713)	(382)	(8,363)	9
COMPREHENSIVE INCOME (LOSS)	$ 662	$ (5,997)	$ (50,311)	$ (12,337)

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POWER-ONE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared without audit and reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of financial position and the results of operations for the interim periods. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to such SEC rules and regulations. Operating results for the period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

The balance sheet at December 31, 2004 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The accompanying interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Form 10-K for the year ended December 31, 2004.

Power-One, Inc. s (the Company) reporting period coincides with the 52- to 53-week period ending on the Sunday closest to December 31, and its fiscal quarters are the 13- to 14-week periods ending on the Sunday nearest to March 31, June 30, September 30 and December 31. For simplicity of presentation, the Company has described the three- and nine-month periods ended October 2, 2005 and September 26, 2004 as September 30, 2005 and 2004, respectively. The three-month periods ended September 30, 2005 and 2004 and the nine-month periods ended September 30, 2005 and 2004 were 13 week and 39 week periods, respectively.

NOTE 2 CHANGES TO SIGNIFICANT ACCOUNTING POLICIES AND RELATED DISCLOSURES

Stock Compensation ***The*** Company currently uses the intrinsic-value method of accounting prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for stock options granted to employees. Accordingly, the Company does not recognize compensation expense in the Consolidated Statements of Operations that have been made at fair market value for stock option grants to employees.

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SFAS 123, Accounting for Stock-Based Compensation, encourages the recognition of compensation expense for employee stock-based compensation arrangements using the fair value method of accounting. The Company has elected the disclosure only alternative and has disclosed the pro forma net income (loss) per share amounts using the fair value method. In accordance with SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123, the required pro forma disclosure is shown below (in millions, except per share data).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Net income (loss), as reported	$ 1.5	$ (5.4)	$ (41.7)	$ (12.1)
Add: Stock-based employee compensation expense included in reported net income (loss)	0.4	0.5	0.7	1.3
Deduct: Total stock-based employee compensation expense determined under fair value based method	(0.6)	(3.5)	(19.4)	(13.0)
Pro forma net income (loss)	$ 1.3	$ (8.4)	$ (60.4)	$ (23.8)
Income (loss) per share:				
Basic net income (loss) per share as reported	$ 0.02	$ (0.06)	$ (0.49)	$ (0.14)
Diluted net income (loss) per share as reported	$ 0.02	$ (0.06)	$ (0.49)	$ (0.14)
Basic net income (loss) per share pro forma	$ 0.02	$ (0.10)	$ (0.71)	$ (0.28)
Diluted net income (loss) per share pro forma	$ 0.01	$ (0.10)	$ (0.71)	$ (0.28)

The pro forma amounts for the three- and nine-month periods ended September 30, 2005 and 2004 do not include a tax benefit on the stock compensation due to the deferred income tax valuation allowance recorded by the Company in each respective period. The fair value of each option grant is estimated on the date of grant using the Black-Scholes model, with the assumptions shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Risk-free interest rate	4.1 %	4.0 %	4.1 %	3.9 %
Volatility	47 %	50 %	48 %	51 %
Option life, years	4.7	5.9	4.7	5.9
Dividends				
Fair value of options granted, millions	$	$ 17.8	$ 0.2	$ 22.7

On February 23, 2005, the Board of Directors of the Company authorized accelerating the vesting of all of the Company s outstanding unvested stock options granted to directors, officers and employees of the Company under applicable equity incentive plans of the Company, which stock options have an exercise price greater than $5.00. The closing price of the Company s common stock on the Nasdaq National Market Quotation System used for measurement of compensation as of the date of acceleration was $5.93. As a result of the acceleration, options to acquire approximately 3.8 million shares of the Company s common stock, which otherwise would have vested from time to time over the next four years, became immediately exercisable. All other terms and conditions applicable to outstanding stock option grants remain in effect. The option plans under which the accelerated grants were issued are the Company s Amended and Restated 1996 Stock Incentive Plan, the 2001 Stock Option Plan, and the 2004 Stock Incentive Plan. The Board of Directors decision to accelerate the vesting of the affected stock options was in response to the issuance by the Financial Accounting Standards Board of SFAS 123 (revised 2004), Share-Based Payment, which will require the Company to treat unvested stock options as an expense effective at the beginning of the Company s first fiscal quarter of 2006. By accelerating the vesting

of the affected stock options now, the Company has elected to recognize an immaterial amount of compensation expense in the first fiscal quarter of 2005 for such accelerated stock options with exercise prices between $5.00 and $5.93. The Company believes that it will thereafter not be required to recognize any compensation expense in future periods associated with the affected options. However, there can be no assurance that the acceleration of the options may not result in some future compensation expense.

Treasury stock *Effective* during the second quarter of 2005, the Company repurchased shares of its common stock as treasury stock with the intent to retire repurchased shares. The Company accounts for treasury shares using the cost method and includes treasury stock as a component of stockholders equity.

Recent Pronouncements and Accounting Changes In December 2004, the FASB issued SFAS 123(R), Share-Based Payment, which revises SFAS 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123(R) requires fair value recognition of stock option grants on the income statement as an expense and is effective for the Company as of the first quarter of 2006. This pronouncement may have a material impact on the Company s operating results. Valuing a stock option is a complex calculation that can be performed by a number of valuation methods, such as the Black-Scholes or lattice binomial methods. Each valuation method, however, may utilize a number of management judgments as calculation inputs, including but not limited to the expected life of the option, expected forfeitures, and future volatility. Changes in the Company s estimates of the valuation assumptions may materially impact the valuation of any options granted and therefore impact operating results.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4 (SFAS No. 151). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, handling costs and wasted material (spoilage). Among other provisions, the new rule requires that such items be recognized as current-period charges, regardless of whether they meet the criterion of so abnormal as stated in ARB No. 43. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company does not expect that adoption of SFAS 151 will have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS 154). This Statement replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Consequently, the Company will adopt provisions of SFAS 154 for the fiscal year beginning January 1, 2006. Management currently believes the adoption of the provisions of SFAS 154 will not have a material impact on its financial position, results of operation or cash flows.

NOTE 3 INVESTMENTS

At September 30, 2005, the Company had investments in certain debt securities that have been classified as held-to-maturity securities and certain other securities that have been classified as available-for-sale securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* (SFAS 115). Held-to-maturity investments are recorded on the balance sheet at cost. Available-for-sale investments are recorded at fair value based upon quoted market prices, with unrealized gains and losses (net of applicable deferred income taxes) included in other comprehensive income. Realized gains and losses on sales of investments are determined using the specific identification method.

The following tables summarize the Company s investments (in millions):

	September 30, 2005		
	Amortized Cost	Unrealized Pretax Net Gains (Losses)	Fair Value
U.S. government and agencies notes and bonds	$ 35.6	$ (0.5)	$ 35.1
Other fixed income investments	11.2		11.2
	$ 46.8	$ (0.5)	$ 46.3

	December 31, 2004		
	Amortized Cost	Unrealized Pretax Net Gains (Losses)	Fair Value
U.S. government and agencies notes and bonds	$ 39.2	$	$ 39.2
Municipal notes and bonds	2.0		2.0
Other fixed income investments	10.5	0.2	10.7
	$ 51.7	$ 0.2	$ 51.9

	September 30, 2005	December 31, 2004
Reported as:		
Available-for-sale securities	$ 5.7	$ 7.5
Investments held to maturity, short-term	11.0	9.4
Investments held to maturity	30.1	34.8
Total	$ 46.8	$ 51.7

The fair value of the Company s held-to-maturity securities at September 30, 2005, by contractual maturity, is shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay and creditors may have the right to call certain obligations.

	Amortized Cost	Fair Value
Due in less than one year	$ 11.0	$ 11.0
Due in 1-2 years	8.0	7.8
Due in 2-5 years	22.1	21.8
	$ 41.1	$ 40.6

The Company also has investments in privately-held enterprises which are accounted for under the cost or equity methods depending on the nature of the investment. Additionally, the Company has an investment in one of its contract manufacturers in Asia, accounted for as available-for-sale. These investments are included in other assets on the balance sheet.

NOTE 4 INVENTORIES

Inventories consist of the following (in millions):

	September 30, 2005	December 31, 2004
Raw materials	$ 23.8	$ 29.8
Subassemblies-in-process	5.0	6.1
Finished goods	13.9	18.4
	$ 42.7	$ 54.3

During the three-and nine-month periods ended September 30, 2005, the Company wrote off $0.6 million and $6.4 million, respectively, related to excess inventory and other inventory adjustments, and recorded the charges as costs of goods sold. The inventory write-down was primarily attributed to locations subject to the Company s restructuring plan.

NOTE 5 INCOME (LOSS) PER SHARE

Basic income (loss) per share is computed by dividing net income (loss) by the weighted average common shares outstanding for the period, while diluted income per share also includes the dilutive effect of common equivalent shares outstanding.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Basic and Diluted loss per share:				
Net income (loss)	$ 1.5	$ (5.4)	$ (41.7)	$ (12.1)
Basic weighted average shares outstanding	85.4	83.9	84.8	83.7
Effect of dilutive potential common shares	0.7			
Diluted weighted average shares outstanding	86.1	83.9	84.8	83.7
Basic income (loss) per share	$ 0.02	$ (0.06)	$ (0.49)	$ (0.14)
Diluted income (loss) per share	$ 0.02	$ (0.06)	$ (0.49)	$ (0.14)

The dilutive effect of stock options outstanding at September 30, 2005 and 2004 was not included in the calculation of diluted loss per share for the three-month period ended September 30, 2004 or for nine-month periods ended September 30, 2005 and 2004 because to do so would have had an anti-dilutive effect as the Company had a net loss for each of these periods. The weighted average number of shares excluded from the diluted loss per share computation was approximately 2.4 million for the three-month period ended September 30, 2004, and 1.0 million and 2.2 million for the nine-month periods ended September 30, 2005 and 2004, respectively.

NOTE 6 GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets consist of the following (in millions):

	September 30, 2005 Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets	Weighted Average Life (In years)
Non-amortizable intangibles				
Goodwill	$ 37.4	$ 5.3	$ 32.1	
Trade name	16.6	5.2	11.4	
Subtotal	54.0	10.5	43.5	
Amortizable intangibles				
Product technology	24.9	19.2	5.7	9
Other	10.6	6.1	4.5	15
Subtotal	35.5	25.3	10.2	
Total	$ 89.5	$ 35.8	$ 53.7	

	December 31, 2004 Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets	Weighted Average Life (In years)
Non-amortizable intangibles				
Goodwill	$ 39.1	$ 5.7	$ 33.4	
Trade name	16.6	5.2	11.4	
Subtotal	55.7	10.9	44.8	
Amortizable intangibles				
Product technology	25.4	17.3	8.1	9
Other	10.7	5.5	5.2	15
Subtotal	36.1	22.8	13.3	
Total	$ 91.8	$ 33.7	$ 58.1	

The changes in the carrying amount of goodwill for the nine months ended September 30, 2005 is as follows (in millions):

Beginning balance	$ 33.4
Changes due to foreign currency fluctuations	(1.3)
Ending balance	$ 32.1

Estimated remaining amortization expense for 2005 through 2009 is as follows (in millions):

Year Ending December 31,	Amortization Expense
2005 (3 months)	$ 0.8
2006	3.1
2007	2.9
2008	1.2
2009	0.5
Total	$ 8.5

NOTE 7 LONG-TERM DEBT AND CREDIT FACILITY

The Company maintains credit facilities with various banks in Europe and Asia. These credit facilities were acquired primarily as a result of acquisitions in 1998 and 2000. The aggregate limit on all credit facilities is approximately $8.0 million. The credit facilities bear interest on amounts outstanding at various intervals based on published market rates. Some credit agreements require the Company s subsidiaries to maintain certain financial covenants and to provide certain financial reports to the lenders. At September 30, 2005, the Company had no outstanding balances on any of its credit facilities and the Company was in compliance with all of its debt covenants.

NOTE 8 OTHER ACCRUED EXPENSES

Other accrued expenses consist of the following (in millions):

	September 30, 2005	December 31, 2004
Accrued income taxes	$ 5.5	$ 5.1
Accrued payroll and related expenses	4.5	5.3
Accrued bonus	4.4	2.1
Accrued warranties	2.3	3.4
Accrued sales discounts	1.7	1.9
Other accrued expenses	5.2	4.2
	$ 23.6	$ 22.0

NOTE 9 CONTINGENCIES

The Company is involved in certain claims and legal proceedings that arose in the normal course of business. Management does not believe that the outcome of any of the claims or legal proceedings in which the Company is currently involved will have a material adverse effect on the Company s consolidated financial position, results of operations, or cash flows.

The Company has initiated suit in Switzerland, seeking reimbursement of legal defense costs incurred in the successful defense of earlier patent litigation asserted against the Company. As part of its defense of the patent dispute, the Company made a claim for indemnification and reimbursement from an escrow account which was created as part of the acquisition of Melcher AG. The Melcher shareholder representative has denied the Company s right to and claim for reimbursement. Proceedings are in the initial stages.

The Company filed suit September 30, 2005 against Artesyn Technologies, Inc. for infringement of patents held by the Company. The lawsuit seeks compensatory damages and a permanent injunction to prohibit Artesyn from making, using, selling or offering to sell infringing products. Suit was filed in the U.S. District Court for the Eastern District of Texas. Proceedings are in the earliest stages.

NOTE 10 RESTRUCTURING COSTS AND ASSET IMPAIRMENT CHARGES

During the first nine months of 2005, the Company announced a restructuring plan which was accounted for in accordance with SFAS 146, Accounting for Costs Associated with Disposal Activities. The Company recorded net pre-tax charges of $11.0 million for restructuring costs and $8.0 million in asset impairment costs during the nine months ended September 30, 2005 related to the restructuring of its worldwide operations.

Restructuring Costs

The restructuring charge is comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Worldwide workforce reduction	$ 0.1	$	$ 4.5	$ 0.7
Facilities closure	(0.2)		6.3	0.1
Other costs	(0.1)		0.2	
	$ (0.2)	$	$ 11.0	$ 0.8

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The net restructuring charge of $11.0 million for the nine months ended September 30, 2005 included a workforce reduction in Europe and North America, and the charges were comprised of severance and related benefits for approximately 250 terminated employees, consolidation of excess facilities and continuing lease obligations thereon, contract termination costs, and other shutdown costs. The Company expects to pay the severance and related components of the restructuring reserve during the remainder of 2005. The facilities closure charge includes a lease termination fee of $1.0 million which the Company paid out during the quarter ended September 30, 2005. The facilities closure charge also contains continuing lease obligations which are expected to be paid over the life of the leases, the longest of which extends into 2011. All restructuring charges are expected to be settled with cash. During the nine months ended September 30, 2004, the Company recorded $0.8 million of restructuring charges primarily related to a workforce reduction at our European locations. No restructuring charges were recorded during the three months ended September 30, 2004.

A summary of the restructuring costs and reserve activity during the nine months ended September 30, 2005 are as follows:

	Restructuring Liabilities at December 31, 2004	Restructuring Charges	Adjustments to Restructuring Charges	Cash Paid	Restructuring Liabilities at September 30, 2005
Worldwide workforce reduction	$	$ 4.5	$	$ (4.1)	$ 0.4
Facilities closure	1.9	6.5	(0.2)	(2.8)	5.4
Other costs	0.4	0.3	(0.1)	(0.6)	
Total Restructuring Costs	$ 2.3	$ 11.3	$ (0.3)	$ (7.5)	$ 5.8

Asset Impairment Charges

During the nine-month period ended September 30, 2005, the Company performed impairment reviews in accordance with SFAS 144, Accounting for the Impairment and Disposal of Long-Lived Assets, to determine whether any of its long-lived assets were impaired. The Company identified certain long-lived assets associated with the 2005 restructuring whose carrying value would not be recoverable from future cash flows, and recorded an impairment charge $8.0 million for these assets for the nine-month period ended September 30, 2005. These assets consisted of an owned building in Norway that was held for use and which was written down to fair market value; leasehold improvements for leased facilities whose operations are being closed; and miscellaneous other long-lived assets that will no longer be used. None of the impairment charges include cash components. No asset impairment charges were recorded during the quarter ended September 30, 2005.

During the quarter and nine months ended September 30, 2004, the Company recorded $1.3 million related to an excess facility. The book value of the excess facility was written down to fair value which the Company determined based on current market activity. In connection with the restructuring of one of its European facilities during the nine months ended September 30, 2004, the company identified manufacturing equipment, which was written down to fair market value resulting in an impairment charge of $0.7 million. The Company determined that the carrying values of these fixed assets would not be recovered from future cash flows of the continuing operations at this European facility. Fair value was determined by using discounted cash flows and market quotes from third party sources.

During the first quarter of 2005, the Company determined two investments in foreign enterprises, recorded in other assets on the balance sheet, were impaired. The impairment charge of $2.5 million was recorded in other expense and primarily resulted from a forecast reduction for the enterprise and the related cash flow. During the quarter and nine months ended September 30, 2004, the Company recorded a $1.1 million investment write-off related to a $1.3 million investment in a privately-held technology

company which was written down to a fair market value of $0.2 million. The impairment charge of $1.1 million was recorded in other expense.

NOTE 11 WARRANTIES

The Company offers its customers warranties on products sold based on product type and application. Management reviews and adjusts the warranty accrual based on warranty repair costs and the rate of return. Actual repair costs are offset against the reserve. A tabular presentation of the activity within the warranty accrual account for the nine months ended September 30, 2005 and 2004 is presented below, in millions:

	Nine Months Ended September 30,	
	2005	2004
Balance, beginning of period	$ 3.4	$ 3.3
Charges and costs accrued	0.6	1.1
Adjustments related to pre-existing warranties (including changes in estimates)		
Less repair costs incurred	(1.6)	(0.7)
Changes due to foreign currency	(0.1)	
Balance, end of period	$ 2.3	$ 3.7

NOTE 12 SUBSEQUENT EVENTS

On October 10, 2005, the Company sold its excess facility in Norway for cash proceeds of approximately $6.1 million and recorded a gain of approximately $2.5 million on the sale.

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

Introduction

We are a worldwide organization and leading designer and manufacturer of hundreds of high-quality brand name AC/DC and DC/DC power supplies and converters and power management products. We sell our products to original equipment manufacturers, distributors and service providers who value quality, reliability, technology and service. We have hundreds of customers in the communications, industrial, transportation, automatic/semiconductor test equipment, medical equipment and other electronic equipment industries. Our board-mounted DC/DC products, provide precise levels of DC power to sensitive electronic components in equipment such as switches, routers and other communications equipment. Our DC power systems are sold to telecommunications and Internet service providers worldwide.

At December 31, 2004, we had four primary divisions: Compact Advanced Power Solutions (CAPS), Energy Solutions (ES), Silicon Power Systems (SPS), and di/dt. CAPS consisted of the original Power-One AC/DC business and the high-density board-mounted DC/DC businesses obtained through our acquisitions of IPD in 1999 and of Melcher in 1998. ES represented the combination of our HC Power and Powec acquisitions in 2000. SPS is a new division that is engaged in developing next-generation silicon-based DC/DC technology. di/dt Inc., a technology leader in the DC/DC space, was acquired in 2003.

In February 2005, we announced a restructuring plan in which most of the operations of both ES and di/dt would be absorbed into the infrastructure of the CAPS division, effectively eliminating the division structure. The most significant component of this plan involved the elimination of most ES operations in Norway and their integration into our other existing locations. In addition to the integration of ES and di/dt into the CAPS division, we have implemented cost reductions in other areas of the Company. We have seen a portion of the $30 million in targeted annual cost savings increasingly each quarter during the year with full savings expected to be realized by the fourth quarter of 2005. We incurred $19.0 million of restructuring and asset impairment charges during the first nine months of 2005, of which approximately $8 million were non-cash in nature and primarily related to asset impairment charges for long-lived assets. The balance of the charges related to severance and continuing lease obligations for closed facilities, the longest of which continues into 2011.

All products are sold under the Power-One brand name by our sales force. We have two product lines, referred to as embedded products and power systems.

The SPS group is strategically significant to the Company and is engaged in the design and production of highly innovative and efficient silicon-based digital power management solutions for next generation DC/DC power conversion products in the Intermediate Bus Architecture (IBA) market. SPS maXyz product line was introduced in 2003 and was developed specifically for the IBA market. In 2004, we introduced our new Z-One digital power management architecture and our new Z-series product line which included a digital controller. We began full production of these products near the end of the third quarter of 2004, and signed on C&D Technologies as a second-source licensing partner for these products. We have continued to strengthen our Z-One Alliance by announcing the addition of Atmel to the partnership during the third quarter of 2005, and by establishing a Z-Alliance website at *www.Z-Alliance.org*. During the first quarter of 2005, we introduced the Z-1000 No-Bus family of digital point-of-load converters, which provides customers with digital power conversion without requiring a change in architecture. In response to our new technology, certain of our competitors have formed a consortium in an attempt to develop competing technologies. We filed a lawsuit on September 30, 2005 against Artesyn Technologies, Inc. for infringement of patents held by the Company related to this technology. The lawsuit seeks compensatory damages and a permanent injunction to prohibit Artesyn from making, using, selling or offering to sell infringing products, and is in the earliest stages.

We have spent and anticipate spending significant capital on R&D related to this developing area of power management technology, but there can be no assurance that the market will accept the resulting technology or that we will recover our investment in this technology through sales of new products. There can also be no assurance that costs related to defending our patents and intellectual property will not be material to our results of operations.

In May 2005, the Board of Directors authorized the purchase of up to $20 million in shares of the Company s common stock with the intent to retire the shares. This authorization expires on December 31, 2006. During the three- and nine- month periods ended September 30, 2005, the Company repurchased 0.2 million and 0.5 million shares, respectively, of its common stock for approximately $1.7 million and $2.5 million respectively. Treasury stock is accounted for using the cost method and is included as a reduction of stockholders equity.

We generate a significant percentage of our revenue internationally through sales offices located throughout Europe and Asia. In addition, manufacturing is performed in our own facilities in the Dominican Republic, China, and Slovakia, and at contract manufacturers in Asia. We believe that the use of contract manufacturers will provide us with greater flexibility and a better ability to respond to changes in the market and will be less capital intensive. We are significantly increasing our presence in Asia to take advantage of its lower cost structure and closer proximity to certain major customers. However, we recognize that there are inherent risks to our international operations that may impact our business, which include but are not limited to the following:

- Currency risk, since we will increasingly receive payments and purchase components in foreign currencies and we have historically not engaged in foreign currency hedging activities;

- Risk associated with expanding into economies and markets that may experience financial or political instability;

- Differing degrees of intellectual property protection outside of the United States;

- Frequent changes in laws and policies affecting trade, investment and taxes, including laws and policies relating to repatriation of funds and to withholding taxes, that are administered under very different judicial systems;

- Increased reliance on overseas contract manufacturers that may not be able to manufacture and deliver products as specified; and

- Additional time constraints on management associated with overseeing an increased number of small operations that are geographically dispersed across Asia.

We are subject to local laws and regulations in various regions in which we operate, including the European Union (EU). In particular, two current EU directives may have a material impact on our business. The first is the Restriction of Certain Hazardous Substances Directive (RoHS), which restricts the distribution of certain substances, including lead, within the EU and is effective July 1, 2006. In addition to eliminating and/or reducing the level of specified hazardous materials from our products, we will also be required to maintain and publish a detailed list of all chemical substances in our products. We are starting to see requests from our customers, including some of our major customers, for RoHS compliant products. We are in the process of compiling RoHS compliant information on our products as well as procuring RoHS compliant material and information from our suppliers.

The second directive is the Waste Electrical and Electronic Equipment Directive (WEEE), which was effective August 13, 2005 and requires covered manufacturers or importers to recycle or dispose of all products manufactured or imported into the EU by a party which is subject to the directive at its own expense at the end of the products useful lives. It is our current position and interpretation of the WEEE directive that our products are not directly covered by or subject to our direct compliance with the

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directive. We believe our end customers bear the responsibility for WEEE directive compliance for the products and/or systems in which our products are components.

There are certain risks we face in complying with, or seeking to conduct our business in connection with, the RoHS and WEEE directives, which include but are not limited to the following:

- For RoHS

- We may be unable to procure appropriate RoHS compliant material in sufficient quantity and quality and/or may be unable to incorporate it into our manufacturing processes without compromising quality and/or impacting our cost structure;

- We may not be able to sell non-compliant product into the EU or to any customer whose end product will be sold into the EU, which may result in reduced sales;

- We may face additional excess and obsolete inventory risk related to non-compliant inventory that we may continue to hold in 2006 for which there is reduced demand and that we may need to write down.

- For WEEE

- We may be determined by applicable national regulatory agencies which implement the WEEE directive that certain of our products are directly covered under the WEEE directive, making us directly responsible for WEEE compliance for such products.

We are unable to estimate at this time the cost of compliance, if any, with either EU directive.

Critical Accounting Policies

Application of our accounting policies requires management to make judgments and estimates about the amounts reflected in the financial statements. Management uses historical experience and all available information to make these estimates and judgments, although differing amounts may be reported if there are changes in the assumptions and estimates. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, inventory allowances, restructuring costs, impairment charges, depreciation and amortization, sales returns, warranty costs, taxes and contingencies. Management has identified the following accounting policies as critical to an understanding of our financial statements and as areas most dependent on management s judgment and estimates.

Revenue Recognition We recognize revenue when persuasive evidence of an arrangement exists, title transfer has occurred, the price is fixed or readily determinable, and collectibility is probable. We recognize revenue in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition. Sales are recorded net of sales returns and discounts, which are estimated at the time of shipment based upon historical data. Changes in assumptions regarding the rate of sales returns and discounts earned by our customers could impact our results.

We generally recognize revenue at the time of shipment (or at the time of inventory consumption for customers on Vendor Managed Inventory (VMI) programs) because this is the point at which revenue is earned and realizable and the earnings process is complete. For most shipments, title to shipped goods transfers at the shipping point, so the risks and rewards of ownership transfer once the product leaves our warehouse. Revenue is only recognized when collectibility is reasonably assured. We may charge shipping and handling fees to customers, which are included in revenue. The related costs are recorded in cost of goods sold.

We offer our distributors a standard agreement which includes payment terms, description of their right to return or exchange product, and price discounts. In general, payment is due within 30 days of our shipment of the product to the distributor. The distributor has a right to return only if we discontinue a

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product that the distributor has on hand. The distributor has a right to exchange up to 5% of the dollar value of products purchased within the prior six-month period, so long as the distributor is currently purchasing at least the equivalent dollar value in new product. Estimated product exchanges and returns are accrued for at the time of the sale based on historical information in accordance with Statement of Financial Accounting Standards (SFAS) 48, Revenue Recognition When Right of Return Exists. Finally, we may give price discounts to a distributor at the time a purchase order is received from the distributor for product that they will sell to a specific customer. The price discount is available for one year following issuance of the purchase order for items listed on the purchase order. We accrue for the estimated price discount at the time revenue is recognized.

We have a joint venture in Asia which, along with certain of our contract manufacturers, may purchase raw components and other goods from us, and may sell finished goods to us as well as to other third parties. We record revenue on sales to the joint venture and contract manufacturers only when the components and goods are for sales to third parties. When the joint venture or contract manufacturer purchases components that will be assembled and sold back to us, no revenue is recorded because the earnings process has not been completed.

Impairment of Long-Lived Assets and Goodwill We review the recoverability of the carrying value of long-lived assets using the methodology prescribed in SFAS 144, Accounting for the Impairment and Disposal of Long-Lived Assets. We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Upon such an occurrence, recoverability of these assets is determined by comparing the forecasted undiscounted net cash flows to which the assets relate, to the carrying amount. If the asset is determined to be unable to recover its carrying value, it is written down to fair value. Fair value is determined based on discounted cash flows, appraised values or other information available in the market, depending on the nature of the assets. Methodologies for determining fair value are inherently based on estimates that may change, such as the useful lives of assets and our cash flow forecasts associated with certain assets. A change in these estimates may result in impairment charges, which would impact our operating results.

We review the carrying value of goodwill and non-amortizable intangible assets using the methodology prescribed in SFAS 142, Goodwill and Other Intangible Assets. SFAS 142 requires that we not amortize goodwill, but instead subject it to impairment tests on at least an annual basis and whenever circumstances suggest that goodwill may be impaired. These impairment tests are also dependent on management s forecasts, which frequently change. A change in our forecasts may result in impairment charges.

Restructuring Costs Effective January 1, 2003, we adopted and recorded restructuring charges in accordance with SFAS 146, Accounting for Costs Associated with Disposal Activities, which requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, in contrast to the date of an entity s commitment to an exit plan. Restructuring costs were related to the downsizing of our operations and primarily consisted of specific charges that had been incurred or were to be incurred with no future economic benefit. These charges included costs related to personnel severance, continuing lease obligations for vacant facilities and write-off of leasehold improvements and equipment therein, and certain contract termination penalties and other shutdown costs. Calculation of the restructuring reserves includes management s judgment regarding closed facilities, which include assumptions about the length of time it will take for facilities to be subleased as well as the likely sublease income amount. Changes in these estimates may impact our operating results.

Deferred Income Tax Asset Valuation Allowance We record a deferred income tax asset in jurisdictions where we generate a loss. We also record a valuation allowance against these deferred tax assets in accordance with SFAS 109, Accounting for Income Taxes, when, in management s judgment, it is more likely than not that the deferred income tax assets will not be realized in the foreseeable future.

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Inventories Inventories are stated at the lower of cost (first-in, first-out method) or market. Slow moving and obsolete inventories are written down quarterly based on a comparison of on-hand quantities to projected usages. Additionally, reserves for non-cancelable open purchase orders for components we are obligated to purchase in excess of projected usage, or for open purchase orders where the market price is lower than the purchase order price, are recorded as other accrued expenses on the balance sheet. Calculation of inventory write-downs is based on management s assumptions regarding projected usage of each component, which are subject to changes in market demand.

Accounts Receivable and Allowance for Doubtful Accounts We establish the allowance for doubtful accounts using the specific identification method and also provide a reserve in the aggregate. Our estimates for calculating the aggregate reserve are based on historical information. Any changes to our assumptions or estimates may impact our operating results.

Recent Pronouncements and Accounting Changes In December 2004, the FASB issued SFAS 123(R), Share-Based Payment, which revises SFAS 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123(R) requires fair value recognition of stock option grants on the income statement as an expense and is effective for us as of the first quarter of 2006. This pronouncement may have a material impact on our operating results. Valuing a stock option is a complex calculation that can be performed by a number of valuation methods, such as the Black-Scholes or lattice binomial methods. Each valuation method, however, may utilize a number of management judgments as calculation inputs, including but not limited to the expected life of the option, expected forfeitures, and future volatility. Changes in our estimates of the valuation assumptions may materially impact the valuation of any options granted and therefore impact our operating results.

On February 23, 2005, the Board of Directors authorized accelerating the vesting of all of our outstanding unvested stock options granted to directors, officers and employees of the Company under applicable equity incentive plans of the Company, which stock options have an exercise price greater than $5.00. The closing price of our common stock on the Nasdaq National Market Quotation System used for measurement of compensation as of the date of acceleration was $5.93. As a result of the acceleration, options to acquire approximately 3.8 million shares of our common stock, which otherwise would have vested from time to time over the next four years, became immediately exercisable. All other terms and conditions applicable to outstanding stock option grants remain in effect. The option plans under which the accelerated grants were issued are our Amended and Restated Stock Incentive Plan, the 2001 Stock Option Plan, and the 2004 Stock Incentive Plan. The Board of Directors decision to accelerate the vesting of the affected stock options was in response to the issuance by the Financial Accounting Standards Board of SFAS 123 (revised 2004), Share-Based Payment, which will require the Company to treat unvested stock options as an expense effective at the beginning of our first fiscal quarter of 2006. By accelerating the vesting of the affected stock options now, we elected to recognize an immaterial amount of compensation expense in the quarter ended March 31, 2005 for such accelerated stock options with exercise prices between $5.00 and $5.93. We believe that it will not be required to recognize any compensation expense in future periods associated with the affected options. However, there can be no assurance that the acceleration of the options may not result in some future compensation expense.

Results of Operations

Net Sales. Net sales decreased $11.1 million, or 5%, to $197.3 million for the nine months ended September 30, 2005 from $208.4 million for the nine months ended September 30, 2004. Net sales were $67.2 million for both quarters ended September 30, 2005 and 2004. The decrease in sales for the nine months ended September 30, 2005 was attributable to volume reductions in sales of embedded products due to softness across all market segments, partly offset by volume increases in the sales of power systems

which occurred during the first and third quarters of 2005. Included in both the quarter and nine months ended September 30, 2005 was approximately $1.4 million of non-recurring engineering revenue.

Net sales for our two product lines are as follow, in millions:

	Three Months Ended September 30, 2005		2004		Nine Months Ended September 30, 2005		2004	
Embedded products	$ 48.9	73 %	$ 50.6	75 %	$ 138.5	70 %	$ 154.7	74 %
Power systems	18.3	27 %	16.6	25 %	58.8	30 %	53.7	26 %
Total	$ 67.2	100 %	$ 67.2	100 %	$ 197.3	100 %	$ 208.4	100 %

Net sales by customer category were as follows, in millions:

	Three Months Ended September 30, 2005		2004		Nine Months Ended September 30, 2005		2004	
OEMs	$ 42.9	64 %	$ 47.2	70 %	$ 129.6	66 %	$ 147.1	70 %
Distributors	19.4	29 %	14.9	22 %	50.9	26 %	45.3	22 %
Service providers	4.9	7 %	5.1	8 %	16.8	8 %	16.0	8 %
Total	$ 67.2	100 %	$ 67.2	100 %	$ 197.3	100 %	$ 208.4	100 %

Cisco Systems was the only customer to exceed 10% of net sales in the nine months ended September 30, 2005 or 2004, with $29.7 million, or 15% of net sales and $22.6 million, or 11% of net sales, respectively. Cisco Systems was the only customer to exceed 10% of net sales in the quarter ended September 30, 2005 or 2004, with $9.8 million, or 15% of net sales and $9.3 million, or 14% of net sales, respectively.

Net sales by market were as follows:

	Three Months Ended September 30, 2005	2004	Nine Months Ended September 30, 2005	2004
Communications	60 %	56 %	61 %	58 %
Industrial	17 %	16 %	17 %	16 %
Transportation	7 %	7 %	7 %	7 %
ATE/Semiconductor test equipment	4 %	8 %	4 %	7 %
Computer and Retail	3 %	5 %	3 %	4 %
Medical	2 %	2 %	2 %	2 %
Other	7 %	6 %	6 %	6 %
Total	100 %	100 %	100 %	100 %

The Company s combined 180-day backlog, combined 90-day backlog, quarterly bookings and book-to-bill ratios are summarized as follows:

Backlog and bookings	September 30, 2005 (in millions)	June 30, 2005	March 31, 2005	December 31, 2004
Combined 180-day backlog	$ 35.6	$ 41.4	$ 38.8	$ 38.0
Combined 90-day backlog	$ 34.0	$ 35.7	$ 34.6	$ 33.9
Quarterly bookings	$ 61.9	$ 64.7	$ 67.2	$ 63.4
Quarterly book-to-bill ratio	0.92	1.02	1.01	0.88

Our bookings and backlog may be impacted from time to time by new VMI programs. When VMI programs are initiated by customers, bookings are canceled (or never placed) and replaced by a forecast. We then supply product to the customer per an agreed-upon electronic signal or an order placed to ship the goods, and the customer uses the inventory as needed. Under a VMI program, the booking and billing occur simultaneously upon use of the product, and therefore there is always a book-to-bill ratio of 1.0 for these programs. We may bring additional VMI programs on-line in the future, which would be expected to result in higher turns business and a lower backlog. As such, we believe that bookings and backlog and the book-to-bill ratio are not necessarily reliable indicators of future results over time.

Gross Profit. Gross profit for the nine months ended September 30, 2005 was $54.8 million compared with a gross profit of $77.6 million for the comparable period in 2004. As a percentage of net sales, gross profit decreased to 27.8% for the nine months ended September 30, 2005 from a gross profit of 37.2% for the same period in 2004. The decrease in gross margin during the nine months ended September 30, 2005 was primarily due to two factors. First, we experienced a $16.2 million decrease in sales of embedded products offset by a $5.1 million increase in our sales of telecom power systems which have lower gross margins than the embedded products. Second, the gross margin was negatively impacted by a write-off of excess inventory resulting from a shift in our forecasted product mix as well as from product rationalization in our telecom power systems division in Europe. We recorded $6.4 million in cost of goods sold related to the write off of the excess inventory and other inventory adjustments.

Gross profit for the quarter ended September 30, 2005 was $22.8 million compared with a gross profit of $24.5 million in the comparable period in 2004. As a percentage of net sales, gross profit decreased to 33.9% for the third quarter of 2005 from a gross profit of 36.4% for the same period in 2004. The decrease in gross margin during the quarter ended September 30, 2005 was primarily due to the decrease in sales of embedded products, as well as a $0.6 million write-off of excess inventory and other inventory adjustments which were offset by approximately $1.4 million of very high gross margin non-recurring engineering revenue.

Selling, General and Administrative Expense. Selling, general and administrative expense decreased $5.0 million, or 10%, to $44.7 million for the nine months ended September 30, 2005 from $49.7 million for the same period in 2004. As a percentage of net sales, selling, general and administrative expense decreased to 23% for the nine months ended September 30, 2005 from 24% for the same period in 2004. Selling, general and administrative expense decreased $2.7 million, or 17%, to $13.7 million for the quarter ended September 30, 2005 from $16.4 million for the same period in 2004. As a percentage of net sales, selling, general and administrative expense decreased to 20% for the quarter ended September 30, 2005 from 24% for the quarter ended September 30, 2004.

Selling expense decreased $3.2 million, or 15%, to $18.7 million for the nine months ended September 30, 2005 from $21.9 million for the same period in 2004. Selling expense decreased $1.1 million, or 17%, to $5.9 million for the quarter ended September 30, 2005 from $7.0 million for the same period in 2004. The decrease in selling expenses during the quarter and nine months ended September 30, 2005 was primarily due to the decrease in product revenue during 2005 and to personnel reductions as a result of the restructuring plan implemented during the first nine months of 2005.

General and administrative expense decreased $1.8 million, or 6%, to $26.0 million for the nine months ended September 30, 2005 from $27.8 million for the same period in 2004. General and administrative expense decreased $1.6 million, or 17%, to $7.8 million for the quarter ended September 30, 2005 from $9.4 million for the same period in 2004. The decrease in general and administrative expenses during the quarter and nine months ended September 30, 2005 was primarily related to the restructuring of our North American and European operations during the first nine months of 2005. The decrease in general and administrative expenses was partly offset by increases in bonus expense of $0.8 and $1.2 million for the quarter and nine months ended September 30, 2005, respectively, compared to the comparable periods in 2004.

Engineering and Quality Assurance Expense. Engineering and quality assurance expense decreased by $2.0 million, or 7%, to $29.0 million for the nine months ended September 30, 2005 compared to $31.0 million in the comparable period in 2004. As a percentage of net sales, engineering and quality assurance expense was 15% for both nine-month periods ended September 30, 2005 and 2004. Engineering and quality assurance decreased by $2.0 million, or 19%, to $8.3 million for the quarter ended September 30, 2005 compared to $10.3 million in the comparable period in 2004. As a percentage of net sales, engineering and quality assurance expense decreased to 12% for the quarter ended September 30, 2005 from 15% for the same period in 2004. The decrease in engineering and quality assurance expenses during the quarter and nine months ended September 30, 2005 was primarily related to the restructuring of our North American and European operations during the nine months of 2005.

Amortization of Intangible Assets. Amortization of intangible assets was $2.9 million for both nine-month periods ended 2005 and 2004, and $1.0 million for both quarters ended September 30, 2005 and 2004.

Restructuring and Asset Impairment Charges during the Nine Months Ended September 30, 2005. During the nine months ended September 30, 2005, we recorded pre-tax restructuring charges of $11.0 million in accordance with SFAS 146, of which $4.5 million related to severance payments for a reduction in headcount and $6.3 million related to consolidation of excess facilities. The charges were a result of our plan to restructure our organization and to realign and consolidate our telecom power systems business, as well as consolidate our domestic facilities. We anticipate that overall we will save approximately $30 million annually as a result of the restructuring initiatives implemented.

As a result of the restructuring, during the nine months ended September 30, 2005 we recorded $8.0 million in asset impairment charges, in accordance with SFAS 144, for our building in Norway that was subsequently sold in the fourth quarter of 2005, for leasehold improvements for leased facilities whose operations are being closed, and for other long-lived assets that will no longer be used.

During the nine months ended September 30, 2004, we recorded pre-tax restructuring charges of $0.8 million, of which $0.7 million related to severance payments for a reduction in headcount and $0.1 million related to consolidation of excess facilities, in accordance with SFAS 146. The charges were a result of the restructuring of our European operations.

In accordance with SFAS 144, we recorded asset impairment charges of $2.0 million during the nine- month period ended September 30, 2004. Included in our nine month asset impairment charge was a $0.7 million charge to write down the equipment at one of our European facilities to fair market value. This impairment charge related to the restructuring of our European operations during the second quarter of 2004. The impairment tests indicated that the carrying value of manufacturing equipment at this European facility was not recoverable by the future cash flows from the continuing operations of that location. In addition and in accordance with SFAS 144, we wrote down our excess Mexico facility, which was sold during the third quarter of 2005, to fair value using current market activity resulting in an impairment charge of $1.3 million for the quarter ended September 30, 2004.

Restructuring and Asset Impairment Charges during the Quarters Ended September 30, 2005 and 2004. During the quarter ended September 30, 2005, we reversed a net $0.2 million of pre-tax restructuring charges in accordance with SFAS 146, as a result of our ability to exit an excess facility earlier than previously anticipated when we implemented our restructuring plan during the first and second quarters of 2005. No restructuring charges were recorded during the quarter ended September 30, 2004.

In accordance with SFAS 144, we wrote down our excess Mexico facility, which was sold during the third quarter of 2005, to fair value using current market activity resulting in an impairment charge of $1.3 million for the quarter ended September 30, 2004. No asset impairment charges were recorded during the quarter ended September 30, 2005.

Income (Loss) from Operations. As a result of the items above, loss from operations was $40.8 million for the nine months ended September 30, 2005 compared to an operating loss of $8.8 million for the nine months ended September 30, 2004. As a result of the items above, income from operations increased $4.5 million to a marginal operating profit for the quarter ended September 30, 2005 from an operating loss of $4.5 million for the same period in 2004.

Interest Income (Expense), Net. Net interest income was $1.7 million for the nine months ended September 30, 2005, an improvement of $0.9 million over net interest income of $0.8 million for the same period in 2004. Net interest income was $0.5 million for the quarter ended September 30, 2005, an improvement of $0.1 million over net interest income of $0.4 million for the same period in 2004. The increase in net interest income between periods is largely attributable to changes in our cash management plan as well as to the decrease in interest expense resulting from the repayment of our long-term debt during the quarter ended March 31, 2004, offset slightly by the decrease in our cash balance.

Other Income (Expense), Net. Net other expense was $0.9 million for the nine months ended September 30, 2005, compared with net other expense of $0.6 million for the same period in 2004. Net other expense for the nine-month period ended September 30, 2005 was comprised of $2.5 million related to the impairment of certain foreign investments resulting from a forecast reduction for those enterprises and the related cash flow and offset by a $0.7 million gain related to foreign currency fluctuations, and $0.6 million of proceeds from the settlement of a lawsuit. Included in other expense for the nine-month period ended September 30, 2004 was a write-down of $1.1 million related to a $1.3 million investment in a privately-held technology company which was written down to a fair market value of $0.2 million, as well as expense related to foreign currency fluctuations, partly offset by income from an investment accounted for under the equity method. Our primary foreign currencies are the Norwegian Kroner, the Swiss Franc, the British Pound, and the Euro.

Net other income was $1.2 million for the quarter ended September 30, 2005, an increase of $0.8 million from net other income of $0.4 million for the same period in 2004. The increase was primarily attributable to settlement proceeds of approximately $0.6 million from a lawsuit.

Provision (Benefit) for Income Taxes. The provision for income taxes was $1.7 million for the nine months ended September 30, 2005 compared to the provision for income taxes of $3.4 million for the same period in 2004. The provision for income taxes was $0.2 million for the quarter ended September 30, 2005 compared to the provision for income taxes of $1.6 million for the same period in 2004. The income tax provision was generated by our profitable European locations.

Although we record deferred income tax assets in jurisdictions where we generate a loss for income tax purposes, we also record a valuation allowance against these deferred income tax assets in accordance with SFAS 109 when, in management s judgment, the deferred tax assets may not be realized in the immediate future. As a result, we may record no tax benefit in jurisdictions where we incur a loss, but record tax expense in jurisdictions where we record taxable income and have no NOL carryforward. As a result, few meaningful comparisons can be made on our consolidated tax rates between periods.

Liquidity and Capital Resources

Our cash and cash equivalents balance decreased $1.8 million, or 5%, to $33.7 million at September 30, 2005 from $35.5 million at December 31, 2004. Our primary uses of cash in the first nine months of 2005 consisted of $5.0 million for the acquisition of property and equipment, $3.9 million for operating activities and $2.5 million for the repurchase of 472,225 shares of our own common stock to be held as treasury stock. Our primary sources of cash in the first nine months of 2005 consisted of $5.3 million from the issuance of common stock primarily related to stock option exercises, $3.2 million and $1.8 million related to the net proceeds from held to maturity and available for sale investments,

respectively, and $1.5 million proceeds from the sale of property and equipment primarily related to the sale of our Mexico facility.

Cash used in operating activities at September 30, 2005 of $3.9 million included a decrease in inventory of $9.8 million, of which $6.4 million related to the write off of excess inventory and other inventory adjustments, and increases of $3.5 million, $3.6 million and $2.8 million in accounts receivable, net, accounts payable and accrued expenses, respectively. In addition, cash used in operating activities also included approximately $7.5 million of cash payments relating to the Company s restructuring programs.

In February 2004, we elected to repay the long term debt of $9.1 million, which was for the purchase of a subsidiary s office and manufacturing facility in Norway, from our cash on hand.

In addition, we maintain credit facilities with various banks in Europe and Asia. These credit facilities were acquired primarily as a result of acquisitions in 1998 and 2000. The aggregate limit on all credit facilities is approximately $8.0 million. The credit facilities bear interest on amounts outstanding at various intervals based on published market rates. Some credit agreements require our subsidiaries to maintain certain financial covenants and to provide certain financial reports to the lenders. At September 30, 2005, we had no outstanding balances on any of our credit facilities and were in compliance with all covenants.

We currently anticipate that our total capital expenditures for 2005 will be in the range of $6 to $8 million, of which $5.0 million was incurred during the first nine months of 2005. These capital expenditures relate primarily to manufacturing equipment and process improvements, equipment related to research and development and product development, additions and upgrades to our facilities and information technology infrastructure, and other administrative requirements. The amount of these anticipated capital expenditures may change during the year based on changes in expected revenues, our financial condition and the general economic climate.

Based on current plans and business conditions, we believe our existing working capital and borrowing capacity, coupled with the funds generated from our operations, will be sufficient to fund our anticipated working capital and capital expenditures for the next twelve months. However, if we make a large acquisition, it may be necessary to raise debt or equity in the private or public securities markets.

Below we identify and disclose all of our significant off balance sheet arrangements and related party transactions. We do not utilize special purpose entities or have any known financial relationships with other companies special purpose entities.

Operating Leases. We enter into operating leases where the economic climate is favorable. The liquidity impact of operating leases is not material.

Purchase Commitments. We have purchase commitments for materials, supplies, services, and property, plant and equipment as part of the normal course of business. Commitments to purchase inventory at above-market prices and liabilities related to not fulfilling purchase commitments have been reserved. Certain supply contracts may contain penalty provisions for early termination. Based on current expectations, we do not believe that we are reasonably likely to incur any material amount of penalties under these contracts.

Other Contractual Obligations. We do not have material financial guarantees that are reasonably likely to affect liquidity.

Related Parties. We maintain minority ownership in a number of investments, which are recorded on the balance sheet. These include investments in entities with which Power-One has a manufacturing relationship, including a joint-venture located in China, as well as an investment made in one of our contract manufacturers in Asia. The investment in the contract manufacturer was made during 2002 by contributing $2.1 million of SMT manufacturing equipment and a $5.2 million note receivable we held from the contract manufacturer, in exchange for common equity. The joint venture is accounted for under

the equity method, and the investment in the contract manufacturer is accounted for under the cost method, since we do not have significant influence on the contract manufacturer and own approximately 5% of its common equity.

The joint venture and contract manufacturer may purchase raw components and other goods from us; moreover, they may sell finished goods to us as well as to other third parties. We record revenue on sales to the joint venture and contract manufacturer only when the components and goods are for sale to third parties. When the joint venture or contract manufacturer purchases components that will be assembled and sold back to us, no revenue is recorded. We also have significant and similar relationships with other contract manufacturers where no investment has been made. These contract manufacturers may purchase raw components from and sell finished goods back to us. No revenue is recognized for these transactions. Revenue is recognized only when the products are sold to third parties.

Summary of Contractual Obligations and Commitments. A summary of our future contractual payments at September 30, 2005 related to lease obligations and non-cancelable open purchase orders is as follows (in millions):

Year Ending December 31,	Operating Leases	Non-Cancelable Purchase Orders	Total
2005 (three months)	$ 1.5	$ 1.6	$ 3.1
2006	4.7		4.7
2007	3.4		3.4
2008	2.5		2.5
2009	2.1		2.1
2010 and thereafter	4.1		4.1
Total	$ 18.3	$ 1.6	$ 19.9

Item 3 Quantitative and Qualitative Disclosures About Market Risk

Market risks relating to our operations result primarily from changes in interest rates and changes in foreign currency exchange rates. Our exposure to interest rate risk results from the financial debt instruments which arise from transactions entered into during the normal course of business. We may enter into derivative financial instrument transactions, such as swaps, in order to manage or reduce our exposure to interest rate changes related to our portfolio of borrowings. Under no circumstances do we enter into derivative or other financial instrument transactions for speculative purposes.

Debt. At September 30, 2005, we have no outstanding balance on any credit facility, and therefore the interest rate volatility would not have a material impact on our liquidity.

Foreign Currency. A significant portion of our business operations are conducted in various countries in Europe and Asia. As a result, we have a certain degree of market risk with respect to our cash flows due to changes in foreign currency exchange rates when transactions are denominated in currencies other than our functional currency. Historically, we have not actively engaged in substantial exchange rate hedging activities, and at September 30, 2005, we had not entered into any significant foreign exchange contracts.

Item 4 Disclosure Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed in our periodic reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the required time periods.

As of September 30, 2005, the Company carried out an evaluation under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer of the effectiveness of our

disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that such disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e), are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. The Company reviews its disclosure controls and procedures on an ongoing basis and may from time to time make changes aimed at enhancing their effectiveness and to ensure that they evolve with the Company s business.

There have been no significant changes in the Company s internal control over financial reporting during the quarter ended September 30, 2005 that materially affected, or was reasonably likely to materially affect, the Company s internal control over financial reporting.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as codified in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended from time to time, regarding future events and our future results that are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as may, will, expect, anticipate, should, believe, continue, variations of such and similar expressions are intended to identify such forward-looking statements. In addition, any statements which refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Such forward-looking information involves important risks and uncertainties that could materially alter results in the future from those expressed in any forward-looking statements made by, or on behalf of, the Company. These risks and uncertainties include, but are not limited to the Company s ability to meet expected revenues and maintain its financial condition which could be affected by any of the following: general domestic and international economic conditions including currency exchange rate fluctuations, communications infrastructure and electronics industries market conditions and growth rates, product line sales volumes, acquisitions, the cyclical nature of the Company s business, inability to turn design wins into sales revenues, delays or cancellations of new product designs by customers, current and future government and regulatory policies, to specifically include environmentally directed requirements, inability to accurately assess RoHS and non-RoHS compliant inventory requirements which could result in inventory write-offs, the level and extent of market acceptance of our new product family, timing of any benefits related to restructuring activities, inability to realize expected savings in the amounts, cost categories and/or timeframe projected from recent restructuring initiatives, technological developments and changes in the competitive environment in which the Company operates, attacks and challenges to, or assertions by us of, our intellectual property rights, most particularly relating to our SPS division products and technologies, and the timing and amount (either in a given quarter, or in aggregate amount) of legal costs involved in protecting or asserting our rights under our intellectual properties. Persons reading this Form 10-Q are cautioned that such forward-looking statements are only predictions, and actual events or results may differ materially and adversely. In evaluating such statements, readers should specifically consider the various factors which could cause actual events or results to differ materially and adversely from those indicated by such forward-looking statements. For a detailed description of such factors, see Risk Factors in the Company s Form 10-K for the year ended December 31, 2004, as well as those set forth in the MD&A included in this 10Q. We undertake no obligation to modify or revise any forward-looking statement to take into account or otherwise reflect subsequent events or circumstances arising after the date that the forward-looking statement was made.

PART II OTHER INFORMATION

Item 1 Legal Proceedings

The Company has initiated suit in Switzerland, seeking reimbursement of legal defense costs incurred in the successful defense of earlier patent litigation asserted against the Company. As part of its defense of the patent dispute, the Company made a claim for indemnification and reimbursement from an escrow account which was created as part of the acquisition of Melcher AG. The Melcher shareholder representative has denied the Company s right to and claim for reimbursement. Proceedings are in the initial stages.

The Company filed suit September 30, 2005 against Artesyn Technologies, Inc. for infringement of patents held by the Company. The lawsuit seeks compensatory damages and a permanent injunction to prohibit Artesyn from making, using, selling or offering to sell infringing products. Suit was filed in the U.S. District Court for the Eastern District of Texas. Proceedings are in the earliest stages.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

The following is a table summarizing the issuer s purchases of its own equity securities during the nine months ended September 30, 2005:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs
June 1 June 30	300,000	$ 5.54	300,000
August 1 August 31	172,225	$ 4.94	172,225
Total	472,225	$ 5.33	472,225

In May 2005, the Company announced that it had received authorization from its Board of Directors to purchase up to $20 million of its outstanding common stock in open-market transactions. At September 30, 2005, $17.5 million remains available for purchase in accordance with this authorization. This authorization expires on December 31, 2006.

Item 6 Exhibits

31.1 Rule 13a-14(a) Certification of Principal Executive Officer
31.2 Rule 13a-14(a) Certification of Principal Financial Officer
32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 11, 2005

POWER-ONE, INC.

By: /s/ STEVEN J. GOLDMAN
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

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