ENTROPIC COMMUNICATIONS INC
Form 10-Q
August 05, 2008
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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2008

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: 001-33844

ENTROPIC COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0947630**
(State or Other Jurisdiction of Incorporation)	**(IRS Employer Identification No.)**

6290 Sequence Drive

San Diego, CA 92121

(Address of Principal Executive Offices and Zip Code)

(858) 768-3600

(Registrant s Telephone Number, Including Area Code)

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.

x Yes ¨ No

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x Smaller reporting company ¨

(Do not check if a smaller reporting company)

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

As of the close of business on July 31, 2008, 68,919,930 shares of the registrant s common stock, $0.001 par value per share, were outstanding.

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ENTROPIC COMMUNICATIONS, INC.

FORM 10-Q

For the Quarterly Period Ended June 30, 2008

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,027	$ 51,475
Restricted cash		58
Marketable securities	12,009	2,965
Accounts receivable, net	35,588	24,489
Inventory	21,079	15,332
Prepaid expenses, deferred income taxes and other current assets	1,925	2,238
Total current assets	87,628	96,557
Property and equipment, net	12,612	8,952
Intangible assets, net	33,185	34,145
Goodwill	88,082	86,256
Other long-term assets	283	416
Total assets	$ 221,790	$ 226,326
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 22,141	$ 18,909
Accrued payroll and benefits	5,490	4,253
Deferred revenues	187	303
Current portion of line of credit and loans payable		2,860
Current portion of software licenses and capital lease obligations	119	384
Total current liabilities	27,937	26,709
Stock repurchase liability	1,208	1,765
Lines of credit and loans payable, less current portion		5,547
Other long-term liabilities	3,165	1,907
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock	69	68
Additional paid-in capital	292,010	282,627
Accumulated deficit	(102,599)	(92,297)
Total stockholders equity	189,480	190,398
Total liabilities, preferred stock and stockholders equity	$ 221,790	$ 226,326

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

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ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net revenues	$ 42,836	$ 26,207	$ 84,824	$ 46,233
Cost of net revenues	23,869	17,961	46,706	32,492
Gross profit	18,967	8,246	38,118	13,741
Operating expenses:				
Research and development	15,678	6,699	28,990	10,889
Sales and marketing	4,455	1,859	8,599	3,359
General and administrative	3,541	1,631	7,064	2,398
Write off of in-process research and development	1,300	21,400	1,300	21,400
Amortization of purchased intangibles	713	42	1,309	42
Restructuring charge	(10)		1,069	
Total operating expenses	25,677	31,631	48,331	38,088
Loss from operations	(6,710)	(23,385)	(10,213)	(24,347)
Other income (expense), net	191	(337)	(7)	(487)
Loss before income taxes	(6,519)	(23,722)	(10,220)	(24,834)
(Benefit) provision for income taxes	(72)		82	
Net loss	(6,447)	(23,722)	(10,302)	(24,834)
Accretion of redeemable convertible preferred stock		(31)		(63)
Net loss attributable to common stockholders	$ (6,447)	$ (23,753)	$ (10,302)	$ (24,897)
Net loss per share attributable to common stockholders basic and diluted	$ (0.10)	$ (3.82)	$ (0.15)	$ (4.33)
Weighted average number of shares used to compute loss per share attributable to common stockholders	67,215	6,223	67,023	5,756

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

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ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Operating activities:		
Net loss	$ (10,302)	$ (24,834)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,514	641
Amortization of purchased intangible assets	4,139	42
Stock-based compensation to consultants	84	58
Stock-based compensation to employees	6,912	813
Interest expense attributable to amortization and early payoff of debt issuance costs	476	57
In-process research and development	1,300	21,400
Revaluation of preferred stock warrant liabilities		612
Impairment of assets related to restructuring charge	259	
Loss on disposal of assets	8	
Changes in operating assets and liabilities:		
Restricted cash	58	
Accounts receivable	(11,097)	(1,073)
Inventory	(5,733)	(7,207)
Prepaid expenses, deferred income taxes and other current assets	313	(387)
Other long-term assets	43	(677)
Accounts payable and accrued expenses	3,050	6,655
Accrued payroll and benefits	1,102	222
Deferred revenues	(116)	3
Other long-term liabilities	1,258	
Net cash used in operating activities	(6,732)	(3,675)
Investing activities:		
Purchases of property and equipment	(5,269)	(551)
Purchases of marketable securities	(17,144)	
Sales/maturities of marketable securities	8,100	7,116
Net cash (used in) provided by acquisitions	(6,113)	4,561
Net cash (used in) provided by investing activities	(20,426)	11,126
Financing activities:		
Principal payments on debt and capital lease obligations	(9,121)	(1,348)
Proceeds from line of credit obligations		2,000
Proceeds from issuance common stock net of repurchases and issuance costs	1,831	1,074
Net cash (used in) provided by financing activities	(7,290)	1,726
Net (decrease) increase in cash and cash equivalents	(34,448)	9,177
Cash and cash equivalents at beginning of period	51,475	5,928
Cash and cash equivalents at end of period	$ 17,027	$ 15,105

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

ENTROPIC COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008

1. Organization and Summary of Significant Accounting Policies

Business

Entropic Communications, Inc. (the Company) was organized under the laws of the state of Delaware on January 31, 2001. The Company is a fabless semiconductor company that designs, develops and markets systems solutions to enable connected home entertainment.

In October 2007, the Company completed a 1-for-3.25 reverse stock split. The accompanying financial statements and notes to the financial statements give retroactive effect to the reverse stock split for all periods presented.

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC). They do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2007 included in the Company s Annual Report on Form 10-K (Annual Report) filed on March 3, 2008 with the SEC.

The interim condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly the Company s consolidated financial position, results of operations and cash flows as of and for the periods indicated. The interim results are not necessarily indicative of the results to be expected for future quarters or the full year.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Among the significant estimates affecting the condensed consolidated financial statements are those related to business combinations, revenue recognition, allowance for doubtful accounts, inventory reserves, long-lived assets (including goodwill and intangible assets), warranty reserves, accrued bonuses, income taxes, valuation of equity securities and stock-based compensation. On an on-going basis, management reviews its estimates based upon currently available information. Actual results could differ materially from those estimates.

Revenue Recognition

The Company s revenues are generated principally by sales of its semiconductor products. During the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, product revenues represented approximately 99% of its total net revenues. The Company also generates service revenues from development contracts.

The majority of the Company s sales occur through the efforts of its direct sales force. The remainder of the Company s sales occurs through distributors. During the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, more than 99% of the Company s sales occurred through the efforts of its direct sales force.

In accordance with SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, and SAB No. 104, *Revenue Recognition*, the Company recognizes product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and

(iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment. However, the Company does not recognize revenue until all customer acceptance requirements have been met, when applicable.

A portion of the Company s sales are made through distributors, agents, or customers acting as agents under agreements allowing for pricing credits and/or rights of return. Product revenues on sales made through these distributors are not recognized until the distributors ship the product to their customers. The Company records reductions to revenues for estimated product returns and pricing adjustments, such as competitive pricing programs, in the same period that the related revenue is recorded. To date, product returns and pricing adjustments have not been significant.

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The Company also has entered into an inventory hubbing arrangement with a key customer. Pursuant to this arrangement, the Company delivers products to the designated third party warehouse based upon the customer s projected needs, but does not recognize product revenue unless and until the customer removes the Company s products from the third party warehouse to incorporate into its own products.

The Company derives revenues from development contracts that involve new and unproven technologies. Revenues under these contracts are deferred until customer acceptance is obtained, and other contract-specific terms have been completed in accordance with the completed contract method of American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Provisions for losses related to development contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. The costs associated with development contracts are included in cost of service revenue. The Company defers the cost of services provided under its development contracts.

The Company acquired a development agreement in connection with its acquisition of RF Magic, Inc. (RF Magic) in June 2007 that provides the Company with royalties in exchange for an exclusive right to manufacture and sell certain products. The Company has determined that it is not able to reliably estimate the royalties earned in the period the sales occur. Thus, the Company records revenues based on cash receipts. The royalty revenues recorded during the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, were $797,000, $0, $1,763,000 and $0, respectively.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash and cash equivalents, marketable securities, accounts receivable, leases payable, lines of credit and loans payable. The Company s policy is to place its cash and cash equivalents with high quality financial institutions in order to limit its credit exposure. Credit is extended based on an evaluation of the customer s financial condition and a cash deposit is generally not required. The Company estimates potential losses on trade receivables on an ongoing basis.

The Company invests cash in deposits and money market funds with major financial institutions, U.S. government obligations and debt securities of corporations with strong credit ratings in a variety of industries. It is the Company s policy to invest in instruments that have a final maturity of no longer than two years, with a portfolio weighted average maturity of no longer than 12 months.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Lower of cost or market adjustments reduce the carrying value of the related inventory and take into consideration reductions in sales prices, excess inventory levels and obsolete inventory. These adjustments are done on a part-by-part basis. Once established, these adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

Guarantees and Indemnifications

In the ordinary course of business, the Company has entered into agreements with customers that include indemnity provisions. To date, there have been no known events or circumstances that have resulted in any significant costs related to these indemnification provisions, and as a result, no liabilities have been recorded in the accompanying interim unaudited financial statements.

Rebates

The Company accounts for rebates in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*, and, accordingly, at the time of the sale accrues 100% of the potential rebate as a reduction to revenue and does not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. The Company reverses the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when management believes unclaimed rebates are no longer subject to payment and will not be paid.

Warranty Accrual

The Company s products are subject to warranty periods of one year or more. The Company provides for the estimated future costs of replacement upon shipment of the product as cost of net revenues. The Company has not incurred significant warranty claims to date. The warranty accrual is based on management s best estimate of expected costs associated with product failure and historical product failures.

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Research and Development Costs

Research and development costs are expensed as incurred and primarily include costs related to personnel, outside services (which consist primarily of contract labor services), fabrication masks, architecture licenses, engineering design development software and hardware tools, allocated overhead expenses and depreciation of equipment used in research and development.

Income Taxes

The Company utilizes the liability method of accounting for income taxes as set forth in Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes* (SFAS 109). Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

The Company also follows Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48), which provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise s financial statements in accordance with SFAS 109. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits within operations as income tax expense.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), including the provisions of SAB No. 107 (SAB 107) and SAB No. 110 (SAB 110). Under SFAS 123R, stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee s requisite service period. The Company has not granted awards with vesting subject to market conditions. The Company adopted the provisions of SFAS 123R using the prospective transition method. Accordingly, prior periods have not been revised for comparative purposes.

The valuation provisions of SFAS 123R apply to new awards and to awards that are outstanding on the effective date, January 1, 2006, which are subsequently modified or canceled. Prior to the adoption of SFAS 123R, the Company used the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), related interpretations, and the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, for employee stock options and recorded compensation cost for options granted at exercise prices that were less than the market value of the Company s common stock at the date of grant. Pursuant to SFAS 123R, as the Company utilized the minimum value method through December 31, 2005, the Company will continue to recognize compensation expense relating to unvested awards as of the date of adoption using APB 25, which is the same accounting principle originally applied to those awards.

The stock-based compensation for the Company s 2007 Employee Stock Purchase Plan (ESPP) was determined using the Black-Scholes option pricing model and the provisions of FASB Technical Bulletin No. 97-1, *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option*, as amended by SFAS 123R.

The Company accounts for stock-based compensation awards granted to non-employees in accordance with EITF 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). Under EITF 96-18, the Company determines the fair value of the stock-based compensation awards granted as either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. If the fair value of the equity instruments issued is used, it is measured using the stock price and other measurement assumptions as of the earlier of either (1) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached, or (2) the date at which the counterparty s performance is complete.

Due to the adoption of SFAS 123R, the Company recognizes excess tax benefits associated with stock-based compensation to stockholders equity only when realized. When assessing whether excess tax benefits relating to stock-based compensation have been realized, the Company follows the with and without approach excluding any indirect effects to be realized until after the utilization of all other tax benefits available to the Company.

Segment Reporting

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), establishes standards for the way public business enterprises report information about operating segments in annual consolidated financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers.

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Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company is organized as, and operates in, one reportable segment: the design, development and sale of silicon integrated circuits. Products within this segment are embedded in electronic devices used to enable the delivery of multiple streams of high definition video and other multimedia content for entertainment purposes into and throughout the home. The Company s chief operating decision maker is its Chief Executive Officer (CEO). The CEO reviews financial information presented on a consolidated basis evaluating financial performance and allocating resources. There are no segment managers who are held accountable for operations below the consolidated financial statement level. The Company s assets are primarily located in the United States of America and not allocated to any specific region. Therefore, geographic information is presented only for total revenue.

Recently Issued Accounting Standards

In September 2006, FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. The Company adopted this pronouncement as of January 1, 2008 for financial instruments. Although the adoption of SFAS 157 did not have an impact on its interim financial results, the Company is now required to provide additional disclosures as part of its financial statements. See Note 2 for information and related disclosures regarding the Company s fair value measurements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to choose to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option have been elected are reported in earnings at each subsequent reporting date. The Company adopted this pronouncement in the first quarter of 2008 and it did not have an impact on its interim financial results.

In June 2007, the FASB ratified EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* (EITF 07-3). EITF 07-3 requires non-refundable advance payments for goods and services to be used in future research and development activities to be recorded as an asset and the payments to be expensed when the research and development activities are performed. The Company adopted this standard in the first quarter of 2008 and it did not have an impact on its interim financial results.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations the Company engages in will be recorded and disclosed in accordance with existing GAAP until January 1, 2009. The Company expects SFAS 141R will have an impact on its consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions consummated after the effective date. The Company is still assessing the impact of this standard on its future consolidated financial statements.

2. Supplemental Financial Information

Fair Value of Financial Instruments

The Company holds certain financial assets, including cash equivalents and marketable securities, that are required to be measured at fair value on a recurring basis. Cash equivalents include commercial paper and corporate bonds of high credit quality. Marketable securities were carried at amortized cost which approximated fair value.

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

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The fair value of the Company s financial assets subject to the disclosure requirements of SFAS 157 was determined using the following levels of inputs as of June 30, 2008 (in thousands):

	Fair Value Measurements as of June 30, 2008			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash equivalents	$ 4,809	$ 4,809	$	$
Marketable securities	12,009	12,009		
Total	$ 16,818	$ 16,818	$	$

During the six months ended June 30, 2008, no transfers were made into the Level 2 or Level 3 categories.

Inventory

The components of inventory were as follows (in thousands):

	As of June 30, 2008	As of December 31, 2007
Capitalized development contract costs	$	$ 66
Work-in-process	12,191	8,379
Finished goods	8,888	6,887
Total inventory	$ 21,079	$ 15,332

Property and Equipment

Property and equipment consisted of the following (in thousands, except for years):

	Useful Lives (in years)	As of June 30, 2008	As of December 31, 2007
Office and laboratory equipment	5	$ 6,038	$ 4,337
Computer equipment	3-5	1,983	1,541
Furniture and fixtures	6-7	1,494	407
Leasehold improvements	Lease term	4,756	287
Licensed software	1-3	2,356	2,284
Construction in progress		504	3,423
		17,131	12,279
Accumulated depreciation		(4,519)	(3,327)
Property and equipment, net		$ 12,612	$ 8,952

Depreciation and amortization expense for the three months ended June 30, 2008 and 2007 and six months ended June 30, 2008 and 2007 was $855,000, $318,000, $1,514,000 and $641,000, respectively.

Intangible Assets

Intangible assets were as follows (in thousands):

	As of June 30, 2008		
	Gross	Accumulated Amortization	Net
Developed technology	$ 28,860	$ (5,605)	$ 23,255
Customer relationships	10,920	(1,830)	9,090
Backlog	1,660	(1,487)	173
Trade name	1,000	(333)	667
	$ 42,440	$ (9,255)	$ 33,185

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As of June 30, 2008, the estimated future amortization expenses of purchased intangible assets charged to cost of net revenues and operating expenses for the remainder of fiscal 2008 and periods thereafter are as follows (in thousands):

Years Ending December 31,	Cost of Net Revenues	Operating Expenses	Total
2008	$ 3,180	$ 1,426	$ 4,606
2009	6,360	2,415	8,775
2010	5,310	2,219	7,529
2011	4,960	2,052	7,012
2012	2,480	1,884	4,364
Thereafter		900	900
Total	$ 22,290	$ 10,896	$ 33,186

Acquisition

On April 3, 2008, the Company acquired certain specified assets of Vativ Technologies, Inc. (Vativ), including Vativ s intellectual property rights, existing product lines, inventory and equipment. Vativ, a fabless semiconductor company based in San Diego, California, focused on providing innovative high-bandwidth, advanced digital signal processing solutions for digital television and 10 gigabit Ethernet markets. The Company paid approximately $5,906,000 in cash at closing, $850,000 of which was contributed, and remains subject, to an escrow fund which is available to satisfy potential indemnity claims. The results of operations of Vativ have been included in the Company s results of operations from the date of acquisition.

The acquired assets did not include Vativ s cash, cash equivalents, investments or any portion of Vativ s accounts receivable. The Company assumed certain liabilities of Vativ equal to approximately $318,000, including current accounts payable and accrued vacation liabilities for the former employees of Vativ hired by the Company. In addition, the Company committed to pay cash retention bonuses in the aggregate amount of $650,000 to employees hired from Vativ in connection with the acquisition earned over the first 90 days of employment. The retention bonuses were recorded as expense during the service period and were not included in the assumed liabilities. In July 2008, the Company paid $560,000 of these retention bonuses to the former Vativ employees and expects to pay the remaining $90,000 within the next nine months.

The Vativ acquisition has been accounted for by the purchase method of accounting in accordance with SFAS No. 141, *Business Combinations*, and as such, the assets acquired and liabilities assumed have been recorded at fair value. The excess of the purchase price over the fair value of net assets acquired was allocated to goodwill. The allocation of the purchase price for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the identifiable tangible and intangible assets acquired and liabilities assumed based on their respective fair values. The Company determined the estimated fair values of in-process research and development, identifiable intangible assets and certain tangible assets of the acquisition based on information available at the time of the acquisition. Such valuations require significant estimates and assumptions including but not limited to: determining the timing and estimated costs to complete the in-process projects, estimating future cash flows and developing appropriate discount rates. The Company believes the fair values assigned to the assets acquired and liabilities assumed, respectively, are based on reasonable assumptions.

The following table summarizes the components of the purchase price (in thousands):

Cash	$ 5,906
Direct acquisition costs	207
Total	$ 6,113

The acquisition was funded from the Company s cash and cash equivalents balances.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed in the acquisition (in thousands):

Current assets	$ 16
Identifiable intangible assets	3,180
Goodwill	1,826
Property and equipment	109
In-process research and development	1,300
Accounts payable and accrued liabilities	(318)
	$ 6,113

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The goodwill recorded for the acquisition of Vativ is deductible for tax purposes over 15 years and will be assessed annually for impairment. Given that the Company has a full valuation allowance for its deferred tax assets, and given that the tax amortization for goodwill has an indefinite reversal period, the Company will be recording income tax expense for the tax impact of this amortization. The weighted average amortization period of the identifiable intangible assets acquired from Vativ is 1.6 years as of June 30, 2008.

The identifiable intangible assets acquired from Vativ and related amortization are summarized below (in thousands, except for years):

Purchased Intangible Assets:	Purchase Price Allocation	Estimated Useful Life (in years)	Amortization for the Six Months Ended June 30, 2008
Developed technology amortization to cost of net revenues	$ 2,800	2	$ 350
Backlog	$ 260	0.75	$ 87
Customer relationships	120	1	30
Total amortization to operating expenses	$ 380		$ 117

These identifiable intangible assets are being amortized on a straight-line basis.

The developed technology represents proprietary knowledge that is technologically feasible as of the valuation date, and included all fully functioning products at the date of the valuation. The amount assigned to the developed technology was assigned based on the estimated net discounted cash flows from the related product lines on the date of acquisition.

The in-process research and development (IPR&D) acquired at the date of acquisition relates to Vativ s High Definition Multimedia Interface switch product. The amount was expensed on the acquisition date because the acquired technology had not yet reached technological feasibility and had no alternative future uses. A discounted cash flow approach was utilized in valuing the IPR&D. The value of the technology was the sum of the present value of projected debt-free net income, in excess of returns on requisite assets, over the economic life of the IPR&D.

Pro Forma Statements of Operations

The following unaudited pro forma financial information reflects the consolidated results of operations as if the acquisition of Vativ had occurred on January 1, 2007 for the three and six month periods ended June 30, 2007 and on January 1, 2008 for the three and six month periods ended June 30, 2008. The unaudited pro forma financial data presented are not necessarily indicative of the Company s results of operations that might have occurred had the transactions been completed at the beginning of the periods presented, and do not purport to represent what the Company s consolidated results of operations might be for any future period (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(unaudited)		(unaudited)	
Net revenues	$ 42,836	$ 26,339	$ 84,998	$ 46,372
Net loss attributable to common stockholders	$ (6,641)	$ (26,941)	$ (13,479)	$ (30,647)
Net loss per share basic and diluted	$ (0.10)	$ (4.33)	$ (0.20)	$ (5.32)

The unaudited pro forma financial data presented above should be read in conjunction with the unaudited pro forma condensed consolidated combined financial statements and related notes and disclosures contained in the Company s Current Report on Form 8-K/A filed with the SEC on June 17, 2008.

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Accrued Warranty

The following table presents a rollforward of the Company s product warranty liability, which is included within accounts payable and accrued expenses in the unaudited condensed consolidated balance sheets (in thousands):

	As of June 30, 2008
Liability as of December 31, 2007	$ 926
Expirations	(107)
Accruals for warranties issued during the year	325
Warranty rate adjustment	(437)
Settlements made during the year	(76)
Liability as of June 30, 2008	$ 631

The Company has revised its warranty accrual based on historical experience of claims resulting in a reduction of the warranty accrual of $437,000 for the six months ended June 30, 2008.

Restructuring Activity

In February 2008, the Company implemented a restructuring plan to exit the operating lease for its former corporate headquarters in San Diego, California. The original lease was effective through May 2010. No employees were terminated in connection with the restructuring plan. The Company accounted for the restructuring plan in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

During the six months ended June 30, 2008, the Company recorded a $1,069,000 restructuring charge in its consolidated statements of operations, including $820,000 that was accrued for the exited facility, and $259,000 related to the impairment of property and equipment and other long-term assets.

In May 2008, the Company entered into a Lease Termination Agreement with its landlord to terminate its operating lease resulting in the completion of its restructuring plan. The Company made cash payments in connection with the restructuring liability of approximately $815,000, including a non-recurring lease termination fee of $702,000.

The following table presents a rollforward of the Company s restructuring liability (in thousands):

	Operating lease commitments	Impairment of property and equipment	Impairment of other long-term assets	Total
Liability as of December 31, 2007	$	$	$	$
Additions	820	195	64	1,079
Non-cash charges		(195)	(64)	(259)
Cash payments	(815)			(815)
Restructuring charge adjustment	(5)			(5)
Liability as of June 30, 2008	$	$	$	$

Debt

In April 2008, the Company entered into a Consent and Amendment to Loan and Security Agreement with Silicon Valley Bank (SVB) to extend the term of its credit facility to April 2009 and increase the maximum amount of credit available under the facility from $7,000,000 to $10,000,000. The amount available under the credit line may be decreased by certain commitments, such as the $1,160,000 standby letter of credit that secures the Company s performance under its current headquarters facilities lease.

In May 2008, the Company entered into an Amendment to Loan and Security Agreement with SVB to further amend its credit facility to provide the Company the option to increase the maximum amount of credit available under the facility from $10,000,000 to $15,000,000 upon payment of a commitment fee of up to $15,000. If the Company elects to exercise its option, the Company will be subject to a loan covenant to maintain a tangible net worth of at least $50,000,000 on a consolidated basis. No amounts were outstanding under the credit agreement as of June 30, 2008.

Deferred Rent

The Company recognized rent expense on a straight-line basis over the lease term as defined in SFAS No. 13, *Accounting for Leases*. In addition, the Company recorded landlord allowances for tenant improvements as deferred rent, in accordance with FASB Technical Bulletin No. 88-1, *Issues Related to Accounting for Leases*. The deferred rent is amortized over the lease term as a reduction of rent expense. As of June 30, 2008 and December 31, 2007, there was $2,614,000 and $1,301,000, respectively, of unamortized deferred rent recorded as a component of other long-term liabilities.

Purchase Commitments

The Company had firm purchase order commitments for the acquisition of inventory as of June 30, 2008 and December 31, 2007 of $12,218,000 and $11,910,000, respectively.

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Stock-Based Compensation

The Company has in effect equity incentive plans under which incentive stock options and non-qualified stock options have been granted to employees, directors and consultants to purchase shares of the Company s common stock at a price not less than the fair market value of the stock at the date of grant, except in the event of a business combination. These equity plans include the 2007 Non-Employee Directors Stock Option Plan, under which the Company continues to grant non-qualified stock options, and the 2007 Equity Incentive Plan, under which the Company continues to grant non-qualified stock options and restricted stock units. These plans are described in the Annual Report.

The Company also grants stock awards under the ESPP. Under the terms of the ESPP, eligible employees may purchase shares of the Company s common stock at the lesser of 85% of the fair market value of the Company s common stock on the offering date or the purchase date.

Stock-based compensation expense recognized in the Company s statement of operations for the three and six months ended June 30, 2008 and 2007 included compensation expense for stock-based options and awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with SFAS 123R. For options and awards granted during the three and six months ended June 30, 2008 and 2007, expenses are amortized under the straight-line method. Stock-based compensation expense recognized in the statement of operations for the three and six months ended June 30, 2008 and 2007 has been reduced for estimated forfeitures of options that are subject to vesting. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The fair value of options granted after January 1, 2006 and awards under the ESPP are estimated on the grant date using the Black-Scholes option valuation model. This valuation model requires the Company to make assumptions and judgments about the variables used in the fair value calculation, including the expected life of the option or award, the volatility of the price of Company s common stock, the expected risk-free interest rate and the expected dividend yield. The expected life for stock options reflects the application of the simplified method set out in SAB 107, as renewed by SAB 110. The expected life of an award granted under the ESPP is based upon the length of the applicable offering periods. The risk-free interest rate is based on zero coupon U.S. Treasury instruments with maturities similar to those of the expected term of the award being valued. The simplified method defines the life as the average of the contractual term of the options and the weighted-average vesting period for all option tranches. The estimated volatility reflects the application of the interpretive guidance provided by SAB 107 and, accordingly, incorporates historical volatility of similar entities whose share prices are publicly available. The expected dividend yield is based on the Company s expectation of not paying dividends on the common stock for the foreseeable future.

The following assumptions are used to value options and awards granted under the Company s equity incentive plans for the three and six months ended June 30, 2008 and 2007:

	Employee stock options				**Employee Stock Purchase Plan**			
	Three Months Ended June 30,		**Six Months Ended June 30,**		**Three Months Ended June 30,**		**Six Months Ended June 30,**	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**
Expected life (years)	6.01	6.01	6.01	6.01	0.01 - 1.01		0.01 - 1.01	
Risk-free interest rate	3.2%	4.8%	3.2 - 4.0%	4.5 - 4.8%	0.8 - 1.98%		0.8 - 1.98%	
Expected volatility	68%	73%	68%	73%	76%		76%	
Expected dividend yield								

The weighted average fair value of options granted for the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007 was approximately $2.67, $5.79, $2.83 and $5.69, respectively.

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The following table shows total stock-based compensation expense included in the unaudited condensed consolidated statements of operations for the three and six months ended June 30, 2008 and 2007 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Cost of sales	$ 64	$ 3	$ 110	$ 3
Research and development	1,829	397	3,587	450
Sales and marketing	611	145	1,234	210
General and administrative	868	186	2,065	208
	$ 3,372	$ 731	$ 6,996	$ 871

For the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, the Company recorded stock-based compensation expense for non-employees totaling $58,000, $33,000, $84,000 and $58,000, respectively. For the three and six months ended June 30, 2008, the Company recorded stock-based compensation expense for the ESPP totaling $44,000 and $421,000, respectively. The Company held its first offering under the ESPP in December 2007; therefore, no stock-based compensation expense for the ESPP was recorded for the three or six months ended June 30, 2007.

In January 2008, the President and Chief Operating Officer of the Company resigned. In connection with his resignation, the Company accelerated vesting of approximately 114,000 shares subject to stock options held by this former employee. The modification resulted in approximately $575,000 of additional stock compensation expense in the three months ended March 31, 2008.

As of June 30, 2008 and December 31, 2007, the Company estimates there were $34,199,000 and $32,999,000 in total unrecognized compensation costs related to unvested employee stock option agreements, which are expected to be recognized over a weighted-average period of 3.0 and 2.8 years, respectively. As of June 30, 2008, the Company estimates there were $810,000 of unrecognized compensation costs related to the shares expected to be purchased through the ESPP, which are expected to be recognized over a weighted-average period of 0.6 years.

Stock Options and Awards Activity

The following is a summary of option activity for the Company s equity incentive plans (excluding options to purchase up to 182,000 shares of the Company s common stock subject to put and call agreements for certain RF Magic options) for the six months ended June 30, 2008:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2007	6,738	$ 1.29	8.6	$ 40,458
Granted	3,177	4.51		
Exercised	(354)	0.74		
Forfeitures and cancellations	(362)	2.16		
Outstanding as of June 30, 2008	9,199	2.39	8.6	22,134

During the three and six months ended June 30, 2008, the Company granted a total of 84,000 restricted stock units with a vesting period of 12 months and a weighted average grant date fair value of $3.92 per share.

During the three and six months ended June 30, 2008, approximately 165,000 shares of the Company s common stock were purchased through the ESPP which resulted in proceeds of $602,000.

As of June 30, 2008, the Company had 6,592,000 authorized shares available for future issuance under all of its equity incentive plans.

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3. Income Taxes

The Company calculates its interim income tax provision in accordance with Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods.* At the end of each interim period, the Company estimates the annual effective tax rate and applies that rate to its ordinary quarterly earnings. The tax expense or benefit related to significant, unusual or extraordinary items that will be separately reported or reported net of their related tax effect and are individually computed, are recognized in the interim period in which those items occur. In addition, the effect of changes in enacted tax laws, rates or tax status is recognized in the interim period in which the change occurs.

The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in foreign jurisdictions, permanent and temporary differences as a result differences between amounts measured and recognized in accordance with tax laws and financial accounting standards, and the likelihood of recovering deferred tax assets. The accounting estimates used to compute the provision for income taxes may change as new events occur, additional information is obtained or as the tax environment changes. When the Company s annual estimated income tax rate changes, the year-to-date effect of the change is recorded in the current period, which can cause fluctuations in effective tax rates in interim periods.

The effective tax rate for the three and six months ended June 30, 2008 was 1.1% and (0.8)%, respectively, compared to 0% for the three and six months ended June 30, 2007. The changes in effective tax rate are due to provisions related to foreign taxes. There were no discrete items recorded in the six months ended June 30, 2008.

A portion of the tax expense recorded for the three months ended March 31, 2008 related to an anticipated U.S. alternative minimum tax liability for the year ended December 31, 2008. As of June 30, 2008, due to an uncertainty in this tax liability, the Company reversed $111,000 of previously recorded federal alternative minimum tax expense. For the six months ended June 30, 2008, the Company has recorded $82,000 of tax expense related to foreign taxes.

FIN 48 prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions.

On January 1, 2007, the Company adopted the provisions of FIN 48. Included in the unrecognized tax benefits of $7,054,000 as of December 31, 2007 was $3,075,000 of tax benefits that, if recognized, would reduce the Company s annual effective tax rate net of any related valuation allowance recorded. The remainder of the unrecognized tax benefits in the amount of $3,979,000 will reduce goodwill. There have been no changes during the six months ended June 30, 2008 for any uncertain tax positions and the Company does not expect its unrecognized tax benefits to change significantly over the next 12 months. There were no accrued interest and penalties associated with uncertain tax positions as of June 30, 2008 or December 31, 2007.

The Company files federal and state income tax returns in the United States and various other income tax returns in foreign jurisdictions. The Company is not currently under audit or has not been notified of any impending examinations by any tax jurisdiction.

4. Net Income Per Share

Under the provisions of SFAS No. 128, *Earnings per Share*, basic loss per share is computed by dividing net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding for the period. Diluted loss per share is computed using the weighted average number of shares of common stock and dilutive common equivalent shares outstanding during the year. Common equivalent shares from stock options and other common stock equivalents are excluded from the computation when their effect is antidilutive. The Company was in a loss position for all periods presented and, accordingly, there is no difference between basic loss per share and diluted loss per share.

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

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Numerator:				
Net loss	$ (6,447)	$ (23,722)	$ (10,302)	$ (24,834)
Accretion of redeemable convertible preferred stock		(31)		(63)
Net loss attributable to common stockholders basic and diluted	$ (6,447)	$ (23,753)	$ (10,302)	$ (24,897)
Denominator:				
Weighted average number of common shares outstanding	68,748	8,086	68,630	7,453
Less: Restricted stock	(1,533)	(1,863)	(1,607)	(1,697)
Weighted average number of shares used in computing net loss per common share basic and diluted	67,215	6,223	67,023	5,756
Net loss per share basic and diluted				
Net loss	$ (0.10)	$ (3.82)	$ (0.15)	$ (4.33)
Accretion of redeemable convertible preferred stock				
Net loss attributable to common stockholders basic and diluted	$ (0.10)	$ (3.82)	$ (0.15)	$ (4.33)

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As of June 30, 2008 and 2007, the Company had securities outstanding which could potentially dilute basic loss per share in the future, but which were excluded from the computation of diluted net loss per share in the periods presented as their effect would have been anti-dilutive. Potentially dilutive outstanding securities consist of the following (in thousands):

	As of June 30, 2008	As of June 30, 2007
Stock options outstanding	9,199	6,333
Stock reserved for issuance under put and call option agreements	182	182
Restricted stock	1,322	2,174
Preferred stock warrants		514
Common stock warrants		323
Redeemable convertible preferred stock		44,897
Total	10,703	54,423

5. Supplemental Disclosure of Cash Flow and Non-Cash Activity

Cash Flow

The following table sets forth supplemental disclosure of cash flow information (in thousands):

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash paid for interest	$ 217	$ 85

Non-Cash Activity

The following table sets forth supplemental disclosure of non-cash activity (in thousands):

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Accretion of redeemable convertible preferred stock	$	$ 63
Issuance of common stock for stockholder notes		183
Issuance of preferred stock warrants in connection with debt financing		414
Issuance of common stock in connection with acquisition of Arabella Software, Ltd.		2,466
Issuance of redeemable convertible preferred stock and common stock in connection with acquisition of RF Magic		149,321
Assets assumed in connection with acquisition of Vativ, net of liabilities assumed	4,287	
Vesting of early exercised stock options	557	825

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6. Significant Customer and Geographic Information

Customers

Based on direct shipments, customers that represented 10% or more of total net revenues and accounts receivable were as follows:

	Revenues				Accounts Receivable	
	Three Months Ended June 30,		Six Months Ended June 30,		As of June 30,	
	2008	2007	2008	2007	2008	2007
Actiontec Electronics, Inc.	20%	31%	23%	32%	13%	21%
Jabil Circuit (Wuxi) Co., Ltd.	*	13	*	15	*	16
Motorola, Inc.	50	51	43	50	59	37

* Customer accounted for less than 10% for the period indicated

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Geographic Information

Net revenues are allocated to the geographic region based on the shipping destination of customer orders. Net revenues as a percentage of total net revenues by geographic region were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Asia	96%	99%	96%	99%
Europe	2	*	3	*
United States of America	1	1	1	1
Other North America	1	*	*	*
	100%	100%	100%	100%

* Region accounted for less than 1% of total net revenues for the period indicated

7. Subsequent Events

In July 2008, the Company paid cash retention bonuses in the aggregate amount of $560,000 of the total $650,000 to be paid to employees hired in connection with the Vativ acquisition. The Company expects to pay the remaining $90,000 within the next nine months.

In July 2008, the Company entered into a three-year software license and maintenance agreement for software tools with Synopsys, Inc. for $5,949,000. The licensing fees will be paid as follows (in thousands):

Years Ended December 31,	
2008	$ 1,837
2009	2,275
2010	1,837
	$ 5,949

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this Quarterly Report on Form 10-Q, or Quarterly Report, and our consolidated financial statements and related notes as of and for the year ended December 31, 2007 and the related Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2007, or Annual Report, filed with the Securities and Exchange Commission, or SEC, on March 3, 2008.

Forward-Looking Statements

The following discussion contains forward-looking statements, which involve risks and uncertainties. These forward-looking statements include, but are not limited to, statements concerning our strategy, future operations, competitors, future financial position, future revenues, projected costs, prospects and plans and objectives of management. These forward-looking statements are based on our current expectations, estimates, approximations and projections about our industry and business, management s beliefs, and certain assumptions made by us, all of which are subject to change. Forward-looking statements can often be identified by words such as anticipates, expects, intends, plans, predicts, believes, seeks, estimates, may, will, should, would, could, potential, continue, ongoing and similar expressions, and variations or negatives of these words. Forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under Risk Factors in Part II, Item 1A and elsewhere in this Quarterly Report, and in our other filings with the SEC. We operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements in this Quarterly Report. Forward-looking statements herein speak only as of the date of this Quarterly Report. Unless required by law, we undertake no obligation to update or revise any forward-looking statements to reflect new information or future events or developments. Thus, you should not assume that our silence over time means that actual events are bearing out as expressed or implied in such forward-looking statements.

Overview

Entropic Communications is a leading fabless semiconductor company that designs, develops and markets systems solutions to enable connected home entertainment. Our technologies significantly change the way high-definition television-quality video, or HD video, and other multimedia content such as movies, music, games and photos are brought into and delivered throughout the home. Our products include home networking chipsets based on the Multimedia over Coax Alliance, or MoCA, standard, high-speed broadband access chipsets, integrated circuits that simplify and enhance digital broadcast satellite services and silicon television tuner integrated circuits. We use our considerable experience with service provider-based deployments to create solutions that address the complex requirements associated with delivering multiple streams of HD video into and throughout the home, while seamlessly coexisting with video, voice and data services that are using the same coaxial cable infrastructure.

In December 2004, we introduced and commenced commercial shipments of our home networking products. In the first quarter of 2006, we began commercially shipping our broadband access solutions. In May 2007, we acquired Arabella Software Ltd., or Arabella, a developer of embedded software. In June 2007, we acquired RF Magic Inc., or RF Magic, a provider of digital broadcast satellite outdoor unit and silicon television tuner solutions. In April 2008, we acquired certain specified assets of Vativ Technologies, Inc., or Vativ, including Vativ s intellectual property rights, existing product lines, inventory and equipment for $5.9 million in cash and approximately $1.0 million in assumed liabilities. We contributed $0.9 million of the purchase price to an escrow fund which is available to satisfy potential indemnity claims. Since inception, we have invested heavily in product development and have not yet achieved profitability on a quarterly or annual basis. Our revenues have grown from $3.7 million in 2005 to $41.5 million in 2006 to $122.5 million in 2007, driven primarily by demand for our home networking products. Our revenues have increased from $46.2 million during the six months ended June 30, 2007 to $84.8 million during the six months ended June 30, 2008, driven primarily by demand for our home networking products and, to a lesser extent, from sales resulting from the RF Magic acquisition. As of June 30, 2008, we had an accumulated deficit of $102.6 million.

We generate revenues principally by sales of our semiconductor products. We also generate service revenues from development contracts. We principally sell our products directly to either original design manufacturers, or ODMs, or original equipment manufacturers, or OEMs. We price our products based on market and competitive conditions and reduce the price of our products over time, as market and competitive conditions change, and as manufacturing costs are reduced. Our markets are generally characterized by declining average selling prices over the life of a product and, accordingly, we must reduce costs and successfully introduce new products and enhancements to maintain our gross margins.

We rely on a limited number of customers for a significant portion of our revenues. Sales to these customers are in turn driven by service providers that purchase our customers products which incorporate our products. Substantially all of our revenues are dependent upon three major service providers, Verizon Communications, Inc. through its FiOS deployment, EchoStar Satellite, LLC and DIRECTV. In addition, we are dependent on sales outside of the United States for almost all of our revenues and expect that to continue in the future.

In the six months ended June 30, 2008, Motorola, Inc., or Motorola, and Actiontec Electronics, Inc., or Actiontec, accounted for 43% and 23%, respectively, of our net revenues. We expect to continue to have major concentrations of sales to a relatively small number of ODM and OEM customers.

In the six months ended June 30, 2008, 96% of our revenues were derived from Asia, 3% were derived from Europe, and 1% was derived from the United States and other North American countries. In the six months ended June 30, 2007, 99% of our revenues were derived from Asia and 1% was derived from the United States and other North American countries. Many of our ODM and OEM customers in Asia incorporate our chipsets into products that they sell to U.S.-based service providers.

We use third party foundries and assembly and test contractors to manufacture, assemble and test our products. This outsourced manufacturing approach allows us to focus our resources on the design, sales and marketing of our products and avoid the cost associated with owning and operating our own manufacturing facility. A significant portion of our cost of net revenues consists of payments for the purchase of wafers and for manufacturing, assembly and test services.

We expect research and development expenses to continue to increase in total dollars as we develop additional products and expand our business, and to fluctuate over the course of the year based on the timing of our fabrication mask costs. We also anticipate that our sales and marketing expenses will increase as we expand our domestic and international sales and marketing organization and activities and build brand awareness. Due to the lengthy sales cycles that we face, we may experience significant delays from the time we incur research and development and sales and marketing expenses until the time, if ever, that we generate sales from the related products.

In February 2008, we relocated our two separate facilities in San Diego, California, into a 90,000 square foot facility which serves as our corporate headquarters.

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Since our inception, we have funded our operations using a combination of preferred stock issuances, cash collections from customers, bank credit facilities, cash received from the exercise of stock options and proceeds from our initial public offering, or IPO. We intend to continue spending substantial amounts in connection with the growth of our business and we may need to obtain additional financing to pursue our business strategy, develop new products, respond to competition and market opportunities and acquire complementary businesses or technologies.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and the results of operations are based on our financial statements which have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies are discussed in our Annual Report and there have been no material changes made to these policies since the date of our Annual Report.

Results of Operations

The following table sets forth selected items from our unaudited condensed consolidated statements of operations as a percentage of total net revenues for the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Consolidated Statements of Operations Data:				
Net revenues	100%	100%	100%	100%
Cost of net revenues	56	69	55	70
Gross profit	44	31	45	30
Operating expenses:				
Research and development	37	26	34	24
Sales and marketing	10	7	10	7
General and administrative	8	6	8	5
Write off of in-process research and development	3	82	2	47
Amortization of purchased intangible assets	2		2	
Restructuring charge			1	
Total operating expenses	60	121	57	83
Loss from operations	(16)	(90)	(12)	(53)
Other income (expense), net		(1)		(1)
(Benefit) provision for income taxes	1			
Net loss	(15)	(91)	(12)	(54)
Accretion of redeemable convertible preferred stock				
Net loss attributable to common stockholders	(15)%	(91)%	(12)%	(54)%

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Comparison of Three and Six Months Ended June 30, 2008 and 2007

(Tables presented in thousands, except percentage amounts)

Net Revenues

	Three Months Ended June 30,			Six Months Ended June 30,		
	2008	2007	% Change	2008	2007	% Change
Net revenues	$ 42,836	$ 26,207	63%	$ 84,824	$ 46,233	83%

The increase in net revenues for the three and six months ended June 30, 2008 compared to the same periods in 2007 was driven primarily by demand for our home networking products and, to a lesser extent, from sales of digital broadcast satellite, or DBS, outdoor unit chips resulting from the RF Magic acquisition.

Gross Profit/Gross Margin

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	% Change	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	% Change
Gross profit	$ 18,967	$ 8,246	130%	$ 38,118	$ 13,741	177%
% of net revenues	44%	31%		45%	30%	

Gross profit increased during the three and six months ended June 30, 2008 over comparable periods in 2007 primarily driven by higher revenues from the sales of our home networking chipsets, and to a lesser extent, from sales of DBS outdoor unit chips.

The increase in gross profit as a percentage of revenue for the three and six months ended June 30, 2008 compared to the same periods in 2007 was primarily due to a decrease in the unit costs of our home networking chipsets principally as a result of more favorable manufacturing costs, as well as the contribution to gross margin from the sales of our DBS outdoor unit products. Additionally, as a result of our acquisitions, which we accounted for by using the purchase method of accounting as required by SFAS No. 141, *Business Combinations,* cost of net revenues included $2.8 million and $1.6 million of amortization of developed technology for the three and six months ended June 30, 2008, respectively. The acquisition of RF Magic occurred on June 30, 2007, therefore no amortization of developed technology was included in cost of goods sold during the three and six months ended June 30, 2007.

Research and Development Expenses