



UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
**Form 10-K**

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2006
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-18277

**VICOR CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**25 Frontage Road, Andover,  
Massachusetts**  
(Address of principal executive offices)

**04-2742817**  
(IRS employer  
identification no.)

**01810**  
(Zip code)

Registrant's telephone number, including area code:  
(978) 470-2900

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

Common Stock, \$0.01 par Value  
(Title of Class)

The NASDAQ Stock Market, LLC  
(Name of Each Exchange on Which Registered)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated filer

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$335,109,775 as of June 30, 2006.

On February 28, 2007, there were 29,710,187 shares of Common Stock outstanding and 11,854,952 shares of Class B Common Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Company's definitive proxy statement (the "Definitive Proxy Statement") to be filed with the Securities and Exchange Commission pursuant to Regulation 14A and relating to the Company's 2007 annual meeting of stockholders are incorporated by reference into Part III.



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**PART I**

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words “believes,” “expects,” “anticipates,” “intend,” “estimate,” “plans,” “assumes,” “may,” “will,” “would,” “should,” “continue,” “prospective,” “project,” and other similar expressions identify forward-looking statements. These statements are based upon the Company’s current expectations and estimates as to the prospective events and circumstances which may or may not be within the Company’s control and as to which there can be no assurance. Actual results could differ materially from those projected in the forward-looking statements as a result of various factors, including our ability to develop and market new products and technologies cost effectively, to leverage design wins into increased product sales, to continue to make progress with key customers and prospects, to decrease manufacturing costs, to enter into licensing agreements that amplify the market opportunity and accelerate market penetration, to realize significant royalties under license agreements, to achieve a sustainable increased bookings rate over a longer period, to hire key personnel and to continue to build our three business units, to successfully enforce our intellectual property rights, to successfully defend outstanding litigation, and to successfully leverage the V•I Chips in standard products to promote market acceptance of Factorized Power, factors impacting the Company’s various end markets, as well as those factors described in the risk factors set forth in this Annual Report on Form 10-K under Part I, Item 1 — “Business,” — “Competition,” — “Patents,” and — “Licensing,” and — “Risk Factors,” under Part I, Item 3 — “Legal Proceedings,” and under Part II, Item 7 — “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” The risk factors contained in this report may not be exhaustive. Therefore, the information contained in this report should be read together with other reports and documents that the Company files with the Securities and Exchange Commission from time to time, including Forms 10-Q, and 8-K, which may supplement, modify, supersede or update those risk factors. The Company does not undertake any obligation to update any forward-looking statements as a result of future events or developments.

**ITEM 1 — BUSINESS**

**The Company**

Vicor Corporation was incorporated in Delaware in 1981. Unless the context indicates otherwise, the term “Company” or “Vicor” mean Vicor Corporation and its consolidated subsidiaries. The Company designs, develops, manufactures and markets modular power components and complete power systems, many of which use an innovative, high frequency electronic power conversion technology called “zero current and zero voltage switching.” In April 2003, the Company announced the introduction of a new power system architecture based on an array of proprietary power conversion technologies called Factorized Power Architecture (“FPA”). The Company believes FPA will provide power system designers with enhanced performance at a lower cost than attained with conventional Distributed Power Architecture (“DPA”). The Company’s principal product lines are covered by one or more United States and foreign patents. Power systems, a central element in any electronic system, convert power from a primary power source (e.g., a wall outlet or battery source) into the stable DC voltages that are required by most contemporary electronic circuits.

In 1986, the Company formed Westcor Corporation (“Westcor”). During 1990, Westcor was merged into the Company and became a division. Westcor manufactures configurable products at its location in Sunnyvale, California. In 1987, the Company formed VLT Corporation as its licensing subsidiary. During 2000, the Company reincorporated VLT Corporation in California by merging it with and into VLT, Inc., a wholly owned subsidiary of the Company. In 1990, the Company established a Technical Support Center in Germany. In 1995, the Company established Technical Support Centers in France, Italy, Hong Kong, and England. Also in 1995, the Company established Vicor Integration Architects (“VIAs”), most of which are majority-owned subsidiaries. VIAs provide customers with local design and manufacturing services for turnkey custom power solutions. At December 31, 2006 there were six (6) VIAs operating in the United States. In 1996, the Company established Vicor B.V., a Netherlands company, which serves as a European Distribution Center. In 1998, the Company acquired the principal assets of the switching power supply businesses owned by the Japan Tobacco, Inc. group and established a direct presence in Japan through a new subsidiary called Vicor Japan

Company, Ltd. ("VJCL"). VJCL markets and sells the Company's products and provides customer support in Japan. In 2001, the Company established Picor Corporation ("Picor"), a subsidiary which designs, develops and markets Power Management Integrated Circuits and related products for use in a variety of power system applications. Picor develops these products to be sold as part of Vicor's products or to third parties for separate applications. The Company's Common Stock became publicly traded on the NASDAQ National Market System in April 1990. All of the above named entities are consolidated in the Company's financial statements.

The Company maintains a website with the address [www.vicorpower.com](http://www.vicorpower.com). We make available free of charge through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission. The information contained on our website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K.

## **The Products**

Power systems are incorporated into virtually all electronic products, such as computers and telecommunications equipment, to convert electric power from a primary source, for example a wall outlet or battery source, into the stable DC voltages required by electronic circuits. Because power systems are arranged in a myriad of application-specific configurations, the Company's basic strategy is to exploit the density and performance advantages of its technology by offering comprehensive families of economical, component-level building blocks which can be used to configure a power system specific to a user's needs. In addition to component-level power converters, which serve as modular power system building blocks, the Company also manufactures and sells complete configurable power systems, accessory products, and custom power solutions. The Company operates in one industry segment: the development, manufacture and sale of power conversion components and systems. The Company's principal product lines include:

### **Modular Power Converters**

The Company currently offers seven families of component-level DC-DC power converters: the VI-200, VI-J00, MI-200, MI-J00, Maxi, Mini and Micro families. Designed to be mounted directly on a printed circuit board assembly and soldered in place using contemporary manufacturing processes, each family comprises a comprehensive set of products which are offered in a wide range of input voltage, output voltage and power ratings. This allows end users to select products appropriate to their individual applications. The product families differ in maximum power ratings, performance characteristics, package size and, in certain cases, in target market.

Since 1998, the Company has introduced four input series of its high power density, component-level DC-DC converters in three standard packages: the full size (Maxi), the half size (Mini) and the quarter size (Micro), along with military-commercial-off-the-shelf ("MIL-COTS") products. In 1998, the 48 Volt input series was introduced, which was designed for the telecommunications market as well as for distributed power systems. Output power levels from 50 to 500 Watts are covered by these products. In 1999, this was followed by two additional series: a 300 Volt input for off-line (rectified 115 or 230 Volt ac) and distributed power applications, and a 375 Volt input specifically designed for use in power factor corrected systems. This latter series increased the power available to 600 Watts. In 2001, a 24 Volt input series was added to the standard product line to address additional telecommunications, industrial and defense market opportunities. The Company has undergone a process of converting these products to the new FasTrak platform that was completed in the first quarter of 2006. The conversion to FasTrak has resulted in lower unit costs, improved manufacturing yields, improved field reliability and improved gross margins.

The Vicor Design Assistance Computer ("VDAC"), a core component of the Vicor PowerBench tool suite, was introduced for general use in 2000 and is a proprietary system, which enables Vicor's customers to specify on-line, and verify in real time, the performance and attributes of its Maxi, Mini, Micro and MIL-COTS DC-DC converters. Using patented technology, VDAC enables the design of DC-DC converters with any output voltage between 2 and 48 Volts and with any input voltage from 18 to 425 Volts, with an

input voltage range of up to 2.1:1, available in all of the Vicor established brick standards, full-, half- and quarter-size. Output power is selectable over a continuous range of 20 to 500 Watts per module and modules can be configured in fault-tolerant arrays capable of delivering several kilowatts.

#### **Configurable Products**

Utilizing its standard converters as core elements, the Company has developed several product families, which provide complete power solutions configured to a customer's specific needs. These products exploit the benefits of the component-level approach to offer higher performance, higher power densities, lower costs, greater flexibility and faster delivery than traditional competitive offerings.

Most process control, information technology ("IT") and industrial electronic products operate directly off of AC lines. "Off-line" power systems require "front end" circuitry to convert AC line voltage into DC voltage for the core converters. The Company's off-line AC-DC products incorporate a set of modular front-end subassemblies to offer a complete power solution from AC line input to highly regulated DC output. The product selection includes a low-profile modular design in various sizes and power levels, and a choice of alternatives to conventional "box switchers," — high power, off-line bulk supplies in industry-standard packages. Voltage and power levels can be either factory or field configurable.

Many telecommunications, defense and transportation electronic products are powered from central DC sources (battery plants or generators). The Company's DC-DC power system choices include a low-profile modular design similar to the corresponding AC-DC system and a rugged, compact assembly for chassis-mounted, bulk power applications.

In February 2001, the Company introduced the VIPAC family of power systems, a class of user defined, modular power solutions. VIPAC is a type of integrated power system leveraging the latest advances in Maxi, Mini, and Micro DC-DC converter technology and modular front ends. VIPAC combines application specific front end units, a choice of chassis styles and, in AC input versions, remotely located hold-up capacitors to provide fast, flexible and highly reliable power solutions for a wide range of demanding applications.

The web-based Vicor Computer Aided Design tool, also a component of Vicor PowerBench, can be utilized by the customer to specify and verify, in real time, that customer's desired VIPAC configuration. The Vicor PowerBench system enables the design of a custom configured VIPAC product from all available combinations of inputs, outputs, chassis and optional features.

#### **Factorized Power Architecture**

In April 2003, the Company announced the introduction of a new power system architecture based on an array of proprietary power conversion technologies called Factorized Power Architecture ("FPA"). The Company believes FPA will provide power system designers with enhanced performance at a lower cost than attained with conventional Distributed Power Architecture ("DPA"). Factorized Power maximizes the competitiveness of a power system with a high degree of systems flexibility, power density, conversion efficiency, transient responsiveness, noise performance and reliability. FPA is enabled by power conversion components called V•I Chips or "VICs". V•I Chips deliver up to 300 Watts of power in a surface-mount ("SMD") J-lead package occupying less than 0.25 cubic-inch of space, with power densities up to 1,200 Watts per cubic-inch, which represents a seven to eight times improvement over the Company's Maxi, Mini and Micro products.

In May 2003, the Company introduced the first family of products based on this new technology, 48 Volt to 12 Volt Bus Converter Modules ("BCM") for conventional Intermediate Bus Architecture applications. In July 2003, the Company introduced its first V•I Chip™ Voltage Transformation Module ("VTM"). VTMs are designed to meet the demands of advanced Digital Signal Processors ("DSP"), Field Programmable Gate Arrays ("FPGA"), Application Specific Integrated Circuits ("ASIC"), processor cores and microprocessor applications at the point of load ("POL") while providing isolation from input to output. They may be paralleled to deliver hundreds of Amperes. In January 2004, the Company announced the availability of the first members of its 48 Volt Intermediate Bus Converter Modules ("IBCs"). Offered in standard 1/4 brick format and operating from a 38-55 Volt DC input, the IBC family consists of ten fixed ratio standard models

with nominal outputs from 3 to 48 Volt DC delivering up to 100 Amperes or 600 Watts. Additional VTM and BCM products were introduced throughout 2004.

In 2005, the Company completed the matrix of 48 Volt V•I Chips: the 36-75 Volt input Pre-Regulator Module (“PRM”), which can operate from the wide DC input voltages normally encountered in telecommunications systems and the complete line of VTMs compatible with this PRM. With these devices, 48 Volt FPA systems can be implemented with regulated and isolated outputs between 0.8-55 Volt DC. In addition, several V•I Chip specialty products were designed for and delivered to specific customers for them to evaluate for use in potential applications where V•I Chips can enable significant market advantages. Prototypes of the first PRM for the military/defense COTS market were also delivered.

#### Accessory Power System Components

Accessory power system components, used with the Company’s component-level power converters, integrate other important functions of the power system, facilitating the design of complete power systems by interconnecting several modules. In general, accessory products are used to condition the inputs and outputs of the Company’s modular power components.

VI-HAMs (Harmonic Attenuator Modules) are universal-AC-input, power-factor-correcting front ends for use with compatible power converters. VI-AIMs (AC Input Modules) provide input filtering, transient protection and rectification of the AC line. VI-IAMs (Input Attenuator Modules) provide the DC input filtering and transient protection required in industrial and telecommunications markets. VI-RAMs (Ripple Attenuator Modules) condition converter module outputs for extremely low noise systems. In 1998, the Company doubled the power capability of its component-level AC front end, the VI-ARM (AC Rectifier Module). This front end product is packaged in the same “Micro” package and includes a microcontroller that tracks the AC line to ensure correct operation for domestic or international line voltages. In addition, two accessory products for the 48 Volt input Maxi, Mini, and Micro family were introduced in 1999: the FiltMod for input filtering and the IAM48 for transient and spike protection. In 2000, the FARM and FIAM were introduced. The FARM combines autoranging AC input capability with filtering to simplify the design of AC-DC systems. The FIAM combines filtering and transient suppression for 48 volt input applications. In 2005, the High-Boost HAM was introduced. This product can be combined with standard Maxi, Mini and Micro DC-DC converters, greatly improving power density and cost effectiveness in AC-DC designs.

In 2002, the MicroRAM (“µRAM”) was introduced. This product, designed by the Company’s Picor subsidiary, performs a function similar to the VI-RAM product in a smaller package at a lower price. In 2003, Picor introduced two new families of products, the QPO (QuietPower™ — Output Ripple Attenuation SiP) and QPI (QuietPower™ — 12 Amp Active EMI Filter for DC-DC Converters). The QPO performs a similar function to the µRAM in a smaller, lower cost surface mount package. Different QPO models allow customers to solve unique output noise problems. The QPI filters unwanted Electro-Magnetic Interference (“EMI”) from the input supply bus. The product is targeted at the telecom market and the emerging Advanced Telecommunication Computing Architecture (“ATCA”) segment. In 2004, Picor expanded its QPI product offerings to include several new products targeted at 24 Volt industrial and military COTS voltage bus supplies. In 2005, Picor introduced the QPI-8, the industry’s first System-in-a-Package (SiP) device designed to integrate the total hot-swap function with an active EMI filter. This integrated device enables live insertion of plug-in cards and simultaneous EMI noise suppression for DC-DC converter applications.

#### Customer Specific Products

Since its inception, the Company has accepted a certain amount of “custom” power supply business. In most cases, the customer was unable to obtain a conventional solution that could achieve the desired level of performance in the available space. By utilizing its component-level power products as core elements in developing most of these products, the Company was able to meet the customer’s needs with a reliable, high power density, total solution. However, in keeping with the Company’s strategy of focusing on sales of standard families of component-level power building blocks, custom product sales have not been directly pursued. The Company has traditionally pursued these custom opportunities through Value-Added-Resellers (“VARs”) and a

network of VIAs (see Part I, Item 1 — “Business — The Company”). Most of the VIAs are majority owned by the Company, while VARs are independent businesses. Both VIAs and VARs are distributed geographically and are in close proximity to many of their customers.

**European Union Restriction of Hazardous Substances (“RoHS”)**

The Company achieved compliance with the European Union’s (“EU”) directive on the use of certain hazardous substances in electrical and electronic equipment, referred to as RoHS or as the “lead free directive” ahead of the designated July 1, 2006 deadline.

**China Restriction of Hazardous Substances (“China RoHS”)**

The Company achieved compliance with the restrictions on the use of certain hazardous substances in electrical and electronic equipment in China, referred to as “China RoHS.”, ahead of the designated March 1, 2007 deadline. Compliance with Phase 2 will involve working with certain suppliers and customers and may potentially require the redesign of certain products and the modification of certain manufacturing processes. (See Part 1, Item 1 — “Risk Factors”).

**Sales and Marketing**

The Company sells its products through a network of 30 independent sales representative organizations in North and South America and internationally, through 37 independent distributors. Sales activities are managed by a staff of Area Directors and Regional and National Account Sales Managers and sales personnel based at the Company’s world headquarters in Andover, Massachusetts, its Westcor division in Sunnyvale, California, a Technical Support Center in Lombard, Illinois, a VIA location in Oceanside, California, in its Technical Support Center subsidiaries in Munich, Germany; Camberley Surrey, England; Milan, Italy; Paris, France; Hong Kong and in its subsidiary in Tokyo, Japan.

Export sales, as a percentage of total net revenues, were approximately 37%, 42% and 41%, in 2006, 2005 and 2004, respectively.

Because of the technical nature of the Company’s product lines, the Company engages a staff of Field Applications Engineers to support the Company’s sales activities. Field Applications Engineers provide direct technical sales support worldwide to review new applications and technical matters with existing and potential customers. There are Field Application Engineers assigned to all Company locations and they are supported by product specialists (Product Line Engineers) located in Andover. The Company generally warrants its products for a period of two years.

The Company also sells directly to customers through Vicor Express, an in-house distribution group. Through advertising and periodic mailing of its catalogs, Vicor Express generally offers customers rapid delivery on small quantities of many standard products. The Company, through Vicor B.V., has Vicor Express operations in Germany, France, Italy and England.

**Customers and Applications**

The Company’s customer base is comprised of large Original Equipment Manufacturers (OEMs) and smaller, lower-volume users that are broadly distributed across several major market areas.



Some examples of the diverse applications of the Company's products are:

*Telecommunications:*

Central Office Systems  
Fiber Optic Systems  
Cellular Telecommunications  
Microwave Communications  
ATM Switches  
Paging Equipment  
Broadcast Equipment  
Remote Telemetry Equipment  
Cable Head End Equipment  
Power Amplifiers

*Military/Defense:*

Secure Communications Equipment  
Unmanned Airborne/Remotely Piloted Vehicles  
Aircraft/Weapons Test Equipment  
Ruggedized Computers  
Electronic Warfare Equipment  
Reconnaissance/Targeting Systems  
Global Positioning Systems  
Missile Defense Systems  
Radio/Telemetry Systems  
NBC Detection Equipment

*Industrial:*

Process Control Equipment  
Medical Equipment  
Seismic Equipment  
Test Equipment  
Transportation Systems  
Agricultural Equipment  
Material Handling Equipment  
Marine Products  
Commercial Avionics

*Information Technology:*

RAID Systems  
Parallel Processors  
Data Storage Systems  
Network Servers  
Enterprise Servers  
File Servers  
Optical Switches

For the years ended December 31, 2006, 2005 and 2004, no single customer accounted for more than 10% of net revenues.

**Backlog**

As of December 31, 2006, the Company had a backlog of approximately \$36.4 million compared to \$38.6 million at December 31, 2005. Backlog is comprised of orders for products, which have a scheduled shipment date within the next 12 months. The Company believes that a substantial portion of sales in each quarter is, and will continue to be, derived from orders booked in the same quarter.

**Research and Development**

As a basic element of its long-term strategy, the Company is committed to the continued advancement of power conversion technology and power component product development. The Company's research and development efforts are focused in four areas: continued enhancement of the Company's patented technology; expansion of the Company's families of component level DC-DC converter products; development of the new FPA products and power management integrated circuits; and continued development of configurable products based upon market opportunities. The Company invested approximately \$31.4 million, \$29.5 million and \$26.2 million in research and development in 2006, 2005 and 2004, respectively. Investment in research and development represented 16.3%, 16.4% and 15.3% of net revenues in 2006, 2005 and 2004, respectively. The Company plans to continue to invest a significant percentage of revenues into research and development.

**Manufacturing**

The Company's principal manufacturing processes consist of assembly of electronic components onto printed circuit boards, automatic testing of components, wave, reflow and infrared soldering of assembled components, encapsulation of converter subassemblies, final environmental stress screening of certain products and product test using automatic test equipment.

The Company continues to pursue its strategy to minimize manual assembly processes, reduce manufacturing costs, increase product quality and reliability and ensure its ability to rapidly and effectively expand capacity, as needed. The strategy is based upon the phased acquisition and/or fabrication, qualification and integration of automated manufacturing equipment. The Company plans to make continuing investments in manufacturing equipment, particularly for the Company's new FPA products (see Part I, Item I — "The Products — Factorized Power Architecture").

Components used in the Company's products are purchased from a variety of vendors. Most of the components are available from multiple sources. In instances of single source items, the Company maintains levels of inventories it considers to be appropriate to enable it to meet delivery requirements of customers. Incoming components, assemblies and other parts are subjected to several levels of inspection procedures.

Compliance by the Company with applicable environmental laws has not had a material effect on the financial condition or results of operations of the Company.

### **Competition**

The power conversion industry is highly competitive. Many power supply manufacturers target markets similar to those of the Company. Representative examples of these manufacturers are: Lambda Electronics, a subsidiary of TDK Corporation; Tyco Electronics Power Systems Business Unit, a subsidiary of Tyco International, Ltd.; Artesyn Technologies and Astec Power, subsidiaries of Emerson Electric Co., Power-One, Inc., and C&D Technologies, Inc., Power Electronics Division. Although certain of the Company's competitors have significantly greater financial and marketing resources and longer operating histories than the Company, the Company believes that it has a strong competitive position, particularly with customers who need small, high density power system solutions requiring a variety of input-output configurations. The Company bases its competitive strategy on technical innovation, product performance, service and technical support, and in offering a broad product line. The principal methods of competition in the markets in which the Company's products compete are price, performance and the level of service and technical support offered.

### **Patents**

The Company believes that its patents afford advantages by building fundamental and multilayered barriers to competitive encroachment upon key features and performance benefits of its principal product families. The Company's patents cover the fundamental conversion topologies used to achieve the performance attributes of its converter product lines; converter array architectures which are the basis of the products' "parallelability"; product packaging design; product construction; high frequency magnetic structures; and automated equipment and methods for circuit and product assembly.

On February 16, 1999, the United States Patent and Trademark Office issued U.S. patent RE36,098 (the "Reissue Patent") as a reissue of U.S. Patent 4,441,146 (the "Reset Patent"). The Reissue Patent includes original claims 1 through 5 of the Reset Patent plus 38 additional new claims. The claims in the Reissue Patent cover non-coincident active clamp technology in a broadly defined class of single-ended forward converters and enable design of power converters that are smaller and more energy efficient than conventional power supplies. The claims cover, but are not limited to, so-called "zero-voltage switching" technology. The Company believes that its rights under the Reset Patent and the Reissue Patent have been infringed. (see Part I, Item 3 — "Legal Proceedings").

The Company has been issued 100 patents in the United States (which expire between 2007 and 2025), 6 in Europe (which expire between 2007 and 2017), and 5 in Japan (which expire between 2007 and 2022). The Company also has a number of patent applications pending in the United States, Europe and the Far East. The Company intends to vigorously protect its rights under its patents. Although the Company believes that patents are an effective way of protecting its technology, there can be no assurances that the Company's patents will prove to be enforceable (see, e.g., Part I, Item 3 — "Legal Proceedings"). While some of the Company's patents are deemed materially important to the Company's operations, the Company believes that no one patent is essential to the success of the Company.

## Licensing

In addition to generating revenue from product sales, licensing is an element of the Company's strategy for building worldwide product and technology acceptance and market share. In granting licenses, the Company generally retains the right to use its patented technologies, and manufacture and sell its products, in all licensed geographic areas and fields of use. Licenses are granted and administered through the Company's wholly-owned subsidiary, VLT, Inc., which owns the Company's patents. Revenues from licensing arrangements have not exceeded 10% of the Company's consolidated revenues in any of the last three fiscal years.

On October 20, 2003, the Company announced that it entered into a non-exclusive license with Celestica Corporation to manufacture and sell the V•I Chip Product Family. V•I Chips are the building blocks of the new FPA products that Vicor announced in April 2003. In September 2004, the Company was notified that Celestica's Power Systems division had been acquired by C&D Technologies, Inc. and that the license was being assigned to C&D. The Company has chosen not to renew the license with C&D which expired on October 20, 2006.

On June 30, 2004, the Company announced that it had entered into a non-exclusive license with Sony Corporation ("Sony") to design and manufacture power converters, using V•I Chip technology and Factorized Power, for use within its products and for sale to its customers in certain agreed-upon applications. The license also grants Sony rights to manufacture certain semiconductor components that are used in V•I Chips. Royalties are based upon the value of the licensed converters used or sold.

## Employees

As of December 31, 2006, the Company employed approximately 1,030 full time and 41 part time people. The Company believes that its continued success depends, in part, on its ability to attract and retain qualified personnel. Although there is strong demand for qualified technical personnel, the Company has not to date experienced difficulty in attracting and retaining sufficient engineering and technical personnel to meet its needs (see Part I, Item I — "Risk Factors").

None of the Company's employees are subject to a collective bargaining agreement.

## ITEM 1A — RISK FACTORS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results could differ materially from those projected in the forward-looking statements as a result of, among other factors, the risk factors set forth below.

### *Our future operating results are subject to fluctuations.*

Our future operating results may be materially affected by a number of factors, including the level of orders and demand from customers, the timing of new product announcements or introductions by us or our competitors, the ability to achieve and/or maintain yield improvements and cost reductions particularly with Maxi, Mini, Micro and FPA products, achieving increased sales of FPA products, changes in the product mix, and changes in economic conditions in the United States and international markets. As a result of these and other factors, we cannot assure you that we will not experience significant fluctuations in future operating results on a quarterly or annual basis.

### *Our future success depends upon our ability to develop and market leading-edge, cost effective products.*

The power supply industry and the industries in which many of our customers operate are characterized by intense competition, rapid technological change, product obsolescence and price erosion for mature products, each of which could have an adverse effect on our results of operations. If we fail to continue to develop and commercialize leading-edge technologies and products that are cost effective and maintain high standards of quality, our competitive position and results of operations could be materially adversely affected.

Specifically, we may not be successful in leveraging the V•I Chips in standard products to promote market acceptance of Factorized Power.

***Our future operating results are dependent on the growth in our customers' businesses.***

We manufacture modular power components and power systems that are incorporated into our customers' electronic products. Our growth is therefore dependent on the growth in the sales of our customers' products as well as the development by our customers of new products. If we fail to anticipate changes in our customers' businesses and their changing product needs, our results of operations and financial position could be negatively impacted.

***If we were unable to use our manufacturing facility in Andover, Massachusetts, we would not be able to manufacture for an extended period of time.***

All modular power components, whether for direct sale to customers or for sale to our subsidiaries for incorporation into their respective products, are manufactured at our Andover, Massachusetts production facility. Damage to this facility due to fire, natural disaster, power loss or other events could cause us to cease manufacturing. Any prolonged inability to utilize all or a significant portion of this facility could have a material adverse effect on our results of operations.

***We may not be able to procure necessary key components for our products, or we may purchase too much inventory or the wrong inventory.***

The power supply industry, and the electronics industry as a whole, can be subject to business cycles. During periods of growth, key components required to build our products may become unavailable in the timeframe required for us to meet our customers' demands. Our inability to secure sufficient components to build products for our customers could negatively impact our sales and operating results. We may choose to mitigate this risk by increasing the levels of inventory for certain key components. Increased inventory levels can increase the potential risk for excess and obsolescence should our forecasts fail to materialize or if there are negative factors impacting our customers' end markets. If we purchase too much inventory or the wrong inventory, we may have to record additional inventory reserves or write-off the inventory, which could have a material adverse effect on our gross margins and on our results of operations.

***Our revenues may not increase enough to offset the expense of additional capacity.***

We have made significant additions to our manufacturing equipment and capacity over the past several years, including equipment for FPA products and the FasTrak platform. If overall revenue levels do not increase enough to offset the increased fixed costs, or significant revenues do not materialize for the FPA products or if there is deterioration in our business, our future operating results could be adversely affected. In addition, asset values could be impaired if the additional capacity is underutilized for an extended period of time resulting in a material adverse effect on our financial position and results of operations.

***We rely on third-party suppliers and subcontractors for components and assemblies and, therefore, cannot control their availability or quality.***

We depend on third party suppliers and subcontractors to provide components and assemblies used in our products, some of which are sole-sourced. If suppliers or subcontractors cannot provide their products or services on time or to our specifications, we may not be able to meet the demand for our products and our delivery times may be negatively affected. In addition, we cannot directly control the quality of the products and services provided by third parties. In order to grow, we may need to find new or change existing suppliers and subcontractors. This could cause disruptions in production, delays in the shipping of product or increases in prices paid to third-parties.

***We are exposed to economic, political and other risks through our foreign sales and distributors.***

International sales have been and are expected to be a significant component of total sales. Dependence on foreign third parties for sales and distribution is subject to special risks, such as foreign economic and political instability, foreign currency controls and market fluctuations, trade barriers and tariffs, foreign regulations and exchange rates. Sudden or unexpected changes in the foregoing could have a material adverse effect on our results of operations.

***Our ability to successfully implement our business strategy may be limited if we do not retain our key personnel and attract and retain skilled and experienced personnel.***

Our success depends on our ability to retain the services of our executive officers. The loss of one or more members of senior management could materially adversely affect our business and financial results. In particular, we are dependent on the services of Dr. Patrizio Vinciarelli, our founder, Chairman, President and Chief Executive Officer. The loss of the services of Dr. Vinciarelli could have a material adverse effect on our development of new products and on our results of operations. In addition, we depend on highly skilled engineers and other personnel with technical skills that are in high demand and are difficult to replace. Our continued operations and growth depend on our ability to attract and retain skilled and experienced personnel in a very competitive employment market. If we are unable to attract and retain these employees, our ability to successfully implement our business strategy may be harmed.

***We may be unable to adequately protect our proprietary rights, which may limit our ability to compete effectively.***

We operate in an industry in which the ability to compete depends on the development or acquisition of proprietary technologies which must be protected to preserve the exclusive use of such technologies. We devote substantial resources to establish and protect our patents and proprietary rights, and we rely on patent and intellectual property law to protect such rights. This protection, however, may not prevent competitors from independently developing products similar or superior to our products. We may be unable to protect or enforce current patents, may rely on unpatented technology that competitors could restrict, or may be unable to acquire patents in the future, and this may have a material adverse effect on our competitive position. In addition, the intellectual property laws of foreign countries may not protect our rights to the same extent as those of the United States. We have been and may need to continue to defend or challenge patents. We have incurred and expect to incur significant costs in and devote significant resources to these efforts which, if unsuccessful, may have a material adverse effect on our results of operations and financial position.

***We may face intellectual property infringement claims that could be costly to resolve.***

We may in the future receive communications from third parties asserting that our products or manufacturing processes infringe on a third party's patent or other intellectual property rights. In the event a third party makes a valid intellectual property claim against us and a license is not available to us on commercially reasonable terms, or at all, we could be forced to either redesign or stop production of products incorporating that technology, and our operating results could be materially and adversely affected. In addition, litigation may be necessary to defend us against claims of infringement, and this litigation could be costly and divert the attention of key personnel. An adverse outcome in these types of matters could have a material adverse impact on the results of our operations and financial condition.

***We may face legal claims and litigation that could be costly to resolve.***

We may in the future encounter legal action from customers, vendors or others concerning product warranty or other claims. We have ongoing litigation with several customers and vendors over product warranty matters, which are fully described in Part I, Item 3 — "Legal Proceedings". Such litigation is costly and diverts the attention of key personnel. An adverse outcome in these current or future matters could have a material adverse impact on the results of our operations and financial condition. In fact, on February 22, 2007, the Company announced that it has reached an agreement in principle with Ericsson, Inc., to settle a lawsuit

brought by Ericsson against the Company in California state court. Under the terms of the settlement agreement, reached on February 16, 2007 after a Court ordered mediation, the Company agreed to pay \$50.0 million to Ericsson, of which \$12.8 million will be paid by the Company's insurance carriers. Accordingly, the Company recorded a net loss of \$37.2 million from litigation-related settlement in the fourth quarter of 2006.

***Compliance with the China RoHS may not proceed as planned.***

The Company achieved compliance with the restrictions on the use of certain hazardous substances in electrical and electronic equipment in China, referred to as "China RoHS", ahead of the designated March 1, 2007 deadline. Compliance with Phase 2 will involve working with certain suppliers and customers and may potentially require the redesign of certain products and the modification of certain manufacturing processes. As a result, the following situations could negatively impact our results of operations:

- Customers' transition to China RoHS compliant products may be unpredictable, and forecasting inaccuracy may negatively impact the availability of raw materials.
- The Phase 2 deadline, for which a formal date has not been established, may be set prior to supplier and product compliance changes being made, which could interrupt product shipments targeted for export and use in China.

**ITEM 1B — UNRESOLVED STAFF COMMENTS**

The Company received written comments from the Securities and Exchange Commission regarding its periodic or current reports under the Securities Exchange Act of 1934, as amended, that were received 180 days or more before December 31, 2006 to which the Company filed responses. There are no unresolved comments from the Securities and Exchange Commission as of December 31, 2006.

**ITEM 2 — PROPERTIES**

The Company's corporate headquarters building, which the Company owns and which is located in Andover, Massachusetts, provides approximately 90,000 square feet of office space for its sales, marketing, engineering and administration personnel.

The Company also owns a building of approximately 230,000 square feet in Andover, Massachusetts, which houses all Massachusetts manufacturing activities.

The Company's Westcor division owns and occupies a building of approximately 31,000 square feet in Sunnyvale, California.

**ITEM 3 — LEGAL PROCEEDINGS**

Vicor and VLT, Inc. ("VLT"), a wholly owned subsidiary of the Company, are pursuing Reset Patent infringement claims directly against Artesyn Technologies, Lucent Technologies and Tyco Electronics Power Systems, Inc. in the United States District Court in Boston, Massachusetts. The lawsuit against Lucent was filed in May 2000 and in April 2001, the Company added Tyco Electronics as a defendant in that lawsuit. The lawsuit against Artesyn was filed in February 2001. In January 2003, the District Court issued a pre-trial decision in each of these patent infringement lawsuits relating to claim construction of the Reset Patent. The District Court's decisions rejected assertions that the Reset Patent claims are invalid for indefiniteness; and affirmed Vicor's interpretation of several terms used in the Reset Patent claims. However, the District Court adopted interpretations of certain terms of the Reset Patent claims that are contrary to Vicor's position. On May 24, 2004, the United States Court of Appeals for the Federal Circuit affirmed the decisions issued in January 2003 by the District Court. Vicor believes that the District Court's decisions, and the affirmation of these decisions by the Federal Circuit, strengthens its position regarding validity of the patent, but reduces the cumulative amount of infringing power supplies and the corresponding amount of potential damages. The Federal Circuit has referred the proceedings back to the District Court for trials on validity of the Reset Patent and infringement and damages by Lucent and Tyco, and Artesyn. In June 2006, Artesyn and Lucent and Tyco

filed motions to dismiss VLT's remanded cases against them. On January 3, 2007, the Court denied Artesyn's motion and set a trial date for March 12, 2007, but granted the Lucent and Tyco motion in part, dismissing VLT's case. On January 9, 2007, in response to the Court's order of dismissal, VLT filed a new action against Lucent and Tyco alleging infringement of VLT's 36,098 patent. In addition, on January 22, 2007, VLT filed a motion requesting the Court to withdraw its order of dismissal in the Lucent and Tyco case. In response to the Company and Artesyn informing the Court that a tentative settlement has been reached between them, the Court has subsequently dismissed the Artesyn case, allowing either party to reopen the action within 60 days if the tentative settlement is not consummated. The District Court has not yet set a date for the remaining trial. There can be no assurance that Vicor and VLT will ultimately prevail with respect to any of these claims or, if they prevail, as to the amount of damages that would be awarded.

In May 2004, *Ericsson Wireless Communications, Inc. v. Vicor Corporation* was filed in Superior Court of the State of California, County of San Diego. The plaintiff has brought an action against the Company seeking compensatory damages and lost profits with respect to post warranty contract and tort claims for products previously purchased by it from the Company. In November 2004, the plaintiff filed a First Amended Complaint adding claims against Exar Corporation, a former vendor of the Company. The Company filed cross-claims against Exar, and third-party claims against Rohm Device USA, LLC and Rohm Co., Ltd., the original manufacturer(s) of a component that Exar sold to the Company, which was included in the product subsequently sold by the Company to the plaintiff.

On February 22, 2007, the Company announced that it has reached an agreement in principle with Ericsson, Inc., to settle a lawsuit brought by Ericsson against the Company in California state court. Under the terms of the settlement agreement, reached on February 16, 2007 after a Court ordered mediation, the Company agreed to pay \$50.0 million to Ericsson, of which \$12.8 million will be paid by the Company's insurance carriers. The Company's decision to enter into the settlement followed an adverse ruling by the Court in January in connection with a settlement between Ericsson and co-defendants Exar Corporation and Rohm Device USA, LLC, two of the Company's component suppliers prior to 2002. The Company strongly disagrees with the ruling, which it is appealing. Although a successful appeal would enable the Company to seek recoveries from Exar and Rohm, there is no assurance that it will be successful in the appeal. In light of this ruling and after taking into consideration the possibility of further recoveries from the insurance carriers, the Company decided to settle the Ericsson case at this time. Accordingly, the Company recorded a net loss of \$37.2 million from litigation-related settlement in the fourth quarter of 2006.

On August 18, 2005, the Company filed an action in The Superior Court of the Commonwealth of Massachusetts, County of Essex ("the Massachusetts Court") against Concurrent Computer Corporation ("Concurrent") in response to a demand made by Concurrent in connection with breach of contract and breach of product warranty claims against the Company. On September 22, 2005, Concurrent filed a Demand For Arbitration with The American Arbitration Association. Concurrent is seeking \$1,500,000 in replacement costs, plus incidental, consequential and any other damages to be determined. On March 8, 2006 the Massachusetts Court allowed Concurrent's motion to compel arbitration. Vicor appealed the motion to compel arbitration decision, but on February 20, 2007, that motion was denied. The arbitration panel has set the matter for discovery with a hearing date of October, 2007. The Company has denied the claims made against it and intends to vigorously defend the claims made against it.

In addition, the Company is involved in certain other litigation and claims incidental to the conduct of its business. While the outcome of lawsuits and claims against the Company cannot be predicted with certainty, management does not expect any current litigation or claims to have a material adverse impact on the Company's financial position or results of operations.

**ITEM 4 — SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

## PART II

## ITEM 5 — MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Common Stock of the Company is listed on The Nasdaq Stock Market under the trading symbol "VICR." The Class B Common Stock of the Company is not traded on any market and is subject to restrictions on transfer under the Company's Restated Certificate of Incorporation, as amended.

The following table sets forth the quarterly high and low sales prices for the Common Stock as reported by The Nasdaq Stock Market for the periods indicated:

	<u>High</u>	<u>Low</u>
<u>2005</u>		
First Quarter	\$ 14.30	\$ 10.16
Second Quarter	14.59	9.77
Third Quarter	16.14	12.75
Fourth Quarter	17.31	14.21
<u>2006</u>		
First Quarter	\$ 20.50	\$ 15.09
Second Quarter	23.38	14.80
Third Quarter	16.70	9.54
Fourth Quarter	13.29	10.79

As of February 28, 2007, there were approximately 299 holders of record of the Company's Common Stock and approximately 19 holders of record of the Company's Class B Common Stock. These numbers do not reflect persons or entities that hold their stock in nominee or "street name" through various brokerage firms.

**Dividend Policy**

Dividends are declared at the discretion of the Company's Board of Directors and depend on actual cash from operations, the Company's financial condition and capital requirements and any other factors the Company's Board of Directors may consider relevant.

On June 24, 2005, the Company's Board of Directors approved an annual cash dividend for 2005 of \$.12 per share of the Company's stock. The total dividend of approximately \$5,025,000 was paid on August 31, 2005 to shareholders of record at the close of business on August 11, 2005.

On February 4, 2006, the Company's Board of Directors approved a cash dividend of \$.12 per of the Company's stock. The total dividend of approximately \$5,030,000 was paid on March 20, 2006 to shareholders of record at the close of business on February 28, 2006.

On June 23, 2006, the Company's Board of Directors approved a cash dividend of \$.15 per share of the Company's stock. The total dividend of approximately \$6,313,000 was paid on August 7, 2006 to shareholders of record at the close of business on July 17, 2006.

On February 16, 2007 the Company's Board of Directors approved a cash dividend of \$.15 per share of the Company's stock. The total dividend of approximately \$6,235,000 is payable on March 27, 2007 to shareholders of record at the close of business on March 9, 2007. The Board of Directors anticipates reviewing its dividend policy on a semi-annual basis.



## Issuer Purchases of Equity Securities

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs
October 1 - 31, 2006	—	\$ —	—	\$ 8,541,000
November 1 - 30, 2006	—	—	—	8,541,000
December 1 - 31, 2006	—	—	—	8,541,000
Total	—	—	—	\$ 8,541,000

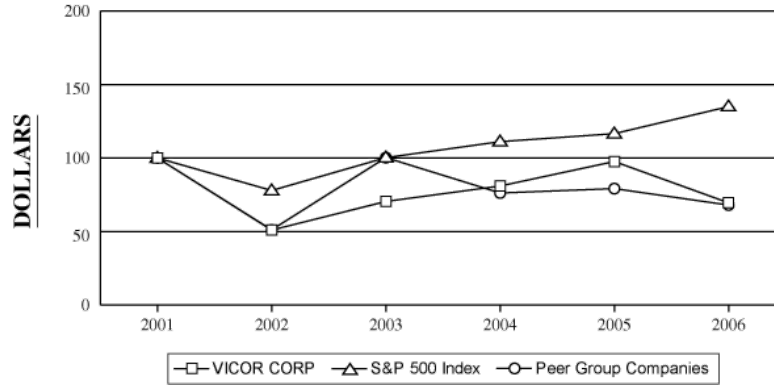
In November 2000, the Board of Directors of the Company authorized the repurchase of up to \$30,000,000 of the Company's Common Stock.

**Stockholder Return Performance Graph**

The graph set forth below presents the cumulative, five-year stockholder return for each of the Corporation's Common Stock, the Standard & Poor's 500 Index ("S&P 500 Index") and an index of peer group companies selected by the Corporation (the "Peer Group"). The Peer Group consists of the following ten (10) publicly-traded companies in the specialty electronic component industry: Analog Devices Incorporated; Intel Corporation; Linear Technology Corporation; LSI Logic Corporation; Xilinx Incorporated; Maxim Integrated Products, Inc.; Semtech Corporation; Intersil Corporation; RF Micro Devices, Inc. and Altera Corporation.

The graph assumes an investment of \$100 on December 31, 2001 in each of the Corporation's Common Stock, the S&P 500 Index and the Peer Group, and assumes reinvestment of all dividends. The peer group indices used in the graph are market capitalization-weighted. The historical information set forth below is not necessarily indicative of future performance.

**Comparison of Five Year Cumulative Return  
Among Vicor Corporation, S&P 500 Index  
and Peer Group Companies**



	2001	2002	2003	2004	2005	2006
Vicor Corporation	\$ 100.00	\$ 50.93	\$ 70.44	\$ 80.94	\$ 97.61	\$ 69.49
S&P 500 Index	\$ 100.00	\$ 77.89	\$ 100.23	\$ 111.13	\$ 116.57	\$ 134.98
Peer Group Companies	\$ 100.00	\$ 51.12	\$ 100.26	\$ 76.19	\$ 79.17	\$ 67.98

**ITEM 6 — SELECTED FINANCIAL DATA**

The following selected consolidated financial data with respect to the Company's statements of operations for the years ended December 31, 2006, 2005 and 2004 and with respect to the Company's balance sheets as of December 31, 2006 and 2005 are derived from the Company's consolidated financial statements, which appear elsewhere in this report and which have been audited by Ernst & Young LLP, the Company's independent registered public accounting firm. The following selected consolidated financial data with respect to the Company's statements of operations for the years ended December 31, 2003 and 2002 and with respect to the Company's balance sheets as of December 31, 2004, 2003 and 2002 are derived from the Company's audited consolidated financial statements, which are not included herein. The data should be read in conjunction with the consolidated financial statements, related notes and other financial information included herein.

Statement of Operations Data	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands except per share data)				
Net revenues	\$ 192,047	\$ 179,351	\$ 171,580	\$ 151,421	\$ 152,591
Income (loss) from operations	(33,182)	3,380	(4,035)	(25,703)	(24,502)
Net income (loss)	(29,738)	3,916	(3,723)	(19,535)	(15,942)
Net income (loss) per share — basic	(.71)	.09	(.09)	(.47)	(.38)
Net income (loss) per share — diluted	(.71)	.09	(.09)	(.47)	(.38)
Weighted average shares — basic	41,839	41,923	42,022	41,896	42,337
Weighted average shares — diluted	41,839	42,089	42,022	41,896	42,337
Cash dividends per share	\$ .27	\$ .12	\$ .08	\$ —	\$ —

Balance Sheet Data	At December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Working capital	\$ 120,890	\$ 150,385	\$ 148,419	\$ 141,547	\$ 153,167
Total assets	248,107	245,755	244,882	251,464	278,445
Long-term debt	—	—	—	—	—
Total liabilities	76,761	28,965	24,259	24,806	30,412
Stockholders' equity	171,346	216,790	220,623	226,658	248,033

**ITEM 7 — MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

Vicor Corporation designs, develops, manufactures and markets modular power components and complete power systems based upon a portfolio of patented technologies. The Company sells its products primarily to the telecommunications, electronic data processing, industrial control and military electronics markets, through a network of 30 independent sales representative organizations in North and South America and, internationally, through 37 independent distributors. Export sales as a percentage of total revenues were approximately 37%, 42% and 41% in 2006, 2005 and 2004, respectively. The Company operates in one industry segment.

For the year ended December 31, 2006 revenues increased to \$192,047,000 from \$179,351,000 in 2005. The Company had a loss before taxes of \$29,090,000 in 2006 as compared to income before taxes of \$4,880,000 in 2005. The Company reported net loss in 2006 of \$29,738,000 as compared net income of \$3,916,000 in 2005, and a diluted loss per share of \$.71 in 2006 as compared with diluted income per share of \$.09 in 2005. The net loss in 2006 was primarily due to a loss from a litigation-related settlement described below.

The book to bill ratio for the third and fourth quarters of 2006 was 1.00:1 and 0.94:1, respectively. The book to bill ratio for the year ended December 31, 2006 was 0.99:1 compared with 1.01:1 in 2005. In light of

the fact that bookings and sales can vary significantly from quarter to quarter, the Company does not believe that this quarterly and annual change in the book to bill ratio is indicative of a trend at this time. The Company ended 2006 with approximately \$36.4 million in backlog compared to \$38.6 million at the end of 2005.

The gross margin for 2006 improved to 42.6% compared with 39.8% in 2005. The gross margins improved throughout the year due to higher levels of shipments, increased productivity due to manufacturing efficiencies resulting in lower average unit costs and a decrease in inventory reserve expense.

In 2006, depreciation and amortization was \$14.2 million, a decrease of approximately \$2.9 million from 2005, and capital additions were \$5.6 million, a decrease of approximately \$3.4 million from 2005. Due to assets which either are now or will be fully depreciated in 2007, the Company expects depreciation and amortization to be less in 2007 than 2006.

Inventories increased by approximately \$4.8 million or 28.2% to \$22.0 million as compared with \$17.2 million at the end of 2005, primarily to meet the increased demand.

On February 22, 2007, the Company announced that it had reached an agreement in principle with Ericsson, Inc., to settle a lawsuit brought by Ericsson against the Company in California state court. Under the terms of the settlement agreement, reached on February 16, 2007 after a Court ordered mediation, the Company agreed to pay \$50.0 million to Ericsson, of which \$12.8 million will be paid by the Company's insurance carriers. Accordingly, the Company recorded a net loss of \$37.2 million from litigation-related settlement in the fourth quarter of 2006.

Significant attention across many functional areas of the Company continues to be focused on the design, development, introduction and production of the new FPA products (see Part I, Item 1 — "The Products — Factorized Power Architecture"). The Company introduced the first families of these products in 2003. Revenues to date from FPA products have not been significant.

The following table sets forth certain items of selected consolidated financial information as a percentage of net revenues for the periods indicated. This table and the subsequent discussion should be read in conjunction with the selected financial data and the Consolidated Financial Statements and related footnotes of the Company contained elsewhere in this report.

	Year Ended December 31,		
	2006	2005	2004
Net revenues	100.0%	100.0%	100.0%
Gross margin	42.6%	39.8%	36.9%
Selling, general and administrative expenses	24.2%	22.8%	24.0%
Research and development expenses	16.3%	16.4%	15.3%
Income (loss) before income taxes	(15.1)%	2.7%	(1.4)%

#### Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition, allowance for doubtful accounts, inventories, investments, intangible assets, income taxes, impairment of long-lived assets, contingencies and litigation. Management bases its estimates and judgments on historical experience, knowledge of current conditions and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different

assumptions or conditions. Management believes the following accounting policies involve its more significant judgments and estimates used in the preparation of its consolidated financial statements.

***Allowance for Doubtful Accounts***

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments, based on assessments of customers' credit-risk profiles and payment histories. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

***Inventories***

The Company employs a variety of methodologies to estimate allowances for its inventory for estimated obsolescence or unmarketable inventory, based upon its known backlog and historical usage, and assumptions about future demand and market conditions. For the Company's brick products produced at the Andover location, its principal manufacturing location, the model used is based upon a comparison of on-hand quantities to projected demand, such that amounts on hand in excess of three-year projected usage are fully reserved for inventories of those products. Since VI-Chip products are at a relatively early stage, a one-year projected usage assumption is used. While we have used our best efforts and believe we have used the best available information to estimate future demand, due to uncertainty in the economy and our business and the inherent difficulty in predicting future demand, it is possible that actual demand for our products will differ from our estimates. If actual future demand or market conditions are less favorable than those projected by management, additional inventory reserves for existing inventories may need to be recorded in future periods.

***Other Investments***

The accounting for other investment transactions is reviewed for compliance with Accounting Principles Board Opinion No. 18, "The Equity Method for Accounting for Investments in Common Stock" (APB 18) and/or FASB Interpretation No. 46 — Revised (FIN 46R) "Consolidation of Variable Interest Entities". The Company has accounted for the investment in Great Wall Semiconductor Corporation, ("GWS") under APB 18 as a cost method investment as management believes it does not have significant influence over GWS.

The Company periodically evaluates the investment in GWS to determine if there are any events or circumstances that are likely to have a significant adverse effect on the fair value of the investment. Examples of such impairment indicators include, but are not limited to: GWS' actual results of operations, actual results of operations compared to forecast, working capital requirements, additional third-party equity investment, if any, or a significant doubt about an investee's ability to continue as a going concern. If we identify an impairment indicator, we will estimate the fair value of the investment and compare it to its carrying value. If the fair value of the investment is less than its carrying value, the investment is impaired and we make a determination as to whether the impairment is other-than-temporary. For other-than-temporary impairments, we recognize an impairment loss equal to the difference between an investment's carrying value and its fair value. Impairment losses on this investment are included in other income (expense), net in our consolidated statements of operations. In the fourth quarter of 2006, the investment was adjusted for a decline in value judged to be other than temporary of \$1,000,000. Deterioration or changes in GWS' business in the future could lead to such impairment adjustments in future periods.

***Long-Lived Assets***

Management evaluates the recoverability of the Company's identifiable intangible assets, goodwill and other long-lived assets in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (FAS 142) and Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144), which generally requires that the recoverability of these assets be assessed when events or circumstances indicate a potential impairment. The Company periodically assesses the remaining use of fixed assets based upon operating results and cash flows

from operations. Equipment has been written-down as a result of these assessments as necessary. Goodwill is tested for potential impairment at least annually at the reporting unit level.

***Stock-Based Compensation***

The adoption of FAS 123(R) in the first quarter of fiscal 2006 requires that stock-based compensation expense associated with stock options and related awards be recognized in the statement of income, rather than being disclosed in a pro forma footnote to the consolidated financial statements. Determining the amount of stock-based compensation requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We calculate the grant-date fair values using the Black-Scholes valuation model. The use of this model requires us to make estimates for the following assumptions: expected volatility, expected term, risk-free interest rate, expected dividend yield and forfeiture rate. Changes in any of these assumptions may have an impact on the amount of stock — based compensation recorded.

***Product Warranties***

The Company generally warrants its products for a period of two years. Vicor maintains allowances for estimated product returns under warranty based upon a review of known or potential product failures in the field and upon historical patterns of product returns. If unforeseen product issues arise or product returns increase above expected rates, additional allowances may be required.

***Income Taxes***

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (FAS 109), which requires that deferred tax assets and liabilities be recognized using enacted rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. FAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. The Company has assessed the need for a valuation allowance against these deferred tax assets and concluded that a valuation allowance for a portion of the deferred tax assets is warranted at December 31, 2006. In reaching this conclusion, the Company evaluated all relevant criteria including the existence of significant temporary differences reversing in the carryforward period, primarily depreciation. The valuation allowance against these deferred tax assets may require adjustment in the future based on changes in the mix of temporary differences, changes in tax laws, and operating performance. In addition, the assessment of the valuation allowance requires the Company to make estimates of future taxable income and to estimate reversals of temporary differences. Changes in the assumptions or other circumstances may require additional valuation allowances if actual reversals of temporary differences differ from those estimates.

The Company operates in numerous taxing jurisdictions and is, therefore, subject to a variety of income and related taxes. The Company has provided for potential tax liabilities due in various jurisdictions which it judges to be probable and reasonably estimable in accordance with Statement of Financial Accounting Standards No. 5 "Accounting for Contingencies". Judgment is required in determining the income tax expense and related tax liabilities. In the ordinary course of business, there are transactions and calculations where the ultimate tax outcome is uncertain. The Company believes it has reasonably estimated its accrued taxes for all jurisdictions for all open tax periods. The Company periodically assesses the adequacy of its tax and related accruals on a quarterly basis and adjusts appropriately as events warrant and open tax periods close. It is possible that the final tax outcome of these matters will be different from management's estimate reflected in the income tax provisions and accrued taxes. Such differences could have a material impact on the Company's income tax provision and operating results in the period in which such determination is made.

***Contingencies***

From time to time, we receive notices for product failure claims or that our products or manufacturing processes may be infringing the patent or intellectual property rights of others or for other matters. We periodically assess each matter to determine if a contingent liability should be recorded in accordance with

Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (FAS 5). In making this assessment, we may, depending on the nature of the matter, consult with external legal counsel and technical experts. Based on the information we obtain, combined with our judgment regarding all the facts and circumstances of each matter, we determine whether it is probable that a contingent loss may be incurred and whether the amount of such loss can be reasonably estimated. Should a loss be probable and reasonably estimable, we record a loss in accordance with FAS 5. In determining the amount of the loss, we consider advice received from experts in the specific matter, current status of legal proceedings, if any, prior case history and other factors. Should the judgments and estimates made by us be incorrect, we may need to record additional contingent losses that could materially adversely impact our results of operations and financial position.

**Year Ended December 31, 2006 compared to Year Ended December 31, 2005**

Net revenues for fiscal 2006 were \$192,047,000, an increase of \$12,696,000, or 7.1%, as compared to \$179,351,000 for the same period a year ago. The increase in net revenues from the prior year resulted from an increase in shipments of standard and custom products. Orders for fiscal year 2006 increased by 4.6% compared with 2005. Subject to continuing demand and productivity improvements, the Company expects modest growth in revenues and further improvements in gross margins in 2007. The book-to-bill ratio for 2006 was 0.99:1 as compared to 1.01:1 for 2005.

Gross margin for fiscal 2006 increased \$10,429,000, or 14.6%, to \$81,836,000 from \$71,407,000 in 2005 and increased as a percentage of net revenues from 39.8% to 42.6%. The primary components of the increase in gross margin dollars and percentage were due to the increase in net revenues, an increase in manufacturing efficiencies resulting in lower average unit costs and significant inventory reserves recorded in 2005. During the second quarter of 2005, the Company provided additional reserves of approximately \$1,600,000 for potential obsolete inventory arising primarily from the European Union RoHS initiative and the conversion of Maxi, Mini, Micro and MIL-COTS product families to the FasTrak platform. In addition, the Company identified other slow-moving and potential obsolete inventory of approximately \$1,200,000, of which \$300,000 was related to raw material inventory in support of pilot production of V•I Chips.

Selling, general and administrative expenses were \$46,437,000 for 2006, an increase of \$5,626,000, or 13.8%, over the same period in 2005. As a percentage of net revenues, selling, general and administrative expenses increased to 24.2% from 22.8%. The principal components of the \$5,626,000 increase were \$1,550,000, or 8.7%, of increased compensation primarily due to annual compensation adjustments in May 2006 and increases in headcount, \$982,000 or 88.0% of increased legal fees due to litigation with Ericsson Wireless Communications, Inc. (See Part I, Item 3 — "Legal Proceedings"), \$725,000, or 39.2%, of increased depreciation and amortization expense principally due to the accelerated amortization for and the write-off of certain patent costs, \$698,000, or 17.8%, increase in commissions due to the increase in net revenues, \$323,000, or 306.1%, increase in employment advertising, recruiting and relocation expense, \$256,000, or 12.2%, in increased advertising expense, and a \$216,000, or 177.3%, increase in outside services expense. The increase in compensation expense also includes \$385,000 of non-cash stock-based compensation recorded under FAS 123(R). See Note 3 to the consolidated financial statements for further discussion.

Research and development expenses increased \$1,915,000, or 6.5%, to \$31,381,000 in 2006 from \$29,466,000 in 2005 but decreased as a percentage of net revenues to 16.3% from 16.4%. The principal components of the \$1,915,000 increase were \$1,676,000, or 9.4%, of increased compensation expense primarily due to annual compensation adjustments in May 2006 and increases in headcount, \$224,000, or 15.5%, of increased expenses related to the Vicor Integration Architects ("VIAs"), \$162,000, or 10.1%, of increased facilities costs and \$152,000, or 110.9%, in increased industrial gas costs. These items were partially offset by a decrease in production materials of \$542,000, or 13.5%. The increase in compensation expense also includes \$281,000 of non-cash stock-based compensation recorded under FAS 123(R). See Note 3 to the consolidated financial statements for further discussion.

On February 22, 2007, the Company announced that it has reached an agreement in principle with Ericsson, Inc., to settle a lawsuit brought by Ericsson against the Company in California state court. Under the

terms of the settlement agreement, reached on February 16, 2007 after a Court ordered mediation, the Company agreed to pay \$50.0 million to Ericsson, of which \$12.8 million will be paid by the Company's insurance carriers. Accordingly, the Company recorded a net loss of \$37.2 million from litigation-related settlement in the fourth quarter of 2006.

In the second quarter of 2005, the Company entered into a settlement agreement with Lambda Americas, Inc., successor to Lambda Electronics, Inc., under which the Company received a payment of \$2,500,000 in full settlement of the Company's Reset Patent claims against Lambda and which settled the lawsuit that the Company had filed against Lambda in June 2001. The full amount of the payment, net of a \$250,000 contingency fee paid by the Company to its litigation counsel, has been included in gain from litigation-related settlement, net in the accompanying condensed consolidated statement of operations.

The changes in the major components of other income (expense), net were as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>Increase (Decrease)</u>
Interest income	\$ 5,389	\$ 3,124	\$ 2,265
Other than temporary decline in investment	(1,000)	—	(1,000)
Minority interest in net income of subsidiaries	(562)	(807)	245
Foreign currency gains (losses)	139	(771)	910
Gain (loss) on disposal of equipment	67	(41)	108
Other	59	(5)	64
	<u>\$ 4,092</u>	<u>\$ 1,500</u>	<u>\$ 2,592</u>

The increase in interest income is due to higher interest rates and higher average balances on the Company's cash equivalents, short-term and long-term investments. The increase in foreign currency gains is due to the favorable exchange rates in 2006 as compared to 2005. In the fourth quarter of 2006, the investment in Great Wall Semiconductor Corporation was adjusted for a decline in value judged to be other than temporary of \$1,000,000.

Loss before income taxes was \$29,090,000 in 2006 compared to income before income taxes of \$4,880,000 for 2005.

The provision for income taxes totaled \$648,000 in 2006 as compared to a provision of \$964,000 in 2005. The Company's effective tax rate was 2.2% and 19.8% for 2006 and 2005, respectively. Tax provisions in 2006 and 2005 have been provided for federal and state taxes for certain minority-owned subsidiaries that are not part of the Company's consolidated income tax returns, for the federal alternative minimum tax and for estimated income taxes due in various state and international taxing jurisdictions. In the third quarter of 2006 and 2005, the Company reduced its tax reserves by \$468,000 and \$770,000, respectively, due to closing tax periods in certain jurisdictions and other tax reserves no longer considered necessary. The decreases in 2006 and 2005 were partially offset by increases in reserves during the year of approximately \$133,000 and \$412,000, respectively, for potential liabilities. The Company will continue to assess its effective tax rate and the need for valuation allowances against its deferred tax assets.

Basic and diluted loss per share was \$0.71 for the year ended December 31, 2006, compared to basic and diluted income per share of \$0.09 for the year ended December 31, 2005.

#### **Year Ended December 31, 2005 compared to Year Ended December 31, 2004**

Net revenues for fiscal 2005 were \$179,351,000, an increase of \$7,771,000, or 4.5%, as compared to \$171,580,000 for the same period a year ago. The increase in net revenues resulted primarily from an increase in unit shipments of standard and custom products of approximately \$8,147,000, partially offset by a decrease in license revenue of \$376,000. Orders for fiscal year 2005 increased by 6.5% compared with 2004. The book-to-bill ratio for 2005 was 1.01:1 compared to 1.00:1 for 2004.



Gross margin for fiscal 2005 increased \$8,119,000, or 12.8%, to \$71,407,000 from \$63,288,000 in 2004 and increased as a percentage of net revenues from 36.9% to 39.8%. The primary components of the increase in gross margin dollars and percentage were due to the higher levels of shipments and increased productivity due to manufacturing efficiencies resulting in lower average unit costs. These increases were partially offset by an increase in inventory reserve expense of approximately \$3,700,000 compared to 2004. During the second quarter of 2005, the Company provided additional reserves of approximately \$1,600,000 for potential obsolete inventory arising primarily from the EU RoHS initiative and the conversion of second-generation products to the FasTrak platform. In addition, the Company identified other slow-moving and potential obsolete inventory of approximately \$1,200,000, of which \$300,000 related to raw material inventories in support of pilot production of V•1 Chips.

Selling, general and administrative expenses were \$40,811,000 for 2005, a decrease of \$301,000, or 0.7%, over the same period in 2004. As a percentage of net revenues, selling, general and administrative expenses decreased to 22.8% from 24.0%, primarily due to the increase in net revenues. The principal components of the \$301,000 decrease were \$1,068,000, or 48.9%, of decreased legal fees and \$553,000, or 23.0%, of decreased depreciation expense, primarily due to certain computer hardware and software becoming fully depreciated in 2004. The overall decrease in legal expense was primarily due to litigation with Exar Corporation that was settled in July 2004 and for reimbursements of legal fees from the Company's insurance carrier beginning in the third quarter of 2004, which reduces legal expense, in connection with the litigation with Ericsson Wireless Communications, Inc. (see Part I, Item 3 — "Legal Proceedings"). The principal components partially offsetting the above decreases were \$412,000, or 143.3%, of increased provision for potential bad debts principally due to a reduction in the allowance for doubtful accounts of \$300,000 in 2004 due to the Company's favorable collection of accounts receivable in 2004, \$316,000, or 32.8%, in increased audit and tax fees due to the requirements of complying with the Sarbanes-Oxley Act of 2002, and \$441,000, or 7.8%, in increased costs associated with Vicor Japan Co., Ltd. and the VIAs.

Research and development expenses increased \$3,255,000, or 12.4%, to \$29,466,000 in 2005 from \$26,211,000 in 2004 and increased as a percentage of net revenues to 16.4% from 15.3%. The principal components of the \$3,255,000 increase were \$1,812,000, or 11.3%, of increased compensation expense, principally due to increased headcount, \$668,000, or 20.0%, of increased project material costs, \$198,000, or 14.0%, of increased facilities costs and \$168,000, or 77.9%, in increased supplies. The increases in compensation expense, project material costs and supplies were principally due to the development efforts associated with the Company's new FPA products.

In the second quarter of 2005, the Company entered into a settlement agreement with Lambda Americas, Inc., successor to Lambda Electronics, Inc., under which the Company received a payment of \$2,500,000 in full settlement of the Company's Reset Patent claims against Lambda and which settled the lawsuit that the Company had filed against Lambda in June 2001. The full amount of the payment, net of a \$250,000 contingency fee paid by the Company to its litigation counsel, has been included in gain from litigation-related settlement, net in the accompanying condensed consolidated statement of operations.

The changes in the major components of other income (expense), net were as follows (in thousands):

	<u>2005</u>	<u>2004</u>	<u>Increase (Decrease)</u>
Interest income	\$ 3,124	\$ 1,764	\$ 1,360
Minority interest in net income of subsidiaries	(807)	(527)	(280)
Foreign currency (losses) gains	(771)	268	(1,039)
Other than temporary decline in investment	—	(70)	70
Loss on disposal of equipment	(41)	(47)	6
Other	(5)	244	(249)
	<u>\$ 1,500</u>	<u>\$ 1,632</u>	<u>\$ (132)</u>

The increase in interest income is due to higher interest rates and higher average balances on the Company's cash equivalents, short-term and long-term investments. The increase in foreign currency losses is due to the unfavorable exchange rates in 2005 as compared to 2004, principally in Japan.

Income before income taxes was \$4,880,000 in 2005 compared to a loss before income taxes of \$2,403,000 for 2004.

The provision for income taxes totaled \$964,000 in 2005 as compared to a provision of \$1,320,000 in 2004. The Company's effective tax rate was 19.8% and 54.9% for 2005 and 2004, respectively. Tax provisions in 2005 and 2004 have been provided for federal and state taxes for certain minority-owned subsidiaries that are not part of the Company's consolidated income tax returns, for the federal alternative minimum tax and for estimated income taxes due in various state and international taxing jurisdictions. In the third quarter of 2005, the Company reduced its tax reserves by \$770,000 due to closing tax periods in certain jurisdictions, offset by an increase in reserves during the year of approximately \$412,000 for potential liabilities. During the third quarter of 2004, the Company provided additional tax expense for potential liabilities related to certain jurisdictions under examination aggregating \$950,000, partially offset by a reduction in the tax reserves for certain jurisdictions due to tax periods closing aggregating \$650,000.

Basic and diluted income per share was \$0.09 for the year ended December 31, 2005, compared to basic and diluted loss per share of \$(0.09) for the year ended December 31, 2004.

#### **LIQUIDITY AND CAPITAL RESOURCES**

At December 31, 2006 the Company had \$36,185,000 in cash and cash equivalents. The ratio of current assets to current liabilities was 2.8:1 at December 31, 2006 compared to 7.6:1 at December 31, 2005. Working capital decreased \$29,495,000, from \$150,385,000 at December 31, 2005 to \$120,890,000 at December 31, 2006. The primary factors affecting the working capital decrease were an increase in the accrual for litigation settlement related to the Ericsson matter of \$50,000,000 (See Part I, Item 3 — "Legal Proceedings") and a decrease in short term investments of \$6,291,000. These decreases were partially offset by an increase in the insurance receivable for litigation of \$12,800,000 (See Part I, Item 3 — "Legal Proceedings"), an increase in cash of \$2,161,000, an increase in inventories of \$4,833,000, an increase in accounts receivable of \$2,327,000 and a decrease in other current liabilities of \$3,983,000. The primary source of cash for the twelve months ended December 31, 2006 was \$14,330,000 from operating activities, \$10,083,000 for the net sales of short-term investments, and \$5,577,000 in net proceeds from the issuance of common stock upon the exercise of stock options. The primary uses of cash for the twelve months ended December 31, 2006 were the payment of a common stock dividends of \$11,343,000, the acquisition of treasury stock of \$10,835,000 and the acquisition of equipment of \$5,603,000.

In November 2000, the Board of Directors of the Company authorized the repurchase of up to \$30,000,000 of the Company's Common Stock (the "November 2000 Plan"). The November 2000 Plan authorizes the Company to make such repurchases from time to time in the open market or through privately negotiated transactions. The timing and amounts of stock repurchases are at the discretion of management based on its view of economic and financial market conditions. The Company spent approximately \$10,835,000 for the repurchase of 825,700 shares of Common Stock during the twelve months ended December 31, 2006. As of December 31, 2006, the Company had approximately \$8,541,000 remaining under the plan.

On February 4, 2006, the Company's Board of Directors approved a cash dividend of \$.12 per share of the Company's stock. The total dividend of approximately \$5,030,000 was paid on March 20, 2006 to shareholders of record at the close of business on February 28, 2006. On June 23, 2006, the Company's Board of Directors approved a cash dividend of \$.15 per share of the Company's stock. The total dividend of approximately \$6,313,000 was paid on August 7, 2006 to shareholders of record at the close of business on July 17, 2006. On February 16, 2007 the Company's Board of Directors approved a cash dividend of \$.15 per share of the Company's stock. The dividend of approximately \$6,235,000 is payable on March 27, 2007 to shareholders of record at the close of business on March 9, 2007.

The table below summarizes the Company's contractual obligations as of December 31, 2006 (in thousands):

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 Year	Years 2 & 3	Years 4 & 5	More Than 5 Years
Operating lease obligations	\$ 3,016	\$ 1,383	\$ 1,288	\$ 345	\$ —
Purchase obligations	2,356	286	571	571	928
Total	<u>\$ 5,372</u>	<u>\$ 1,669</u>	<u>\$ 1,859</u>	<u>\$ 916</u>	<u>\$ 928</u>

The Company's primary liquidity needs are for making continuing investments in manufacturing equipment, particularly equipment for the Company's new FPA products. In addition, the Company anticipates making a net payment to Ericsson, Inc., of approximately \$37.2 million for a litigation-related settlement (see Part I — Item 3 "Legal Proceedings"). The Company believes that cash generated from operations and the total of its cash and cash equivalents, together with other sources of liquidity, will be sufficient to fund planned operations, capital equipment purchases for the foreseeable future and the litigation settlement payment. At December 31, 2006, the Company also had approximately \$1,104,000 of capital expenditure commitments, principally for manufacturing equipment.

The Company does not consider the impact of inflation and changing prices on its business activities or fluctuations in the exchange rates for foreign currency transactions to have been material during the last three fiscal years.

**ITEM 7A — QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK**

The Company is exposed to a variety of market risks, including changes in interest rates affecting the return on its cash and cash equivalents, short-term and long-term investments and fluctuations in foreign currency exchange rates.

As the Company's cash and cash equivalents consist principally of money market securities, which are short-term in nature, the Company's exposure to market risk on interest rate fluctuations for these investments is not significant. The Company's short-term and long-term investments consist mainly of corporate debt securities. These debt securities are all highly-rated investments, in which a significant portion have interest rates reset at auction at regular intervals. As a result, the Company believes there is minimal market risk to these investments. Our annual interest income would change by approximately \$1,000,000 in 2006 for each 100 basis point increase or decrease in interest rates.

The Company's exposure to market risk for fluctuations in foreign currency exchange rates relates primarily to the operations of VJCL and changes in the dollar/yen exchange rate. Relative to foreign currency exposure against the yen existing at December 31, 2006, a 10% unfavorable movement in the dollar/yen exchange rate would increase the foreign currency loss by approximately \$250,000. In addition, the functional currency of the Company's subsidiaries in Europe and Hong Kong is the U.S. Dollar. Therefore, the Company believes that market risk is mitigated since these operations are not exposed to foreign exchange fluctuations.

ITEM 8 — FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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FINANCIAL STATEMENTS

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders  
Vicor Corporation

We have audited the accompanying consolidated balance sheets of Vicor Corporation as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Vicor Corporation at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, on January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" which requires the Company to recognize expense related to the fair-value of share-based compensation awards.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Vicor Corporation's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 12, 2007 expressed an adverse opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts  
March 12, 2007

**VICOR CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
(In thousands, except share data)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 36,185	\$ 34,024
Short-term investments	82,401	88,692
Accounts receivable, less allowance of \$583 in 2006 and \$635 in 2005	30,399	28,072
Insurance receivable for litigation	12,800	—
Inventories, net	22,001	17,168
Deferred tax assets	3,702	2,673
Other current assets	2,181	2,518
Total current assets	<u>189,669</u>	<u>173,147</u>
Long-term investments	—	3,348
Property, plant and equipment, net	51,573	59,114
Other assets	6,865	10,146
	<u>\$ 248,107</u>	<u>\$ 245,755</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,273	\$ 8,741
Accrued compensation and benefits	5,192	4,583
Accrued expenses	4,189	3,016
Accrual for litigation settlement	50,000	—
Income taxes payable	2,049	6,279
Deferred revenue	76	143
Total current liabilities	<u>68,779</u>	<u>22,762</u>
Deferred income taxes	4,389	3,172
Commitments and contingencies	—	—
Minority interests	3,593	3,031
Stockholders' equity:		
Preferred Stock, \$.01 par value, 1,000,000 shares authorized; no shares issued or outstanding in 2006 and 2005	—	—
Class B Common Stock: 10 votes per share, \$.01 par value, 14,000,000 shares authorized, 11,854,952 shares issued and outstanding in 2006 and 2005	119	119
Common Stock: 1 vote per share, \$.01 par value, 62,000,000 shares authorized, 38,106,377 shares issued and 29,707,979 shares outstanding (37,670,533 shares issued and 30,097,835 shares outstanding in 2005)	382	377
Additional paid-in capital	158,021	151,698
Retained earnings	134,579	175,660
Accumulated other comprehensive income (loss)	72	(72)
Treasury stock at cost: 8,398,398 shares in 2006 (7,572,698 shares in 2005)	<u>(121,827)</u>	<u>(110,992)</u>
Total stockholders' equity	<u>171,346</u>	<u>216,790</u>
	<u>\$ 248,107</u>	<u>\$ 245,755</u>

See accompanying notes

**VICOR CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**Years ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
	(In thousands, except per share amounts)		
Net revenues	\$ 192,047	\$ 179,351	\$ 171,580
Cost of revenues	110,211	107,944	108,292
Gross margin	81,836	71,407	63,288
Operating expenses:			
Selling, general and administrative	46,437	40,811	41,112
Research and development	31,381	29,466	26,211
Loss (gain) from litigation-related settlements, net	37,200	(2,250)	—
Total operating expenses	115,018	68,027	67,323
Income (loss) from operations	(33,182)	3,380	(4,035)
Other income (expense), net	4,092	1,500	1,632
Income (loss) before income taxes	(29,090)	4,880	(2,403)
Provision for income taxes	648	964	1,320
Net income (loss)	<u>\$ (29,738)</u>	<u>\$ 3,916</u>	<u>\$ (3,723)</u>
Net income (loss) per common share:			
Basic	<u>\$ (.71)</u>	<u>\$ .09</u>	<u>\$ (.09)</u>
Diluted	<u>\$ (.71)</u>	<u>\$ .09</u>	<u>\$ (.09)</u>
Shares used to compute net income (loss) per share:			
Basic	<u>41,839</u>	<u>41,923</u>	<u>42,022</u>
Diluted	<u>41,839</u>	<u>42,089</u>	<u>42,022</u>
Cash dividends per share	<u>\$ .27</u>	<u>\$ .12</u>	<u>\$ .08</u>

See accompanying notes

**VICOR CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years ended December 31, 2006, 2005 and 2004**

	2006	2005 (in thousands)	2004
<b>Operating activities:</b>			
Net income (loss)	\$ (29,738)	\$ 3,916	\$ (3,723)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	14,158	17,082	20,898
Loss on litigation-related settlement	37,200	—	—
Other than temporary decline in investments	1,000	—	70
Stock compensation expense	751	—	—
Minority interest in net income of subsidiaries	562	807	527
Amortization of bond premium	(167)	573	1,002
Deferred income taxes	86	(133)	—
(Gain) loss on disposal of equipment	(67)	41	47
Change in current assets and liabilities, net	(9,455)	6,985	(2,939)
Net cash provided by operating activities	14,330	29,271	15,882
<b>Investing activities:</b>			
Purchase of short-term and long-term investments	(189,818)	(115,932)	(75,357)
Sales and maturities of short-term and long-term investments	199,901	100,746	63,619
Additions to property, plant and equipment	(5,603)	(8,944)	(5,022)
Proceeds from sale of equipment	88	—	6
Increase in other assets	(176)	(573)	(2,414)
Net cash provided by (used in) investing activities	4,392	(24,703)	(19,168)
<b>Financing activities:</b>			
Proceeds from exercise of stock options	5,577	3,578	2,344
Common stock dividends	(11,343)	(5,025)	(3,371)
Acquisitions of treasury stock	(10,835)	(5,544)	(1,088)
Net cash used in financing activities	(16,601)	(6,991)	(2,115)
Effect of foreign exchange rates on cash	40	170	(45)
Net increase (decrease) in cash and cash equivalents	2,161	(2,253)	(5,446)
Cash and cash equivalents at beginning of year	34,024	36,277	41,723
Cash and cash equivalents at end of year	\$ 36,185	\$ 34,024	\$ 36,277
<b>Change in current assets and liabilities:</b>			
Accounts receivable	\$ (2,363)	\$ (4,941)	\$ (784)
Inventories, net	(4,854)	8,913	(4,095)
Other current assets	337	(279)	1,858
Accounts payable and accrued liabilities	303	3,545	31
Income taxes payable	(2,811)	(90)	(98)
Deferred revenue	(67)	(163)	149
	\$ (9,455)	\$ 6,985	\$ (2,939)
<b>Supplemental disclosures:</b>			
Cash paid during the year for income taxes, net of refunds	\$ 3,590	\$ 1,085	\$ 1,307

See accompanying notes



**VICOR CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**Years ended December 31, 2006, 2005 and 2004**

	Class B Common Stock	Common Stock	Additional Paid-In Capital	Retained Earnings (In thousands)	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance at December 31, 2003	\$ 119	\$ 371	\$ 146,479	\$ 183,863	\$ 186	\$ (104,360)	\$ 226,658
Sales of Common Stock			2,342				2,344
Conversion of Class B Common Stock to Common Stock		2					
Purchase of treasury stock						(1,088)	(1,088)
Common stock dividends				(3,371)			(3,371)
Net loss for 2004				(3,723)			(3,723)
Unrealized loss on investments					(243)		(243)
Currency translation adjustments					46		46
Comprehensive loss							(3,920)
Balance at December 31, 2004	119	373	148,821	176,769	(11)	(105,448)	220,623
Sales of Common Stock		4	3,574				3,578
Conversion of Class B Common Stock to Common Stock							
Purchase of treasury stock						(5,544)	(5,544)
Common stock dividends				(5,025)			(5,025)
Minority interest adjustment			(697)				(697)
Net income for 2005				3,916			3,916
Unrealized gain on investments					33		33
Currency translation adjustments					(94)		(94)
Comprehensive income							3,855
Balance at December 31, 2005	119	377	151,698	175,660	(72)	(110,992)	216,790
Sales of Common Stock		5	5,572				5,577
Purchase of treasury stock						(10,835)	(10,835)
Common stock dividends				(11,343)			(11,343)
Stock-based compensation expense			751				751
Net loss for 2006				(29,738)			(29,738)
Unrealized gain on investments					164		164
Currency translation adjustments					(20)		(20)
Comprehensive loss							(29,594)
Balance at December 31, 2006	<u>\$ 119</u>	<u>\$ 382</u>	<u>\$ 158,021</u>	<u>\$ 134,579</u>	<u>\$ 72</u>	<u>\$ (121,827)</u>	<u>\$ 171,346</u>

See accompanying notes

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. DESCRIPTION OF BUSINESS**

Vicor Corporation (the "Company" or "Vicor") designs, develops, manufactures and markets modular power converters, power system components, and power systems using a patented, high frequency power conversion technology designated "zero current switching." The Company also licenses certain rights to its technology in return for ongoing royalties. The principal markets for the power converters and systems are large Original Equipment Manufacturers and smaller, lower volume users which are broadly distributed across several major market areas.

**2. SIGNIFICANT ACCOUNTING POLICIES**

*Principles of consolidation*

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated upon consolidation. Certain of the Company's Vicor Integration Architects ("VIAs") are not majority owned by the Company. These entities are consolidated by the Company as management believes that the Company has the ability to exercise control over their activities and operations. During 2005, the Company increased the minority interests balance by \$697,000, with a corresponding offset to additional paid-in capital, to adjust the balance to reflect the minority interest ownership percentage in the net equity of these subsidiaries.

*Revenue recognition*

Product revenue is recognized in the period when persuasive evidence of an arrangement with a customer exists, the products are shipped and title has transferred to the customer, the price is fixed or determinable, and collection is considered probable. License fees are recognized as earned. The Company recognizes revenue on such arrangements only when the contract is signed, the license term has begun, all obligations have been delivered to the customer, and collection is probable. The Company evaluates revenue arrangements with potential multi-element deliverables in accordance with Emerging Issues Task Force ("EITF") Issue No. 00-21 "Revenue Arrangements with Multiple Deliverables" (EITF 00-21).

*Foreign currency translation*

The financial statements of Vicor Japan Company, Ltd. ("VJCL"), for which the functional currency is the Japanese yen, have been translated into U.S. dollars in accordance with FASB Statement No. 52, "Foreign Currency Translation." All balance sheet accounts have been translated using the exchange rate in effect at the balance sheet date. Income statement amounts have been translated at the average exchange rates in effect during the year. The gains and losses resulting from the changes in exchange rates from year to year have been reported in other comprehensive income. Transaction gains and losses, and translation gains (losses) resulting from the remeasurement of foreign currency denominated assets and liabilities of the Company's foreign subsidiaries where the functional currency is the U.S. dollar are included in other income (expense), net. Foreign currency gains (losses), included in other income (expense), net, were approximately \$139,000, (\$771,000), and \$268,000 in 2006, 2005 and 2004, respectively.

*Cash and cash equivalents*

Cash and cash equivalents include funds held in checking and money market accounts with banks, certificates of deposit and debt securities with maturities of less than three months when purchased and money market securities. Cash and cash equivalents are valued at cost which approximates market value. The Company's money market securities, which are classified as cash equivalents on the balance sheet, are purchased and redeemed at par. The estimated fair value is equal to the cost of the securities and due to the

## VICOR CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

nature of the securities there are no unrealized gains or losses at the balance sheet dates. As of December 31, 2006, approximately \$325,000 of cash was restricted as a guarantee for certain foreign letters of credit.

***Short-term and long-term investments***

The Company's short-term and long-term investments are classified as available-for-sale securities and are recorded at fair value, with the unrealized gains and losses, net of tax, reported in a separate component of stockholders' equity. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization, along with interest and realized gains and losses, are included in other income (expense), net. The Company has no trading securities or held-to-maturity securities. As of December 31, 2006, approximately \$720,000 of short-term investments were restricted as a guarantee for certain foreign letters of credit.

***Allowance for doubtful accounts***

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments, based on assessments of customers' credit-risk profiles and payment histories. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

***Inventories***

Inventories are valued at the lower of cost (determined using the first-in, first-out method) or market. The Company provides reserves for inventories estimated to be excess, obsolete or unmarketable. The Company's estimation process for such reserves is based upon its known backlog, projected future demand and expected market conditions. If the Company's estimated demand and or market expectation were to change or if product sales were to decline, the Company's estimation process may cause larger inventory reserves to be recorded, resulting in larger charges to cost of revenues.

***Concentrations of credit risk***

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, short-term and long-term investments and trade accounts receivable. The Company maintains cash and cash equivalents and certain other financial instruments with various high credit, quality financial institutions. The Company's short-term and long-term investments consist of highly rated corporate debt securities. The Company's investment policy, approved by the Board of Directors, limits the amount the Company may invest in any one type of investment, thereby reducing credit risk concentrations. Concentrations of credit risk with respect to trade accounts receivable are limited due to the number of entities comprising the Company's customer base. Credit losses have consistently been within management's expectations.

***Goodwill and intangible assets***

The Company accounts for its goodwill and other intangible assets in accordance with FASB Statement No. 142, "Goodwill and Other Intangible Assets" (FAS 142), which resulted in the elimination of goodwill amortization beginning in fiscal 2002. The Company performs a test of goodwill for potential impairment at least annually. Values assigned to patents are amortized using the straight-line method over periods ranging from five to twenty years.

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

***Long-lived assets***

In accordance with FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", long-lived assets such as property, plant and equipment and intangible assets, are included in impairment evaluations when events or circumstances exist that indicate the carrying amount of those assets may not be recoverable. If the impairment evaluation indicates the affected asset is not recoverable, the asset's carrying value would be reduced to fair value. No event has occurred that would suggest any impairment in the value of long-lived assets recorded in the accompanying consolidated financial statements.

***Other investments***

The accounting for other investment transactions is reviewed for compliance with Accounting Principles Board Opinion No. 18, "The Equity Method for Accounting for Investments in Common Stock" (APB 18) and/or FASB Interpretation No. 46 — Revised (FIN 46R) "Consolidation of Variable Interest Entities". The Company periodically evaluates each investment to determine if there are any events or circumstances that are likely to have a significant adverse effect on the fair value of the investment. Examples of such impairment indicators include, but are not limited to: actual results of operations, actual results of operations compared to forecast, working capital requirements, additional third-party equity investment, if any, or a significant doubt about an investee's ability to continue as a going concern. If we identify an impairment indicator, we will estimate the fair value of the investment and compare it to its carrying value. If the fair value of the investment is less than its carrying value, the investment is impaired and we make a determination as to whether the impairment is other-than-temporary. For other-than-temporary impairments, we recognize an impairment loss equal to the difference between an investment's carrying value and its fair value. Impairment losses on investments are included in other income (expense), net in our consolidated statements of operations.

***Advertising expense***

The cost of advertising is expensed as incurred. The Company incurred \$2,473,000, \$1,913,000 and \$1,960,000 in advertising costs during 2006, 2005 and 2004, respectively.

***Product warranties***

The Company generally offers a two-year warranty for all of its products. The Company provides for the estimated cost of product warranties at the time product revenue is recognized. Factors that affect the Company's warranty reserves include the number of units sold, historical and anticipated rates of warranty returns and the cost per return. The Company periodically assesses the adequacy of the warranty reserves and adjusts the amounts as necessary. Warranty obligations are included in accrued expenses in the accompanying consolidated balance sheets.

VICOR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

*Net income (loss) per common share*

Basic and diluted income (loss) per share are calculated in accordance with FASB Statement No. 128, "Earnings per Share." The following table sets forth the computation of basic and diluted income (loss) per share (in thousands, except per share amounts):

	2006	2005	2004
<b>Numerator:</b>			
Net income (loss)	\$ (29,738)	\$ 3,916	\$ (3,723)
<b>Denominator:</b>			
Denominator for basic income (loss) per share — weighted average shares	41,839	41,923	42,022
<b>Effect of dilutive securities:</b>			
Employee stock options	—	166	—
Denominator for diluted income (loss) per share — adjusted weighted-average shares	41,839	42,089	42,022
Basic income (loss) per share	\$ (.71)	\$ .09	\$ (.09)
Diluted income (loss) per share	\$ (.71)	\$ .09	\$ (.09)

Options to purchase 1,643,629 and 3,035,350 shares of Common Stock in 2006 and 2004, respectively, were not included in the calculation of net loss per share as the effect would have been antidilutive. Options to purchase 1,213,679 shares of Common Stock were outstanding during 2005, but were not included in the computation of diluted income per share because the options' exercise prices were greater than the average market price of the Common Stock and, therefore, the effect would have been antidilutive.

*Income taxes*

The Company accounts for income taxes in accordance with FASB Statement No. 109, "Accounting for Income Taxes" (FAS 109). FAS 109 requires that deferred tax assets and liabilities are determined based on the differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted income tax rates and laws that are expected to be in effect when the temporary differences are expected to reverse. FAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. Additionally, deferred tax assets and liabilities are separated into current and noncurrent amounts based on the classification of the related assets and liabilities for financial reporting purposes or the expected reversal.

*Stock-based compensation*

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (FAS 123R), which is a revision of FAS No. 123, "Accounting for Stock-Based Compensation". FAS 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and amends SFAS No. 95, "Statement of Cash Flows". Generally, the approach in FAS 123(R) is similar to the approach described in FAS 123. However, FAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values at the date of grant. Pro forma disclosure is no longer an alternative.

The Company is using the modified prospective method as permitted under FAS 123(R). Under this transition method, compensation cost recognized in fiscal 2006 includes:  
(a) compensation cost for all share-

VICOR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

based payments granted prior to but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123, and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123(R). In accordance with the modified prospective method of adoption, Vicor's results of operations and financial position for prior periods have not been restated.

*Use of estimates*

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

*Comprehensive income*

The Company reports comprehensive income in accordance with FASB Statement No. 130, "Reporting Comprehensive Income" (FAS 130). FAS 130 requires the foreign currency translation adjustments related to VJCL and unrealized gains (losses) on short-term and long-term investments to be included in other comprehensive income, net of related income tax effects.

*Impact of recently issued accounting standards*

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", (FIN 48), an interpretation of FAS 109, "Accounting for Income Taxes". This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective starting January 1, 2007. The Company is in the process of evaluating the impact, if any, that FIN 48 will have on its financial position or results of operations.

In September 2006, the FASB issued statement of Financial Accounting Standards No. 157, "Fair Value Measurements", (FAS 157), which the Company must adopt for the fiscal year ending December 31, 2008. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. The Company has not determined the impact, if any, that FAS 157 will have on its financial position or results of operations.

**3. STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS**

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (FAS 123R), which is a revision of FAS No. 123, "Accounting for Stock-Based Compensation". FAS 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and amends SFAS No. 95, "Statement of Cash Flows". Generally, the approach in FAS 123(R) is similar to the approach described in FAS 123. However, FAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values at the date of grant. Pro forma disclosure is no longer an alternative.

The Company is using the modified prospective method as permitted under FAS 123(R). Under this transition method, compensation cost recognized in fiscal 2006 includes:  
(a) compensation cost for all share-

## VICOR CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**3. STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS (Continued)**

based payments granted prior to but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123, and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123(R). In accordance with the modified prospective method of adoption, Vicor's results of operations and financial position for prior periods have not been restated.

Prior to the adoption of FAS 123(R), the Company used the intrinsic value method in accounting for its employee stock options in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and related Interpretations, as permitted under FASB Statement No. 123, "Accounting for Stock-Based Compensation" (FAS 123) and FASB Statement No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure" (FAS 148). Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Vicor currently grants stock options under the following equity compensation plans that are shareholder-approved:

*Amended and Restated 2000 Stock Option and Incentive Plan (the "2000 Plan")* — Under the 2000 Plan, the Board of Directors or the Compensation Committee may grant stock incentive awards based on the Company's Common Stock, including stock options, stock appreciation rights, restricted stock, performance shares, unrestricted stock, deferred stock and dividend equivalent rights. Awards may be granted to employees and other key persons, including non-employee directors. Discretionary awards of stock options to non-employee directors shall be in lieu of any automatic grant of stock options under the Company's 1993 Stock Option Plan (the "1993 Plan") and the Company's 1998 Stock Option and Incentive Plan (the "1998 Plan"). Incentive stock options may be granted to employees at a price at least equal to the fair market value per share of the Common Stock on the date of grant, and non-qualified options may be granted to non-employee directors at a price at least equal to 85% of the fair market value of the Common Stock on the date of grant. A total of 4,000,000 shares of Common Stock have been reserved for issuance under the 2000 Plan. The period of time during which an option may be exercised and the vesting periods are determined by the Compensation Committee. The term of each option may not exceed ten years from the date of grant.

*1998 Stock Option and Incentive Plan (the "1998 Plan")* — The 1998 Plan permitted the grant of share options to its employees and other key persons, including non-employee directors for up to 2 million shares of common stock. As a result of the approval of the 2000 Plan, no further grants were made under the 1998 Plan.

*1993 Stock Option Plan (the "1993 Plan")* — The 1993 Plan permitted the grant of share options to its employees and non-employee directors for up to 4 million shares of common stock. As a result of the approval of the 2000 Plan, no further grants were made under the 1993 Plan.

Picor Corporation ("Picor"), a privately held majority owned subsidiary of Vicor, currently grants stock options under the following equity compensation plan that has been approved by its Board of Directors:

*2001 Stock Option and Incentive Plan, as amended (the "2001 Picor Plan")* — The 2001 Picor Plan permits the grant of share options to its employees and other key persons, including non-employee directors and full or part-time officers, for up to 10 million shares of common stock.

All option awards are granted at an exercise price equal to or greater than the market price for Vicor at the date of the grant, and are granted at the fair market value for Picor at the date of grant. Options vest over various periods of up to five years and may be exercised for up to ten years from the date of grant, which is

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS (Continued)**

the maximum contractual term. The Company uses the graded attribution method to recognize expense for all stock-based awards in accordance with FAS 123(R).

As a result of adopting FAS 123(R), the Company recorded \$751,000 of non-cash stock-based compensation for the year ended December 31, 2006. The stock-based compensation included \$85,000 in cost of revenues, \$385,000 in selling, general and administrative expense, and \$281,000 in research and development expense, respectively, for the year ended December 31, 2006. The compensation expense did not have a material impact on basic or diluted net income per share.

Had expense been recognized using the fair value method described in FAS 123, using the Black-Scholes option pricing model, the following pro forma results of operations would have been reported (in thousands except for per share information):

	<u>Years Ended December 31,</u>	
	<u>2005</u>	<u>2004</u>
Net income (loss), as reported	\$ 3,916	\$ (3,723)
Total stock-based employee compensation expense determined under fair-value based methods for all awards, net of related tax effects	(845)	(1,983)
<b>Pro forma net income (loss)</b>	<b>\$ 3,071</b>	<b>\$ (5,706)</b>
Net income (loss) per share, as reported:		
Basic	\$ .09	\$ (.09)
Diluted	\$ .09	\$ (.09)
<b>Pro forma net income (loss) per share:</b>		
Basic	\$ .07	\$ (.14)
Diluted	\$ .07	\$ (.14)

The above table includes compensation expense for Picor options of \$105,000 and \$96,000 for the years ended December 31, 2005 and 2004, respectively. The 2005 and 2004 expense have been revised to include these Picor amounts. The fair value of Picor common stock was estimated by obtaining an independent valuation of Picor.

The fair value for the options was estimated at the date of grant using a Black-Scholes option pricing model under both methods with the following weighted-average assumptions:

<b>Vicor:</b>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Risk-free interest rate	4.7%	3.9%	3.4%
Expected dividend yield	1.50%	.38%	—
Expected volatility	.53	.59	.68
Expected lives	3.8 years	4.0 years	4.0 years
<b>Picor:</b>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Risk-free interest rate	5.1%	4.4%	4.4%
Expected dividend yield	—	—	—
Expected volatility	.48	.43	.43
Expected lives	6.5 years	6.5 years	6.5 years



VICOR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS (Continued)

**Risk-free interest rate:**

*Vicor* — The Company uses the yield on zero-coupon U.S. Treasury Strip securities for a period that is commensurate with the expected term assumption for each vesting period.

*Picor* — The Company uses the yield to maturity of a ten-year treasury bond, since all of *Picor*'s options expire ten years after they are granted.

**Expected dividend yield:**

*Vicor* — The Company determines the expected dividend yield by annualizing the most recent prior cash dividends declared by the Company's Board of Directors and dividing that result by the closing stock price on the date of that dividend declaration. Because the Company historically has not paid regular periodic dividends and has not committed to do so in the future, the Company annualizes the most recent prior cash dividends based on its expectations at the time regarding the frequency of dividends to be declared over the next twelve months. Dividends are not paid on options.

*Picor* — *Picor* has not and does not expect to declare and pay dividends in the foreseeable future. Therefore, the expected dividend yield is not applicable.

**Expected volatility:**

*Vicor* — Under FAS 123, *Vicor* used historical volatility to estimate the grant-date fair value of the options. Under FAS 123(R), *Vicor* has elected to continue to use historical volatility, using the expected term for the period over which to calculate the volatility (see below). The Company does not expect its future volatility to differ from its historical volatility. The computation of the Company's volatility is based on a simple average calculation of monthly volatilities over the expected term.

*Picor* — As *Picor* is a nonpublic entity, historical volatility information is not available. As permitted under FAS 123(R), an industry sector index of approximately 40 publicly traded fabless semiconductor firms was developed for calculating historical volatility for *Picor*. Historical prices for each of the companies in the index based on the market price of the shares on each day of trading over the expected term were used to determine the historical volatility.

**Expected term:**

*Vicor* — The Company uses historical employee exercise and option expiration data to estimate the expected term assumption for the Black-Scholes grant-date valuation. The Company believes that this historical data is currently the best estimate of the expected term of options, and that generally all groups of our employees exhibit similar exercise behavior.

*Picor* — Due to the lack of historical information, the "simplified" method prescribed by the Securities and Exchange Commission's Staff Accounting Bulletin No. 107 was used to determine the expected term.

**Forfeiture rate**

*Vicor* — The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. FAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is distinct from "cancellations" or "expirations" and represents only the unvested portion of the surrendered option. The Company currently expects, based on an analysis of its historical forfeitures, that approximately 84% of its options will actually vest, and therefore has applied an

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS (Continued)**

annual forfeiture rate of 5.75% to all unvested options as of December 31, 2006. This analysis will be re-evaluated quarterly and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

*Picor* — Since the compensation expense for years ended December 31, 2006 and 2005 was immaterial, the Company did not apply an estimated forfeiture rate to the compensation expense.

**Vicor Stock Options**

A summary of the activity under Vicor's stock option plans as of December 31, 2006 and changes during the year then ended, is presented below (in thousands except for share and weighted-average data):

	Options Outstanding	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at December 31, 2003	3,809,603	\$ 18.28		
Granted	63,880	\$ 13.58		
Forfeited and expired	(595,046)	\$ 22.55		
Exercised	(243,087)	\$ 9.65		
Outstanding at December 31, 2004	3,035,350	\$ 18.04		
Granted	78,160	\$ 14.04		
Forfeited and expired	(475,964)	\$ 23.78		
Exercised	(377,298)	\$ 9.47		
Outstanding at December 31, 2005	2,260,248	\$ 18.14		
Granted	117,860	\$ 17.95		
Forfeited and expired	(298,635)	\$ 25.84		
Exercised	(435,844)	\$ 12.78		
Outstanding at December 31, 2006	<u>1,643,629</u>	\$ 18.14	2.98	\$ 656
Exercisable at December 31, 2006	<u>1,418,885</u>	\$ 18.63	2.49	\$ 542
Vested or expected to vest at December 31, 2006(1)	<u>1,623,717</u>	\$ 18.16	2.93	\$ 651

(1) In addition to the vested options, the Company expects a portion of the unvested options to vest at some point in the future. Options expected to vest is calculated by applying an estimated forfeiture rate to the unvested options.

As of December 31, 2005 and 2004 the Company had shares exercisable of 1,918,674 and 2,385,819, respectively, for which the weighted average exercise prices were \$19.30 and \$19.44, respectively.

During the years ended December 31, 2006, 2005 and 2004 under all plans, the total intrinsic value of Vicor options exercised (i.e. the difference between the market price at exercise and the price paid by the employee to exercise the options) was \$3,051,000, \$2,027,000 and \$1,477,000, respectively. The total amount of cash received by the Company from exercise of options exercised in 2006 was \$5,570,000. The total grant-date fair value of stock options that vested during the years ended December 31, 2006, 2005 and 2004 was approximately \$1,421,000, \$3,036,000, and \$5,793,000, respectively.

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS (Continued)**

As of December 31, 2006, there was \$792,000 of total unrecognized compensation cost related to unvested share-based awards for Vicor. That cost is expected to be recognized over a weighted-average period of 1.62 years for all Vicor awards. The expense will be recognized as follows: \$407,000 in 2007, \$216,000 in 2008, \$111,000 in 2009, \$50,000 in 2010, and \$8,000 in 2011.

The weighted-average fair value of Vicor options granted was \$6.54, \$7.02 and \$7.05 in 2006, 2005 and 2004, respectively. The weighted-average contractual life for Vicor options outstanding as of December 31, 2006 is 3 years.

**Picor Stock Options**

Under the Picor Corporation 2001 Stock Option and Incentive Plan (the "2001 Picor Plan"), the Board of Directors of Picor Corporation ("Picor") may grant stock incentive awards based on the Picor Common Stock, including stock options, restricted stock or unrestricted stock. Awards may be granted to employees and other key persons, including non-employee directors and full or part-time officers. Incentive stock options may be granted to employees at a price at least equal to the fair market value per share of the Picor Common Stock, based on judgments made by the Company, on the date of grant. A total of 10,000,000 shares of Picor Common Stock have been reserved for issuance under the 2001 Picor Plan. The period of time during which an option may be exercised and the vesting periods are determined by the Picor Board of Directors. The term of each option may not exceed ten years from the date of grant.

A summary of the activity under Picor's stock option plan as of December 31, 2006 and changes during the year then ended, is presented below (in thousands except for share and weighted-average data):

	<u>Options Outstanding</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Life in Years</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at December 31, 2003	2,782,820	\$ 0.36		
Granted	577,200	\$ 0.75		
Forfeited and expired	(70,020)	\$ 0.31		
Exercised	—	—		
Outstanding at December 31, 2004	3,290,000	\$ 0.43		
Granted	212,000	\$ 0.75		
Forfeited and expired	(60,000)	\$ 0.25		
Exercised	—	—		
Outstanding at December 31, 2005	3,442,000	\$ 0.45		
Granted	1,040,500	\$ 0.85		
Forfeited and expired	(147,960)	\$ 0.31		
Exercised	(30,000)	\$ 0.25		
Outstanding at December 31, 2006	<u>4,304,540</u>	\$ 0.55	6.92	\$ 1,402
Exercisable at December 31, 2006	<u>2,269,704</u>	\$ 0.39	5.77	\$ 1,117
Vested or expected to vest at December 31, 2006 (1)	<u>4,304,540</u>	\$ 0.55	6.92	\$ 1,402

(1) In addition to the vested options, the Company expects a portion of the unvested options to vest at some point in the future. Options expected to vest is calculated by applying an estimated forfeiture rate to the unvested options.

VICOR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**3. STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS (Continued)**

All Picor share and per share data have been restated to reflect a four-for-one stock split of Picor Common Stock effected in the form of a stock dividend and authorized by the Picor Board of Directors on March 6, 2006.

As of December 31, 2005 and 2004 the Company had shares exercisable of 1,683,280 and 1,049,280, respectively, for which the weighted average exercise prices were \$0.36 and \$0.31, respectively.

During the year ended December 31, 2006, under all plans, the total intrinsic value of Picor options exercised (i.e. the difference between the market price at exercise and the price paid by the employee to exercise the options) was \$19,000 (none in 2005 and 2004). The total amount of cash received by the Company from exercise of options exercised in 2006 was \$7,000. The total grant-date fair value of stock options that vested during the years ended December 31, 2006, 2005 and 2004 was approximately \$111,000, \$101,000 and \$65,000 respectively.

As of December 31, 2006, there was \$517,000 of total unrecognized compensation cost related to unvested share-based awards for Picor. That cost is expected to be recognized over a weighted-average period of 1.87 years for all Picor awards. The expense will be recognized as follows: \$170,000 in 2007, \$142,000 in 2008, \$92,000 in 2009, \$79,000 in 2010, and \$34,000 in 2011.

The weighted-average fair value of Picor options granted was \$.37, \$.32 and \$.33 in 2006, 2005 and 2004, respectively. The weighted-average contractual life for Picor options outstanding as of December 31, 2006 is 7 years.

**401(k) Plan**

The Company sponsors a savings plan available to all domestic employees, which qualifies under Section 401(k) of the Internal Revenue Code. Employees may contribute to the plan from 1% to 20% of their pre-tax salary subject to statutory limitations. The Company matches employee contributions to the plan at a rate of 50% up to the first 3% of an employee's compensation. The Company's matching contributions currently vest at a rate of 20% per year based upon years of service. The Company's contribution to the plan was approximately \$684,000, \$622,000 and \$628,000 in 2006, 2005 and 2004, respectively.

**Stock Bonus Plan**

Under the Company's 1985 Stock Bonus Plan, as amended, shares of Common Stock may be awarded to employees from time to time as determined by the Board of Directors. At December 31, 2006, 109,964 shares were available for further award. All shares awarded to employees under this plan have vested. No further awards are contemplated under this plan at the present time.

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**4. SHORT-TERM AND LONG-TERM INVESTMENTS**

The following is a summary of available-for-sale securities (in thousands):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>December 31, 2006</b>				
U.S. corporate securities	\$ 25,933	\$ —	\$ (7)	\$ 25,926
Obligations of states and political subdivisions	56,477	—	(2)	56,475
	<u>\$ 82,410</u>	<u>\$ —</u>	<u>\$ (9)</u>	<u>\$ 82,401</u>
<b>December 31, 2005</b>				
U.S. corporate securities	\$ 35,301	\$ —	\$ (261)	\$ 35,040
Obligations of states and political subdivisions	57,025	—	(25)	57,000
	<u>\$ 92,326</u>	<u>\$ —</u>	<u>\$ (286)</u>	<u>\$ 92,040</u>

The amortized cost and estimated fair value of debt securities at December 31, 2006, by contractual maturities, are shown below (in thousands):

	Cost	Estimated Fair Value
Due in one year or less	\$ 3,552	\$ 3,552
Due in one year to two years	2,232	2,232
Due after two years	76,626	76,617
	<u>\$ 82,410</u>	<u>\$ 82,401</u>

At December 31, 2006, the Company held available-for-sale securities with an aggregate fair value of approximately \$2,996,000 that have been in a continuous unrealized loss position for less than twelve months, with aggregate gross unrealized losses of approximately \$2,000. At December 31, 2006, the Company held available-for-sale securities with an aggregate fair value of approximately \$4,128,000 that have been in a continuous unrealized loss position for more than twelve months, with aggregate gross unrealized losses of approximately \$7,000. The Company believes that the impairment to those investments are not other-than-temporary at this time as these corporate debt securities are all highly rated investments which have been subject to routine market changes that have not been significant to date and the Company has the ability and intent to hold the investments through a period of market recovery.

**5. INVENTORIES**

Inventories were as follows (in thousands):

	December 31,	
	2006	2005
Raw materials	\$ 23,805	\$ 21,519
Work-in-process	2,319	2,502
Finished goods	4,240	3,838
	30,364	27,859
Inventory reserves	(8,363)	(10,691)
	<u>\$ 22,001</u>	<u>\$ 17,168</u>

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INVENTORIES (Continued)**

During the fourth quarter of 2006, the Company disposed of and wrote-off approximately \$2,700,000 of obsolete inventory which had been fully reserved.

**6. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment are stated at cost and are depreciated and amortized over a period of 3 to 31.5 years generally under the straight-line method for financial reporting purposes and accelerated methods for income tax purposes.

Property, plant and equipment were as follows (in thousands):

	December 31,	
	2006	2005
Land	\$ 2,089	\$ 2,089
Buildings and improvements	40,691	40,575
Machinery and equipment	174,570	167,865
Furniture and fixtures	5,571	5,514
Construction-in-progress	391	2,383
	<u>223,312</u>	<u>218,426</u>
Less accumulated depreciation and amortization	171,739	159,312
	<u>\$ 51,573</u>	<u>\$ 59,114</u>

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 was approximately \$13,123,000 \$16,790,000, and \$20,334,000 respectively.

At December 31, 2006, the Company had approximately \$1,104,000 of capital expenditure commitments.

**7. INVESTMENTS**

In August 2003, the Board of Directors approved the investment by the Company of \$1,000,000 in non-voting preferred stock of Great Wall Semiconductor Corporation ("GWS"). In March and August 2004, the Audit Committee of the Board of Directors approved additional investments by the Company of \$1,000,000 each for a total 2004 investment of \$2,000,000 in non-voting preferred stock of GWS. The Company's total investment in GWS was \$3,000,000 as of December 31, 2006 and 2005. In 2006, GWS granted Vicor stock options for 2,700,000 shares of non-voting common stock, the value of which was not considered to be material. The options vest at the point at which the Company has provided a specified value of technical consulting services, which is not material, to GWS. A director of Vicor is founder, president and a shareholder of GWS. GWS is majority owned and controlled by an unrelated company. In addition to the investment, the Company and GWS have entered into a cross-license agreement and the Company purchases certain components from GWS. Revenues under the cross-license agreement and purchases from GWS were not significant in 2006, 2005 or 2004.

The Company considered the requirements of FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R), in accounting for the additional investments in GWS, and determined that GWS is not a variable interest entity. As a result, the Company has accounted for the investment under Accounting Principles Board Opinion No. 18, "The Equity Method for Accounting for Investments in Common Stock" (APB 18), as a cost method investment as management believes it does not have significant influence over GWS. The investment in GWS is included in other assets in the accompanying consolidated balance sheets. The Company periodically evaluates the investment in GWS to determine if there

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**7. INVESTMENTS (Continued)**

are any events or circumstances that are likely to have a significant adverse effect on the fair value of the investment. Examples of such impairment indicators include, but are not limited to: GWS' actual results of operations, actual results of operations compared to forecast, working capital requirements, additional third-party equity investment, if any, or a significant doubt about an investee's ability to continue as a going concern. If we identify an impairment indicator, we will estimate the fair value of the investment and compare it to its carrying value. If the fair value of the investment is less than its carrying value, the investment is impaired and we make a determination as to whether the impairment is other-than-temporary. For other-than-temporary impairments, we recognize an impairment loss equal to the difference between an investment's carrying value and its fair value. Impairment losses on these investments are included in other income (expense), net in our consolidated statements of operations. In the fourth quarter of 2006, the investment was adjusted for a decline in value judged to be other than temporary of \$1,000,000. Deterioration or changes in GWS' business in the future could lead to such impairment adjustments in future periods.

**8. GOODWILL AND OTHER INTANGIBLE ASSETS**

The Company accounts for goodwill and other intangible assets under Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" (FAS 142). Under FAS 142, goodwill and indefinite lived intangible assets are not amortized but are tested for impairment at least annually at the reporting unit level. The Company reassessed the carrying value of its goodwill of approximately \$2,000,000 related to the operations of one of its subsidiaries, VJCL, during the fourth quarter of fiscal 2006 as required by the provisions of FAS 142, and determined that there was no impairment to the carrying value. The Company has no other goodwill on the balance sheet at December 31, 2006 and 2005.

Patent costs, which are included in other assets in the accompanying balance sheets, were as follows, (in thousands):

	December 31,	
	2006	2005
Patent costs	\$ 4,042	\$ 5,701
Less accumulated amortization	1,630	2,429
	<u>\$ 2,412</u>	<u>\$ 3,272</u>

In 2006 the Company wrote off patent costs associated with abandoned patents with a net book value of approximately \$785,000, which was charged to amortization expense.

Amortization expense was approximately \$1,036,000, \$292,000 and \$564,000 in 2006, 2005 and 2004, respectively. The estimated amortization expense for the next five years is as follows (in thousands):

Year	
2007	\$ 239
2008	229
2009	228
2010	226
2011	219

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. PRODUCT WARRANTIES**

Product warranty activity for the years ended December 31, 2006, 2005 and 2004 were as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance at the beginning of the period	\$ 755	\$ 1,042	\$ 1,268
Accruals for warranties for products sold in the period	714	173	301
Fulfillment of warranty obligations	(185)	(180)	(120)
Revisions of estimated obligations	(238)	(280)	(407)
Balance at the end of the period	<u>\$ 1,046</u>	<u>\$ 755</u>	<u>\$ 1,042</u>

**10. STOCKHOLDERS' EQUITY**

In November 2000, the Board of Directors of the Company authorized the repurchase of up to \$30,000,000 of the Company's Common Stock (the "November 2000 Plan"). The plan authorizes the Company to make repurchases from time to time in the open market or through privately negotiated transactions. The timing of this program and the amount of the stock that may be repurchased is at the discretion of management based on its view of economic and financial market conditions. In 2006 and 2005, the Company spent \$10,835,000 and \$5,544,000, respectively, in the repurchase of 825,700 and 452,200 shares, respectively, of its Common Stock under the November 2000 Plan. At December 31, 2006, the Company had approximately \$8,541,000 remaining under the plan.

**Common Stock**

Each share of Common Stock entitles the holder thereof to one vote on all matters submitted to the stockholders. Each share of Class B Common Stock entitles the holder thereof to ten votes on all such matters.

Shares of Class B Common Stock are not transferable by a stockholder except to or among the stockholder's spouse, certain of the stockholder's relatives, and certain other defined transferees. Class B Common Stock is not listed or traded on any exchange or in any market. Class B Common Stock is convertible at the option of the holder thereof at any time and without cost to the stockholder into shares of Common Stock on a one-for-one basis.

Dividends are declared at the discretion of the Company's Board of Directors and depend on actual cash from operations, the Company's financial condition and capital requirements and any other factors the Company's Board of Directors may consider relevant.

On June 24, 2005, the Company's Board of Directors approved an annual cash dividend for 2005 of \$.12 per share of the Company's stock. The total dividend of approximately \$5,025,000 was paid on August 31, 2005 to shareholders of record at the close of business on August 11, 2005.

On February 4, 2006, the Company's Board of Directors approved a cash dividend of \$.12 per share of the Company's stock. The total dividend of approximately \$5,030,000 was paid on March 20, 2006 to shareholders of record at the close of business on February 28, 2006.

On June 23, 2006, the Company's Board of Directors approved a cash dividend of \$.15 per share of the Company's stock. The total dividend of approximately \$6,313,000 was paid on August 7, 2006 to shareholders of record at the close of business on July 17, 2006.

On February 16, 2007 the Company's Board of Directors approved a cash dividend of \$.15 per share of the Company's stock. The dividend of approximately \$6,235,000 is payable on March 27, 2007 to shareholders of record at the close of business on March 9, 2007.



**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. STOCKHOLDERS' EQUITY (Continued)**

During 2006 a total of 435,844 shares of Common Stock were issued upon the exercise of stock options, and no shares of Class B Common Stock were converted into Common Stock.

At December 31, 2006, there were 17,290,399 shares of Vicor Common Stock reserved for issuance under Vicor stock options and upon conversion of Class B Common Stock.

**11. OTHER INCOME (EXPENSE), NET**

The major components of the other income (expense), net were as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Interest income	\$ 5,389	\$ 3,124	\$ 1,764
Other than temporary decline in investments	(1,000)	—	(70)
Minority interest in net income of subsidiaries	(562)	(807)	(527)
Foreign currency gains (losses)	139	(771)	268
Gain (loss) on disposal of equipment	67	(41)	(47)
Other	59	(5)	244
	<u>\$ 4,092</u>	<u>\$ 1,500</u>	<u>\$ 1,632</u>

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**12. INCOME TAXES**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows (in thousands):

	December 31,	
	2006	2005
<b>Deferred tax assets:</b>		
Accrual for litigation settlement, net	\$ 15,319	\$ —
Research and development tax credit carryforwards	5,231	2,451
Inventory reserves	3,385	4,351
Net operating loss carryforwards	2,452	4,767
Investment basis differences	1,236	824
Vacation accrual	1,163	1,019
Investment tax credit carryforwards	892	1,493
Stock-based compensation	509	—
Alternative minimum tax credit carryforward	359	—
Warranty reserve	352	206
Bad debt reserves	233	236
Other	817	616
Total deferred tax assets	31,948	15,963
Less: Valuation allowance for deferred tax assets	(26,565)	(8,050)
Net deferred tax assets	5,383	7,913
<b>Deferred tax liabilities:</b>		
Depreciation	(4,381)	(6,279)
Patent amortization	(993)	(1,347)
Other	(696)	(786)
Total deferred tax liabilities	(6,070)	(8,412)
Net deferred tax liabilities	\$ (687)	\$ (499)

The Company has assessed the need for a valuation allowance against its deferred tax assets and concluded that a valuation allowance for a portion of the deferred tax assets is warranted at December 31, 2006 and 2005. In reaching this conclusion, the Company evaluated all relevant criteria including the existence of temporary differences reversing in the carryforward period, primarily depreciation. The valuation allowance against these deferred tax assets may require adjustment in the future based on changes in the mix of temporary differences, changes in tax laws, and operating performance.

For financial reporting purposes, income (loss) before income taxes includes the following components (in thousands):

	2006	2005	2004
Domestic	\$ (30,023)	\$ 5,073	\$ (3,311)
Foreign	933	(193)	908
	<u>\$ (29,090)</u>	<u>\$ 4,880</u>	<u>\$ (2,403)</u>

**VICOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**12. INCOME TAXES (Continued)**

Significant components of the provision (benefit) for income taxes are as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
<b>Current:</b>			
Federal	\$ 377	\$ 942	\$ 1,075
Foreign	105	75	185
State	80	80	60
	<u>562</u>	<u>1,097</u>	<u>1,320</u>
<b>Deferred:</b>			
Federal	86	(133)	—
	<u>\$ 648</u>	<u>\$ 964</u>	<u>\$ 1,320</u>

The reconciliation of the federal statutory rate to the effective income tax rate is as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Statutory federal tax rate	(35.0)%	35.0%	(35.0)%
State income taxes, net of federal income tax benefit	(3.4)	2.5	(1.8)
Tax credits	(3.4)	—	—
Meals and entertainment expense	0.6	2.9	5.5
Foreign income taxes	0.4	2.3	2.1
ETI benefit	(1.2)	(11.5)	—
Reduction in tax reserves	(0.5)	(7.3)	—
Alternative minimum tax	—	5.5	1.6
Other	1.2	0.1	—
Increase (decrease) in valuation allowance	43.5	(9.7)	82.5
	<u>2.2%</u>	<u>19.8%</u>	<u>54.9%</u>

Tax provisions in 2006, 2005 and 2004 have been provided for federal and state taxes for certain minority-owned subsidiaries that are not part of the Company's consolidated income tax returns, for the federal alternative minimum tax and for estimated income taxes due in various state and international taxing jurisdictions. In the third quarter of 2006, the Company reduced its tax reserves by \$468,000 due to closing tax periods in certain jurisdictions. In the third quarter of 2005, the Company reduced its tax reserves by \$770,000 due to closing tax periods in certain jurisdictions. The decreases in 2006 and 2005 were offset by increases in reserves during the year of approximately \$133,000 and \$412,000, respectively for potential liabilities. During the third quarter of 2004, the Company provided additional tax expense for potential liabilities related to certain jurisdictions under examination aggregating \$950,000, partially offset by a reduction in the tax reserves for certain jurisdictions due to tax periods closing aggregating \$650,000.

As a result of the difference in treatment of excess stock option deductions available for income tax return and financial statement reporting purposes, the Company has approximately \$3,900,000 of stock option related net operating loss, \$800,000 of federal research and development tax credit, and \$359,000 of federal alternative minimum tax credit carryforwards that may be offset against future taxable income. It is anticipated that when these tax attributes are realized on an income tax return in the future, the related benefit will be recorded against additional paid in capital. The net operating loss carryforwards expire beginning in 2007 for state purposes and in 2023 for federal purposes. The research and development tax credit carryforwards expire beginning in 2015 for state purposes and in 2023 for federal purposes.

## VICOR CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**12. INCOME TAXES (Continued)**

The Company operates in numerous taxing jurisdictions and is, therefore, subject to a variety of income and related taxes. The Company has provided for potential tax liabilities due in various jurisdictions which it judges to be probable and reasonably estimable in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies". Judgment is required in determining the income tax expense and related tax liabilities. In the ordinary course of business, there are transactions and calculations where the ultimate tax outcome is uncertain. The Company believes it has reasonably estimated its accrued taxes for all jurisdictions for all open tax periods. The Company periodically assesses the adequacy of its tax and related accruals on a quarterly basis and adjusts appropriately as events warrant and open tax periods close. It is possible that the final tax outcome of these matters will be different from management's estimate reflected in the income tax provisions and accrued taxes. Such differences could have a material impact on the Company's income tax provision and operating results in the period in which such determination is made.

The Company recently underwent an audit of its federal tax returns for tax periods 1994 through 2002 by the Internal Revenue Service ("IRS"). The conclusions reached by the IRS based on their audit were agreed to by the Joint Committee on Taxation of the U.S. Department of the Treasury. During the second quarter of 2006, the Company remitted payments to the IRS in settlement of the assessments, including interest. The amounts paid were not materially different from the amounts previously accrued by the Company.

**13. COMMITMENTS AND CONTINGENCIES**

The Company leases certain of its office, warehousing and manufacturing space. The future minimum rental commitments under noncancelable operating leases with remaining terms in excess of one year are as follows (in thousands):

Year	
2007	\$ 1,383
2008	813
2009	475
2010	305
2011 and thereafter	40

Rent expense was approximately \$1,471,000, \$1,420,000 and \$1,346,000 in 2006, 2005 and 2004, respectively. The Company also pays executory costs such as taxes, maintenance and insurance.

In addition, the Company has a contract with a third-party to supply nitrogen for its manufacturing and research and development activities. Under the contract, the Company is obligated to pay a minimum of \$286,000 annually, subject to semi-annual price adjustments, through March 2015.

Vicor and VLT, Inc. ("VLT"), a wholly owned subsidiary of the Company, are pursuing Reset Patent infringement claims directly against Artesyn Technologies, Lucent Technologies and Tyco Electronics Power Systems, Inc. in the United States District Court in Boston, Massachusetts. The lawsuit against Lucent was filed in May 2000 and in April 2001, the Company added Tyco Electronics as a defendant in that lawsuit. The lawsuit against Artesyn was filed in February 2001. In January 2003, the District Court issued a pre-trial decision in each of these patent infringement lawsuits relating to claim construction of the Reset Patent. The District Court's decisions rejected assertions that the Reset Patent claims are invalid for indefiniteness; and affirmed Vicor's interpretation of several terms used in the Reset Patent claims. However, the District Court adopted interpretations of certain terms of the Reset Patent claims that are contrary to Vicor's position. On May 24, 2004, the United States Court of Appeals for the Federal Circuit affirmed the decisions issued in January 2003 by the District Court. Vicor believes that the District Court's decisions, and the affirmation of these decisions by the Federal Circuit, strengthens its position regarding validity of the patent, but reduces the cumulative amount of infringing power supplies and the corresponding amount of potential damages. The

## VICOR CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**13. COMMITMENTS AND CONTINGENCIES (Continued)**

Federal Circuit has referred the proceedings back to the District Court for trials on validity of the Reset Patent and infringement and damages by Lucent and Tyco, and Artesyn. In June 2006, Artesyn and Lucent and Tyco filed motions to dismiss VLT's remanded cases against them. On January 3, 2007, the Court denied Artesyn's motion and set a trial date for March 12, 2007, but granted the Lucent and Tyco motion in part, dismissing VLT's case. On January 9, 2007, in response to the Court's order of dismissal, VLT filed a new action against Lucent and Tyco alleging infringement of VLT's 36,098 patent. In addition, on January 22, 2007, VLT filed a motion requesting the Court to withdraw its order of dismissal in the Lucent and Tyco case. In response to the Company and Artesyn informing the Court that a tentative settlement has been reached between them, the Court has subsequently dismissed the Artesyn case, allowing either party to reopen the action within 60 days if the tentative settlement is not consummated. The District Court has not yet set a date for the remaining trial. There can be no assurance that Vicor and VLT will ultimately prevail with respect to any of these claims or, if they prevail, as to the amount of damages that would be awarded.

In the second quarter of 2005, the Company entered into a settlement agreement with Lambda Americas, Inc., successor to Lambda Electronics, Inc., under which the Company received a payment of \$2,500,000 in full settlement of the Company's Reset Patent claims against Lambda and which settled the lawsuit that the Company had filed against Lambda in June 2001. The full amount of the payment, net of a \$250,000 contingency fee paid by the Company to its litigation counsel, has been included in gain from litigation-related settlement, net in the accompanying consolidated statements of operations.

In May 2004, Ericsson Wireless Communications, Inc. v. Vicor Corporation was filed in Superior Court of the State of California, County of San Diego. The plaintiff has brought an action against the Company seeking compensatory damages and lost profits with respect to post warranty contract and tort claims for products previously purchased by it from the Company. In November 2004, the plaintiff filed a First Amended Complaint adding claims against Exar Corporation, a former vendor of the Company. The Company filed cross-claims against Exar, and third-party claims against Rohm Device USA, LLC and Rohm Co., Ltd., the original manufacturer(s) of a component that Exar sold to the Company, which was included in the product subsequently sold by the Company to the plaintiff.

On February 22, 2007, the Company announced that it has reached an agreement in principle with Ericsson, Inc., to settle a lawsuit brought by Ericsson against the Company in California state court. Under the terms of the settlement agreement, reached on February 16, 2007 after a Court ordered mediation, the Company agreed to pay \$50.0 million to Ericsson, of which \$12.8 million will be paid by the Company's insurance carriers. The Company's decision to enter into the settlement followed an adverse ruling by the Court in January in connection with a settlement between Ericsson and co-defendants Exar Corporation and Rohm Device USA, LLC, two of the Company's component suppliers prior to 2002. The Company strongly disagrees with the ruling, which it is appealing. Although a successful appeal would enable the Company to seek recoveries from Exar and Rohm, there is no assurance that it will be successful in the appeal. In light of this ruling and after taking into consideration the possibility of further recoveries from the insurance carriers, the Company decided to settle the Ericsson case at this time. Accordingly, the Company recorded a net loss of \$37.2 million from litigation-related settlement in the fourth quarter of 2006.

On August 18, 2005, the Company filed an action in The Superior Court of the Commonwealth of Massachusetts, County of Essex ("the Massachusetts Court") against Concurrent Computer Corporation ("Concurrent") in response to a demand made by Concurrent in connection with breach of contract and breach of product warranty claims against the Company. On September 22, 2005, Concurrent filed a Demand For Arbitration with The American Arbitration Association. Concurrent is seeking \$1,500,000 in replacement costs, plus incidental, consequential and any other damages to be determined. On March 8, 2006 the Massachusetts Court allowed Concurrent's motion to compel arbitration. Vicor appealed the motion to compel arbitration decision, but on February 20, 2007, that motion was denied. The arbitration panel has set the matter

VICOR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. COMMITMENTS AND CONTINGENCIES (Continued)

for discovery with a hearing date of October, 2007. The Company has denied the claims made against it and intends to vigorously defend the claims made against it.

In addition, the Company is involved in certain other litigation and claims incidental to the conduct of its business. While the outcome of lawsuits and claims against the Company cannot be predicted with certainty, management does not expect any current litigation or claims to have a material adverse impact on the Company's financial position or results of operations.

14. SEGMENT INFORMATION

Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" (FAS 131), establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information of those segments to be presented in interim financial reports issued to stockholders. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions on how to allocate resources and assess performance. The Company's chief decision maker, as defined under FAS 131, is the chief executive officer. The Company operates in one industry segment: the development, manufacture and sale of power conversion components and systems. During 2006, 2005 and 2004, no customer accounted for more than 10% of net revenues. Export sales, as a percentage of total net revenues, were approximately 37%, 42% and 41% in 2006, 2005 and 2004, respectively. Export sales and receipts are recorded and received in U.S. dollars.

15. QUARTERLY RESULTS OF OPERATIONS (Unaudited)

The following table sets forth certain unaudited quarterly financial data (in thousands, except per share amounts):

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Total</u>
<b>2006:</b>					
Net revenues	\$ 47,872	\$ 49,210	\$ 46,932	\$ 48,033	\$ 192,047
Gross profit	21,102	21,109	19,951	19,674	81,836
Net income (loss)	3,076	2,874	2,462	(38,150)	(29,738)
Net income (loss) per share:					
Basic and diluted	.07	.07	.06	(.92)	(.71)
<b>2005:</b>					
Net revenues	\$ 43,180	\$ 44,579	\$ 45,298	\$ 46,294	\$ 179,351
Gross profit	17,045	15,579	19,014	19,769	71,407
Net income	39	89	1,708	2,080	3,916
Net income per share:					
Basic and diluted	.00	.00	.04	.05	.09

On February 22, 2007, the Company announced that it has reached an agreement in principle with Ericsson, Inc., to settle a lawsuit brought by Ericsson against the Company in California state court. Under the terms of the settlement agreement, reached on February 16, 2007 after a Court ordered mediation, the Company agreed to pay \$50.0 million to Ericsson, of which \$12.8 million will be paid by the Company's insurance carriers. Accordingly, the Company recorded a net loss of \$37.2 million from litigation-related settlement in the fourth quarter of 2006.

In the fourth quarter of 2006, the Company's investment in Great Wall Semiconductor Corporation was adjusted for a decline in value judged to be other than temporary of \$1,000,000.

**ITEM 9 — CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A — CONTROLS AND PROCEDURES**

Attached as exhibits to this Form 10-K are certifications of Vicor's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), which are required in accordance with Rule 13a-14 of the Exchange Act of 1934, as amended (the "Exchange Act"). This "Controls and Procedures" section includes information concerning the controls and controls evaluation referred to in the certifications.

**(a) Evaluation of disclosure controls and procedures.**

As required by Rule 13a-15 under the Exchange Act, the Company's management conducted an evaluation with the participation of the Company's CEO and CFO, regarding the effectiveness of the Company's disclosure controls and procedures, as of the end of the last fiscal year. In designing and evaluating the Company's disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, our management, including our CEO and CFO, has concluded that our disclosure controls and procedures were not effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms because of the material weakness described in item (b) below. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. We intend to continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and we may from time to time make changes to the disclosure controls and procedures to enhance their effectiveness and to ensure that our systems evolve with our business.

**(b) Management Report on Internal Control Over Financial Reporting**

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

Management assessed our internal control over financial reporting as of December 31, 2006, the end of our fiscal year. Management based its assessment on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and our overall control environment.

As of December 31, 2006, the Company's accounting department did not have sufficient experienced personnel and resources with the requisite technical skills to address complex and judgmental accounting and tax matters as part of its financial statement close process.

As a result, the Company's financial statement close process was not effective as of December 31, 2006 as it relates to evaluating and accounting for complex and judgmental accounting and tax matters, including evaluating the accounting for the Company's cost-based investments. The Company recorded an adjustment to its cost-based investments in the fourth quarter of 2006 of \$1 million as a reduction of Other assets and a charge to Other income (expense), net, for a decline in value judged to be other than temporary. Management views this matter as a material weakness as of December 31, 2006 as this control deficiency could have resulted in a material misstatement of our interim or annual consolidated financial statements that would not be prevented or detected in a timely manner.

Because of the material weakness discussed above, management has concluded that the Company did not maintain effective control over financial reporting as of December 31, 2006, based on the criteria in the Internal Control — Integrated Framework issued by COSO.

Our independent registered public accounting firm, Ernst & Young LLP, audited management's assessment and independently assessed the effectiveness of the Company's internal control over financial reporting. Ernst & Young has issued an attestation report which is included at Item 9A(e) of this Form 10-K.

**(c) Inherent Limitations on Effectiveness of Controls**

The Company's management, including the CEO and CFO, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**(d) Change in Internal Control Over Financial Reporting**

Other than the items noted below, there was no change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

We have implemented or intend to implement during fiscal 2007, the following measures to remediate the material weakness in internal control over financial reporting noted in Item 9A(b) above:

- Perform an overall assessment of the staffing requirements for the accounting department and add resources to our corporate accounting function to assist in evaluating complex and judgmental accounting and tax issues.
- Enhance our policies and procedures related to the review and evaluation of our cost-based investments, including obtaining input from additional members of management, including the Company's CEO.

As of March 12, 2007, our remediation efforts related to the material weakness which existed as of December 31, 2006 were not complete. Our efforts to remediate the material weakness will continue during fiscal 2007.



**(e) Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Vicor Corporation

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting, that Vicor Corporation did not maintain effective internal control over financial reporting as of December 31, 2006, because of the effect of the material weakness identified in management's assessment, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Vicor Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

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

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

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment. As of December 31, 2006, the Company's accounting department did not have sufficient experienced personnel and resources with the requisite technical skills to address complex and judgmental accounting and tax matters as part of its financial statement close process. As a result, the Company's financial statement close process was not effective as of December 31, 2006 as it relates to evaluating and accounting for complex and judgmental accounting and tax matters, including evaluating the accounting for the Company's cost-based investments. The Company recorded an adjustment to its cost-based investments in the fourth quarter of 2006 for \$1 million as a reduction of Other assets and a charge to Other income (expense), net, for a decline in value judged to be other-than-temporary. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2006 consolidated financial statements, and this report does not affect our report dated March 12, 2007 on those consolidated financial statements.

In our opinion, management's assessment that Vicor Corporation did not maintain effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Vicor Corporation has not maintained effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

/s/ Ernst & Young LLP

Boston, Massachusetts  
March 12, 2007

**ITEM 9B — OTHER INFORMATION**

None.

**PART III**

**ITEM 10 — DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Incorporated by reference from the Company's Definitive Proxy Statement for its 2007 annual meeting of stockholders.

**ITEM 11 — EXECUTIVE COMPENSATION**

Incorporated by reference from the Company's Definitive Proxy Statement for its 2007 annual meeting of stockholders.

**ITEM 12 — SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Incorporated by reference from the Company's Definitive Proxy Statement for its 2007 annual meeting of stockholders.

**ITEM 13 — CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Incorporated by reference from the Company's Definitive Proxy Statement for its 2007 annual meeting of stockholders.

**ITEM 14 — PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Incorporated by reference from the Company's Definitive Proxy Statement for its 2007 annual meeting of stockholders.

**PART IV**

**ITEM 15 — EXHIBITS AND FINANCIAL STATEMENTS**

(a) (1) *Financial Statements*

See index in Item 8

(a) (2) *Schedules*

Schedule II Valuation and Qualifying Accounts

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

(b) Exhibits

<u>Exhibits</u>	<u>Description of Document</u>
3.1	• Restated Certificate of Incorporation, dated February 28, 1990(1)
3.2	• Certificate of Ownership and Merger Merging Westcor Corporation, a Delaware Corporation, into Vicor Corporation, a Delaware Corporation, dated December 3, 1990(1)
3.3	• Certificate of Amendment of Restated Certificate of Incorporation, dated May 10, 1991(1)
3.4	• Certificate of Amendment of Restated Certificate of Incorporation, dated June 23, 1992(1)
3.5	• Bylaws, as amended(9)
4.1	• Specimen Common Stock Certificate(2)
10.1	• 1984 Stock Option Plan of the Company, as amended(2)
10.2	• 1993 Stock Option Plan(3)
10.3	• 1998 Stock Option and Incentive Plan(4)
10.4	• Amended and Restated 2000 Stock Option and Incentive Plan(5)
10.5	• Form of Non-Qualified Stock Option under the Vicor Corporation Amended and Restated 2000 Stock Option and Incentive Plan(6)
10.6	• Sales Incentive Plan(7)
10.7	• Picor Corporation 2001 Stock Option and Incentive Plan(8)
10.8	• Form of Non-Qualified Stock Option under the Picor Corporation 2001 Stock Option and Incentive Plan(8)
21.1	• Subsidiaries of the Company(10)
23.1	• Consent of Independent Registered Public Accounting Firm(10)
31.1	• Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934(10)
31.2	• Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934(10)
32.1	• Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(10)
32.2	• Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(10)

- (1) Filed as an exhibit to the Company's Annual Report on Form 10-K filed on March 29, 2001 and incorporated herein by reference.
- (2) Filed as an exhibit to the Company's Registration Statement on Form 10, as amended, under the Securities Exchange Act of 1934 (File No. 0-18277), and incorporated herein by reference.
- (3) Filed as an exhibit to the Company's Registration Statement on Form S-8, as amended, under the Securities Act of 1933 (No. 33-65154), and incorporated herein by reference.
- (4) Filed as an exhibit to the Company's Registration Statement on Form S-8, as amended, under the Securities Act of 1933 (No. 333-61177), and incorporated herein by reference.
- (5) Filed as an exhibit to the Company's Proxy Statement for use in connection with its 2002 Annual Meeting of Stockholders, which was filed on April 29, 2002, and incorporated herein by reference.
- (6) Filed as an exhibit to the Company's Quarterly Report on Form 10-Q filed on November 4, 2004 and incorporated herein by reference.
- (7) Filed as an exhibit to the Company's Annual Report on Form 10-K filed on March 16, 2005 and incorporated herein by reference.
- (8) Filed as an exhibit to the Company's Annual Report on Form 10-K filed on March 14, 2006 and incorporated herein by reference.
- (9) Filed as an exhibit to the Company's Quarterly Report on Form 10-Q filed on November 8, 2006 and incorporated herein by reference.
- (10) Filed herewith.

VICOR CORPORATION

SCHEDULE II  
VALUATION AND QUALIFYING ACCOUNTS  
Years ended December 31, 2006, 2005 and 2004

Description	Balance at Beginning of Period	(Credit) Charge to Costs and Expenses	Other Charges, Deductions(1)	Balance at End of Period
2006				
Allowance for doubtful accounts	\$ 635,000	\$ 96,000	\$ (148,000)	\$ 583,000
2005				
Allowance for doubtful accounts	\$ 468,000	\$ 195,000	\$ (28,000)	\$ 635,000
2004				
Allowance for doubtful accounts	\$ 807,000	\$ (217,000)	\$ (122,000)	\$ 468,000

(1) Reflects uncollectible accounts written off, net of recoveries.

Description	Balance at Beginning of Period	(Credit) Charge to Costs and Expenses	Other Charges, Deductions(2)	Balance at End of Period
2006				
Inventory reserves	\$ 10,691,000	\$ 702,000	\$ (3,030,000)	\$ 8,363,000
2005				
Inventory reserves	\$ 7,844,000	\$ 4,777,000	\$ (1,930,000)	\$ 10,691,000
2004				
Inventory reserves	\$ 8,051,000	\$ 1,079,000	\$ (1,286,000)	\$ 7,844,000

(2) Reflects amounts associated with inventory that have been discarded or sold.

**SIGNATURES**

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

Vicor Corporation

By: /s/ Mark A. Glazer  
 Mark A. Glazer  
 Chief Financial Officer

Dated: March 13, 2007

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Patrizio Vinciarelli</u> Patrizio Vinciarelli	President, Chief Executive Officer and Chairman of the Board (Principal Executive Officer)	March 13, 2007
<u>/s/ Mark A. Glazer</u> Mark A. Glazer	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 13, 2007
<u>/s/ Estia J. Eichten</u> Estia J. Eichten	Director	March 13, 2007
<u>/s/ David T. Riddiford</u> David T. Riddiford	Director	March 13, 2007
<u>/s/ Jay M. Prager</u> Jay M. Prager	Director	March 13, 2007
<u>/s/ Barry Kelleher</u> Barry Kelleher	Director	March 13, 2007
<u>/s/ M. Michael Ansour</u> M. Michael Ansour	Director	March 13, 2007
<u>/s/ Samuel Anderson</u> Samuel Anderson	Director	March 13, 2007

EXHIBIT 21.1

SUBSIDIARIES OF THE COMPANY

<u>Name</u>	<u>State or Jurisdiction of Incorporation</u>
Picor Corporation	Delaware, USA
VLT, Inc.	California, USA
Vicor GmbH	Germany
VICR Securities Corporation	Massachusetts, USA
Vicor France SARL	France
Vicor Italy SRL	Italy
Vicor Hong Kong Ltd.	Hong Kong
Vicor U.K. Ltd.	United Kingdom
Vicor B.V	Netherlands
Vicor Japan Company, Ltd.	Japan
Vicor Development Corporation	Delaware, USA
Aegis Power Systems, Inc.	Delaware, USA
Mission Power Systems, Inc.	Delaware, USA
Northwest Power Integration, Inc.	Delaware, USA
Converpower Corporation	Delaware, USA
Freedom Power Systems, Inc.	Delaware, USA

**EXHIBIT 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the following Registration Statements:

- (1) Registration Statement (Form S-8, No. 33-37491) pertaining to the 1984 Stock Option Plan of Vicor Corporation,
- (2) Registration Statement (Form S-8, No. 33-65154) pertaining to the 1993 Stock Option Plan of Vicor Corporation,
- (3) Registration Statement (Form S-8, No. 333-61177) pertaining to the 1998 Stock Option and Incentive Plan of Vicor Corporation,
- (4) Registration Statement (Form S-8, No. 333-44790) pertaining to the 2000 Stock Option and Incentive Plan of Vicor Corporation, and
- (5) Registration Statement (Form S-8, No. 333-99423) pertaining to the Amended and Restated 2000 Stock Option and Incentive Plan of Vicor Corporation;

of our report dated March 12, 2007, with respect to the consolidated financial statements and schedule of Vicor Corporation and our report dated March 12, 2007 with respect to Vicor Corporation management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Vicor Corporation, included in this Annual Report (Form 10-K) for the year ended December 31, 2006.

/s/ Ernst & Young LLP

Boston, Massachusetts  
March 12, 2007

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Patrizio Vinciarelli, certify that:

1. I have reviewed this annual report on Form 10-K of Vicor Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Patrizio Vinciarelli  
Patrizio Vinciarelli  
Chief Executive Officer

Dated: March 13, 2007



CHIEF FINANCIAL OFFICER CERTIFICATION

I, Mark A. Glazer, certify that:

1. I have reviewed this annual report on Form 10-K of Vicor Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Mark A. Glazer  
Mark A. Glazer  
Chief Financial Officer

Dated: March 13, 2007

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Vicor Corporation (the "Company") on Form 10-K for the period ending December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Patrizio Vinciarelli, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Patrizio Vinciarelli  
\_\_\_\_\_  
Patrizio Vinciarelli  
President, Chairman of the Board and  
Chief Executive Officer

March 13, 2007

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Vicor Corporation (the "Company") on Form 10-K for the period ending December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark A. Glazer, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Mark A. Glazer

\_\_\_\_\_  
Mark A. Glazer  
Chief Financial Officer

March 13, 2007

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.