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

Form 10-Q

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

For the quarterly period ended April 2, 2006

OR

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

For the transition period from _____ to _____

Commission File Number 000-21507

POWERWAVE TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

11-2723423

(I.R.S. Employer Identification No.)

1801 E. St. Andrew Place, Santa Ana, CA 92705

(Address of principal executive offices, zip code)

Registrant's telephone number, including area code: (714) 466-1000

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of May 5, 2006, the number of outstanding shares of Common Stock, par value \$0.0001 per share, of the Registrant was 112,130,574.

POWERWAVE TECHNOLOGIES, INC.

INDEX

CAUTIONARY STATEMENT RELATED TO FORWARD LOOKING STATEMENTS	3
HOW TO OBTAIN POWERWAVE SEC FILINGS	3
PART I – FINANCIAL INFORMATION.....	3
Item 1. Financial Statements (Unaudited)	3
Condensed Consolidated Balance Sheets	4
Condensed Consolidated Statements of Operations	5
Condensed Consolidated Statements of Comprehensive Operations	6
Condensed Consolidated Statements of Cash Flows.....	7
Notes to Condensed Consolidated Financial Statements.....	8
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3. Quantitative and Qualitative Disclosures About Market Risk.....	30
Item 4. Controls and Procedures.....	32
PART II – OTHER INFORMATION	32
Item 1. Legal Proceedings	32
Item 1A. Risk Factors.....	32
Item 6. Exhibits	42
SIGNATURES	43

CAUTIONARY STATEMENT RELATED TO FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q includes forward-looking statements as defined within Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, relating to revenue, revenue composition, market conditions, demand and pricing trends, future expense levels, competition in our industry, trends in average selling prices and gross margins, product and infrastructure development, market demand and acceptance, the timing of and demand for next generation products, customer relationships, employee relations, the timing of and cost saving synergies from integration activities of the former LGP Allgon and REMEC, Inc.'s wireless systems businesses ("REMEC Wireless"), the timing and cost to acquire the remaining outstanding common shares of LGP Allgon under compulsory acquisition proceedings, restructuring charges, the completion of integration activities related to LGP Allgon, REMEC Wireless and the level of expected future capital and research and development expenditures. Such forward-looking statements are based on the beliefs of, estimates made by, and information currently available to Powerwave Technologies, Inc.'s ("Powerwave" or the "Company") management and are subject to certain risks, uncertainties and assumptions. Any other statements contained herein (including without limitation statements to the effect that Powerwave or management "estimates," "expects," "anticipates," "plans," "believes," "projects," "continues," "may," "will," "could," or "would" or statements concerning "potential" or "opportunity" or variations thereof or comparable terminology or the negative thereof) that are not statements of historical fact are also forward-looking statements. The actual results of Powerwave may vary materially from those expected or anticipated in these forward-looking statements. The realization of such forward-looking statements may be impacted by certain important unanticipated factors, including those discussed in under Part II, Item 1A, "Risk Factors." Because of these and other factors that may affect Powerwave's operating results, past performance should not be considered as an indicator of future performance, and investors should not use historical results to anticipate results or trends in future periods. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers should carefully review the risk factors described in this and other documents that Powerwave files from time to time with the Securities and Exchange Commission, including subsequent Current Reports on Form 8-K, Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K.

HOW TO OBTAIN POWERWAVE SEC FILINGS

All reports filed by Powerwave with the SEC are available free of charge via EDGAR through the SEC website at www.sec.gov. In addition, the public may read and copy materials filed by the Company with the SEC at the SEC's public reference room located at 100 F Street, N.E., Washington, D.C. 20549. Powerwave also provides copies of its Forms 8-K, 10-K, 10-Q, Proxy Statement and Annual Report at no charge to investors upon request and makes electronic copies of its most recently filed reports available through its website at www.powerwave.com as soon as reasonably practicable after filing such material with the SEC.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

POWERWAVE TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

ASSETS	<u>April 2, 2006</u>	<u>January 1, 2006</u>
	(Unaudited)	(See Note)
Current assets:		
Cash and cash equivalents.....	\$ 239,383	\$232,519
Restricted cash	5,081	5,002
Accounts receivable, net of allowance for sales returns and doubtful accounts of \$8,329 and \$8,558 at April 2, 2006 and January 1, 2006, respectively.....	213,088	233,726
Inventories, net.....	117,265	100,453
Prepaid expenses and other current assets.....	23,210	23,490
Deferred tax assets	<u>3,242</u>	<u>4,768</u>
Total current assets.....	601,269	599,958
Property, plant and equipment, net.....	162,832	172,426
Goodwill.....	299,925	280,127
Intangible assets, net.....	65,474	69,374
Other non-current assets.....	<u>10,863</u>	<u>8,365</u>
TOTAL ASSETS	<u>\$1,140,363</u>	<u>\$1,130,250</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 99,021	\$ 106,864
Accrued income taxes	15,049	14,952
Accrued expenses and other current liabilities	<u>94,798</u>	<u>93,399</u>
Total current liabilities	208,868	215,215
Long-term debt.....	330,000	330,000
Deferred tax liabilities.....	9,830	3,249
Other non-current liabilities	<u>545</u>	<u>525</u>
Total liabilities	<u>549,243</u>	<u>548,989</u>
Commitments and contingencies (Notes 8 and 9).....	—	—
Shareholders' equity:		
Preferred stock, \$0.0001 par value, 5,000 shares authorized and no shares issued or outstanding	—	—
Common stock, \$0.0001 par value, 250,000 shares authorized, 112,130 shares issued and outstanding at April 2, 2006 and 111,138 shares issued and outstanding at January 1, 2006.....	583,747	575,038
Accumulated other comprehensive income	(14,258)	(17,688)
Retained Earnings	<u>21,631</u>	<u>23,911</u>
Total shareholders' equity.....	<u>591,120</u>	<u>581,261</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$1,140,363</u>	<u>\$1,130,250</u>

Note: January 1, 2006 balances were derived from the audited consolidated financial statements of Powerwave Technologies, Inc.

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

POWERWAVE TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	Three Months Ended	
	April 2, 2006	April 3, 2005
Net sales	\$ 193,065	\$ 162,179
Cost of sales:		
Cost of goods.....	152,051	119,036
Intangible asset amortization.....	<u>3,042</u>	<u>1,921</u>
Total cost of sales.....	<u>155,093</u>	<u>120,957</u>
Gross profit.....	37,972	41,222
Operating expenses:		
Sales and marketing.....	8,811	9,495
Research and development.....	15,464	14,629
General and administrative.....	14,309	8,615
Intangible asset amortization.....	2,076	1,986
In-process research and development.....	—	350
Restructuring and impairment charges	<u>171</u>	<u>—</u>
Total operating expenses.....	<u>40,831</u>	<u>35,075</u>
Operating income (loss)	(2,859)	6,147
Other income, net	<u>854</u>	<u>233</u>
Income (loss) before income taxes	(2,005)	6,380
Provision for income taxes	<u>275</u>	<u>1,009</u>
Net income (loss)	<u>\$ (2,280)</u>	<u>\$ 5,371</u>
Basic income (loss) per share	<u>\$ (0.02)</u>	<u>\$ 0.05</u>
Diluted income (loss) per share.....	<u>\$ (0.02)</u>	<u>\$ 0.05</u>
Basic weighted average common shares	<u>111,660</u>	<u>99,574</u>
Diluted weighted average common shares	<u>111,660</u>	<u>131,229</u>

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

POWERWAVE TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS
(Unaudited)
(In thousands)

	Three Months Ended	
	April 2, 2006	April 3, 2005
Net income (loss).....	\$ (2,280)	\$ 5,371
Other comprehensive loss:		
Foreign currency translation adjustments.....	3,430	(28,692)
Comprehensive income (loss).....	<u>\$ 1,150</u>	<u>\$ (23,321)</u>

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

POWERWAVE TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended	
	April 2, 2006	April 3, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss).....	\$ (2,280)	\$ 5,371
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization.....	13,017	11,540
In-process research and development charges	—	350
Provision for sales returns and doubtful accounts	157	322
Provision for excess and obsolete inventories	1,730	2,833
Compensation costs related to stock-based awards	1,033	—
Deferred income taxes	—	(1,554)
Gain on disposal of property, plant and equipment	22	(278)
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable.....	24,179	(19,906)
Inventories	(16,267)	269
Prepaid expenses and other current assets	(1,187)	7,091
Accounts payable.....	(9,623)	(2,141)
Accrued expenses and other current liabilities	(20,889)	(5,515)
Other non-current assets	388	(910)
Other non-current liabilities.....	(789)	(10)
Net cash used in operating activities	(10,509)	(2,538)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment.....	(2,948)	(5,985)
Restricted cash	—	(525)
Maturities of short-term investments	—	135,200
Proceeds from the sale of property, plant and equipment	—	304
Proceeds from sale of assets	19,118	4,260
Acquisition, net of cash acquired	(7,350)	(10,850)
Net cash provided by investing activities	8,820	122,404
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from stock – based compensation arrangements	7,676	1,306
Net cash provided by financing activities	7,676	1,306
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS ...	877	98
NET INCREASE IN CASH AND CASH EQUIVALENTS	6,864	121,270
CASH AND CASH EQUIVALENTS, beginning of period	232,519	147,451
CASH AND CASH EQUIVALENTS, end of period	\$ 239,383	\$ 268,721

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

POWERWAVE TECHNOLOGIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Tabular amounts in thousands, except per share data)

Note 1. Nature of Operations

Powerwave is a global supplier of end-to-end wireless solutions for wireless communications networks. Powerwave designs, manufactures and markets antennas, boosters, combiners, filters, radio frequency power amplifiers, repeaters, tower-mounted amplifiers and advanced coverage solutions for use in cellular, PCS and 3G networks throughout the world. Powerwave also manufactures and sells advanced industrial components, primarily for the automotive and food industries, under contract manufacturing arrangements.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements of Powerwave have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include certain footnotes and financial presentations normally required under accounting principles generally accepted in the United States of America for complete financial reporting. The interim financial information is unaudited, but reflects all normal adjustments and accruals, which are, in the opinion of management, considered necessary to provide a fair presentation for the interim periods presented. All intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements. Certain prior period amounts have been reclassified to conform to the current period presentation.

The results of operations for the quarter ended April 2, 2006 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2006 ("fiscal 2006.") The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2006.

On September 2, 2005, Powerwave completed the acquisition of selected assets and liabilities of REMEC, Inc.'s Wireless Systems Business (the "REMEC Wireless Acquisition.") Therefore, these condensed consolidated financial statements include the operations of the REMEC Wireless Acquisition for the entire first quarter of fiscal year 2006, but such results are not included in the first quarter of fiscal year 2005.

Stock-Based Compensation

On January 2, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (or "SFAS 123R"), which supersedes our previous accounting under APB Opinion No. 25, "Accounting for Stock Issued to Employees" (or "APB 25"). SFAS 123R requires the recognition of compensation expense, using a fair-value based method, for costs related to all share-based payments including stock options and stock issued under our employee stock plans. SFAS 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense on a straight-line basis over the requisite service periods in our consolidated statements of operations. We adopted SFAS 123R using the modified prospective transition method, which requires that compensation expense be recognized in the financial statements for all awards granted after the date of adoption as well as for existing awards which have not vested as of the date of adoption. The modified prospective transition method does not require restatement of prior periods to reflect the impact of SFAS 123R.

Prior to the adoption of SFAS 123R, we accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (or "SFAS 123"). Under the intrinsic value method, employee stock-based compensation expense was not recognized in our consolidated statements of operations for any period prior to our adoption of SFAS 123R on January 2, 2006, as long as the exercise price of the stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Prior to the adoption of SFAS 123(R), we presented all tax benefits resulting from the exercise of stock options as operating cash flows in our consolidated statements of cash flows. SFAS 123(R) requires that the realized tax

benefit related to the excess of the deductible amount over the compensation cost recognized (excess tax benefits) be classified in the statement of cash flow as a cash inflow from financing activities and a cash outflow from operating activities. At the end of 2004 we took a 100% valuation allowance against our deferred tax assets. This valuation allowance is still in place. Accordingly we have booked no tax benefit related to stock-based compensation as financing cash inflows and operating cash outflows on our accompanying condensed consolidated statements of cash flows for the three months ended April 2, 2006. In addition, we previously presented unearned compensation as a separate component of stockholders' equity. In accordance with the provisions of SFAS No. 123R, upon adoption, we also reclassified the balance in unearned compensation to common stock on our accompanying condensed consolidated balance sheet.

In November 2005, the Financial Accounting Standards Board (the "FASB"), issued FASB Staff Position FAS123(R)-3, *Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards*, ("FSP"). This FSP requires an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS 123(R) or the alternative transition method as described in the FSP. An entity that adopts SFAS 123(R) using the modified prospective method may make a one-time election to adopt the transition method described in this FSP. An entity may take up to one year from the later of its initial adoption of SFAS 123(R) or the effective date of this FSP to evaluate its available transition alternatives and make its one-time election. This FSP became effective in November 2005. We are still evaluating whether we will adopt the alternative method for calculating our additional-paid-in-capital pool described in the FSP.

During the three months ended April 2, 2006, the Company recognized compensation expense of \$0.8 million for stock options and \$0.2 million for employee stock purchase plan awards in its consolidated statement of operations.

Stock-based compensation expense was recognized as follows in the statement of operations (in thousands):

	Three Months Ended April 2, 2006
Cost of sales.....	\$ 50
Sales and marketing expenses.....	71
Research and development expenses.....	121
General and administrative expenses.....	<u>791</u>
Increase to operating loss before income taxes.....	1,033
Income tax effect using the current period effective tax rate.....	<u>(142)</u>
Increase to net loss.....	<u>\$ 891</u>
Increase to net loss per share:	
Basic.....	<u>\$ 0.01</u>
Diluted.....	<u>\$ 0.01</u>

As of April 2, 2006, unrecognized compensation expense related to the unvested portion of the company's stock options and employee stock purchase plan awards was approximately \$4.0 million, which is expected to be recognized over a weighted-average period of 1.2 years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation methods require the input of highly subjective assumptions including the weighted average risk-free interest rate, the expected life, and the expected stock price volatility. The weighted average risk-free interest rate was determined based upon actual U.S. treasury rates over the actual vesting periods of the grants. The expected life was determined based upon actual option grant lives over a 10 year period. We have utilized various market sources to calculate the implied volatility factor utilized in the Black-Scholes option valuation model. These included the implied volatility utilized in the pricing of options on the Company's Common Stock as well as the implied volatility utilized in determining market prices of the Company's outstanding convertible notes. Using the Black-Scholes option valuation model, the estimated weighted average fair value of options granted during the first quarter of fiscal years 2006 and 2005 were \$4.17 per share and \$2.42 per share, respectively. Had compensation cost for the Company's stock option plans and its stock purchase plans been determined based on the estimated fair value at the grant dates for awards under those plans consistent with the fair value method of SFAS 123R utilizing the Black-Scholes option-pricing model, the Company's net income and basic and diluted earnings per share for the quarter ended April 3, 2005 would have approximated the pro forma amounts indicated below:

	Three Months Ended April 3, 2005
Net income:	
As reported	\$ 5,371
Deduct: Additional expense from fair value method, net of tax	<u>(839)</u>
Basic pro forma net income	4,532
Add: Interest expense of convertible debt, net of tax	<u>1,511</u>
Diluted pro forma net income	<u>\$ 6,043</u>
Basic income per share:	
As reported	\$ 0.05
Pro forma	\$ 0.05
Diluted income per share:	
As reported	\$ 0.05
Pro forma	\$ 0.05

The fair value of options granted under the Company's stock incentive plans during the first three months of fiscal 2006 and 2005 was estimated on the date of grant using the Black-Scholes option-pricing model utilizing the multiple option approach and the following weighted-average assumptions:

	Three Months Ended	
	April 2, 2006	April 3, 2005
Weighted average risk-free interest rate	4.89%	3.61%
Expected life (in years)	4.64	5.3
Expected stock volatility	38%	50%
Dividend yield	None	None

The following table represents stock option activity for the three months ended April 2, 2006:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands) ⁽¹⁾
Outstanding at January 1, 2006	7,142,723	\$ 10.63		
Granted	11,000	\$ 13.66		
Exercised	(929,552)	\$ 7.21		
Canceled	<u>(288,939)</u>	\$ 22.93		
Outstanding at April 2, 2006	<u>5,935,232</u>	\$ 10.57	4.93	<u>\$ 31,796</u>
Vested or expected to vest at April 2, 2006	<u>5,638,962</u>	\$ 10.71	4.85	<u>\$ 30,137</u>
Exercisable at April 2, 2006	<u>4,199,927</u>	\$ 11.95	4.26	<u>\$ 20,933</u>

⁽¹⁾ These amounts represent the difference between the exercise price and \$13.49, the Company's closing Common Stock price reported by Nasdaq on March 31, 2006, the last trading day of the fiscal quarter, for all in-the-money options outstanding.

Note 3. Inventories

Net inventories consist of the following:

	<u>April 2, 2006</u>	<u>January 1, 2006</u>
Parts and components.....	\$ 48,928	\$ 42,634
Work-in-process.....	5,593	5,544
Finished goods.....	<u>62,744</u>	<u>52,275</u>
Total inventories, net.....	<u>\$117,265</u>	<u>\$100,453</u>

Inventories are net of an allowance for excess and obsolete inventory of approximately \$18.0 million and \$17.9 million as of April 2, 2006 and January 1, 2006, respectively.

Note 4. Goodwill

The changes in the carrying amount of goodwill by reportable operating segment for the quarter ended April 2, 2006 is as follows:

	<u>Telecom</u>	<u>Contract Manufacturing</u>	<u>Total</u>
Balance, January 1, 2006.....	\$ 261,956	\$ 18,171	\$ 280,127
Goodwill from acquisitions.....	14,439	—	14,439
Effect of exchange rates.....	<u>4,934</u>	<u>425</u>	<u>5,359</u>
Balance, April 2, 2006.....	<u>\$ 281,329</u>	<u>\$ 18,596</u>	<u>\$ 299,925</u>

Note 5. Other Income, Net

Other income, net, includes gains and losses on foreign currency transactions, interest income and interest expense associated with our subordinated convertible notes. The components of other income, net, are as follows:

	<u>Three Month Ended</u>	
	<u>April 2, 2006</u>	<u>April 3, 2005</u>
Interest income.....	\$ 2,189	\$ 1,581
Interest expense.....	(2,056)	(1,935)
Foreign currency gain, net.....	164	246
Other income, net.....	<u>557</u>	<u>341</u>
Total.....	<u>\$ 854</u>	<u>\$ 233</u>

Note 6. Restructuring and Impairment Charges

Integration of REMEC's Wireless Systems Business

In connection with the REMEC Wireless Acquisition during the third quarter of fiscal 2005, we formulated and began to implement our plan to restructure and integrate the combined operations. As a result, we recorded restructuring charges related to our operations of approximately \$0.2 million for the first quarter ended April 2, 2006, which amounts to aggregate restructuring charges totaling \$0.6 million since the acquisition date. The current period charges are included in restructuring and impairment charges within operating expenses in the accompanying condensed consolidated statement of operations. Additionally, since the acquisition date we have recognized \$12.6 million as liabilities in connection with the acquisition for estimated restructuring and integration costs related to the consolidation of REMEC's Wireless operations, including severance and future lease obligations on excess facilities. These estimated costs were included in the allocation of the purchase consideration and resulted in additional goodwill pursuant to EITF 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*. The implementation of the restructuring and integration plan is underway and further actions are expected pending the further assessment of workforce and facility related requirements and certain product related decisions with respect to duplicate technology, product defects and inventory for which there will no longer be an active market for the combined company. Our restructuring and integration plan is subject to continued future refinement as additional information becomes available. During the first quarter of fiscal 2006, we recorded an

additional warranty accrual of approximately \$9.5 million related to product defects in connection with pre-acquisition shipments (see Note 9) that also increased our goodwill related to the acquisition by the same amount. We are assessing our ability to pursue remedies against REMEC for these product defects. Integration activities related to this restructuring plan are currently expected to continue through the fourth quarter of fiscal 2006.

Integration with LGP Allgon

In connection with our acquisition of LGP Allgon during the second quarter of fiscal 2004, we formulated and began to implement a plan to restructure and integrate LGP Allgon's operations with Powerwave's operations. During fiscal 2005, we finalized our restructuring and integration plan with respect to the consolidation of LGP Allgon's legacy operations bringing the total costs recognized as liabilities and additional asset fair value adjustments related to such restructuring and integration plan to \$26.6 million. These estimated costs were included in the allocation of the purchase price and resulted in additional goodwill pursuant to EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*. Integration activities related to this restructuring plan are currently expected to continue through the second quarter of fiscal 2006.

A summary of the activity that affected the Company's restructuring and impairment charges and accrued restructuring liability for the year ended January 1, 2006 and the three months ended April 2, 2006 is as follows:

	Workforce Reductions	Facility Closures & Equipment Write-downs	Other	Total
Balance at January 2, 2005.....	\$ 12,754	\$ 4,001	\$ 599	\$ 17,354
Amounts assumed from REMEC.....	63	—	252	315
Amounts accrued in purchase accounting...	12,743	3,580	29	16,352
Amounts expensed.....	402	929	—	1,331
Amounts paid/incurred.....	(15,270)	(1,075)	(590)	(16,935)
Effect of exchange rates.....	<u>(1,905)</u>	<u>(76)</u>	<u>(47)</u>	<u>(2,028)</u>
Balance at January 1, 2006.....	8,787	7,359	243	16,389
Amounts accrued in purchase accounting...	—	188	—	188
Amounts expensed.....	116	55	—	171
Amounts paid/incurred.....	(1,878)	(1,302)	(50)	(3,230)
Effect of exchange rates.....	<u>51</u>	<u>(83)</u>	<u>1</u>	<u>(31)</u>
Balance at April 2, 2006.....	<u>\$ 7,076</u>	<u>\$ 6,217</u>	<u>\$ 194</u>	<u>\$ 13,487</u>

Note 7. Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, which requires that the Company recognize deferred tax assets and liabilities for each tax jurisdiction within which it operates based on the differences between the financial statement carrying amounts and the tax bases of the associated assets and liabilities, using enacted tax rates in effect for each separate tax jurisdiction for the years such differences are expected to reverse. The Company does not provide deferred U.S. income taxes on undistributed earnings from certain foreign subsidiaries where such earnings are considered to be permanently reinvested. Deferred income tax expense (benefit) results from the change in net deferred tax assets or deferred tax liabilities.

Powerwave recorded an effective tax rate of 13.7% for the three months ended April 2, 2006. The rate differs from the U.S. federal statutory tax rate of 35% primarily due to the utilization of net operating loss carryforwards that had a full valuation allowance; the impact of the distribution of earnings and losses in various tax jurisdictions; and the impact of the in-process research and development charge which was not tax deductible. Given the increased global scope of Powerwave's operations and the complexity of global tax and transfer pricing rules and regulations, it has become increasingly difficult to predict and thereafter realize our earnings within each tax jurisdiction. This has resulted in, and could continue to result in, significant fluctuations in Powerwave's effective tax rate.

As of April 2, 2006, Powerwave had a consolidated net deferred tax asset of approximately \$3.2 million related to certain foreign jurisdictions. The Company continually assesses the recoverability of its deferred tax assets and records a valuation allowance when it is more likely than not that some or all or such deferred tax assets will not be realized. Recoverability of its deferred tax assets is dependent upon continued profitability from operations, as well as the geographic region generating the profits.

Note 8. Commitments and Contingencies

Powerwave is subject to various legal proceedings from time to time as part of its business. As of April 2, 2006, Powerwave was not currently party to any legal proceedings or threatened legal proceedings, the adverse outcome of which, individually or in the aggregate, it believes would have a material adverse effect on its business, financial condition or results of operations.

Note 9. Contractual Guarantees and Indemnities

Warranty Reserves

The Company establishes reserves for future product warranty costs that are expected to be incurred pursuant to specific warranty provisions with its customers. The Company also has contractual requirements with various customers that could require the Company to incur costs to repair an epidemic defect with respect to its products outside of the normal warranty period if such defect were to occur. The Company's warranty reserves are generally established at the time of sale and updated throughout the warranty period based upon numerous factors including historical warranty return rates and expenses over various warranty periods. The Company also accrues additional warranty liabilities for significant and unusual product performance issues at the time such issues are identified and the associated warranty related costs can be reasonably estimated. A summary of the activity that affected the Company's accrued warranty costs for the three months ended April 2, 2006 and April 3, 2005 are as follows:

<u>Description</u>	<u>Three Months Ended</u>	
	<u>April 2, 2006</u>	<u>April 3, 2005</u>
Warranty reserve beginning balance	\$ 20,321	\$ 10,164
Reserve balances recorded or assumed by acquisition.....	9,500	50
Reductions for warranty costs incurred.....	(1,683)	(755)
Warranty accrual related to current period sales.....	2,500	64
Effect of exchange rates.....	<u>7</u>	<u>(358)</u>
Warranty reserve ending balance	<u>\$ 30,645</u>	<u>\$ 9,165</u>

During the normal course of its business, Powerwave makes certain contractual guarantees and indemnities pursuant to which the Company may be required to make future payments under specific circumstances. Powerwave has not recorded any liability for these contractual guarantees and indemnities in the accompanying condensed consolidated financial statements. A description of significant contractual guarantees and indemnities existing as of April 2, 2006 is included below:

Intellectual Property Indemnities

The Company indemnifies certain customers and its contract manufacturers against liability arising from third-party claims of intellectual property rights infringement related to the Company's products. These indemnities appear in development and supply agreements with our customers as well as manufacturing service agreements with our contract manufacturers, are not limited in amount or duration and generally survive the expiration of the contract. Given that the amount of any potential liabilities related to such indemnities cannot be determined until an infringement claim has been made, Powerwave is unable to determine the maximum amount of losses that it could incur related to such indemnifications. Historically, any amounts payable pursuant to such intellectual property indemnifications have not had a material effect on the Company's business, financial condition or results of operations.

Director and Officer Indemnities and Contractual Guarantees

The Company has entered into indemnification agreements with its directors and executive officers which require the Company to indemnify such individuals to the fullest extent permitted by Delaware law. The Company's indemnification obligations under such agreements are not limited in amount or duration. Certain costs incurred in connection with such indemnifications may be recovered under certain circumstances under various insurance policies. Given that the amount of any potential liabilities related to such indemnities cannot be determined until a lawsuit has been filed against a director or executive officer, the Company is unable to determine the maximum amount of losses that it could incur relating to such indemnifications. Historically, any amounts

payable pursuant to such director and officer indemnifications have not had a material negative effect on the Company's business, financial condition or results of operations.

The Company has also entered into severance and change in control agreements with certain of its executives. These agreements provide for the payment of specific compensation benefits to such executives upon the termination of their employment with Powerwave.

General Contractual Indemnities/Products Liability

During the normal course of business, the Company enters into contracts with customers where it has agreed to indemnify the other party for personal injury or property damage caused by the Company's products. The Company's indemnification obligations under such agreements are not limited in duration and are generally not limited in amount. Historically, any amounts payable pursuant to such contractual indemnities have not had a material negative effect on the Company's business, financial condition or results of operations. The Company maintains product liability insurance as well as errors and omissions insurance which may provide a source of recovery to the Company in the event of an indemnification claim.

Other Guarantees and Indemnities

The Company occasionally issues guarantees for certain contingent liabilities under various contractual arrangements, including customer contracts, self-insured retentions under certain insurance policies, and governmental value-added tax compliance programs. These guarantees normally take the form of standby letters of credit issued by the Company's bank, which may be secured by cash deposits or pledges, or performance bonds issued by an insurance company. Historically, any amounts payable pursuant to such guarantees have not had a material negative effect on Powerwave's business, financial condition or results of operations. In addition, the Company, as part of the agreements to register the convertible notes it issued in November 2004 and July 2003, agreed to indemnify the selling security holders against certain liabilities, including liabilities under the Securities Act of 1933. The Company's indemnification obligations under such agreements are not limited in duration and generally not limited in amount.

Note 10. Earnings (Loss) Per Share

In accordance with SFAS No. 128, *Earning Per Share*, basic earnings (loss) per share is based upon the weighted average number of common shares outstanding. Diluted earnings (loss) per share is based upon the weighted average number of common and potential common shares for each period presented and income available to common stockholders is adjusted to reflect any changes in income or loss that would result from the issuance of the dilutive common shares. The Company's potential common shares include stock options under the treasury stock method and convertible subordinated debt under the if-converted method. Potential common shares of 33,074,533 related to the Company's stock option programs and convertible debt have been excluded from diluted weighted average common shares for the three months ended April 2, 2006, as the effect would be anti-dilutive. Diluted earnings per share for the three months ended April 3, 2005 includes the add-back of interest expense (net of tax) associated with the assumed conversion of the Company's outstanding convertible subordinated debt of approximately \$1.5 million and the addition of approximately 31,654,462 shares.

The following details the calculation of basic and diluted income (loss) per share:

	Three Months Ended	
	April 2, 2006	April 3, 2005
Basic:		
Net income (loss)	\$ (2,280)	\$ 5,371
Weighted average common shares	<u>111,660</u>	<u>99,574</u>
Basic income (loss) per share	<u>\$ (0.02)</u>	<u>\$ 0.05</u>
Diluted:		
Net income (loss)	\$ (2,280)	\$ 5,371
Interest expense of convertible debt, net of tax	<u>—</u>	<u>1,511</u>
Net income (loss), as adjusted	<u>\$ (2,280)</u>	<u>\$ 6,882</u>
Weighted average common shares	111,660	99,574
Potential common shares	<u>—</u>	<u>31,655</u>
Weighted average common shares, as adjusted	<u>111,660</u>	<u>131,229</u>
Diluted income (loss) per share	<u>\$ (0.02)</u>	<u>\$ 0.05</u>

Note 11. Customer Concentrations

Powerwave's product sales have historically been concentrated in a small number of customers. During the three months ended April 2, 2006 and April 3, 2005, sales to customers that accounted for 10% or more of revenues for the quarter totaled \$51.9 million and \$69.2 million, respectively. Sales to Nokia accounted for approximately 15% and 14% while sales to Nortel Networks Corporation and related entities ("Nortel") accounted for approximately 8% and 17% of total revenues during such quarters, respectively. During the three months ended April 2, 2006, sales to one additional customer accounted for approximately 12% of revenues.

As of April 2, 2006, approximately 16% of total accounts receivable related to two customers that each accounted for 10% or more of Powerwave's total revenue during the first three months of 2006. The inability to collect outstanding receivables from these customers or the loss of, or reduction in, sales to any of these customers could have a material adverse effect on the Company's business, financial condition and results of operations.

Note 12. Supplier Concentrations

Certain of Powerwave's products, as well as components utilized in such products, are available in the short-term only from a single or a limited number of sources. In addition, in order to take advantage of volume pricing discounts, the Company purchases certain customized components from single-source suppliers as well as finished products from single-source contract manufacturers. The inability to obtain single-source components or finished products in the amounts needed on a timely basis or at commercially reasonable prices could result in delays in product introductions, interruption in product shipments or increases in product costs, which could have a material adverse effect on the Company's business, financial condition and results of operations until alternative sources could be developed at a reasonable cost.

Note 13. Segments

Powerwave operates in two reportable business segments: "Wireless Communications" and "Contract Manufacturing." Sales in the wireless communications segment are derived primarily from the sale of wireless communications network products and coverage solutions, including antennas, boosters, combiners, filters, radio frequency power amplifiers, repeaters, tower-mounted amplifiers and advanced coverage solutions for use in cellular, PCS, and 3G wireless communications networks throughout the world. Sales in the contract manufacturing segment are derived primarily from the sale of advanced industrial components, primarily for the automotive and food industries, under contract manufacturing arrangements. These two reportable segments are regularly evaluated by the Company's executive management in deciding how to allocate resources and in assessing performance. The accounting policies for each reportable segment are the same as those described in "Note 2. Summary of Significant Accounting Policies."

The following schedule presents an analysis of certain financial information for these two business segments:

	Three Months Ended	
	April 2, 2006	April 3, 2005
<i>Net sales:</i>		
Wireless communications.....	\$ 181,811	\$ 152,388
Contract manufacturing.....	<u>11,254</u>	<u>9,791</u>
Total net sales.....	<u>\$ 193,065</u>	<u>\$ 162,179</u>
<i>Operating income (loss):</i>		
Wireless communications	\$ (3,902)	\$ 5,098
Contract manufacturing.....	<u>1,043</u>	<u>1,049</u>
Total operating income (loss)..	<u>\$ (2,859)</u>	<u>\$ 6,147</u>
	April 2, 2006	January 1, 2006
<i>Total assets:</i>		
Wireless communications	\$1,098,316	\$1,095,670
Contract manufacturing.....	<u>42,047</u>	<u>34,580</u>
Total assets.....	<u>\$1,140,363</u>	<u>\$1,130,250</u>

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included under Item 1, "Financial Statements (Unaudited)." This discussion contains forward-looking statements, the realization of which may be impacted by certain important factors including, but not limited to, those discussed in "Risk Factors, in Part II, Item 1A" included herein.

Introduction and Overview

Powerwave is a global supplier of end-to-end wireless solutions for wireless communications networks. Our primary business consists of the design, manufacture, marketing and sale of products to improve coverage, capacity and data speed in wireless communication networks, including antennas, boosters, combiners, filters, radio frequency power amplifiers, repeaters, tower-mounted amplifiers and advanced coverage solutions. These products are utilized in major wireless networks throughout the world that support voice and data communications by use of cell phones and other wireless communication devices. We sell such products to both original equipment manufacturers, who incorporate our products into their proprietary base stations (which they then sell to wireless network operators), and directly to individual wireless network operators for deployment into their existing networks.

We also operate a contract manufacturing business under the trade name of "Arkivator." This business manufactures and sells advanced industrial components, primarily for the automotive and food industries, under contract manufacturing arrangements. This business accounted for approximately 6% of our revenues for the three months ended April 2, 2006.

During the last six years, demand for wireless communications infrastructure equipment has fluctuated dramatically. While demand for wireless infrastructure was strong during 2005, in the past there have been significant slowdowns in capital spending by wireless network operators due to delays in the expected deployment of infrastructure equipment and financial difficulties on the part of the wireless network operators who were forced to consolidate and reduce spending to strengthen their balance sheets and improve their profitability. These changes had a significant negative impact on overall demand for wireless infrastructure products, and at various times, have directly reduced demand for our products and increased price competition within our industry which has in the past led to reductions in our revenues and contributed to our reported operating losses. During the first quarter of 2006, we experienced a significant slowdown in demand from one of our customers, Cingular Wireless, which directly reduced demand for our products and contributed to our operating loss for the first quarter.

We believe that we have maintained our overall market share within the wireless communications infrastructure equipment market during this period. We continue to invest in the research and development of wireless communications network technology and the diversification of our product offerings, and we believe that we have one of our industry's leading product portfolios in terms of performance and features. We believe that our proprietary design technology is a further differentiator for our products.

Looking back over the last four years, beginning in fiscal 2004 we focused on cost savings while we expanded our market opportunities, as evidenced by our acquisition of LGP Allgon. This acquisition involved the integration of two companies based in different countries that previously operated independently, which was a complex, costly and time-consuming process. We have implemented our plans to restructure and integrate LGP Allgon's operations, technology and personnel with ours. During fiscal 2005, we continued to focus on cost savings while we expanded our market opportunities, as evidenced by our acquisition of selected assets and liabilities of REMEC, Inc.'s Wireless Systems Business (the "REMEC Wireless Acquisition.") We believe the product offerings and customer relationships included as part of the REMEC Wireless Acquisition are highly complimentary with our products and that this acquisition has further strengthened our position in the global wireless infrastructure market and improved our ability to provide more complete end-to-end solutions for our customers' complex network requirements.

We measure our success by monitoring our net sales and gross margins, with a short-term goal of maintaining a positive operating cash flow while striving to achieve long-term operating profits. We believe that there continues to be long-term growth opportunities within the wireless communications infrastructure marketplace, and we are focused on positioning Powerwave to benefit from these long-term opportunities.

Critical Accounting Policies and Estimates

We prepare our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information currently available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Any future changes to these estimates and assumptions could cause a material change to our reported amounts of revenue, expenses, assets and liabilities. The critical accounting policies that we believe are the most significant for purposes of fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

The majority of our revenue is derived from the sales of products. We recognize revenue from product sales at the time of shipment or delivery and passage of title depending upon the terms of the sale. We offer certain of our customers the right to return products within a limited time after delivery under specified circumstances. We monitor and track such product returns and record a provision for the estimated amount of such future returns based on historical experience and any notification we receive of pending returns. While such returns have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same return rates that we have in the past. Any significant increase in product returns could have a material adverse effect on our operating results for the period or periods in which such returns materialize.

Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history, the customer's credit worthiness and various other factors, as determined by our review of their credit information. We monitor collections and payments from our customers and maintain an allowance for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Since our accounts receivable are highly concentrated in a small number of customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse effect on the collectibility of our accounts receivable, our liquidity and our future operating results.

Inventories

We value our inventory at the lower of the actual cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review inventory quantities on hand and on order and record a provision for excess and obsolete inventory and/or vendor cancellation charges related to purchase commitments. Depending on the product line, such provisions are established based on historical usage for the preceding twelve months, adjusted for known changes in demands for such products, or the estimated forecast of product demand and production requirements for the next twelve months. Our industry is characterized by rapid technological change, frequent new product development, and rapid product obsolescence that could result in an increase in the amount of obsolete inventory quantities on hand. As demonstrated during the past three fiscal years, demand for our products can fluctuate significantly. A significant increase in the demand for our products could result in a short-term increase in the cost of inventory purchases while a significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. In addition, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. In the future, if our inventory is determined to be overvalued, we would be required to recognize additional expense in our cost of goods sold at the time of such determination. Likewise, if our inventory is determined to be undervalued, we may have over-reported our costs of goods sold in previous periods and would be required to recognize additional gross profit at the time such inventory is sold. Although we make reasonable efforts to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a material effect on the value of our inventory and our reported operating results.

Income Taxes

We recognize current and deferred tax assets and liabilities, as well as the associated income statement benefit or expense, based on our reported operating results and the differences between the financial statement carrying values and the tax bases of assets and liabilities in each separate tax jurisdiction within which we conduct business.

We do not provide deferred U.S. income taxes on undistributed earnings from certain foreign subsidiaries where we consider such earnings to be permanently reinvested. Given the global scope of our operations and the complexity of global tax and transfer pricing rules and regulations, it has become increasingly difficult to predict and thereafter realize our earnings within each tax jurisdiction. This has resulted in, and could continue to result in, significant fluctuations in our effective tax rate.

We regularly review our deferred tax assets for recoverability and establish a valuation allowance based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences within each taxing jurisdiction.

Goodwill, Intangible Assets and Long-Lived Assets

We record the assets acquired and liabilities assumed in business combinations at their respective fair values at the date of acquisition, with any excess purchase price recorded as goodwill. Because of the expertise required to value intangible assets and in-process research and development, we typically engage independent valuation specialists to assist us in determining those values. Valuation of intangible assets and in-process research and development entails significant estimates and assumptions including, but not limited to, determining the timing and expected costs to complete development projects, estimating future cash flows from product sales, developing appropriate discount rates, estimating probability rates for the successful completion of development projects, continuation of customer relationships and renewal of customer contracts, and approximating the useful lives of the intangible assets acquired. To the extent actual results differ from these estimates, our future results of operations may be affected.

We review the recoverability of the carrying value of goodwill on an annual basis or more frequently when an event occurs or circumstances change to indicate that an impairment of goodwill has possibly occurred. The determination of whether any potential impairment of goodwill exists is based upon a comparison of the fair value of a reporting unit to the accounting value of the underlying net assets of such reporting unit. To determine the fair value of a reporting unit, we utilize subjective valuations for the reporting unit based upon a discounted cash flow analysis. The discounted cash flow analysis is dependent upon a number of various factors including estimates of forecasted revenues and costs, appropriate discount rates and other variables. If the fair value of the reporting unit is less than the carrying value of the underlying net assets, goodwill is deemed impaired and an impairment loss is recorded to the extent that the carrying value of goodwill is less than the difference between the fair value of the reporting unit and the fair value of all its underlying identifiable assets and liabilities.

Purchased intangible assets with determinable useful lives are carried at cost less accumulated amortization, and are amortized using the straight-line method over their estimated useful lives, which generally range up to 6 years. We review the recoverability of the carrying value of identified intangibles and other long-lived assets, including fixed assets, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of these assets is determined based upon the forecasted undiscounted future net cash flows expected to result from the use of such asset and its eventual disposition. Our estimate of future cash flows is based upon, among other things, certain assumptions about expected future operating performance, growth rates and other factors. The actual cash flows realized from these assets may vary significantly from our estimates due to increased competition, changes in technology, fluctuations in demand, consolidation of our customers and reductions in average selling prices. If the carrying value of an asset is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized to the extent the carrying value exceeds the estimated fair market value of the asset. While we do not believe that any of our intangible or other long-lived assets are currently impaired, any future impairment of such assets could have a material adverse affect on our financial position and results of operations.

Warranties

We offer warranties of various lengths to our customers depending upon the specific product and terms of the customer purchase agreement. Our standard warranties require us to repair or replace defective product returned to us during such warranty period at no cost to the customer. We record an estimate for standard warranty-related costs based on our actual historical return rates and repair costs at the time of the sale and update such estimate throughout the warranty period. While our warranty costs have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same warranty return rates or repair costs that we have in the past. We also have contractual commitments to various customers that require us to incur costs to repair an epidemic defect with respect to our products outside of our standard warranty period if such defect were to occur. Any costs related to epidemic defects are generally recorded at the time the epidemic defect becomes known to us and the costs of repair can be reasonably estimated. While we have not historically experienced significant costs related to epidemic defects, we cannot guarantee that we will not experience

significant costs to repair epidemic defects in the future. A significant increase in product return rates, a significant increase in the costs to repair our products, or an unexpected epidemic defect in our products, could have a material adverse effect on our operating results during the period in which such returns or additional costs materialize.

Accruals for Restructuring and Impairment Charges

We recorded \$1.3 million, \$2.6 million and \$15.5 million of restructuring and impairment charges during fiscal years 2005, 2004 and 2003, respectively. In connection with the REMEC Wireless Acquisition during the third quarter of fiscal 2005, we formulated and began to implement our plan to restructure and integrate the combined operations. We recognized \$12.6 million as liabilities in connection with the acquisition for estimated restructuring and integration costs related to the consolidation of REMEC's Wireless operations, including severance and future lease obligations on excess facilities. The implementation of the restructuring and integration plan is in process and further actions are expected pending the further assessment of workforce and facility related requirements and certain product related decisions with respect to duplicate technology, product defects and inventory for which there will no longer be an active market for the combined company. Our restructuring and integration plan is subject to continued future refinement as additional information becomes available. During the first quarter of fiscal 2006, we recorded an additional warranty accrual of approximately \$9.5 million related to product defects in connection with pre-acquisition shipments that also increased our goodwill related to the acquisition by the same amount. We are assessing our ability to pursue remedies against REMEC for these product defects. Integration activities related to this restructuring plan are currently expected to continue through the fourth quarter of fiscal 2006. In addition, as a result of the acquisition of LGP Allgon in May 2004, we recorded \$26.6 million of additional restructuring liabilities and asset write-downs under purchase accounting for expected integration and consolidation activities related to their operations. Integration activities related to this restructuring plan are currently expected to continue through the second quarter of fiscal 2006. These restructuring and impairment accruals related primarily to workforce reductions, consolidation of facilities, and the discontinuation of certain product lines, including the associated write-downs of inventory, manufacturing and test equipment, and certain intangible assets. Such accruals were based on estimates and assumptions made by management about matters which were uncertain at the time, including the timing and amount of sublease income that will be recovered on vacated property and the net realizable value of used equipment that is no longer needed in our continuing operations. While we used our best current estimates based on facts and circumstances available at the time to quantify these charges, different estimates could reasonably be used in the relevant periods to arrive at different accruals and/or the actual amounts incurred or recovered may be substantially different from the assumptions utilized, either of which could have a material impact on the presentation of our financial condition or results of operations for a given period. As a result, we periodically review the estimates and assumptions used and reflect the effects of those revisions in the period that they become known.

Results of Operations

The following table summarizes Powerwave's results of operations as a percentage of net sales for the three months ended April 2, 2006 and April 3, 2005:

	Three Months Ended	
	April 2, 2006	April 3, 2005
Net sales	100.0%	100.0%
Cost of sales:		
Cost of goods	78.7	73.4
Intangible asset amortization	<u>1.6</u>	<u>1.2</u>
Total cost of sales	<u>80.3</u>	<u>74.6</u>
Gross profit	19.7	25.4
Operating expenses:		
Sales and marketing	4.6	5.9
Research and development	8.0	9.0
General and administrative	7.4	5.3
Intangible asset amortization	1.1	1.2
In-process research and development	—	0.2
Restructuring and impairment charges	<u>0.1</u>	<u>—</u>
Total operating expenses	<u>21.2</u>	<u>21.6</u>
Operating income (loss)	(1.5)	3.8
Other income, net	<u>0.4</u>	<u>0.1</u>
Income (loss) before income taxes	(1.1)	3.9
Provision for income taxes	<u>0.1</u>	<u>0.6</u>
Net income (loss)	<u>(1.2)%</u>	<u>3.3%</u>

Three Months ended April 2, 2006 and April 3, 2005

Net Sales

Our sales are derived primarily from the sale of wireless communications network products and coverage solutions, including antennas, boosters, combiners, filters, radio frequency power amplifiers, repeaters, tower-mounted amplifiers and advanced coverage solutions for use in cellular, PCS, and 3G wireless communications networks throughout the world. We also manufacture and sell advanced industrial components, primarily for the automotive and food industries, under contract manufacturing arrangements. Sales increased by 19% to \$193.1 million for the three months ended April 2, 2006, from \$162.2 million, for the three months ended April 3, 2005. This increase was primarily due to the impact of our acquisition of selected assets and liabilities of REMEC Wireless Business in the third quarter of fiscal 2005, offset by a significant reduction in demand during the first quarter of fiscal 2006 by a major North American wireless network operator.

Segment	Three Months Ended (dollars in thousands)			
	April 2, 2006		April 3, 2005	
Wireless communications	\$ 181,811	94%	\$ 152,388	94%
Contract manufacturing	<u>11,254</u>	<u>6%</u>	<u>9,791</u>	<u>6%</u>
Total net sales	<u>\$ 193,065</u>	<u>100%</u>	<u>\$ 162,179</u>	<u>100%</u>

The following table presents a further analysis of our sales within the wireless communications business segment, based upon product group:

Wireless Communications Product Group	Three Months Ended (dollars in thousands)			
	April 2, 2006		April 3, 2005	
Antenna systems	\$ 51,200	28%	\$ 43,164	28%
Base station systems	112,096	62%	88,949	59%
Coverage systems	18,515	10%	20,275	13%
Total	<u>\$ 181,811</u>	<u>100%</u>	<u>\$ 152,388</u>	<u>100%</u>

Antenna systems consist of base station antennas and tower-mounted amplifiers. Base station systems consist of products that are installed into or around the base station of wireless networks and include products such as boosters, combiners, filters and radio frequency power amplifiers. Coverage systems consist primarily of repeaters and advanced coverage solutions. The increase in antenna and base station systems during the three months ended April 2, 2006 as compared to the three months ended April 3, 2005 is a result of our acquisition of REMEC Wireless offset by a significant reduction in demand during the first quarter of fiscal 2006 by a major North American wireless network operator. The reduction in coverage systems is largely due to the sale of our Microwave outdoor unit business in September 2005.

We track the geographic location of our sales based upon the location of our customers to which our products are shipped. Since many of our original equipment manufacturer customers purchase products from us at central locations and then reship the product with other base station equipment to locations throughout the world, we are unable to identify the final installation location of many of our products. The following table presents an analysis of our net sales based upon the geographic area to which a product was shipped:

Geographic Area	Three Months Ended (dollars in thousands)			
	April 2, 2006		April 3, 2005	
Americas.....	\$ 58,152	30%	\$ 48,520	30%
Asia Pacific.....	24,336	13%	16,641	10%
Europe.....	109,287	56%	94,291	58%
Other international.....	1,290	1%	2,727	2%
Total net sales.....	<u>\$ 193,065</u>	<u>100%</u>	<u>\$ 162,179</u>	<u>100%</u>

Revenues in the Americas, Asia Pacific, Europe and other international locations increased in the first quarter of fiscal 2006 as compared to the first quarter of fiscal 2005, primarily as a result of our acquisition of REMEC Wireless. Since wireless network infrastructure spending is dependent on individual network coverage and capacity demands during a quarter, we do not believe that our revenue fluctuations for any geographic region are necessarily indicative of a predictable trend for our future revenues by geographic area. In addition, as noted above, growth in one geographic location may not reflect actual demand growth in that location due to the centralized buying processes of our original equipment manufacturer customers.

For the quarter ended April 2, 2006, total sales to Nokia accounted for approximately 15% of sales and sales to Siemens accounted for 10% or more of sales for the quarter. For the quarter ended April 3, 2005, total sales to Nokia accounted for approximately 14% of sales and sales to Nortel accounted for 10% or more of sales. The decrease in the percentage of our sales to Nortel during the quarter ended April 2, 2006 is the result of our various acquisitions, which substantially increased our total revenues and number of customers, as well as a reduction in demand for products purchased by Nortel. Notwithstanding our acquisitions, our business remains largely dependent upon the limited number of customers within the wireless communications market and we cannot guarantee that we will continue to be successful in attracting new customers or retaining or increasing business with our existing customers. As an example, our revenues significantly declined during the first quarter of fiscal 2006 in compared to the fourth quarter of fiscal 2005, largely due to a significant reduction in demand by a major North American wireless network operator, Cingular Wireless. Cingular Wireless accounted for approximately 23% of sales for the fourth quarter of fiscal year 2005 while accounting for approximately 10% of sales in the first quarter of

fiscal 2006. This reduction had a negative impact on our operating results for the quarter. Therefore, as recently demonstrated, our revenues can be significantly reduced if a large customer reduces its demand for our products.

A number of factors have caused delays and may cause future delays in new wireless infrastructure and upgrade deployment schedules throughout the world, including deployments in the United States, Europe, Asia, South America and other areas. In addition, a number of factors may cause original equipment manufacturers to alter their outsourcing strategy concerning certain wireless communications network products, which could cause such original equipment manufacturers to reduce or eliminate their demand for external supplies of such products or shift their demand to alternative suppliers or internal suppliers. Such factors include lower perceived internal manufacturing costs and competitive reasons to remain vertically integrated. Due to the possible uncertainties associated with wireless infrastructure deployments and original equipment manufacturer demand, we have experienced and expect to continue to experience significant fluctuations in demand from our original equipment manufacturer and network operator customers. Such fluctuations have caused and may continue to cause significant reductions in our revenues and/or operating results, which has adversely impacted and may continue to adversely impact our business, financial condition and results of operations.

Cost of Sales and Gross Profit

Our cost of sales includes both fixed and variable cost components and consists primarily of materials, assembly and test labor, overhead, which includes equipment and facility depreciation, transportation costs, warranty costs and amortization of product-related intangibles. Components of our fixed cost structure include test equipment and facility depreciation, purchasing and procurement expenses and quality assurance costs. Given the fixed nature of such costs, the absorption of our overhead costs into inventory decreases and the amount of overhead variances expensed to cost of sales increases as volumes decline since we have fewer units to absorb our overhead costs against. Conversely, the absorption of our overhead costs into inventory increases and the amount of overhead variances expensed to cost of sales decreases as volumes increase since we have more units to absorb our overhead costs against. As a result, our gross profit margins generally decrease as revenue and volumes decline due to lower sales volume and higher amounts of overhead variances expensed to cost of sales; and our gross profit margins generally increase as our revenue and volumes increase due to higher sales volume and lower amounts of overhead variances expensed to cost of sales.

The following table presents an analysis of our gross profit:

	Three Months Ended			
	(dollars in thousands)			
	April 2, 2006		April 3, 2005	
Net sales.....	\$ 193,065	100.0%	\$ 162,179	100.0%
Cost of sales:				
Cost of sales.....	152,050	78.7%	119,036	73.4%
Intangible amortization	<u>3,042</u>	<u>1.6%</u>	<u>1,921</u>	<u>1.2%</u>
Total cost of sales.....	<u>155,092</u>	<u>80.3%</u>	<u>120,957</u>	<u>74.6%</u>
Gross profit.....	<u>\$ 37,973</u>	<u>19.7%</u>	<u>\$ 41,222</u>	<u>25.4%</u>

Our gross profit margins decreased during the first quarter of fiscal 2006 due to our significant revenue shortfall, when compared to our fourth quarter of fiscal 2005 revenues of \$258.7 million. Our lower revenues contributed to poor absorption of our manufacturing overheads and delayed previously anticipated material cost reductions due to the lower purchasing volume. Also contributing to the reduction in our gross margins was a significant reduction in direct operator sales, which typically have carried higher margins than our OEM based sales. All of these factors were significantly influenced by the reduction in our revenues due to the reduction in demand during the first quarter of fiscal 2006 by a major North American wireless network operator. Our gross margins is also reduced due to increased intangible amortization costs due to the REMEC Wireless Acquisition.

The wireless communications infrastructure equipment industry is extremely competitive and is characterized by rapid technological change, new product development and product obsolescence, evolving industry standards and significant price erosion over the life of a product. Certain of our competitors have aggressively lowered prices in an attempt to gain market share. Due to these competitive pressures and the pressures of our customers to continually lower product costs, we expect that the average sales prices of our products will continue to decrease and negatively impact our gross margins. In addition, we have introduced new products at lower sales prices and these lower sales prices have impacted the average sales prices of our products. We have also reduced prices on our existing products in response to our competitors and customer demands. We currently expect that pricing pressures

will remain strong in our industry. Future pricing actions by our competitors and us may adversely impact our gross profit margins and profitability, which could result in decreased liquidity and adversely affect our business, financial condition and results of operations.

We continue to strive for manufacturing and engineering cost reductions to offset pricing pressures on our products, as evidenced by our decision to sell the Philippine manufacturing operations acquired in the REMEC Wireless Acquisition as part of our plan to reduce manufacturing costs associated with our REMEC Wireless Acquisition. However, we cannot guarantee that these cost reduction, outsourcing or product redesign efforts will keep pace with price declines and cost increases. If we are unable to further reduce our costs through our manufacturing, outsourcing and/or engineering efforts, our gross margins and profitability will be adversely affected. See “Our average sales prices have declined...; and Our reliance on contract manufacturers exposes us to risks...” under Part II, Item 1A. “Risk Factors.”

Operating Expenses

The following table presents a breakdown of our operating expenses by functional category and as a percentage of net sales:

Operating Expenses	Three Months Ended (dollars in thousands)			
	April 2, 2006		April 3, 2005	
Sales and marketing.....	\$ 8,811	4.6%	\$ 9,495	5.9%
Research and development	15,464	8.0%	14,629	9.0%
General and administrative.....	14,310	7.4%	8,615	5.3%
Intangible amortization.....	2,076	1.1%	1,986	1.2%
Restructuring and impairment charges	171	0.1%	—	—%
In-process research and development.....	—	—%	350	0.2%
Total operating expenses.....	<u>\$ 40,832</u>	<u>21.2%</u>	<u>\$ 35,075</u>	<u>21.6%</u>

Sales and marketing expenses consist primarily of sales salaries and commissions, travel expenses, charges for customer demonstration units and trade show expenses. Sales and marketing expenses decreased by \$0.7 million, or 7.2%, during the quarter ended April 2, 2006 as compared to the quarter ended April 3, 2005. The decrease resulted primarily from significantly reduced personnel costs in our Swedish operations, somewhat offset by increased personnel and trade costs in the U.S.

Research and development expenses consist primarily of ongoing design and development expenses for new wireless communications network products, as well as for advanced coverage solutions. We also incur design expenses associated with reducing the cost and improving the manufacturability of our existing products. Research and development expenses can fluctuate dramatically from period to period depending on numerous factors including new product introduction schedules, prototype developments and hiring patterns. Research and development expenses increased by \$0.8 million, or 5.7%, during the quarter ended April 2, 2006 as compared to the quarter ended April 3, 2005 primarily due to the result of our acquisition of REMEC Wireless, which added approximately 100 people to our research and development area as well as increased the number of product areas within which such work is undertaken in. This increase was partially offset by savings realized as part of our integration activities from personnel reductions and facility consolidations in the legacy Powerwave operations.

General and administrative expenses consist primarily of salaries and other expenses for management, finance, information systems, facilities and human resources. General and administrative expenses increased \$5.7 million, or 66.1%, during the quarter ended April 2, 2006 as compared to the quarter ended April 3, 2005. This increase was due to several factors including our acquisition of REMEC Wireless, costs incurred for documentation and testing of our internal controls over financial reporting at locations acquired in our acquisitions, expenses incurred for the implementation of our Oracle enterprise resource planning system as well as increased personnel costs for compensation expense recognized in the first quarter of fiscal year 2006 for stock options and employee stock purchase plan awards that was not recorded in the first quarter of fiscal year 2005.

Amortization of customer-related intangibles, primarily from the LGP Allgon acquisition, amounted to \$2.1 million for the first quarter of fiscal 2006, compared to \$2.0 million for the first quarter of fiscal 2005. We also recorded a charge of \$0.2 million in the first quarter of fiscal 2006 for restructuring related to the REMEC Wireless.

Other Income, net

The following table presents an analysis of other income, net:

	Three Months Ended			
	(dollars in thousands)			
	April 2, 2006		April 3, 2005	
Interest income.....	\$ 2,189	1.1%	\$ 1,581	1.0%
Interest expense.....	(2,056)	(1.1)%	(1,935)	(1.2)%
Foreign currency gain, net.....	164	0.1%	246	0.2%
Other income, net.....	<u>557</u>	<u>0.3%</u>	<u>341</u>	<u>0.2%</u>
Other income, net	<u>\$ 854</u>	<u>0.4%</u>	<u>\$ 233</u>	<u>0.2%</u>

Interest income increased by \$0.6 million during the quarter ended April 2, 2006 primarily due to increased cash balances following the issuance of our 1.875% subordinated convertible notes in November 2004. This was somewhat offset by \$0.1 million of additional interest expense during the quarter ended April 2, 2006 primarily due to the interest expense associated with such subordinated convertible notes.

Provision for Income Taxes

Our effective tax rate differs from the U.S. federal statutory tax rate of 35% primarily due to the utilization of net operating loss carryforwards that were fully reserved and the geographic distribution of our income, which is taxed at various rates depending upon the country where such earnings are reported, as well as the impact of state taxes on U.S. domestic operations. We recorded a tax provision at the rate of 13.7% during the quarter ended April 2, 2006 as compared to 15.8% for the quarter ended April 3, 2005. Given the increased global scope of our combined operations after the LGP Allgon acquisition and the difficulty in predicting and, thereafter, realizing our earnings within each tax jurisdiction, we expect that our effective tax rate may fluctuate dramatically in the future.

Net Income (Loss)

The following table presents a reconciliation of operating income (loss) to net income (loss):

	Three Months Ended	
	(dollars in thousands)	
	April 2, 2006	April 3, 2005
Operating income (loss).....	\$ (2,859)	\$ 6,147
Other income, net	<u>854</u>	<u>233</u>
Income (loss) before income taxes	(2,005)	6,380
Provision for income taxes	<u>275</u>	<u>1,009</u>
Net income (loss).....	<u>\$ (2,280)</u>	<u>\$ 5,371</u>

Our net loss for the quarter ended April 2, 2006 of \$2.3 million compared to a net income of \$5.4 million for the quarter ended April 3, 2005. The decrease in net income during the first quarter of fiscal 2006 as compared to the first quarter of fiscal 2005 is primarily the result of lower than anticipated revenues which resulted in lower gross margins and a resulting operating loss, due to operation expense geared to a higher revenue expectation.

Liquidity and Capital Resources

We have historically financed our operations through a combination of cash on hand, cash provided from operations, equipment lease financings, available borrowings under bank lines of credit, private debt placements and both private and public equity offerings. Our principal sources of liquidity consist of existing cash balances and funds expected to be generated from future operations. As of April 2, 2006, we had working capital of \$392.4 million, including \$239.3 million in unrestricted cash and cash equivalents as compared to working capital of \$343.8 million at April 3, 2005, which included \$268.7 million in unrestricted cash and cash equivalents. We currently invest our excess cash in short-term, investment-grade, money-market instruments with maturities of three months or less. We typically hold such investments until maturity and then reinvest the proceeds in similar money market instruments. We believe that all of our cash investments would be readily available to us should the need arise.

Cash Flows

The following table summarizes Powerwave's cash flows for the quarters ended April 2, 2006 and April 3, 2005:

	Three Months Ended	
	(dollars in thousands)	
	April 2, 2006	April 3, 2005
Net cash provided by (used in):		
Operating activities.....	\$ (10,509)	\$ (2,538)
Investing activities.....	8,820	122,404
Financing activities.....	7,676	1,306
Effect of exchange rates on cash and cash equivalents.....	<u>877</u>	<u>98</u>
Net increase in cash and cash equivalents	<u>\$ 6,864</u>	<u>\$121,270</u>

Net cash used in operations during the three months ended April 2, 2006 was \$10.5 million as compared to \$2.5 million during the three months ended April 3, 2005. The increase in cash used in operations during the first three months of fiscal 2006 is primarily due to higher inventory and lower accounts payable and accrued expenses balances offset by lower accounts receivable balances.

Net cash provided by investing activities during the first quarters of fiscal 2006 and fiscal 2005 was \$8.8 million and \$122.4 million, respectively. The decrease primarily related to maturities of short-term investments of \$135.2 million during the quarter ended April 3, 2005 related to our transfer out of short-term auction rate securities. In addition, during the first quarter of fiscal 2006 we generated \$19.1 million in proceeds from the disposition of our Philippines operations and spent \$7.4 million for an acquisition. Total capital expenditures during the three months ended April 2, 2006 and April 3, 2005 were approximately \$2.9 million and \$6.0 million, respectively. The majority of the capital spending during such periods related to computer hardware and test equipment utilized in our manufacturing and research and development areas. We expect our capital spending requirements for the remainder of this year to range between \$15 million and \$20 million, consisting of test and production equipment, as well as computer hardware and software primarily related to our implementation of Oracle, our new worldwide enterprise resource planning system.

The \$7.7 million in net cash provided by financing activities during the three months ended April 2, 2006 and \$1.3 million during the three months ended April 3, 2005 resulted from the issuance of our Common Stock under our employee stock option programs and our Employee Stock Purchase Plan.

We currently believe that our existing cash balances and funds expected to be generated from operations will provide us with sufficient funds to finance our current operations for at least the next twelve months. Our principal source of liquidity consists of our existing cash balances. We regularly review our cash funding requirements and attempt to meet those requirements through a combination of cash on hand and cash provided by operations. Our ability to increase revenues and generate profits is subject to numerous risks and uncertainties, and any significant decrease in our revenues or profitability would reduce our operating cash flows and erode our existing cash balances. No assurances can be given that we will be able to generate positive operating cash flows in the future or maintain and/or grow our existing cash balances.

Financing Activities

We currently do not have a committed credit facility. We continue to evaluate our long-term financing needs and may decide in the future to negotiate a new credit agreement. However, we cannot guarantee that we will be able to establish a new credit agreement on terms acceptable to us. Currently, due to our cash balances, we do not require a credit line to finance our operations.

On occasion, we have previously utilized both operating and capital lease financing for certain equipment purchases used in our manufacturing and research and development operations and may selectively continue to do so in the future. We may require additional funds in the future to support our working capital requirements or for other purposes such as acquisitions, and we may seek to raise such additional funds through the sale of public or private equity and/or debt financings, as well as from other sources. Our ability to secure additional financing or sources of funding is dependent upon our financial performance, credit rating and the market price for our Common Stock, which are both directly impacted by our ability to grow revenues and generate profits. We can make no guarantees that we will be able to obtain additional financing or secure new financing arrangements in the future. If

our operating performance was to deteriorate and our cash balances were to be significantly reduced, we would likely encounter a more difficult environment in terms of raising additional funding to support our business.

Off-Balance Sheet Arrangements

Our off-balance sheet arrangements consist primarily of conventional operating leases, purchase commitments and other commitments arising in the normal course of business, as further discussed below under “Contractual Obligations and Commercial Commitments.” As of April 2, 2006, we did not have any other relationships with unconsolidated entities or financial partners, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Contractual Obligations and Commercial Commitments

We incur various contractual obligations and commercial commitments in our normal course of business. Such obligations and commitments consist primarily of the following:

Long-Term Debt

At April 2, 2006, we had \$330.0 million of long-term debt, consisting of our outstanding 1.25% convertible subordinated notes due July 2008 and our 1.875% convertible subordinated notes due November 2024. These notes are convertible into shares of our Common Stock at the option of the holder. See “Note 10. Financing Arrangements and Long-Term Debt” in the “Notes to Consolidated Financial Statements” included under Part II, Item 8, “Financial Statements and Supplementary Data” of the Company’s Annual Report on Form 10-K for the fiscal year ended January 1, 2006 for additional information.

Capital Lease Obligations

Our current outstanding capital lease obligations of \$0.4 million relate primarily to manufacturing and test equipment and are included as part of other current liabilities within our consolidated balance sheet.

Operating Lease Obligations

We have various operating leases covering vehicles, equipment, facilities and sales offices located throughout the world.

Purchase Commitments with Contract Manufacturers

We generally issue purchase orders to our contract manufacturers with delivery dates from four to six weeks from the purchase order date. In addition, we regularly provide such contract manufacturers with rolling six-month forecasts of material and finished goods requirements for planning and long-lead time parts procurement purposes only. We are committed to accept delivery of materials pursuant to our purchase orders subject to various contract provisions which allow us to delay receipt of such orders or cancel orders beyond certain agreed lead times. Such cancellations may or may not result in cancellation costs payable by us. In the past, we have been required to take delivery of materials from our suppliers that were in excess of our requirements and we have previously recognized charges and expenses related to such excess material. If we are unable to adequately manage our contract manufacturers and adjust such commitments for changes in demand, we may incur additional inventory expenses related to excess and obsolete inventory. Such expenses could have a material adverse effect on our business, financial condition and results of operations.

Other Commitments

We also incur various purchase obligations with other vendors and suppliers for the purchase of inventory, as well as other goods and services, in the normal course of business. These obligations are generally evidenced by purchase orders with delivery dates from four to six weeks from the purchase order date, and in certain cases, supply agreements that contain the terms and conditions associated with these purchase arrangements. We are committed to accept delivery of such materials pursuant to such purchase orders subject to various contract provisions which allow us to delay receipt of such orders or cancel orders beyond certain agreed lead times. Such cancellations may or may not result in cancellation costs payable by us. In the past, we have been required to take delivery of materials from our suppliers that were in excess of our requirements and we have previously recognized charges and expenses related to such excess material. If we are not able to adequately manage our supply chain and adjust such commitments for changes in demand, we may incur additional inventory expenses related to excess and obsolete

inventory. Such expenses could have a material adverse effect on our business, financial condition and results of operations.

We have initiated compulsory acquisition proceedings under Swedish law to acquire the remaining outstanding common shares of LGP Allgon that were not tendered in our exchange offer. We currently expect to pay approximately \$4.6 million as additional purchase price related to such proceedings within the next twelve months.

Guarantees Under Letters of Credit

We occasionally issue guarantees for certain contingent liabilities under various contractual arrangements, including customer contracts, self-insured retentions under certain insurance policies, and governmental value-added tax compliance programs. These guarantees normally take the form of standby letters of credit issued by our bank that may be secured by cash deposits or pledges, or performance bonds issued by an insurance company.

As of April 2, 2006, expected future cash payments related to contractual obligations and commercial commitments were as follows:

	Payments Due by Period				
	(in thousands)				
	Less than 1 Year	1-3 Years	3-5 Years	Thereafter	Total
Long-term debt (including interest).....	\$ 5,375	\$ 9,938	\$ 137,500	\$252,500	\$ 405,313
Capital lease obligations.....	302	76	—	—	378
Operating lease obligations	4,803	6,233	2,319	71	13,426
Purchase commitments with contract manufacturers	102,121	—	—	—	102,121
Other commitments	75,402	—	—	—	75,402
Guarantees	—	—	—	—	—
Total contractual obligations and commercial commitments	<u>\$ 188,003</u>	<u>\$ 16,247</u>	<u>\$ 139,819</u>	<u>\$ 252,571</u>	<u>\$ 596,640</u>

We believe that our existing cash balances and funds expected to be generated from future operations will be sufficient to satisfy these contractual obligations and commercial commitments and that the ultimate payments associated with these commitments will not have a material adverse effect on our liquidity position.

Disclosure About Stock Option Plans

Our stock option program is a broad-based, long-term retention program that is intended to attract and retain talented employees and align stockholder and employee interests. The program consists of six separate plans: one under which non-employee directors may be granted options to purchase shares of stock and five broad-based plans under which options may be granted to all employees, including officers. The sixth plan provides for both option grants and stock based awards including restricted stock awards. Options granted under these plans expire either 5 or 10 years from the grant date and generally vest over two to four years.

All stock option grants and awards to our executive officers and vice presidents are made after a review by, and with the approval of, either the Compensation Committee of the Board of Directors or the entire Board of Directors. All members of the Compensation Committee are independent directors, as defined in the applicable rules for issuers traded on the Nasdaq Stock Market. Our executive officers include Bruce C. Edwards, Executive Chairman of the Board, Ronald J. Buschur, President and Chief Executive Officer; Kevin T. Michaels, Chief Financial Officer and Secretary; Robert J. Legendre, Senior Vice President, Global Operations; and Gregory K. Gaines, Vice President, Global Sales and Marketing. See the “Compensation Committee Report On Executive Compensation” appearing in the Company’s Annual Proxy Statement for further information concerning the policies and procedures of the Company and the Compensation Committee regarding the use of stock options.

During the three months ended April 2, 2006, we granted options to purchase a total of 11,000 shares of Common Stock to employees. After deducting 288,939 shares for options forfeited, the result was net option forfeitures of 277,939. Net option forfeitures during the year represented 0.2% of our total outstanding common shares of 112,129,564 as of April 2, 2006. The following table summarizes the net stock option grants to our employees, directors and executive officers during the three most recent fiscal periods:

	Three Months Ended April 2, 2006	Year Ended January 1, 2006	Year Ended January 2, 2005
Net grants (forfeitures) during the period as a % of total outstanding common shares	(0.2)%	(0.4)%	0.2%
Grants to executive officers during the period as a % of total options granted during the period.....	—%	—%	46.8%
Grants to executive officers during the period as a % of total outstanding common shares	—%	—%	0.8%
Cumulative options held by executive officers as a % of total options outstanding.....	34.4%	30.5%	26.7%

At April 2, 2006, a total of 9,759,398 options were available for grant under all of our option plans and a total of 81,661 shares of Common Stock were held in escrow to cover all remaining exercises under the 1995 Stock Option Plan. See “Note 13. Stock Option Plans” in the “Notes to Consolidated Financial Statements” included under Part II, Item 8, and “Financial Statements and Supplementary Data” of the Company’s Annual Report on Form 10-K for the fiscal year ended January 1, 2006 for further information regarding the 1995 Stock Option Plan. The following table summarizes activity for outstanding options under all of our stock option plans during the three months ended April 2, 2006:

	Number of Shares	Price Per Share	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
Balance at January 1, 2006	7,142,723	\$ 1.33 - \$67.08	\$ 10.63	5,053,466	\$ 12.08
Granted	11,000	\$ 13.04 - \$14.28	\$ 13.66		
Exercised	(929,552)	\$ 1.33 - \$12.87	\$ 7.21		
Canceled	(288,939)	\$ 3.64 - \$61.67	\$ 22.93		
Balance at April 2, 2006	<u>5,935,232</u>	\$ 1.56 - \$67.08	\$ 10.57	4,199,927	\$ 11.95

The following table summarizes outstanding stock options that are “in-the-money” and “out-of the-money” as of April 2, 2006. For purposes of this table, in-the-money stock options are those options with an exercise price less than \$13.49 per share, the closing price of Powerwave Common Stock on March 31, 2006, the last trading day of the fiscal quarter, and out-of-the-money stock options are stock options with an exercise price greater than or equal to the \$13.49 per share closing price.

	Exercisable		Unexercisable		Total Shares
	Shares	Wtd. Avg. Exercise Price	Shares	Wtd. Avg. Exercise Price	
In-the-Money.....	3,267,401	\$ 7.09	1,615,949	\$ 6.81	4,883,350
Out-of-the-Money	932,526	\$ 29.00	119,356	\$ 12.89	1,051,882
Total Options Outstanding	<u>4,199,927</u>	\$ 11.95	<u>1,735,305</u>	\$ 7.23	<u>5,935,232</u>

The following table sets forth certain information concerning the exercise of options by each of our executive officers during the three months ended April 2, 2006, including the aggregate value of gains on the date of exercise held by such executive officers, as well as the number of shares covered by both exercisable and unexercisable stock options as of April 2, 2006. Also reported are the values for the in-the-money options which represent the positive spread between the exercise prices of any such existing stock options and the closing price of the Company’s Common Stock on the last trading day of the fiscal quarter.

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at April 2, 2006		Value of Unexercised In-the-Money Options at April 2, 2006 ⁽¹⁾	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Bruce C. Edwards....	50,000	\$ 430,345	166,666	33,334	\$ 1,346,661	\$ 269,339
Ronald J. Buschur....	—	\$ —	695,832	204,168	\$ 2,955,489	\$ 1,604,511
Kevin T. Michaels...	25,000	\$ 264,887	356,645	152,605	\$ 2,548,776	\$ 1,245,277
Robert J. Legendre ..	60,000	\$ 495,000	128,645	156,355	\$ 938,207	\$ 1,265,443
Gregory K. Gaines...	—	\$ —	33,333	66,667	\$ 192,331	\$ 384,669

⁽¹⁾ In accordance with the Securities and Exchange Commission's rules, values are calculated by subtracting the exercise price from the fair market value of the underlying Common Stock. For purposes of this table, fair market value per share is deemed to be \$13.49, the Company's closing Common Stock price reported by Nasdaq on March 31, 2006, the last trading day of the fiscal quarter.

Our shareholders have previously approved all stock option plans under which our Common Stock is reserved for issuance. The following table provides summary information as of April 2, 2006, for all of our stock option plans:

	Number of Shares of Common Stock to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Shares of Common Stock Remaining Available for Future Issuance under our Stock Option Plans (Excluding Shares Reflected in Column 1)
Approved by Shareholders.....	6,135,232 ⁽¹⁾	\$10.57	9,759,398 ⁽²⁾
Not Approved by Shareholders.....	—	—	—
Total.....	<u>6,135,232</u>	<u>\$10.57</u>	<u>9,759,398</u>

⁽¹⁾ Includes 200,000 shares of restricted stock issued under the 2005 Stock Incentive Plan.

⁽²⁾ The number of securities remaining available for future issuance has also been reduced to reflect 200,000 shares of restricted stock issued under the 2005 Stock Incentive Plan.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments include cash and cash equivalents, restricted cash, short-term investments, capital leases and long-term debt. At April 2, 2006, the carrying values of our financial instruments approximated their fair values based upon current market prices and rates.

We are exposed to a number of market risks in the ordinary course of business. These risks, which include foreign currency risk, interest rate risk and commodity price risk, arise in the normal course of business rather than from trading. We have examined our exposures to these risks and have concluded that none of our exposures in these areas are material to fair values, cash flows or earnings.

Foreign Currency Risk

Our international operations represent a substantial portion of our operating results and asset base. We maintain various operations in multiple foreign locations including Brazil, China, Estonia, Finland, France, Germany, Singapore, Sweden and the United Kingdom. These international operations generally incur local operating costs and generate third party revenues in currencies other than the U.S. dollar. Such foreign currency revenues and expenses expose us to foreign currency risk and give rise to foreign exchange gains and losses.

We regularly pursue new customers in various international locations where new deployments or upgrades to existing wireless communication networks are planned. As a result, a significant portion of our revenues are derived from international sources, with our international customers accounting for approximately 70% of our net sales during the three months ended April 2, 2006, 64% of our fiscal 2005 net sales, 71% of our fiscal 2004 net sales and 46% of our fiscal 2003 net sales. Such international sources include Europe, Asia and South America, where there has been historical volatility in several of the regions' currencies. Changes in the value of the U.S. Dollar versus the local currency in which our products are sold exposes us to foreign currency risk since the weakening of an international customer's local currency and banking market may negatively impact such customer's ability to meet their payment obligations to us. In addition, certain of our international customers require that we transact business with them in their own local currency, regardless of the location of our operations, which also exposes us to foreign currency risk. As we sell products or services in foreign currencies, we may be required to convert the payments received into U.S. Dollars or utilize such foreign currencies as payments for expenses of our business, which may give rise to foreign exchange gains and losses. Given the uncertainty as to when and what specific foreign currencies we may be required or decide to accept as payment from our international customers, we cannot predict the ultimate impact that such a decision would have on our business, gross margins and results of operations.

While we monitor our foreign currency exposures, we do not currently maintain an active foreign currency hedging program. We may decide in the future to implement an active hedging program utilizing derivative instruments to assist in managing our foreign exchange rate risk. Based on our overall foreign exchange rate exposure at April 2, 2006, a 10% change in the Euro and the Swedish Krona could have a material effect on our consolidated results of operations or cash flows.

Interest Rate Risk

As of April 2, 2006, we had cash equivalents of approximately \$244.5 million in both interest and non-interest bearing accounts, including restricted cash. We also had \$130.0 million of convertible subordinated notes due July 2008 at a fixed annual interest rate of 1.25%, \$200.0 million of convertible subordinated notes due November 2024 at a fixed annual interest rate of 1.875%, and \$0.4 million capital lease obligations with various maturities at fixed interest rates. We are exposed to interest rate risk primarily through our cash investment portfolio. While short-term investment rates have increased significantly during fiscal 2005, we believe that we are not subject to material fluctuations in principal given the short-term maturities and high-grade investment quality of our investment portfolio, and the fact that the effective interest rate of our portfolio tracks closely to various short-term money market interest rate benchmarks. Therefore, we currently do not use derivative instruments to manage our interest rate risk. Based on our overall interest rate exposure at April 2, 2006, we do not believe that a 100 basis point change in interest rates would have a material effect on our consolidated financial position, results of operations or cash flows.

Commodity Price Risk

Our internal manufacturing operations and contract manufacturers require significant quantities of transistors, semiconductors and various metals for use in the manufacture of our products. Therefore, we are exposed to certain commodity price risk associated with variations in the market prices for these electronic components as these prices directly impact the cost to manufacture products and the price we pay our contract manufacturers to manufacture our products. We attempt to manage this risk by entering into supply agreements with our contract manufacturers and various suppliers of these components. These supply agreements are not long-term supply agreements. If we or our contract manufacturers become subject to a significant increase in the price of one of these components, we would likely be forced to pay such higher prices and we may be unable to pass such costs onto our customers. In addition, certain transistors and semiconductors are regularly revised or changed by their manufacturers, which may result in a requirement for us to redesign a product that utilizes such components or cease to produce such products. In such events, our business, results of operations and financial condition could be adversely affected. Additionally, we require specialized electronic test equipment, which is utilized in both the design and manufacture of our products. Such electronic test equipment is available from limited sources and may not be available in the time periods required for us to meet our customers' demand. If required, we may be forced to pay higher prices for such equipment and/or we may not be able to obtain the equipment in the time periods required, which would then delay our development or production of new products. Such delays and any potential additional costs could have a material adverse effect on our business, results of operations and financial condition.

ITEM 4. CONTROLS AND PROCEDURES

Controls and Procedures

We have established disclosure controls and procedures to ensure that material information relating to Powerwave and its consolidated subsidiaries is made known to the officers who certify the Company's financial reports, as well as other members of senior management and the Board of Directors, to allow timely decisions regarding required disclosures. As of the end of the period covered by this report, Powerwave carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information related to the Company that is required to be included in Powerwave's annual and periodic SEC filings.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, 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. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Powerwave have been detected.

Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the first quarter of fiscal 2006 that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various legal proceedings and threatened legal proceedings from time to time as part of our business. We are not currently party to any legal proceedings nor aware of any threatened legal proceedings, the adverse outcome of which, individually or in the aggregate, we believe would have a material adverse effect on our business, financial condition and results of operations. However, any potential litigation, regardless of its merits, could result in substantial costs to us and divert management's attention from our operations. Such diversions could have an adverse impact on our business, results of operations and financial condition.

ITEM 1A. RISK FACTORS

We rely upon a few customers for the majority of our revenues and the loss of any one of these customers, or a significant loss, reduction or rescheduling of orders from any of these customers, would have a material adverse effect on our business, results of operations and financial condition.

We sell most of our products to a small number of customers, and we expect that this will continue. For the three months ended April 2, 2006, sales to Nokia accounted for approximately 15% of net sales and sales to Siemens accounted for 10% or more of our net sales. For fiscal year 2005, Cingular Wireless accounted for approximately 15% of our net sales and Nokia accounted for 10% or more of our net sales. During the first quarter of 2006, our direct sales to Cingular Wireless significantly declined when compared to the fourth quarter of 2005 and such decline contributed to our operating loss for the first quarter. Our future success is dependent upon the continued purchases of our products by such customers and any fluctuations in demand from such customers could negatively impact our results of operations. If we are unable to broaden our customer base and expand relationships with major wireless original equipment manufacturers and major operators of wireless networks, our business will continue to be impacted by unanticipated demand fluctuations due to our dependence on a small number of customers. Unanticipated demand fluctuations can have a negative impact on our revenues and business, and an adverse effect

on our results of operations and financial condition. In addition, our dependence on a small number of major customers exposes us to numerous other risks, including:

- a slowdown or delay in deployment of wireless networks by any one customer could significantly reduce demand for our products;
- reductions in a single customer's forecasts and demand could result in excess inventories;
- each of our customers has significant purchasing leverage over us to require changes in sales terms including pricing, payment terms and product delivery schedules;
- direct competition should a customer decide to increase its level of internal designing and/or manufacturing of wireless communication network products; and
- concentration of accounts receivable credit risk, which could have a material adverse effect on our liquidity and financial condition if one of our major customers declared bankruptcy or delayed payment of their receivables.

We may incur unanticipated costs as we complete the integration of our business with businesses we recently acquired.

On May 3, 2004, we completed the exchange offer for the outstanding shares of LGP Allgon and on September 2, 2005, we completed the REMEC Wireless Acquisition. These acquisitions involve the integration of companies and operations, many of which are based in different countries that previously have operated independently. This is a complex, costly and time consuming process. We have limited experience integrating operations as substantial and geographically diverse as those of LGP Allgon and REMEC Wireless, and as a result, we may not successfully integrate these operations with our own in a timely manner, or at all. The failure to successfully integrate these operations could undermine the anticipated benefits and synergies of the acquisitions, which could adversely affect our business, financial condition and results of operations. The anticipated benefits and synergies of these acquisitions relate to cost savings associated with operational efficiencies, greater economies of scale and revenue enhancement opportunities. However, these anticipated benefits and synergies are based on projections and assumptions, not actual experience, and assume a smooth and successful integration of these businesses.

In addition, the acquisition of LGP Allgon and REMEC's Wireless systems business are the largest acquisitions we have completed and the complex process of integrating these businesses requires significant resources. We have incurred and will continue to incur significant costs and commit significant management time in integrating LGP Allgon's and REMEC Wireless' operations, information, communications and other systems and personnel, among other items. The integration of these businesses has resulted and will continue to result in cash outflows related to the integration process, such as:

- fees and expenses of professionals and consultants involved in completing the integration process;
- settling existing liabilities of the acquired businesses; and
- integrating technology and personnel.

We have begun the process of implementing a new worldwide enterprise resource planning system and if we are unsuccessful in deploying the system or, if it takes longer than anticipated to deploy the system, we may incur significant additional costs which would negatively impact our financial results as well as potentially weaken our systemic internal controls.

At the end of 2004, we made the decision to replace our existing enterprise resource planning systems with a single global system from Oracle. We have begun the implementation phase and intend to convert the remainder of our enterprise resource planning systems during the next six months to the Oracle platform. System conversions are expensive and time consuming undertakings that impact all areas of the Company. While a successful implementation will provide many benefits to the Company, an unsuccessful or delayed implementation will cost the Company significant time and resources, as well as expense. In addition, due to the systemic internal control features within enterprise resource planning systems, any changes in our enterprise resource planning system will have an impact on the testing of our internal controls over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002. If we encounter unanticipated delays in deploying our new enterprise resource planning system, we may be unable to complete within the currently required time period our Section 404 testing of the systemic internal controls within such system, which could create a material weakness or significant deficiency in our overall internal controls as of the end of a fiscal year.

We have previously experienced significant reductions in demand for our products, by certain customers and if this continues, our operating results will be adversely impacted.

We have a history of significant unanticipated reductions in demand that demonstrates the risks related to our customer and industry concentration levels. While our revenues increased during fiscal year 2005, a significant portion of this increase was due to our acquisitions of LGP Allgon and REMEC Wireless. During the first quarter of 2006, we experienced significantly reduced demand for our products due to lower than anticipated purchasing plans by a major North American wireless network operator, Cingular Wireless. As a result of this reduction and general slowness in the infrastructure marketplace during the quarter, our revenues decreased to \$193.1 million from \$258.7 million in the fourth quarter of 2005. Revenues from wireless network operators decreased to \$47.9 million in 2003 from \$73.5 million in 2002. These types of reductions in overall market demand had a negative impact on our results of operations.

During fiscal 2005, we experienced a significant reduction in demand from Nortel. While during 2005 we were able to offset this reduction with demand from other customers, we cannot guarantee that we will be able to continue to generate new demand to offset reductions from existing customers. If we are unable to continue to generate new demand, our revenues will go down and our results of operations will be negatively impacted.

We have also in the past experienced significant unanticipated reductions in wireless network operator demand as well as significant delays in demand for WCDMA, or 3G, based products due to the high projected capital cost of building such networks and market concerns regarding the inoperability of such network protocols. In combination with these market issues, a majority of wireless network operators have, in the past, regularly reduced their capital spending plans in order to improve their overall cash flow. The continuation of any delays in development of 3G networks will result in reduced demand for our products which will have a material adverse effect on our business.

We have experienced, and will continue to experience, significant fluctuations in sales and operating results from quarter to quarter.

Our quarterly results fluctuate due to a number of factors, including:

- the lack of any obligation by our customers to purchase their forecasted demand for our products;
- variations in the timing, cancellation, or rescheduling of customer orders and shipments;
- high fixed expenses that increase operating expenses, especially during a quarter with a sales shortfall;
- product failures and associated warranty and in-field service support costs; and
- discounts given to certain customers for large volume purchases.

We have regularly generated a large percentage of our revenues in the last month of a quarter. Since we attempt to ship products quickly after we receive orders, we may not always have a significant backlog of unfilled orders at the start of each quarter and we may be required to book a substantial portion of our orders during the quarter in which such orders ship. Our major customers generally have no obligation to purchase forecasted amounts and may cancel orders, change delivery schedules or change the mix of products ordered with minimal notice and without penalty. As a result, we may not be able to accurately predict our quarterly sales. Because our expense levels are partially based on our expectations of future sales, our expenses may be disproportionately large relative to our revenues, and we may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. Any shortfall in sales relative to our quarterly expectations or any delay of customer orders would adversely affect our revenues and results of operations.

Order deferrals and cancellations by our customers, declining average sales prices, changes in the mix of products sold, delays in the introduction of new products and longer than anticipated sales cycles for our products have, in the past, adversely affected our results of operations. Despite these factors, we, along with our contract manufacturers, maintain significant finished goods, work-in-progress and raw materials inventory to meet estimated order forecasts. If our customers purchase less than their forecasted orders or cancel or delay existing purchase orders, there will be higher levels of inventory that face a greater risk of obsolescence. If our customers desire to purchase products in excess of the forecasted amounts or in a different product mix, there may not be enough inventory or manufacturing capacity to fill their orders.

Due to these and other factors, our past results are not reliable indicators of our future performance. Future revenues and operating results may not meet the expectations of public market analysts or investors. In either case, the price of our Common Stock could be materially adversely affected.

Our average sales prices have declined, and we anticipate that the average sales prices for our products will continue to decline and negatively impact our gross profit margins.

Wireless service providers are continuing to place pricing pressure on wireless infrastructure manufacturers, which in turn, has resulted in lower selling prices for our products, with certain competitors aggressively reducing prices in an effort to increase their market share. We believe that the average sales prices of our products will continue to decline for the foreseeable future. The average sales price for our radio frequency power amplifier products declined by between 1% to 27% from fiscal 2004 to fiscal 2005. Since wireless infrastructure manufacturers frequently negotiate supply arrangements far in advance of delivery dates, we must often commit to price reductions for our products before we know how, or if, we can obtain such cost reductions. In addition, average sales prices are affected by price discounts negotiated without firm orders for large volume purchases by certain customers. To offset declining average sales prices, we must reduce manufacturing costs and ultimately develop new products with lower costs or higher average sales prices. If we cannot achieve such cost reductions or increases in average selling prices, our gross margins will decline.

Our suppliers, contract manufacturers or customers could become competitors.

Many of our customers internally design and/or manufacture their own wireless communications network products. These customers also continuously evaluate whether to manufacture their own wireless communications network products or utilize contract manufacturers to produce their own internal designs. Certain of our customers regularly produce or design wireless communications network products in an attempt to replace products manufactured by us. We believe that this practice will continue. In the event that our customers manufacture or design their own wireless communications network products, such customers could reduce or eliminate their purchases of our products, which would result in reduced revenues and would adversely impact our results of operations and liquidity. Wireless infrastructure equipment manufacturers with internal manufacturing capabilities, including many of our customers, could also sell wireless communications network products externally to other manufacturers, thereby competing directly with us. In addition, our suppliers or contract manufacturers may decide to produce competing products directly for our customers and, effectively, compete against us. If, for any reason, our customers produce their wireless communications network products internally, increase the percentage of their internal production, require us to participate in joint venture manufacturing with them, engage our suppliers or contract manufacturers to manufacture competing products, or otherwise compete directly against us, our revenues would decrease, which would adversely impact our results of operations.

Our success is tied to the growth of the wireless services communications market and our future revenue growth is dependent upon the expected increase in the size of this market.

Our revenues come primarily from the sale of wireless communications network products and coverage solutions. Our future success depends upon the growth and increased availability of wireless communications services. Wireless communications services may not grow at a rate fast enough to create demand for our products, as we experienced during fiscal 2003. During this period, wireless network operators reduced or delayed capital spending on wireless networks in order to preserve their operating cash and improve their balance sheets. Such reduced spending on wireless networks has had a negative impact on our operating results. If wireless network operators begin to delay or reduce levels of capital spending, our operating results will be negatively impacted.

Our reliance on contract manufacturers exposes us to risks of excess inventory or inventory carrying costs.

If our contract manufacturers are unable to timely respond to changes in customer demand, we may be unable to produce enough products to respond to sudden increases in demand resulting in lost revenues, or alternatively, in the case of order cancellations or decreases in demand, we may be liable for excess or obsolete inventory or cancellation charges resulting from contractual purchase commitments that we have with our contract manufacturers. We regularly provide rolling forecasts of our requirements to our contract manufacturers for planning purposes, pursuant to our agreements, a portion of which is binding upon us. Additionally, we are committed to accept delivery on the forecasted terms for a portion of the rolling forecast. Cancellations of orders or changes to the forecasts provided to any of our contract manufacturers may result in cancellation costs payable by us. In the past, we have been required to take delivery of materials from other suppliers and subcontractors that were in excess of our requirements and we have previously recognized charges and expenses related to such excess material. We expect that we will incur such costs in the future.

By using contract manufacturers, our ability to directly control the use of all inventory is reduced since we do not have full operating control over their operations. If we are unable to accurately forecast demand for our contract manufacturers and manage the costs associated with our contract manufacturers, we may be required to pay inventory carrying costs or purchase excess inventory. If we or our contract manufacturers are unable to utilize such

excess inventory in a timely manner, and are unable to sell excess components or products due to their customized nature, our operating results and liquidity would be negatively impacted.

Our acquisition of selected assets and liabilities of REMEC, Inc.'s Wireless Systems Business, as well as future acquisitions or strategic alliances, may present risks, and we may be unable to achieve the financial and strategic goals intended at the time of any acquisition or strategic alliance.

On September 2, 2005, we completed the REMEC Wireless Acquisition. In the past, we have acquired and made investments in other companies, products and technologies and entered into strategic alliances with other companies. We continually evaluate these types of opportunities. In addition to the REMEC Wireless Acquisition, we may acquire or invest in other companies, products or technologies, or we may enter into joint ventures, mergers or strategic alliances with other companies. Such transactions subject us to numerous risks, including the following:

- difficulty integrating the operations, technology and personnel of the acquired company;
- inability to achieve the anticipated financial and strategic benefits of the specific acquisition or strategic alliance;
- significant additional warranty costs due to product failures and or design differences that were not identified during due diligence, and such costs could result in charges to earnings if they are not recoverable from the seller;
- inability to retain key technical and managerial personnel from the acquired company;
- difficulty in maintaining controls, procedures and policies during the transition and integration process;
- diversion of our management's attention from other business concerns;
- failure of our due diligence process to identify significant issues, including issues with respect to product quality, product architecture, legal and financial contingencies, and product development; and
- significant exit charges if products acquired in business combinations are unsuccessful.

If we are unable to effectively manage these risks as part of any acquisition or joint venture, our business would be adversely affected.

We depend on single sources or limited sources for key components and products, which exposes us to risks related to product shortages or delays, as well as potential product quality issues, all of which could increase the cost of our products thereby reducing our operating profits.

A number of our products and the parts used in our products are available from only one or a limited number of outside suppliers due to unique component designs, as well as certain quality and performance requirements. To take advantage of volume pricing discounts, we also purchase certain products, and along with our contract manufacturers, purchase certain customized components from single or limited sources. We have experienced, and expect to continue to experience, shortages of single-source and limited-source components. Shortages have compelled us to adjust our product designs and production schedules and have caused us to miss customer requested delivery dates. To date, the missed customer delivery dates have not had a material adverse impact on our financial results. If single-source or limited-source components become unavailable in sufficient quantities in the desired time periods, are discontinued or are available only on unsatisfactory terms, we would be required to purchase comparable components from other sources and may be required to redesign our products to use such components which could delay production and delivery of our products. If production and delivery of our products are delayed such that we do not meet the agreed upon delivery dates of our customers, such delays could result in lost revenues due to customer cancellations, as well as potential financial penalties payable to our customers. Any such loss of revenue or financial penalties could have a material adverse effect on our results of operations.

Our reliance on certain single-source and limited-source components and products also exposes us and our contract manufacturers to quality control risks if these suppliers experience a failure in their production process or otherwise fail to meet our quality requirements. A failure in a single-source or limited-source component or product could force us to repair or replace a product utilizing replacement components. If we cannot obtain comparable replacements or redesign our products, we could lose customer orders or incur additional costs, which would have a material adverse effect on our results of operations.

We may fail to develop products that are sufficiently manufacturable, which could negatively impact our ability to sell our products.

Manufacturing our products is a complex process that requires significant time and expertise to meet customers' specifications. Successful manufacturing is substantially dependent upon the ability to assemble and tune these products to meet specifications in an efficient manner. In this regard, we largely depend on our staff of assembly workers and trained technicians at our internal manufacturing operations in the U.S., Costa Rica, Europe and Asia, as well as our contract manufacturers' staff of assembly workers and trained technicians predominantly located in Asia. If we cannot design our products to minimize the manual assembly and tuning process, or if we or our contract manufacturers lose a number of trained assembly workers and technicians or are unable to attract additional trained assembly workers or technicians, we may be unable to have our products manufactured in a cost effective manner.

We have recently sold our Philippines manufacturing facility to Celestica. If after the transfer of ownership production efficiency falls, we could be adversely affected.

On March 10, 2006, we sold our manufacturing facility in the Philippines to Celestica. As part of this sale, we have committed to buy products from Celestica manufactured in the Philippines facility. If Celestica is unable to maintain current production levels or has some other difficulty in managing the facility, we could be adversely impacted and unable to deliver certain products to our customers. Such failure could cause us to purchase replacement products which would have a negative impact on our operating results.

We may fail to develop products that are of adequate quality and reliability, which could negatively impact our ability to sell our products.

We have had quality problems with our products in the past and may have similar problems in the future. We have replaced components in some products and replaced entire products in accordance with our product warranties. We believe that our customers will demand that our products meet increasingly stringent performance and reliability standards. If we cannot keep pace with technological developments, evolving industry standards and new communications protocols, if we fail to adequately improve product quality and meet the quality standards of our customers, or if our contract manufacturers fail to achieve the quality standards of our customers, we risk losing business which would negatively impact our results of operations. Design problems could also damage relationships with existing and prospective customers and could limit our ability to market our products to large wireless infrastructure manufacturers, many of which build their own products and have stringent quality control standards.

If we are unable to hire and retain highly qualified technical and managerial personnel, we may not be able to sustain or grow our business.

Competition for personnel, particularly qualified engineers, is intense. The loss of a significant number of such persons, as well as the failure to recruit and train additional technical personnel in a timely manner, could have a material adverse effect on our business, results of operations and financial condition. The departure of any of our management and technical personnel, the breach of their confidentiality and non-disclosure obligations to Powerwave or the failure to achieve our intellectual property objectives may also have a material adverse effect on our business.

We believe that our success depends upon the knowledge and experience of our management and technical personnel and our ability to market our existing products and to develop new products. Our employees are generally employed on an at-will basis and do not have non-compete agreements. Therefore, we have had, and may continue to have, employees leave us and go to work for competitors.

There are significant risks related to our internal and contract manufacturing operations in Asia.

As part of our manufacturing strategy, we utilize contract manufacturers in China, Singapore and Thailand. We also maintain our own manufacturing operations in China, Costa Rica, Estonia and Sweden, as well as limited capability in the United States. We sold our Philippines manufacturing facility to one of our contract manufacturers in March 2006.

The Chinese legal system lacks transparency, which gives the Chinese central and local government authorities a higher degree of control over our business in China than is customary in the United States and makes the process of obtaining necessary regulatory approval in China inherently unpredictable. In addition, the protection accorded our proprietary technology and know-how under the Chinese and Thai legal systems is not as strong as in the United States and, as a result, we may lose valuable trade secrets and competitive advantage. Also, manufacturing our products and utilizing contract manufacturers, as well as other suppliers throughout the Asia region, exposes our

business to the risk that our proprietary technology and ownership rights may not be protected or enforced to the extent that they may be in the United States.

Although the Chinese government has been pursuing economic reform and a policy of welcoming foreign investments during the past two decades, it is possible that the Chinese government will change its current policies in the future, making continued business operations in China difficult or unprofitable.

In February 2006, the Philippines experience a failed coup to overturn the existing government, which prompted the government to declare a state of emergency. While the state of emergency was eventually lifted, this highlights some of the political risks of relying upon manufacturing operations in this location. If there were to be a coup or some other type of political unrest, such activity may impact the ability to manufacture products in this region and may prevent shipments from entering or leaving the country. Any such disruptions could have a material negative impact on our operations and financial results.

We require air or ocean transport to ship products built in our various manufacturing locations to our customers. High energy costs have increased our transportation cost which has had a negative impact on our production costs. Transportation costs would escalate if there were a shortage of air or ocean cargo space and any significant increase in transportation costs would cause an increase in our expenses and negatively impact our results of operations. In addition, if we are unable to obtain cargo space or secure delivery of components or products due to labor strikes, lockouts, work slowdowns or work stoppages by longshoremen, dock workers, airline pilots or other transportation industry workers, our delivery of products could be adversely delayed.

The initial sales cycle associated with our products is typically lengthy, often lasting from nine to eighteen months, which could cause delays in forecasted sales and cause us to incur substantial expenses before we record any associated revenues.

Our customers normally conduct significant technical evaluations, trials and qualifications of our products before making purchase commitments. This qualification process involves a significant investment of time and resources from both our customers and us in order to ensure that our product designs are fully qualified to perform as required. The qualification and evaluation process, as well as customer field trials, may take longer than initially forecasted, thereby delaying the shipment of sales forecasted for a specific customer for a particular quarter and causing our operating results for the quarter to be less than originally forecasted. Such a sales shortfall would reduce our profitability and negatively impact our results of operations.

We conduct a significant portion of our business internationally, which exposes us to increased business risks.

For the three months ended April 2, 2006, and fiscal years 2005, 2004, and 2003, international revenues (excluding North American sales) accounted for approximately 70%, 64%, 71%, and 46% of our net sales, respectively. There are many risks that currently impact, and will continue to impact our international business and multinational operations, including the following:

- compliance with multiple and potentially conflicting regulations in Europe, Asia, North and South America, including export requirements, tariffs, import duties and other trade barriers, as well as health and safety requirements;
- potential labor strikes, lockouts, work slowdowns and work stoppages at U.S. and international ports;
- differences in intellectual property protections throughout the world;
- difficulties in staffing and managing foreign operations in Europe, Asia and South America, including dealings with unionized labor pools in Europe;
- longer accounts receivable collection cycles in Europe, Asia and South America;
- currency fluctuations and resulting losses on currency translations;
- terrorists attacks on American companies;
- economic instability, including inflation and interest rate fluctuations, such as those previously seen in South Korea and Brazil;
- competition for foreign based suppliers throughout the world;
- overlapping or differing tax structures;

- the complexity of global tax and transfer pricing rules and regulations and our potential inability to benefit/offset losses in one tax jurisdiction with income from another;
- cultural and language differences between the United States and the rest of the world; and
- political or civil turmoil.

Any failure on our part to manage these risks effectively would seriously reduce our competitiveness in the wireless infrastructure marketplace.

Protection of our intellectual property is limited.

We rely upon trade secrets and patents to protect our intellectual property. We execute confidentiality and non-disclosure agreements with certain employees and our suppliers, as well as limit access to and distribution of our proprietary information. We have an on-going program to identify and file applications for U.S. and other international patents.

The departure of any of our management and technical personnel, the breach of their confidentiality and non-disclosure obligations to us, or the failure to achieve our intellectual property objectives could have a material adverse effect on our business, results of operations and financial condition. We do not have non-compete agreements with our employees who are generally employed on an at-will basis. Therefore, we have had, and may continue to have, employees leave us and go to work for competitors. If we are not successful in prohibiting the unauthorized use of our proprietary technology or the use of our processes by a competitor, our competitive advantage may be significantly reduced which would result in reduced revenues.

We are at risk of third-party claims of infringement that could harm our competitive position.

We have received third-party claims of infringement in the past and have been able to resolve such claims without having a material impact on our business. As the number of patents, copyrights and other intellectual property rights in our industry increases, and as the coverage of these rights and the functionality of the products in the market further overlap, we believe that we may face additional infringement claims. Such claims, whether or not valid, could result in substantial costs and diversion of our resources. A third party claiming infringement may also obtain an injunction or other equitable relief, which could effectively block the distribution or sale of allegedly infringing products, which would adversely affect our customer relationships and negatively impact our revenues.

The communications industry is heavily regulated. We must obtain regulatory approvals to manufacture and sell our products, and our customers must obtain approvals to operate our products. Any failure or delay by us or any of our customers to obtain such approvals could negatively impact our ability to sell our products.

Various governmental agencies have adopted regulations that impose stringent radio frequency emissions standards on the communications industry. Future regulations may require that we alter the manner in which radio signals are transmitted or otherwise alter the equipment transmitting such signals. The enactment by governments of new laws or regulations or a change in the interpretation of existing regulations could negatively impact the market for our products.

The increasing demand for wireless communications has exerted pressure on regulatory bodies worldwide to adopt new standards for such products, generally following extensive investigation and deliberation over competing technologies. The delays inherent in this type of governmental approval process have caused, and may continue to cause, the cancellation, postponement or rescheduling of the installation of communications systems by our customers. These types of unanticipated delays would result in delayed or cancelled customer orders.

The price of our Common Stock has been, and may continue to be, volatile and our shareholders may not be able to resell shares of our Common Stock at or above the price paid for such shares.

The price for shares of our Common Stock has exhibited high levels of volatility with significant volume and price fluctuations, which makes our Common Stock unsuitable for many investors. For example, for the two years ended January 1, 2006, the price of our Common Stock ranged from a high of \$13.92 to a low of \$4.54. The fluctuations in the price of our Common Stock have occasionally been unrelated to our operating performance. These broad fluctuations may negatively impact the market price of shares of our Common Stock. The price of our Common Stock has also been influenced by:

- fluctuations in our results of operations or the operations of our competitors or customers;

- failure of our results of operations and sales revenues to meet the expectations of stock market analysts and investors;
- reductions in wireless infrastructure demand or expectations of future wireless infrastructure demand by our customers;
- delays or postponement of wireless infrastructure deployments, including new 3G deployments;
- changes in stock market analyst recommendations regarding us, our competitors or our customers;
- the timing and announcements of technological innovations, new products or financial results by us or our competitors; and
- changes in the wireless industry.

In addition, the increase in the number of shares of our outstanding Common Stock due to the potential conversion of our outstanding convertible debt instruments would add approximately 30.4 million shares of Common Stock to our outstanding shares. Such an increase may lead to sales of such shares or the perception that such sales may occur, either of which may adversely affect the market for, and the market price of, our Common Stock. Any potential future sale or issuance of shares of our Common Stock or instruments convertible or exchangeable into shares of our Common Stock, or the perception that such sales or transactions could occur, could adversely affect the market price of our Common Stock.

Based on the above, we expect that our stock price will continue to be extremely volatile. Therefore, we cannot guarantee that our investors will be able to resell their Powerwave shares at or above their acquisition price.

We may need additional capital in the future and such additional financing may not be available at favorable terms.

We may need to raise additional funds through public or private debt or equity financings in order to take advantage of opportunities, including more rapid international expansion or acquisitions of complementary businesses or technologies. If we are not successful in integrating our businesses and managing the worldwide aspects of our company, our operations may not generate profits and may consume our cash resources faster than we anticipate. Such losses would make it difficult to obtain new sources of financing. In addition, if we do not generate sufficient cash flow from operations, we may need to raise additional funds to repay our \$330.0 million of outstanding convertible debt that we issued in 2003 and 2004. Our ability to secure additional financing or sources of funding is dependent upon numerous factors, including the current outlook of our business, our credit rating and the market price of our common stock, all of which are directly impacted by our ability to increase revenues and generate profits. Our ability to increase revenues and generate profits is subject to numerous risks and uncertainties and any significant decrease in our revenues or profitability could reduce our operating cash flows and erode our existing cash balances. If we are unable to secure additional financing or such financing is not available at acceptable terms, we may not be able to take advantage of such opportunities, or otherwise respond to unanticipated competitive pressures.

The wireless communications infrastructure equipment industry is extremely competitive and is characterized by rapid technological change, frequent new product development, rapid product obsolescence, evolving industry standards and significant price erosion over the life of a product. If we are unable to compete effectively, our business, results of operations and financial condition would be adversely affected.

Our products compete on the basis of the following characteristics:

- performance;
- functionality;
- reliability;
- pricing;
- quality;
- designs that can be efficiently manufactured in large volumes;
- time-to-market delivery capabilities; and
- compliance with industry standards.

If we fail to address the above factors, there could be a material adverse effect on our business, results of operations and financial condition.

Our current competitors include Andrew Corporation, Filtronic PLC, Fujitsu Limited, Hitachi Kokusai Electric Inc., Japan Radio Co., Ltd., Kathrein-Werke KG, Mitsubishi Electric Corporation, and Radio Frequency Systems, in addition to a number of privately held companies throughout the world, subsidiaries of certain multinational corporations and the internal manufacturing operations and design groups of the leading wireless infrastructure manufacturers such as Ericsson, Motorola, Nokia, Nortel, Samsung and Siemens. Some competitors have adopted aggressive pricing strategies in an attempt to gain market share, which in return, has caused us to lower our prices in order to remain competitive. Such pricing actions have had an adverse effect on our financial condition and results of operations. In addition, some competitors have significantly greater financial, technical, manufacturing, sales, marketing and other resources than we do and have achieved greater name recognition for their products and technologies than we have. If we are unable to successfully increase our market penetration or our overall share of the wireless communications infrastructure equipment market, our revenues will decline, which would negatively impact our results of operations.

Our failure to enhance our existing products or to develop and introduce new products that meet changing customer requirements and evolving technological standards could have a negative impact on our ability to sell our products.

To succeed, we must improve current products and develop and introduce new products that are competitive in terms of price, performance and quality. These products must adequately address the requirements of wireless infrastructure manufacturing customers and end-users. To develop new products, we invest in the research and development of wireless communications network products and coverage solutions. We target our research and development efforts on major wireless network deployments worldwide, which cover a broad range of frequency and transmission protocols. In addition, we are currently working on products for next generation networks, as well as development projects for products requested by our customers and improvements to our existing products. The deployment of a wireless network may be delayed which could result in the failure of a particular research or development effort to generate a revenue producing product. Additionally, the new products we develop may not achieve market acceptance or may not be able to be manufactured cost effectively in sufficient volumes. Our research and development efforts are generally funded internally and our customers do not normally pay for our research and development efforts. These costs are expensed as incurred. Therefore, if our efforts are not successful at creating or improving products that are purchased by our customers, there will be a negative impact on our operating results due to high research and development expenses.

Failure to maintain effective internal controls over financial reporting could adversely affect our business and the market price of our Common Stock.

Pursuant to rules adopted by the SEC implementing Section 404 of the Sarbanes-Oxley Act of 2002, we are required to assess the effectiveness of our internal controls over financial reporting and provide a management report on our internal controls over financial reporting in all annual reports, beginning with our Annual Report on Form 10-K for the fiscal year ended January 2, 2005. This report contains, among other matters, a statement as to whether or not our internal controls over financial reporting are effective and the disclosure of any material weaknesses in our internal controls over financial reporting identified by management. Section 404 also requires our independent registered public accounting firm to audit management's report.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) provides a framework for companies to assess and improve their internal control systems. Auditing Standard No. 2 provides the professional standards and related performance guidance for auditors to attest to, and report on, management's assessment of the effectiveness of internal control over financial reporting under Section 404. Management's assessment of internal controls over financial reporting requires management to make subjective judgments and, particularly because Section 404 and Auditing Standard No. 2 are newly effective, some of the judgments will be in areas that may be open to interpretation. Therefore, our management's report on our internal controls over financial reporting may be difficult to prepare, and our auditors may not agree with our management's assessment.

While we currently believe our internal controls over financial reporting are effective, we are required to comply with Section 404 on an annual basis. If, in the future, we identify one or more material weaknesses in our internal controls over financial reporting during this continuous evaluation process, our management will be unable to assert such internal controls are effective. Although we currently anticipate being able to continue to satisfy the requirements of Section 404 in a timely fashion, we cannot be certain as to the timing of completion for our future evaluation, testing and any required remediation due in large part to the fact that there are limited precedents available by which to measure compliance with these new requirements. In addition, we have begun the process of replacing our enterprise resource planning system and such system replacement during fiscal 2006 may create unanticipated delays in completing the documentation and testing requirements of Section 404. Therefore, if we are

unable to assert that our internal controls over financial reporting are effective in the future, or if our auditors are unable to attest that our management's report is fairly stated or they are unable to express an opinion on the effectiveness of our internal controls, we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our business and the market price of our Common Stock.

Our shareholder rights plan and charter documents could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders.

Our shareholder rights plan and certain provisions of our certificate of incorporation and Delaware law are intended to encourage potential acquirers to negotiate with us and allow our Board of Directors the opportunity to consider alternative proposals in the interest of maximizing shareholder value. However, such provisions may also discourage acquisition proposals or delay or prevent a change in control, which in turn, could harm our stock price and our shareholders.

Our business is subject to the risks of earthquakes and other natural catastrophic events, and to interruptions by man made problems such as computer viruses or terrorism.

Our corporate headquarters and the majority of our U.S. based research and development operations are located in the State of California in regions known for seismic activity. In addition, we have production facilities and have outsourced some of our production to contract manufacturers in Asia, another region known for seismic activity. A significant natural disaster, such as an earthquake in either of these regions, could have a material adverse effect on our business, operating results and financial condition. In addition, despite our implementation of network security measures, our servers are vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems. Any such event could have a material adverse effect on our business.

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report:

Exhibit Number	Description
10.33.1	Amending Agreement dated March 10, 2006 between the Company and Celestica Corporation. **
31.16	2006 Executive Bonus Plan. *
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.***
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.***

* Indicates Item 15(a)(3) exhibit (management contract or compensation plan or arrangement).

** Registrant has sought confidential treatment pursuant to Rule 24b-2 of the Securities Exchange Act of 1934 for a portion of the referenced exhibit.

*** In accordance with Item 601(b)(32)(ii) of Regulation S-K, this exhibit shall not be deemed "filed" for the purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

SIGNATURES

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

Date: May 12, 2006

POWERWAVE TECHNOLOGIES, INC.

By: /s/ KEVIN T. MICHAELS

Kevin T. Michaels
Chief Financial Officer