NETLOGIC MICROSYSTEMS INC
Form 8-K
March 24, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT

PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Date of Report (Date of earliest event reported): March 24, 2010

NetLogic Microsystems, Inc.

(Exact Name of Registrant as Specified in Charter)

Delaware	**000-50838**	**77-0455244**
(State or Other Jurisdiction of Incorporation)	**(Commission File Number)**	**(I.R.S. Employer Identification Number)**

1875 Charleston Road, Mountain View, CA 94043

(Address of Principal Executive Offices) (Zip Code)

Registrant s telephone number, including area code: (650) 961-6676

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (*see* General Instruction A.2. below):

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

This Current Report on Form8-K is being filed in connection with the filing of our registration statement on Form S-3 on March 24, 2010 registering the sale and resale of our common stock.

Item 8.01 Other Events

On February 3, 2010, we provided an estimate in our fourth quarter 2009 financial results conference call of our net loss per share in accordance with generally accepted accounting principles, or GAAP, for the first quarter of 2010 of ($0.63) per pre-split share, or ($0.32) per post-split share. That estimate did not include an estimate for changes in our contingent earn-out liability from December 31, 2009 to March 31, 2010. As discussed in Note 2 of the Notes to our 2009 financial statements filed in our Form 10-K/A, the earn-out consideration is based upon achievement of specified percentages or revenue targets for either the 12-month period from October 1, 2009 through September 30, 2010, or the 12-month period from November 1, 2009 through October 31, 2010, whichever period results in the higher percentage of the revenue target. The additional earn-out consideration, if any, net of applicable indemnity claims, will be paid on or before December 31, 2010. The amount of estimated contingent earn-out liability as of the end of any period is determined from our assessment of the probability of achieving the target revenue milestones associated with the products acquired in the RMI acquisition for which the earn-out would be paid and by multiplying the number of shares of common stock we would expect to issue to former RMI stockholders as a result of such achievement by the closing price for a share of our common stock on each balance sheet date. The price of our common stock has increased significantly since December 31, 2009, and as of the filing date of this Form 8-K we also anticipate a higher probability assessment of achieving the target revenue milestones. Therefore, we expect to record a significant charge under GAAP related to an estimated increase in the contingent earn-out liability associated with the RMI acquisition in the first quarter of 2010 due to changes in these variables. The amount of the contingent earn-out liability that is reflected on our balance sheet at December 31, 2009 was $11.7 million. Assuming a stock price of $30.83 (the last closing sale price of the Company s common stock on March 22, 2010) the change in contingent earn-out liability and the potential impact to expected GAAP net loss per share for the first quarter of 2010 could range as follows:

	Contingent earn-out liability	Change in earn-out liability	Impact on GAAP EPS guidance for Q1 2010 (adjusted for stock split)	Revised GAAP EPS guidance for Q1 2010 (adjusted for stock split)
80% of revenue achievement	$ 17,014	$ 5,328	$ (0.09)	$ (0.40)
90% of revenue achievement	$ 55,954	$ 44,268	$ (0.71)	$ (1.03)
100% of revenue achievement	$ 111,413	$ 99,727	$ (1.61)	$ (1.92)

Our current expectation is that the revenue achievement will be in the middle of the above range. Furthermore, we expect the contingent earn-out liability and associated charge to fluctuate significantly from period-to-period prior to the earn-out measurement date occurring in the fourth quarter of 2010.

The disclosure in this Item 8.01 contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which include, without limitation, statements about our potential earn-out liability of with respect to the products we acquired from RMI (the Acquired RMI Products). Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed forward-looking statements. For example, the words believes , anticipates , plans , expects , intends and similar expressions are intended to identify forward-looking statements. Our actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a discrepancy include, but are not limited to, those discussed in Business , Risk Factors , Management s Discussion and Analysis of Financial Condition and Results of Operation and Qualitative and Quantitative Disclosures About Market Risk in our Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on March 24, 2010, as well as, customer acceptance and demand for the Acquired RMI Products, the volume of sales to our principal product customers of the Acquired RMI Products, manufacturing yields for the Acquired RMI Products, the timing of manufacture and delivery of the Acquired RMI Products by our foundry suppliers, the length of our sales cycles, our average selling prices of the Acquired RMI Products, and the cyclical nature of that market and the semiconductor industry, as well as the changes in the price of our common stock and the probability assessment of achieving the target renewal milestones for the Acquired RIM Products. Our actual results could differ materially from any such forward-looking statements including any guidance regarding EPS provided above. All forward-looking statements in this document are based on information available to us as of the date of this report, and we assume no obligation to update any such forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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Item 9.01(a) Financial Statements of Business Acquired
(a) Financial Statements of Business Acquired.

Audited Consolidated Financial Statements of RMI Corporation and Subsidiaries as of December 31, 2008 and 2007, and for each of the years in the three-year period ended December 31, 2008.

Unaudited Condensed Consolidated Statements of Operations, Statements of Cash Flows and notes thereto of RMI Corporation and Subsidiaries for the nine months ended September 30, 2009 and 2008.

INDEPENDENT AUDITORS REPORT

The Board of Directors

RMI Corporation:

We have audited the accompanying consolidated balance sheets of RMI Corporation and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RMI Corporation and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008 in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has incurred recurring losses from operations and has an accumulated deficit that raise substantial doubt about its ability to continue as a going concern. Management s plan in regard to these matters is also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ KPMG LLP

Mountain View, California

May 22, 2009

RMI CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	December 31, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,188	$ 14,785
Accounts receivable, net of allowances of $351 and $304 in 2008 and 2007, respectively	6,801	5,084
Inventories	7,621	6,930
Prepaid expenses and other current assets	1,905	1,604
Total current assets	30,515	28,403
Property and equipment, net	4,645	3,018
Goodwill	7,163	7,163
Purchased intangibles and other assets, net	4,146	4,233
Total assets	$ 46,469	$ 42,817
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,756	$ 2,853
Accrued payroll and related benefits	2,406	2,386
Other accrued liabilities	5,560	6,049
Deferred income on shipments to distributors	547	909
Line of credit	489	277
Notes payable, current	5,026	4,244
Total current liabilities	16,784	16,718
Notes payable, non-current	1,310	6,336
Deferred tax liability	471	282
Other liabilities	312	384
Total liabilities	18,877	23,720
Commitments and contingencies (Note 11)		
Shareholders equity:		
Series A convertible preferred stock, $0.001 par value. Authorized, issued, and outstanding 6,650,000 shares as of December 31, 2008 and 2007; aggregate liquidation preference of $7,875 as of December 31, 2008	7	7
Series B-1 convertible preferred stock, $0.001 par value. Authorized, issued, and outstanding 35,491,041 shares as of December 31, 2008 and 2007; aggregate liquidation preference of $28,900 as of December 31, 2008	35	35
Series B-2 convertible preferred stock, $0.001 par value. Authorized 70,167,963 shares; issued and outstanding 68,489,838 shares as of December 31, 2008 and 2007; aggregate liquidation preference of $70,253 as of December 31, 2008	68	68
Series C convertible preferred stock, $0.001 par value. Authorized 52,000,000 shares; issued and outstanding 50,730,394 shares as of December 31, 2008 and 2007, respectively; aggregate liquidation preference of $71,368 as of December 31, 2008	50	50
Series D convertible preferred stock, $0.001 par value. Authorized 16,000,000 shares; issued and outstanding 15,822,785 and 0 shares as of December 31, 2008 and 2007, respectively; aggregate liquidation preference of $25,000 as of December 31, 2008	16	
Common stock, $0.001 par value. Authorized 278,000,000 shares; issued and outstanding 33,502,724 and 32,464,750 shares as of December 31, 2008 and 2007, respectively; aggregate liquidation preference of	41	30

$3,350 as of December 31, 2008		
Additional paid-in capital	205,385	177,645
Accumulated deficit	(178,010)	(158,738)
Total shareholders equity	27,592	19,097
Total liabilities and shareholders equity	$ 46,469	$ 42,817

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

RMI CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands)

	Year Ended December 31,		
	2008	**2007**	**2006**
Revenue	$ 78,946	$ 64,345	$ 30,053
Cost of revenue:			
Cost of revenue excluding amortization of purchased technology	30,409	30,032	17,906
Amortization of purchased technology	1,397	3,622	4,274
Total cost of revenue	31,806	33,654	22,180
Gross profit	47,140	30,691	7,873
Operating expenses:			
Research and development	38,875	34,195	26,134
Sales, general and administrative	24,547	18,183	12,169
Delayed public offering	653		
Amortization of other purchased intangible assets	351	774	161
In-process research and development			3,130
Total operating expenses	64,426	53,152	41,594
Loss from operations	(17,286)	(22,461)	(33,721)
Other income (expense)			
Interest expense	(1,940)	(1,937)	(1,354)
Other income, net	57	855	904
Other expense, net	(1,883)	(1,082)	(450)
Loss before income taxes	(19,169)	(23,543)	(34,171)
Provision for income taxes	103	222	94
Net loss before extraordinary item	(19,272)	(23,765)	(34,265)
Extraordinary gain on the resolution of acquisition purchase price contingency (Note 5(b))		3,185	
Net loss	$ (19,272)	$ (20,580)	$ (34,265)

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

RMI CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in thousands, except share data)

	Convertible preferred stock														
	Series A		**Series B-1**		**Series B-2**		**Series C**		**Series D**		**Common stock**		**Additional paid-in capital**	**Accumulated deficit**	**Total share-holders equity**
	Shares	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**			
Balances as of December 31, 2005	**6,650,000**	**7**	**35,491,041**	**35**	**68,489,838**	**68**					**26,214,954**	**24**	**105,075**	**(103,893)**	**1,316**
Issuance of restricted common stock upon exercise of stock options											1,057,878	1	80		81
Repurchases of restricted common stock											(367,333)				
Vesting of restricted common stock													75		75
Share-based compensation on options granted to employees													282		282
Share-based compensation on options granted to non-employees													8		8
Fair value of common stock warrants issued to placement agent in connection with sales of Series C convertible preferred stock													50		50
Fair value of warrants issued to purchase shares of Series C preferred stock in connection with loan agreement													356		356
Issuance of Series C convertible preferred stock for acquisition of business and inventory							20,078,002	20					28,226		28,246
Issuance of Series C convertible preferred stock, net of issuance costs of $1,435							23,189,686	23					31,165		31,188

Net loss												(34,265)	(34,265)
Balances as of December 31, 2006	**6,650,000**	**7**	**35,491,041**	**35**	**68,489,838**	**68**	**43,267,688**	**43**	**26,905,499**	**25**	**165,317**	**(138,158)**	**27,337**
Issuance of restricted common stock upon exercise of stock options									5,566,751	4	439		443
Repurchases of restricted common stock									(7,500)				
Vesting of restricted common stock										1	182		183
Share-based compensation on options granted to employees											1,309		1,309
Share-based compensation on options granted to non-employees											154		154
Fair value of common stock warrants issued to placement agent in connection with sales of Series C convertible preferred stock											19		19
Fair value of warrants issued to purchase shares of Series C preferred stock in connection with loan agreement											190		190
Issuance of Series C convertible preferred stock, net of issuance costs of $457							7,462,706	7			10,035		10,042
Net loss												(20,580)	(20,580)
Balances as of December 31, 2007	**6,650,000**	**7**	**35,491,041**	**35**	**68,489,838**	**68**	**50,730,394**	**50**	**32,464,750**	**30**	**177,645**	**(158,738)**	**19,097**
Issuance of restricted common stock upon exercise of stock options									604,735	6	101		107
Repurchases of restricted common stock									(80,207)				
Vesting of restricted common stock											53		53
Issuance of common stock upon exercise of warrants									513,446	5	36		41

Share-based compensation on options granted to employees													3,695		3,695
Share-based compensation on options granted to non-employees													147		147
Fair value of common stock warrants issued to placement agent in connection with sales of Series D convertible preferred stock													632		632
Issuance of Series D convertible preferred stock, net of issuance costs of $1,276									15,822,785	16			23,076		23,092
Net loss														(19,272)	(19,272)
Balances as of December 31, 2008	**6,650,000**	**$ 7**	**35,491,041**	**$ 35**	**68,489,838**	**$ 68**	**50,730,394**	**$ 50**	**15,822,785**	**$ 16**	**33,502,724**	**$ 41**	**$ 205,385**	**$ (178,010)**	**$ 27,592**

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

RMI CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2008	**2007**	**2006**
Cash flows from operating activities:			
Net loss	$ (19,272)	$ (20,580)	$ (34,265)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	3,836	5,842	5,611
Extraordinary gain		(3,185)	
In-process research and development			3,130
Change in fair value of contingent debt milestone derivative	352	118	
Amortization of loan discounts	757	750	386
Share-based compensation and expense	3,842	1,463	290
Deferred tax provision	188	188	94
Changes in operating assets and liabilities:			
Accounts receivable, net	(1,717)	(1,970)	(2,168)
Inventories	(691)	1,612	1,495
Prepaid expenses and other current assets	(301)	(518)	(425)
Accounts payable	(97)	(566)	2,266
Accrued payroll and related benefits	20	984	363
Other accrued liabilities	(841)	1,140	1,512
Deferred income on shipments to distributors	(362)	633	276
Other, net	(1,284)	(104)	(79)
Net cash used in operating activities	(15,570)	(14,193)	(21,514)
Cash flows from investing activities:			
Purchases of property and equipment	(3,478)	(2,288)	(945)
Cash paid for acquisition			(25)
Net cash used in investing activities	(3,478)	(2,288)	(970)
Cash flows from financing activities:			
Net proceeds from issuance of convertible preferred stock	23,092	9,919	31,544
Net proceeds from issuance of common stock	148	617	190
Repurchase of common stock			(33)
Proceeds from line of credit	212	277	
Proceeds from issuance of notes payable		11,670	3,330
Principal payments of notes payable	(5,001)	(6,481)	(5,960)
Principal payments of intellectual property license obligation		(3,062)	(1,894)
Net cash provided by financing activities	18,451	12,940	27,177
Net increase (decrease) in cash and cash equivalents	(597)	(3,541)	4,693
Cash and cash equivalents at beginning of year	14,785	18,326	13,633
Cash and cash equivalents at end of year	$ 14,188	$ 14,785	$ 18,326
Supplemental disclosures of cash flow information:			
Cash paid for interest	$ 1,236	$ 1,125	$ 839
Noncash financing and investing activities:			
Fair value of common stock warrants issued in connection with preferred stock issuances	632	19	50

Fair value of convertible preferred stock warrants issued in connection with loan agreements	190	356
Fair value of embedded derivatives separated from notes payable	968	253
Fair value of preferred stock issued for acquisition of business and inventory	123	28,246

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

RMI CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 The Company

RMI Corporation, formerly known as Raza Microelectronics, Inc., was formed in September 2002 as a wholly-owned subsidiary of Foundries Holdings, LLC (FHLLC) as a result of the reorganization of various development stage companies majority owned by FHLLC. On September 17, 2002, Transpera Inc., a majority-owned subsidiary of FHLLC and a development stage company, merged with Raza Microelectronics, Inc. (Raza Micro), a wholly owned subsidiary of FHLLC with no previous material activities. Transpera, Inc. continued as the surviving entity and changed its name to Raza Microelectronics, Inc. On October 10, 2002, Raza Micro merged with SiSilk Networks, Inc., a majority-owned subsidiary of FHLLC and a development stage company, with Raza Micro continuing as the surviving entity. In January 2003, Raza Micro issued additional shares such that FHLLC was no longer the majority stockholder. Raza Micro changed its name to RMI Corporation in December 2007.

RMI Corporation and its subsidiaries (the Company) are engaged in the design, production, and sale of semiconductor processor solutions for networking, communication and consumer applications. The Company s headquarters is located in Cupertino, California with branch and subsidiary offices in Texas, India, Hong Kong, Korea, Japan, Taiwan, China, United Kingdom, France, and Cayman Islands.

Note 2 Summary of Significant Accounting Policies

The following is a summary of the Company s significant accounting policies:

(a) Basis of Presentation

The consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and include RMI Corporation and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

The Company has incurred recurring losses from operations and had an accumulated deficit of $178.0 million as of December 31, 2008 that raise substantial doubt about its ability to continue as a going concern. The Company plans to finance its operations through raising additional capital or through other strategic alternatives such as a sale or merger. There can be no assurance that the Company will be successful with these plans. The consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

(b) Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates.

(c) Foreign currencies

The functional currency for all of the Company s foreign subsidiaries is the U.S. dollar. The Company remeasures assets and liabilities at the period end exchange rate for monetary items and at historical exchange rates for non-monetary items. Revenues and expenses are remeasured at the average exchange rate during the period except for income and expenses related to non-monetary items which are remeasured using historical exchange rates. Foreign currency gains (losses) for the years ended December 31, 2008, 2007, and 2006 were not significant and are included in other income, net.

(d) Cash equivalents

The Company considers all highly liquid investments purchased with an original maturity or remaining maturity at the date of purchase of three months or less to be cash equivalents. Cash equivalents consist of money market funds which are available to be redeemed at par value at any time in order to meet liquidity needs.

(e) Fair value of financial instruments

The carrying value of the Company s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and line of credit approximate their fair values due to their relatively short maturities. The Company does not hold any investments other than cash equivalents. As of December 31, 2008 and 2007, the fair value of notes payable was $6.9 million and $11.9 million, respectively. The Company estimates the fair value of notes payable by discounting the future cash flows of the notes using the market rate of interest on the reporting date as determined by the Prime lending rate on that date and the spread of the Company s historical borrowing rate over the Prime lending rate.

(f) Concentrations of risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company s cash equivalents consist of money market accounts with a large financial institution. Cash bank balances generally exceed the amount of federal deposit insurance provided on such balances.

Sales to foreign customers for the years ended December 31, 2008, 2007, and 2006, all of which were denominated in U.S. dollars, accounted for 86%, 88%, and 84%, respectively of total revenue.

The Company performs ongoing credit evaluations of its customers financial condition and requires collateral from certain customers in the form of standby letters of credit. The Company records an allowance for doubtful accounts for its best estimate of the amount of probable credit losses in the existing accounts receivable. The Company determines the allowance based on historical write-off experience and probability of collection. Doubtful accounts expense was not significant in 2008, 2007, and 2006. The Company does not have any off-balance-sheet credit exposure related to its customers.

See Note 10 for individual customers whose revenue or accounts receivable balances were 10% or higher of respective consolidated amounts. An end customer is a customer who uses our products in its systems design but does not purchase products directly from the Company because of its use of outsourced manufacturers. A ship to customer purchases products directly from the Company and includes outsourced manufacturers of the end customers.

Summarized below are individual customers whose accounts receivable balances were 10% or higher of respective consolidated amounts at each period end:

	December 31,	
	2008	**2007**
Percentage of gross accounts receivable		
Customer I	14%	*
Customer F	13%	11%
Customer J	10%	*
Customer E	*	24%
Customer G	*	11%

* Less than 10% of accounts receivable for the respective period end.

The Company outsources its manufacturing to third party wafer foundries and contract manufacturers and some of the key components in the Company s products come from single or limited sources of supply. The inability of any supplier or manufacturer to fulfill supply requirements of the Company could have a negative impact on its business.

(g) Inventories

Inventories are stated at the lower of cost or market. Cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis. Inventories consist primarily of finished goods, work-in-process and raw materials. The Company writes-down the value of inventories for estimated excess and obsolete amounts based upon assumptions about future demand and market conditions. Inventory write downs result in an adjustment to the cost basis of the inventory and are not reversed prior to sale or disposition of the related inventory.

(h) Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, which range from three to five years. Leasehold improvements are amortized over the lower of the useful life or the related remaining lease term which are periods that range from three to five years. Depreciation and amortization expense for the years ended December 31, 2008, 2007 and 2006 was $1.9 million, $1.4 million, and $1.2 million, respectively.

In 2008, the Company capitalized the cost of photomask purchases. A photomask is a type of tooling purchased from the foundry and used in the qualification and manufacturing of the Company s products. In 2008, these costs were capitalized since the Company determined in this period, from its historical experience, that tooling purchased in connection with the qualification of a product had a probable alternate future use in the manufacturing of the product. In 2008, $1.3 million of photomask tooling purchases was capitalized and is being amortized to cost of revenue over useful lives of 2-3 years. Prior to 2008, all costs of photomask purchases were expensed to research and development expense as incurred.

(i) Purchased intangibles

Purchased intangibles consist of purchased technology, customer relationships, order backlog and intellectual property license. Intangible assets are either amortized on a straight-line basis or in proportion to the economic benefits consumed over their estimated useful lives which are periods that range from nine months to seven years. Amortization of intangible assets was $2.0 million, $4.4 million, and $4.4 million in 2008, 2007, and 2006, respectively.

(j) Goodwill and impairment of goodwill

Goodwill represents the excess of the aggregate purchase price over the fair value of the net tangible and intangible assets acquired by the Company. Goodwill is tested for impairment each fiscal year or more often if an event or circumstances indicate that an impairment loss may have been incurred. Goodwill impairment is determined using a two-step approach in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The two-step impairment test identifies potential goodwill impairment and measures the amount of a goodwill impairment loss, if any. Under the first step, the fair value of the reporting unit is compared with its carrying value, including goodwill. If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit s goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, *Business Combinations* (SFAS 141). The residual fair value after this allocation is the implied fair value of the reporting unit s goodwill. An impairment charge is recognized if a reporting unit s goodwill carrying amount exceeds its implied fair value. The Company has allocated all goodwill to a single company-wide reporting unit. Based on the impairment tests performed, there was no impairment of goodwill in 2008, 2007, or 2006.

The Company s goodwill is amortized and deductible for tax purposes which gives rise to a deferred tax liability due to the indefinite life for financial reporting purposes.

(k) Impairment of long-lived assets

The Company continually monitors events and changes in circumstances that could indicate carrying amounts of long-lived assets, including intangible assets, may not be recoverable. When such events or changes in circumstances occur, the Company assesses the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future cash flows is less than the carrying amount of those assets, the Company records an impairment charge based on the excess of the carrying amount over the fair value of the assets.

(l) Share-based compensation

On January 1, 2006, the Company adopted SFAS No. 123(R) *Share-Based Payment* (SFAS 123R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair value. SFAS 123R supersedes the Company s previous accounting using the intrinsic value method of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), for periods beginning in 2006. 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 over the requisite service period. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, *Share-Based Payment* (SAB 107), relating to SFAS 123R. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

The Company adopted SFAS 123R using the prospective transition method, which requires the Company to recognize share-based compensation expense on a prospective basis only for share-based awards granted after the effective date of January 1, 2006. The Company adopted SFAS 123R prospectively because prior to the period of adoption it was a non-public entity that used the minimum value method for pro forma disclosures under SFAS 123. In accordance with the prospective transition method, the Company s consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. In addition, awards granted prior to the effective date of SFAS 123R continued to be accounted for under the intrinsic value method under APB 25 subsequent to the effective date.

The Company accounts for stock issued to non-employees in accordance with the provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and Emerging Issues Task Force Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18).

Share-based compensation expense recognized for the year ended December 31, 2008 was $3.8 million which consisted of share-based compensation expense related to employee stock options of $3.7 million and expense related to non-employee stock options of $147,000. As part of a termination agreement with certain key employees, the Company agreed to accelerate the vesting of options representing 55,209 shares of common stock. This modification to accelerate vesting of the associated stock options resulted in the recognition of share-based compensation expense of $63,000 in 2008. Share-based compensation expense recognized for the year ended December 31, 2007 was $1.5 million which consisted of share-based compensation expense related to employee stock options of $1.3 million and expense related to non-employee stock options of $154,000. As part of a termination agreement with an executive, the Company agreed to waive its repurchase right on 145,833 shares of common stock which were acquired by the executive through the exercise of unvested options. This waiver resulted in a modification to accelerate vesting of the associated stock options and the recognition of share-based compensation expense of $129,000 in 2007. Share-based compensation expense recognized for the year ended December 31, 2006 was $290,000 which consisted of share-based compensation expense related to employee stock options in the amount of $282,000 and expense related to non-employee stock options of $8,000.

Share-based compensation expense recognized in the consolidated statements of operations for the years ended December 31, 2008, December 31, 2007 and December 31, 2006, are based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In conjunction with the adoption of SFAS 123R, the Company continued to use the single option method of straight-line expense amortization over the vesting period.

See Note 7(d) for additional information on share-based compensation.

(m) Revenue recognition

The Company derives its revenue primarily from the sale of semiconductor products to direct customers and through distributors. The Company recognizes product revenue in accordance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. The Company recognizes revenue for products when persuasive evidence of an arrangement exists, the product has been delivered, title and risk of loss have been transferred to the customer, the fee is fixed or determinable, and collection of the resulting receivable is reasonably assured. Arrangements involving more than one deliverable are accounted for in accordance with Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21).

Evidence of an arrangement is manifested by a master distribution or purchase agreement or an individual binding purchase order. In most cases, sales are governed by a master agreement against which individual binding purchase orders are placed on a transaction-by-transaction basis.

At the time of the transaction, the Company assesses whether the fee associated with the transaction is fixed or determinable, and whether or not collection is reasonably assured. The Company assesses whether the fee is fixed or determinable based upon the terms of the binding purchase order, including the payment terms associated with the transaction. For sales to direct customers, if it cannot be concluded that a fee associated with the transaction is fixed or determinable, the Company recognizes revenue as payments from customers become due (assuming all other conditions for revenue recognition have been satisfied). Because of frequent price adjustments, sales made to distributors under agreements that permit price adjustments are deferred until the distributors sell the product. Deferred income on shipments to distributors reflects the amount of gross profit to be realized when distributors sell through the product. Accounts receivable from distributors is recorded and inventory is relieved when title to inventory transfers at which point the Company has a legally enforceable right to collection under normal payment terms.

The Company assesses probability of collection based on a number of factors, including past transaction history with the customer and its credit-worthiness. The Company requires collateral from certain customers. If the Company determines that collection of a fee is not reasonably assured, it defers the fee and recognizes revenue at the time collection becomes reasonably assured, which is generally upon receipt of cash.

The Company s arrangements do not generally include acceptance clauses. However, if an arrangement includes an acceptance provision, recognition of revenue occurs upon the earlier of receipt of a written customer acceptance or expiration of the acceptance period.

The Company also enters into agreements with some customers to provide engineering design services. Engineering design service arrangements are accounted for under the percentage of completion method in accordance with Statement of Position No. 81-1, *Accounting for Performance in Construction-Type and Certain Production-Type Contracts* (SOP 81-1). Revenue for the year ended December 31, 2008, 2007, and 2006 included $675,000, $1.7 million and $1.4 million, respectively, of engineering design service revenue accounted for under SOP 81-1.

The Company collects and remits sales taxes on products and services that it purchases and sells under its contracts with customers, and reports such amounts under the net method in its consolidated statements of operations. Accordingly, there are no sales taxes included in revenue. The Company records costs related to shipping and handling of products in cost of revenue for all periods presented.

(n) Sales returns and allowances

The Company provides its customers limited return rights under its standard warranty, which for most customers is effective for a period of one year after the sale. The Company has entered into master purchase agreements with some customers that provide for a warranty period of two years. The Company s warranty obligation is limited to replacing or repairing defective products or, at its option, issuing a credit for amounts billed. The Company records an estimate for sales returns based on historical data and current business expectations and reduces revenue for estimated future returns through the allowance for sales returns. In 2008, 2007 and 2006, sales returns and warranty expenses were not significant.

(o) Income taxes

The Company accounts for income taxes under the asset and liability method, which requires, among other things, that deferred income taxes be provided for temporary differences between the tax bases of the Company s assets and liabilities and their financial statement reported amounts. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. A valuation allowance is provided to reduce deferred tax assets to an amount for which realization is more likely than not.

In accordance with FASB Staff Position FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises,* the Company has elected to defer the application of FASB Interpretation No. 48.

(p) Reclassifications

Certain reclassifications have been made to prior-period balances to present the financial statements on a consistent basis with current year presentation. Such reclassifications have not changed previously reported net income (loss) or shareholders equity.

(q) Recent accounting pronouncements

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). This standard identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS No. 162 became effective on November 15, 2008. The adoption of SFAS No. 162 did not have a material effect on the Company s consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of SFAS No. 133* (SFAS 161). This standard amends SFAS No. 133, *Accounting* *for Derivative Instruments and Hedging Activities* by requiring expanded disclosure about an entity s derivative instruments and hedging activities, but does not change the scope or accounting for SFAS No. 133. SFAS No. 161 requires qualitative, quantitative and credit-risk disclosures. Required qualitative disclosures include 1) how and why an entity is using derivative instruments or hedging activity, 2) how an entity is accounting for its derivative instruments and hedging items under SFAS No. 133, and 3) how the instruments affect an entity s financial position, financial performance and cash flow. The qualitative disclosure should include information about the fair value of the derivative instruments, including gains and losses. Credit-risk disclosures should include information about the existence and nature of credit risk related contingent features included in derivative instruments. SFAS No. 161 also amends SFAS No. 107, *Disclosures about Fair Value of Financial Assets*, to clarify that derivative instruments are subject to SFAS No. 107 s concentration-of-credit-risk disclosures. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and will be adopted by the Company in the first quarter of 2009. The Company does not expect the adoption of SFAS 161 to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (SFAS 160*)*, which establishes new accounting and reporting standards for noncontrolling interest (minority interest) and for the deconsolidation of a subsidiary. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not expect the adoption of SFAS 160 to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R), which requires the recognition of assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree at the acquisition date fair value with limited exceptions. SFAS 141R will change the accounting treatment for certain specific items and includes a substantial number of new disclosure requirements. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS 141R will be effective for acquisitions consummated on or after January 1, 2009 and have an impact on its accounting for future business combinations.

In June 2007, the FASB ratified EITF consensus conclusion on EITF 07-03, *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development*. EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by an entity for future research and development activities. Under this conclusion, an entity is required to defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 and requires prospective application for new contracts entered into after the effective date. The Company adopted this consensus in 2008. The adoption of EITF 07-3 had no material impact to the Company s consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 is expected to expand the use of fair value accounting but does not affect existing standards which require certain assets or liabilities to be carried at fair value. Under SFAS 159, a company may choose, at specified election dates, to measure eligible items at fair value and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company did not elect to value any of its financial assets or liabilities in accordance with SFAS No. 159.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157) which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Fair value measurements would be separately disclosed by level within the fair value hierarchy. The Company has adopted SFAS 157 for the fiscal year beginning January 1, 2008. In February 2008, the FASB issued FASB Staff Position (FSP) 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* and FSP FAS 157-2, *Effective Date of FASB Statement No. 157*. These FSPs (1) defer the effective date in SFAS 157 for one year for certain nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, (2) exclude certain leasing transactions accounted for under SFAS No. 13, *Accounting for Leases*, from the scope of SFAS 157, and (3) include several specific examples of items eligible or not eligible for the one-year deferral. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. FSP 157-1 is effective upon the initial adoption of SFAS 157. FSP 157-2 defers the effective date of certain provisions of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of the FSP. However, the effective date for financial assets and liabilities remains intact. There was no material impact to the Company s consolidated financial statements as a result of the adoption of SFAS No. 157. See Note 9 for the disclosures required by SFAS 157. In October 2008, the FASB issued FASB Staff Position (FSP) 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active.* FSP 157-3 clarifies the application of SFAS 157 in a market that is not active and addresses application issues such as the use of internal assumptions when relevant observable data does not exist, the use of observable market information when the market is not active and the use of market quotes when assessing the relevance of observable and unobservable data. FSP 157-3 is effective for all periods presented in accordance with SFAS 157. The guidance in FSP 157-3 is effective immediately and did not have a material impact on the Company s consolidated financial statements. In addition, the Company does not expect the adoption of SFAS 157 for nonfinancial assets and liabilities to have a material impact on its consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (SFAS 109). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109. In December 2008, the FASB issued FSP FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. This FSP defers the effective date of FIN 48 for certain nonpublic enterprises, including nonpublic not-for-profit organizations, for fiscal years beginning after December 15, 2008. The Company elected to deter the application of FIN 48 in accordance with this FSP. The Company believes the adoption of this interpretation will not have a material impact on its consolidated financial statements.

Note 3 Balance Sheet Components

	December 31, 2008	December 31, 2007
	(in thousands)	
Inventories:		
Finished goods	$ 2,565	$ 3,959
Work-in-process	4,284	2,479
Raw materials	772	492
	$ 7,621	$ 6,930
Property and equipment, net:		
Computers and equipment	$ 9,187	$ 6,194
Office equipment and furniture	405	331
Leasehold improvements	1,190	1,104
Software	2,370	2,063
	13,152	9,692
Less: accumulated depreciation and amortization	(8,507)	(6,674)
	$ 4,645	$ 3,018
Purchased intangibles and other assets, net:		
Purchased intangible assets, net	$ 3,752	$ 3,792
Restricted cash under terms of lease agreement	250	250
Other assets	144	191
	$ 4,146	$ 4,233
Other accrued liabilities:		
Contingent debt milestone derivative liability	$ 1,691	$ 1,339
Accrued royalty	272	363
Accrued interest	71	125
Other accrued liabilities	3,526	4,222
	$ 5,560	$ 6,049

Note 4 Goodwill and Purchased Intangibles

In connection with the acquisition of the ultra low-power processor product line from Advanced Micro Devices, Inc. (AMD) in July 2006, the Company recorded Goodwill of $7.2 million. There were no changes in Goodwill in 2008 and 2007. As discussed in Note 2(j) the Company does not amortize goodwill but instead tests for impairment annually or more frequently if certain events or circumstances indicate that the carrying value may not be recoverable.

Intangible assets as of December 31, 2008 and 2007 consist of the following (in thousands):

	Weighted Average Amortization Period	December 31, 2008 Gross Carrying Amount	Accumulated Amortization	Net	December 31, 2007 Gross Carrying Amount	Accumulated Amortization	Net
Purchased technology	36 month	$ 7,998	$ (7,642)	$ 356	$ 7,998	$ (6,824)	$ 1,174
Intellectual property license	151 month	7,926	(4,530)	3,396	5,981	(3,714)	2,267
Customer relationships	12 month	1,287	(1,287)		1,287	(936)	351
Backlog	8 month	1,345	(1,345)		1,345	(1,345)	
Total intangibles	81 month	$ 18,556	$ (14,804)	$ 3,752	$ 16,611	$ (12,819)	$ 3,792

All of the Company s intangible assets excluding goodwill are subject to amortization. Estimated future amortization expense to be included in cost of revenue and in operating expenses is as follows (in thousands):

Year Ended December 31,	Cost of Revenue	Operating Expenses	Total Amortization
2009	$ 670	$ 237	$ 907
2010	314	236	550
2011	314	236	550
2012	314		314
2013	314		314
Thereafter	1,117		1,117
Total	$ 3,043	$ 709	$ 3,752

In October 2008, the Company signed purchased agreement to acquire a nonexclusive, worldwide, nontransferable intellectual property license for $1.6 million. This license is used to integrate the licensed technology into the Company s products. Under this licensing arrangement, the Company made cash payments of $129,000 in 2008. The payments under this arrangement were based on predetermined quarterly payment which is payable over 36 months. Amortization of this intellectual property intangible is recorded to research and development expense in proportion to the economic benefits consumed based on when the licensed technology is incorporated into the Company s products under development. As of December, 31, 2008, $945,000 of intellectual property license has been capitalized and $236,000 has been expensed to research and development.

In July 2006, in connection with the acquisition of the ultra low-power processor product line, the Company recorded a purchased technology intangible asset of $5.7 million. Amortization is recorded to cost of revenue in proportion to the economic benefits consumed based on the estimated discounted cash flows over the estimated useful life of the asset, which is three years. Amortization expense for the years ended December 31, 2008, 2007, and 2006 was $818,000, $2.6 million, and $1.9 million, respectively. The Company also recorded a customer relationships intangible asset of $1.3 million which related to non-contractual relationships with ultra low-power processor customers. Amortization is recorded to sales and marketing expense in proportion to the economic benefits consumed. Amortization expense for the years ended December 31, 2008, 2007, and 2006 was $351,000, $774,000, and $162,000, respectively. In addition, the Company recorded a backlog intangible asset of $1.2 million which related to customer orders scheduled for delivery within one year from acquisition. Amortization is recorded to cost of revenue in proportion to the economic benefits consumed over the useful life of one year. Amortization expense for the years ended December 31, 2007 and 2006 was $153,000 and $1.0 million, respectively. This backlog intangible asset was fully amortized at the end of fiscal 2007. See Note 5(a) for additional information about the acquisition of the ultra low-power processor product line.

In July 2003, in connection with the acquisition of the SandCraft, Inc. assets, the Company recorded a purchased technology intangible asset of $2.3 million. Amortization is recorded to cost of revenue using the default straight-line method, which is used when a pattern of consumption cannot be reliably determined over the estimated useful life of the asset, which is three years. Amortization expense for the years ended December 31, 2006 was $416,000. The purchased technology intangible asset was fully amortized in 2006. See Note 5(b) for additional information about the acquisition of SandCraft, Inc.

In July 2003, the Company acquired a nonexclusive, worldwide, nontransferable intellectual property license for a term of seven years. The intellectual property license is used to integrate the licensed technology into the Company s products. Under the licensing arrangement, the Company made cash payments of $200,000 in 2003 and issued shares of Series B Preferred Stock with an aggregate fair value of $650,000. During the years ended December 31, 2007, 2006, and 2005, the Company made further payments of approximately $3.1 million, $2.1 million and $1.0 million, respectively. The payments under the arrangement were based on the greater of a predetermined minimum quarterly payment threshold or a percentage of net revenue received from the sale of products that contain the intellectual property. As of December 31, 2007, the Company has fully paid the license fee obligation of this license arrangement.

The Company recorded the estimated net present value of the license fee of approximately $6.0 million as an intangible asset and a liability in the consolidated balance sheets. Amortization is recorded to cost of revenue using straight-line method over the useful life of seven years. Interest expense was accreted on the discounted liability until it was fully retired in 2007.

In June 2008, this licensing arrangement for a nonexclusive, worldwide, nontransferable intellectual property license was amended primarily to extend the term and modify the royalties provision of the arrangement. In consideration for acquiring an additional term of seven years through 2017, the Company paid a nonrefundable extension fee of $1.0 million in 2008. The Company recorded the extension fee as an addition to the existing intangible asset and, together with the unamortized portion of this asset immediately prior to the extension of term, is amortized using straight-line method over its remaining useful life of 10 years. Total amortization expense for the years ended December 31, 2008, 2007, and 2006 was $579,000, $878,000, and $878,000, respectively.

Under the terms of the original license agreement, the Company is also required to pay quarterly royalties to the licensor based on the number of units sold containing the licensed technology or the corresponding net revenue recognized. Under the amended terms of the licensing agreement, the quarterly royalties to the licensor is a graduated percentage of net revenue. The percentage rate is dependent on cumulative units sold containing the licensed technology. The Company incurred royalty expense under this agreement of approximately $1.2 million, $1.3 million, and $580,000, for the years ended December 31, 2008, 2007, and 2006, respectively, which was charged to cost of revenue.

Note 5 Acquisitions

(a) Ultra Low-Power Processor Product Line

On July 6, 2006, the Company completed the acquisition of the Alchemy product line and operations from AMD for approximately $28.4 million in purchase consideration, consisting of 20,078,002 shares of Series C convertible preferred stock with a fair value of approximately $28.2 million and additional consideration of $151,000 consisting of the assumption of certain liabilities, a cash payment, and acquisition expenses. In accordance with SFAS 141, this transaction was accounted for under the purchase method. The Company acquired the Alchemy product line to broaden its current product offerings and establish a strategic relationship with AMD, which became a preferred stock investor by virtue of the acquisition.

The fair value of the Series C preferred stock issued as consideration for the acquisition was based on cash prices paid by other investors in sales of Series C preferred stock during fiscal year 2006. The allocation of the purchase price was based upon the independent appraisals of the fair value of the identified intangible assets. The excess of the purchase price over the fair value of the assets acquired and liabilities assumed was allocated to goodwill in accordance with SFAS 141 and 142.

The table below sets forth the estimated fair values of the assets acquired and liabilities assumed as of the closing date of July 6, 2006 (in thousands):

Fair Values	
Inventories	$ 9,990
Property and equipment	25
In-process research and development	3,130
Intangible assets:	
Purchased technology	5,706
Customer relationships	1,287
Backlog	1,191
Goodwill	7,163
Total assets acquired	28,492
Total liabilities assumed	95
Net assets acquired	$ 28,397

The Company s methodology for allocating a portion of the purchase price for purchase acquisitions to in-process research and development (IPR&D) is determined using the multi-period excess earnings method based on the income approach, which discounts expected future cash flows to present value using estimates and assumptions determined by management. The IPR&D acquired pertains to the development project of a next generation product in one of the product families within the Alchemy product line. The expected revenue contribution of this next generation product once it is developed and in full production, is expected to last through 2010, indicating a useful life to be 5 years. The discount rate used for the valuation of the IPR&D was 40% since it was still in the development stage and thus has some inherent risk of failure associated with it. At the date of acquisition, the estimated time to complete this development is one year with an estimated cost of the efforts necessary to complete this project of $2.0 million. IPR&D was expensed upon acquisition in 2006 because technological feasibility has not been established and no future alternative use exists. Total IPR&D expense of $3.1 million was charged to operations in 2006 on the date the assets were acquired.

Following the allocation of the initial purchase price to the fair value of assets acquired, the Company issued 87,100 shares of the Company s Series C preferred stock at a price of $1.4068 per share on February 28, 2007 in payment for inventory on hand at distributors and for a certain consulting agreement with AMD. The liability to issue these shares was recorded in accrued liabilities as of December 31, 2006.

The results of operations of Alchemy have been included in the Company s consolidated financial statements subsequent to the date of acquisition. The financial information in the table below summarizes the combined revenue of the Company and Alchemy product line, on a pro forma basis, as though the business combination occurred as of the beginning of each of the periods presented (in thousands):

	Year Ended December 31,	
(unaudited)	**2006**	**2005**
Proforma revenue	$ 39,679	$ 25,829
Reported revenue	$ 30,053	$ 13,295

The unaudited pro forma revenue information is presented for informational purposes only and is not indicative of the results that would have been achieved if the acquisition had taken place at the beginning of each of the periods presented. Pro forma net loss was not presented because no discrete financial information regarding costs and expenses was available for Alchemy as it was formerly a component of AMD and no discrete accounting was maintained with regards to the product line s operations.

(b) SandCraft, Inc.

On July 18, 2003, the Company completed the acquisition of the assets of SandCraft, Inc. (SandCraft) for approximately $2.5 million in initial purchase consideration consisting of (1) cash of approximately $2.5 million; and (2) warrants issued to purchase 500,000 shares of the Company s common stock at an exercise price of $0.08 per share. These warrants had an estimated fair value of $35,000. In accordance with the purchase agreement, these warrants cannot be exercised until the earlier of July 29, 2008, an initial public offering, an acquisition or transaction whereby the stockholders of the Company own less than 50% of the outstanding voting power of the capital stock, or a sale of substantially all of the assets of the Company. Additional information regarding these warrants is provided in Note 7(c).

The purchase agreement with SandCraft also required the Company to pay up to an additional $12.5 million, payable as a percentage of revenues from SandCraft related products, if certain predetermined production yield rates were met. The contingent purchase price was payable commencing July 2003 and each quarter thereafter through December 2007.

The Company acquired the assets of SandCraft to expand its product offering. In accordance with SFAS 141 this transaction was accounted for as a purchase business combination. The Company allocated the initial aggregate purchase price of $2.5 million based upon the estimated fair value of the assets acquired. The Company obtained independent appraisals of the fair value of the identified intangible assets. The following is the allocation of the purchase consideration (in thousands):

Fair Values	
Property and equipment	$ 1,206
In-process research and development	2,801
Intangible assets:	
Purchased technology	2,139
Backlog	154
Goodwill	(3,765)
Total assets acquired	$ 2,535

The acquired purchased technology was amortized over its estimated useful life of three years and as of December 31, 2007 this intangible asset is fully amortized. IPR&D of $2.8 million was charged to operations upon acquisition because technological feasibility had not been established and no future alternative uses exist.

Following the allocation of the initial purchase price to the fair value of assets acquired, the Company recorded an amount of negative goodwill. The negative goodwill of $3.8 million represented assets acquired in excess of the initial purchase price and was recorded as a liability since there was a contingent earn-out provision related to production yields as described above. The earn-out contingency expired in December 2007 and the Company recognized an extraordinary gain in the consolidated statements of operations of approximately $3.2 million which represents the remaining amount of the contingent earn-out liability net of all earn-out payments on the date of expiration of the earn-out period. As of the date of expiration, the carrying value of assets acquired from SandCraft had been fully depreciated or amortized.

The results of operations of SandCraft have been included in the Company s consolidated financial statements subsequent to the date of acquisition.

Note 6 Debt

Notes payable consists of the following (in thousands):

		December 31, 2008	December 31, 2007
Loans from lending syndicate, interest rate at 12.0%, maturity date	October 1, 2009	$ 981	$ 2,151
Loans from lending syndicate, interest rate at 12.0%, maturity date	January 1, 2010	1,288	2,421
Loans from lending syndicate, interest rate at 12.0%, maturity date	April 1, 2010	1,589	2,691
Loans from lending syndicate, interest rate at 12.0%, maturity date	July 1, 2010	2,811	4,408
Unamortized loan discounts		(333)	(1,091)
Total notes payable		6,336	10,580
Less: current portion		(5,026)	(4,244)
Notes payable, non-current		$ 1,310	$ 6,336

(a) 2006 Loan Agreement

On December 26, 2006, the Company entered into a loan agreement (2006 Loan Agreement) with a lending syndicate for an initial aggregate loan commitment of $10.0 million available to the Company in three tranches based on different dates of availability and the achievement of certain financial and non financial conditions: (1) $3.3 million, (2) $3.3 million, and (3) $3.4 million. All three tranches became available and were drawn down in full prior to June 30, 2007. Additionally, under the 2006 Loan Agreement, an incremental loan of $5.0 million was available from one of the members of the lending syndicate in September 2007 after additional financial and nonfinancial conditions were met by the Company. This additional $5.0 million loan was drawn down by the Company in September 2007.

The Company borrowed $11.7 million and $3.3 million under the 2006 Loan Agreement during the year ended December 31, 2007 and December 31, 2006, respectively. The Company is required to repay each term loan in 32 equal consecutive monthly installments of principal and interest. The Company has made advance payments of the last installment of the loans, which have been applied to the loan principal. Borrowings under the 2006 Loan Agreement are collateralized by all the intell