ENTROPIC COMMUNICATIONS INC
Form 10-Q
November 01, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 September 30, 2012

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 or Organization)	**(I.R.S. Employer Identification No.)**

6290 Sequence Drive

San Diego, CA 92121

(Address of Principal Executive Offices, Including Zip Code)

Registrant s telephone number, including area code: (858) 768-3600

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 x	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 ¨ No x

There were 88,546,867 shares of the registrant s common stock, par value $0.001 per share, issued and outstanding as of October 29, 2012.

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ENTROPIC COMMUNICATIONS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

Entropic Communications, Inc.

Unaudited Condensed Consolidated Balance Sheets

(in thousands)

	September 30, 2012	December 31, 2011 [1]
Assets		
Current assets:		
Cash and cash equivalents	$ 22,511	$ 20,193
Marketable securities	90,560	91,625
Accounts receivable	36,104	25,896
Inventory	39,532	20,253
Deferred tax assets, current	13,658	13,565
Prepaid expenses and other current assets	23,323	9,927
Total current assets	225,688	181,459
Property and equipment, net	14,969	11,250
Long-term marketable securities	53,255	104,708
Intangible assets, net	49,953	
Goodwill	4,664	
Deferred tax assets, long-term	9,953	9,600
Other long-term assets	9,501	11,542
Total assets	$ 367,983	$ 318,559
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 20,083	$ 11,559
Accrued expenses and other current liabilities	16,005	4,078
Accrued payroll and benefits	13,057	3,835
Total current liabilities	49,145	19,472
Deferred rent	727	1,098
Other long-term liabilities	1,307	196
Stockholders equity:		
Common Stock	89	87
Additional paid-in capital	462,592	448,440
Accumulated deficit	(146,165)	(150,639)
Accumulated other comprehensive income (loss)	288	(95)
Total stockholders equity	316,804	297,793
Total liabilities and stockholders equity	$ 367,983	$ 318,559

(1) The unaudited condensed consolidated balance sheet at December 31, 2011 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The accompanying notes are an integral part of these unaudited 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 September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net revenues	$ 89,825	$ 51,465	$ 231,980	$ 184,459
Cost of net revenues	45,778	22,996	111,886	82,581
Gross profit	44,047	28,469	120,094	101,878
Operating expenses:				
Research and development	28,072	15,142	69,214	42,439
Sales and marketing	6,966	4,073	18,986	13,196
General and administrative	5,718	2,939	19,592	10,143
Amortization of intangibles	930		1,645	
Total operating expenses	41,686	22,154	109,437	65,778
Income from operations	2,361	6,315	10,657	36,100
Loss related to equity method investment	(799)	(91)	(2,536)	(91)
Other income, net	31	224	567	626
Income before income taxes	1,593	6,448	8,688	36,635
Income tax provision	1,185	1,803	4,214	12,379
Net income	$ 408	$ 4,645	$ 4,474	$ 24,256
Net income per share basic	$	$ 0.05	$ 0.05	$ 0.28
Net income per share diluted	$	$ 0.05	$ 0.05	$ 0.27
Weighted average number of shares used to compute net income per share basic	88,399	86,541	87,913	85,993
Weighted average number of shares used to compute net income per share diluted	90,885	88,884	89,918	89,165

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

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Entropic Communications, Inc.

Unaudited Condensed Consolidated Statements of Comprehensive Income

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income	$ 408	$ 4,645	$ 4,474	$ 24,256
Other comprehensive income:				
Change in foreign currency translation adjustment	59	18	76	35
Available-for-sale investments:				
Change in net unrealized gains, net of taxes	172	(180)	307	(90)
	231	(162)	383	(55)
Comprehensive income	$ 639	$ 4,483	$ 4,857	$ 24,201

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

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Entropic Communications, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30,	
	2012	**2011**
Operating activities:		
Net income	$ 4,474	$ 24,256
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,937	3,245
Amortization of intangible assets	5,447	
Change in acquisition-related contingent consideration liability	230	
Deferred taxes	(202)	11,862
Excess tax benefit on stock option exercises	(286)	
Stock-based compensation	10,982	9,426
Amortization of premiums on investments	2,652	2,938
Provision for excess and obsolete inventory	365	1,547
Loss related to equity method investment	2,536	91
Changes in operating assets and liabilities:		
Accounts receivable	(2,142)	(16,889)
Inventory	(12,553)	12,588
Prepaid expenses and other current assets	(4,117)	(2,611)
Other long-term assets	(363)	787
Accounts payable	8,524	(12,138)
Accrued expenses and other current liabilities	3,296	(539)
Accrued payroll and benefits	6,728	(924)
Deferred rent	(371)	(350)
Other long-term liabilities	942	54
Net cash provided by operating activities	30,079	33,343
Investing activities:		
Purchases of property and equipment	(4,876)	(3,279)
Purchases of marketable securities	(79,719)	(180,961)
Sales/maturities of marketable securities	129,953	83,680
Investment in non-consolidated entity		(10,000)
Net cash used in acquisition Trident	(69,490)	
Net cash used in acquisition PLX	(6,874)	
Net cash used in investing activities	(31,006)	(110,560)
Financing activities:		
Net proceeds from the issuance of equity plan exercises	2,885	3,793
Excess tax benefit on stock option exercises	286	
Net cash provided by financing activities	3,171	3,793
Net effect of exchange rates on cash	74	46
Net increase (decrease) in cash and cash equivalents	2,318	(73,378)
Cash and cash equivalents at beginning of period	20,193	98,100
Cash and cash equivalents at end of period	$ 22,511	$ 24,722

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

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Entropic Communications, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

Business

Entropic Communications, Inc. was organized under the laws of the state of Delaware on January 31, 2001. Entropic Communications is a leading fabless semiconductor company that designs, develops and markets semiconductor solutions to enable home entertainment. Our technologies change the way traditional broadcast video, streaming video, and other multimedia content such as movies, music, games and photos are brought into, distributed and processed throughout the home.

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP.

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

The accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals, which we consider necessary for a fair presentation of the financial position and results of operations for the periods presented.

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 unaudited condensed consolidated financial statements and these accompanying notes. Among the significant estimates affecting the unaudited condensed consolidated financial statements are those related to business combinations, revenue recognition, allowance for doubtful accounts, inventory reserves, long-lived assets (including intangible assets), warranty reserves, accrued bonuses, income taxes, valuation of equity securities and stock-based compensation. On an ongoing basis, management reviews its estimates based upon currently available information. Actual results could differ materially from those estimates.

Foreign Currency Translation

The functional currency for our foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rates on the balance sheet dates. Net revenues and expenses are translated using the average exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income (loss) within stockholders equity in the unaudited condensed consolidated balance sheets. Foreign currency transaction gains and losses are reported in operating expenses in the unaudited condensed consolidated statements of operations.

Revenue Recognition

Our net revenues are generated principally by sales of our semiconductor solutions products. During the three and nine months ended September 30, 2012 and 2011, product net revenues represented more than 99% of our total net revenues.

Our sales primarily occur through the efforts of our direct sales force. The remainder of our sales occurs through third-party sales representatives and distributors. During the three and nine months ended September 30, 2012, approximately 94% and 96%, respectively, of our sales occurred through the efforts of our direct sales force. During the three and nine months ended September 30, 2011, more than 99% of our sales occurred through the efforts of our direct sales force.

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We recognize revenue 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, we do not recognize revenue until all substantive customer acceptance requirements have been met, when applicable.

A portion of our sales are made through distributors, agents or customers acting as agents under agreements allowing for pricing credits and/or rights of return. Net revenues on sales made through these distributors are not recognized until the distributors ship the product to their customers.

Revenues derived from billing customers for shipping and handling costs are classified as a component of net revenues. Costs of shipping and handling charged by suppliers are classified as a component of cost of net revenues.

We record reductions to net revenues for estimated product returns and pricing adjustments, such as competitive pricing programs, in the same period that the related revenue is recorded. The amount of these reductions is based on historical sales returns and other factors known at the time. If actual returns differ significantly from our estimates, such differences would be recorded in our results of operations for the period in which the actual returns become known. To date, changes in estimated returns have not been material to net revenues in any related period.

We are party to an inventory hubbing agreement with Motorola Mobility, Inc. (formerly Motorola, Inc.), or Motorola. Pursuant to this agreement, we deliver products to the designated third-party warehouse based upon Motorola s projected needs, but do not recognize product revenue unless and until Motorola removes our products from the third-party warehouse to incorporate into its own products.

We have entered into agreements to license certain hardware and software, also referred to as the nodes, to certain members of the Multimedia over Coax Alliance, or MoCA, for a period of three years and to provide upgrades when and if they become available. The agreements limit the rights to use the nodes to test compliance of the members own products to the MoCA specification. For these arrangements, we defer all of the license revenues when the nodes are delivered and recognize the revenues on a straight-line basis over the three-year term of the agreement.

We provide rebates on our products to certain customers. At the time of the sale, we accrue 100% of the potential rebate as a reduction to net revenue and do not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. We reverse the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when we believe unclaimed rebates are no longer subject to payment and will not be paid. For the three and nine months ended September 30, 2012, we reduced net revenue by $0.2 million and $0.4 million, respectively, in connection with our rebate programs. For the three and nine months ended September 30, 2012, the reduction in our revenues in connection with our rebate programs was not material.

We occasionally enter into agreements where revenue is derived from multiple deliverables including any mix of products and/or services. These products and/or services are generally delivered from approximately three months to two years after the execution date of the agreement. Revenue recognition for agreements with multiple deliverables is based on the individual units of accounting determined to exist in the agreement. A delivered item is considered a separate unit of accounting when the delivered item has value to the customer on a stand-alone basis. Items are considered to have stand-alone value when they are sold separately by any vendor or when the customer could resell the item on a stand-alone basis.

For multiple deliverable agreements, consideration is allocated at the inception of the agreement to all deliverables based on their relative selling price. The relative selling price for each deliverable is determined using vendor specific objective evidence, or VSOE, of selling price or third-party evidence of selling price if VSOE does not exist. If neither VSOE nor third-party evidence of selling price exists, we use our best estimate of the selling price for the deliverable. The fair value of an item is generally the price charged for the product if the item is regularly sold on a stand-alone basis.

In order to establish VSOE of selling price, we must regularly sell the product and/or service on a standalone basis with a substantial majority priced within a relatively narrow range. VSOE of selling price is usually the midpoint of that range. If there are not a sufficient number of standalone sales and VSOE of selling price cannot be determined, then we consider whether third-party evidence can be used to establish the selling price. If neither VSOE nor third-party evidence of selling price exists, we determine our best estimate of selling price using average selling prices on a standalone basis over a rolling 12-month period as well as market conditions. If the product or service has no history of sales, we rely upon sales prices set by our pricing committee, adjusted for applicable discounts.

We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the timing of revenue recognition but do not change the total revenue recognized on any agreement. To date, multiple deliverable contacts have not been material to net revenues in any related period.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentration of credit risk consist primarily of cash and cash equivalents, marketable securities, accounts receivable, leases payable and lines of credit. Our policy is to place our cash, cash equivalents and marketable securities with high quality financial institutions in order to limit our credit exposure. We extend credit to certain of our customers based on an evaluation of the customer s financial condition and a cash deposit is generally not required. We estimate potential losses on trade receivables on an ongoing basis.

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

Concentration of Supplier Risk

We are dependent on NXP Semiconductors Netherlands B.V., or NXP, as our sole source manufacturer of set-top-box system-on-a-chip products and certain other products. If NXP became unable to manufacture products for us in a timely manner and we were unable to find alternative vendors, our business, operating results and financial condition could be materially adversely affected.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and money market funds. We consider all highly liquid investments with a maturity of three months or less from the date of purchase that are readily convertible into cash to be cash equivalents.

Deferred Compensation

In June 2011, we implemented a non-qualified deferred compensation plan that permits certain key employees to defer portions of their compensation, subject to annual deferral limits, and have it credited to one or more investment options in the plan. At September 30, 2012, we had marketable securities totaling $0.2 million related to investments in equity securities that are held in a rabbi trust under our non-qualified deferred compensation plan. The total related deferred compensation liability was $0.2 million at September 30, 2012, all of which was classified as non-current liabilities and is recorded in the unaudited condensed consolidated balance sheets under other long-term liabilities.

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Marketable Securities

We account for marketable securities by determining the appropriate classification of such securities at the time of purchase and reevaluating such classification as of each balance sheet date. As of September 30, 2012, we had classified $0.4 million of bank and time deposits and $0.2 million held under our non-qualified deferred compensation plan as trading securities. Trading securities are bought and held principally for the purpose of selling in the near term and are reported at fair value, with unrealized gains and losses included in earnings. All other marketable securities were classified as available-for-sale. Cash equivalents and available-for-sale marketable securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of stockholders equity, net of tax. The investments are adjusted for amortization of premiums and discounts to maturity and such amortization is included in interest income. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in the unaudited condensed consolidated statements of operations.

Fair Value of Financial Instruments

The carrying amounts of cash equivalents, marketable securities, trade receivables, accounts payable and other accrued liabilities approximate their fair value due to the relative short-term maturities. The fair value of marketable securities was determined using the quoted market price for those securities. The carrying amounts of our capital lease obligations and other long-term liabilities approximate their fair value. The fair value of capital lease obligations was estimated based on the current interest rates available to us for debt instruments with similar terms, degrees of risk and remaining maturities.

Allowance for Doubtful Accounts

We evaluate the collectability of accounts receivable based on a combination of factors. In cases where we are aware of circumstances that may impair a specific customer s ability to meet its financial obligations subsequent to the original sale, we will record a specific allowance against amounts due, and thereby reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize allowances for doubtful accounts based upon specific identification, industry and geographic concentrations, the current business environment and our historical experience. We recorded no allowance for doubtful accounts as of September 30, 2012 and December 31, 2011.

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 calculated on a part-by-part basis and, in general, represent excess inventory value on hand compared to 12-month demand projections. Once established, these adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

We have entered into a capacity agreement with one of our third-party foundry contractors in order to guarantee minimum capacity volumes on our direct broadcast satellite outdoor unit, and silicon tuner solutions. Pursuant to the capacity agreement, we have made prepayments which will result in reduced prices paid on future inventory purchases up to a specified volume. The prepayments are being amortized into the cost of our inventory purchases based on the specified volume commitments under the terms of the capacity agreement and our estimated purchases over the period if less than the specified volume. The prepaid inventory volume commitments are assessed for impairment on a periodic basis by comparing the remaining prepaid balance to our estimate of remaining purchases. There have been no impairments to date.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets (three to seven years), except leasehold improvements and software which are amortized over the lesser of the estimated useful lives of the asset or the remaining lease/license term.

Goodwill and Intangible Assets

We record goodwill and other intangible assets based on the fair value of the assets acquired. In determining the fair value of the assets acquired, we utilize extensive accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired. We use the discounted cash flow method to estimate the value of intangible assets acquired. The estimates used to value and amortize intangible assets are consistent with the plans and estimates that we use to manage our business and are based on available historical information and industry estimates and averages.

We assess goodwill and intangible assets for impairment using fair value measurement techniques on an annual basis, during the fourth quarter of the year or more frequently if indicators of impairment exist. We perform an interim goodwill impairment test when it is more likely than not that the fair value of a reporting unit is less than the carrying amount. We operate as one reporting unit. The goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill to measure the amount of the impairment loss, if any. Determining the fair value of the implied goodwill is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including the size and timing of deployments by our customers and related projections and timing of future cash flows, discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, stage of products in development, determination of appropriate market comparables, and determination of whether a premium or discount should be applied to comparables.

Investment in a Privately Held Company

We account for our investment in a privately held company under the equity method of accounting since we exercise significant influence, but we do not have the elements of control that would require consolidation. The rights of the other investors are both protective and participating. Unless we are determined to be the primary beneficiary, these rights preclude us from consolidating the investment. The investment is recorded initially at cost as an investment in a privately held company, and subsequently is adjusted for equity in net income and cash contributions and distributions. Any difference between the carrying amount of the investment on our balance sheet and the underlying equity in net assets is evaluated for impairment at each reporting period. As of September 30, 2012, our investment in a privately held company was $6.7 million, which is included in other long-term assets on our balance sheet.

Warranty Accrual

We generally provide a warranty on our products for a period of one year; however, it may be longer for certain customers. Accordingly, we establish provisions for estimated product warranty costs at the time revenue is recognized based upon our historical activity and, additionally, for any known product warranty issues. Warranty provisions are recorded as a cost of net revenues. The determination of such provisions requires us to make estimates of product return rates and expected costs to replace or rework the products under warranty. When the actual product failure rates, cost of replacements and rework costs differ from our estimates, revisions to the estimated warranty accrual are made. Actual claims are charged against the warranty reserve.

Guarantees and Indemnifications

In the ordinary course of business, we have 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 financial statements.

Software Development Costs

Software development costs are capitalized beginning when technological feasibility has been established and ending when a product is available for sale to customers. To date, the period between achieving technological feasibility and when the software is made available for sale to customers has been relatively short and software development costs qualifying for capitalization have not been significant. As such, all software development costs have been expensed as incurred in research and development expense.

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Income Taxes

We estimate income taxes based on the various jurisdictions where we conduct business. Significant judgment is required in determining our worldwide income tax provision. We estimate the current tax liability and assess temporary differences that result from differing treatments of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are reflected in our balance sheets. We then assess the likelihood that deferred tax assets will be realized. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized. When a valuation allowance is established or increased, we record a corresponding tax expense in our statements of operations. When a valuation allowance is decreased, we record the corresponding tax benefit in our statements of operations. We review the need for a valuation allowance each interim period to reflect uncertainties about whether we will be able to utilize deferred tax assets before they expire. The valuation allowance analysis is based on estimates of taxable income for the jurisdictions in which we operate and the periods over which our deferred tax assets will be realizable.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not of being sustained upon audit, the second step is to measure the tax benefit as the largest amount that has more than a 50% chance of being realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. We evaluate uncertain tax positions on a quarterly basis. The evaluations are based upon a number of factors, including changes in facts or circumstances, changes in tax law, correspondence with tax authorities during the course of audits and effective settlement of audit issues.

Stock-Based Compensation

We have equity incentive plans under which incentive stock options have been granted to employees and restricted stock units and non-qualified stock options have been granted to employees and non-employees. We also have an employee stock purchase plan for all eligible employees.

Our stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense over the employee s requisite service period. We have no stock-based compensation awards with market or performance conditions. The stock-based compensation expense attributable to awards under our 2007 Employee Stock Purchase Plan, or ESPP, was determined using the Black-Scholes option pricing model.

We also grant awards to non-employees and determine the fair value of such 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 (i) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached, or (ii) the date at which the counterparty s performance is completed.

We recognize 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, we follow the with and without approach excluding any indirect effects to be realized until after the utilization of all other tax benefits available to us.

Segment Reporting

We are organized as, and operate 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, or HD, video and other multimedia content for entertainment purposes into and throughout the home. Our chief operating decision maker is our chief executive officer, or CEO. Our CEO reviews financial information presented on a consolidated basis for the purpose of evaluating financial performance and allocating resources. There are no segment managers who are held accountable for operations below the consolidated financial statement level. Our assets are primarily located in the United States and not allocated to any specific region. Therefore, geographic information is presented only for total revenue.

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Recently Issued Accounting Standards

In May 2011, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standard , or IFRS. This update amends Accounting Standards Codification Topic 820, Fair Value Measurement and Disclosure. ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011. We have adopted ASU 2011-04 effective January 1, 2012 and the application of this guidance did not have a significant impact on our financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in stockholders equity and requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We have adopted this guidance effective January 1, 2012. The adoption of ASU 2011-05 concerns presentation and disclosure only and does not have an impact on our consolidated financial position or results of operations.

There have been no other recent accounting standards, or changes in accounting standards, during the nine months ended September 30, 2012, as compared to the recent accounting standards described in the Annual Report, that are of material significance, or have potential material significance, to us.

2. Supplemental Financial Information

Marketable Securities

We have marketable securities and financial instruments that are classified as either available-for-sale or trading securities. As of September 30, 2012, our short-term investment portfolio included $0.2 million of trading securities invested in a defined set of mutual funds directed by the participants in our non-qualified deferred compensation plan. As of September 30, 2012 these securities had net unrealized gains of $14,000 and a cost basis of $0.2 million. As of September 30, 2012, our short-term investment portfolio also included $0.4 million of trading securities invested in principal and interest guaranteed bank and time deposit accounts.

The following tables summarize available-for-sale investments by security type as of September 30, 2012 and December 31, 2011 (in thousands):

	As of September 30, 2012			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
Commercial paper	$ 1,992	$	$	$ 1,992
Corporate notes/bonds	82,643	100	(25)	82,718
U.S. Treasury and agency notes/bonds	2,999	10		3,009
State and municipal bonds	2,265	5		2,270
Total marketable securities, short-term	89,899	115	(25)	89,989
Corporate notes/bonds, long-term	53,150	126	(21)	53,255
Total	$ 143,049	$ 241	$ (46)	$ 143,244

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	As of December 31, 2011			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
Commercial paper	$ 12,084	$ 2	$ (19)	$ 12,067
Corporate notes/bonds	73,453	27	(62)	73,418
U.S. Treasury and agency notes/bonds	5,966	10		5,976
Total marketable securities, short-term	91,503	39	(81)	91,461
Corporate notes/bonds, long-term	72,017	23	(143)	71,897
U.S. Treasury and agency notes/bonds, long-term	30,502	26	(19)	30,509
State and municipal bonds, long-term	2,301	3	(2)	2,302
Total	$ 196,323	$ 91	$ (245)	$ 196,169

Realized gains on our available-for-sale securities for the three months ended September 30, 2012 and 2011 and the nine months ended September 30, 2012 and 2011 were $2,000, $0, $13,000 and $0, respectively.

The following table summarizes the contractual maturities of our available-for-sale securities (in thousands):

	As of September 30, 2012
Less than one year	$ 89,989
Due in one to five years	53,255
Due after five years	
	$ 143,244

Fair Value of Financial Instruments

We determine a fair value measurement based on the assumptions a market participant would use in pricing an asset or liability. Accounting Standards Codification, or ASC, 820 establishes a three-level hierarchy making a distinction between market participant assumptions based on (i) unadjusted quoted prices for identical assets or liabilities in an active market (Level 1), (ii) quoted prices in markets that are not active or inputs that are observable either directly or indirectly for substantially the full term of the asset or liability (Level 2), and (iii) prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement (Level 3).

Cash and cash equivalents consist primarily of bank deposits with third-party financial institutions and highly liquid money market securities with original maturities at date of purchase of 90 days or less and are stated at cost which approximates fair value and are classified as Level 1 assets.

Marketable securities are recorded at fair value, defined as the exit price in the principal market in which we would transact, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Level 1 instruments are valued based on quoted market prices in active markets for identical instruments and include our investments in money market and mutual funds. Level 2 securities are valued using quoted market prices for similar instruments, non-binding market prices that are corroborated by observable market data, or discounted cash flow techniques and include our investments in corporate bonds and notes, U.S. government agency securities, U.S. treasury bills, state and municipal bonds and commercial paper.

Our non-qualified deferred compensation plan and employee pension plan liabilities are classified as Level 1 liabilities within the hierarchy. The fair values of the liabilities are directly related to the valuation of the short-term and long-term investments held in trust for the plan. Hence, the carrying value of the non-qualified deferred compensation liability and employee pension plan liability represents the fair value of the investment assets.

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Level 3 instruments are valued based on unobservable inputs that are supported by little or no market activity and reflect our own assumptions in measuring fair value. We have no assets classified as Level 3 instruments. There were no transfers between different levels during the three and nine months ended September 30, 2012.

The valuation of contingent consideration is based on a probability-weighted earnouts model which relies primarily on estimates of milestone achievements and discount rates applicable for the period expected payout. The most significant unobservable input used in the determination of estimated fair value of contingent consideration is the estimates on the likelihood of milestone achievements, which directly correlates to the fair value recognized in the Consolidated Balance Sheets.

The fair value of this liability is estimated quarterly by management based on inputs received from the Company s engineering and finance personnel. The determination of the milestone achievement is performed by the Company s engineering department and reviewed by the accounting department. Potential valuation adjustments are made as the progress toward achieving milestones becomes determinable with the impact of such adjustments being recorded through Other income (expense), net.

The fair value measurements of our cash equivalents, marketable securities and non-qualified deferred compensation plan consisted of the following as of September 30, 2012 and December 31, 2011 (in thousands):

	Fair Value Measurements as of September 30, 2012			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash equivalents	$ 2,231	$ 2,231	$	$
Short-term investments:				
Commercial paper	1,992		1,992	
Corporate notes/bonds	82,718		82,718	
U.S. Treasury and agency notes/bonds	3,009		3,009	
State and municipal bonds	2,270		2,270	
Mutual funds	211	211		
Bank and time deposits	360	360		
Long-term investments:				
Corporate notes/bonds	53,255		53,255	
Total assets at fair value	$ 146,046	$ 2,802	$ 143,244	$
Liabilities:				
Acquisition related contingent consideration	$ 3,329	$	$	$ 3,329
Non-qualified deferred compensation plan	211	211		
Total liabilities at fair value	$ 3,540	$ 211	$	$ 3,329

	Fair Value Measurements as of December 31, 2011			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash equivalents	$ 11,036	$ 11,036	$	$
Short-term investments:				
Commercial paper	12,067		12,067	
Corporate notes/bonds	73,418		73,418	