

RADISYS CORP  
Form 10-Q  
November 07, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended September 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 0-26844

**RADISYS CORPORATION**

(Exact name of registrant as specified in its charter)

**OREGON**  
(State or other jurisdiction of  
Incorporation or Organization)

**93-0945232**  
(I.R.S. Employer  
Identification Number)

**5445 N.E. Dawson Creek Drive**

**Hillsboro, OR 97124**

(Address of principal executive offices, including zip code)

**(503) 615-1100**

(Registrant's telephone number, including area code)

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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 the filing requirements for the past 90 days. 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  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  No

Number of shares of common stock outstanding as of November 6, 2008: 22,863,101

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**RADISYS CORPORATION**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****RADISYS CORPORATION****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share amounts, unaudited)**

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Revenues	\$ 100,258	\$ 83,630	\$ 283,916	\$ 226,013
Cost of sales:				
Cost of sales	69,652	60,907	201,191	165,348
Amortization of purchased technology	3,868	3,532	11,906	9,999
Total cost of sales	73,520	64,439	213,097	175,347
Gross margin	26,738	19,191	70,819	50,666
Research and development	11,896	11,775	37,593	34,084
Selling, general and administrative	12,763	11,889	38,715	35,146
Intangible assets amortization	1,302	1,078	3,907	3,124
Restructuring and other charges (reversals)	(23)	(141)	575	1,391
Income (loss) from operations	800	(5,410)	(9,971)	(23,079)
Interest expense	(672)	(416)	(1,933)	(1,279)
Interest income	605	1,690	2,555	4,946
Other income (expense), net	27	(30)	36	(151)
Income (loss) before income tax provision (benefit)	760	(4,166)	(9,313)	(19,563)
Income tax provision (benefit)	1,006	(1,720)	45	(4,401)
Net loss	\$ (246)	\$ (2,446)	\$ (9,358)	\$ (15,162)
Net loss per share:				
Basic	\$ (0.01)	\$ (0.11)	\$ (0.42)	\$ (0.70)
Diluted	\$ (0.01)	\$ (0.11)	\$ (0.42)	\$ (0.70)
Weighted average shares outstanding:				
Basic	22,653	21,937	22,442	21,808
Diluted	22,653	21,937	22,442	21,808

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

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**RADISYS CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

(In thousands)

	September 30, 2008 (Unaudited)	December 31, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 83,676	\$ 50,522
Short-term investments		72,750
Accounts receivable, net	49,129	70,548
Other receivables	1,995	2,678
Inventories, net	31,351	23,101
Other current assets	3,674	5,299
Deferred tax assets, net	6,603	6,489
Total current assets	176,428	231,387
Property and equipment, net	11,757	11,233
Goodwill	67,644	67,644
Intangible assets, net	22,950	38,779
Long-term investments, net	56,522	
Long-term deferred tax assets, net	42,110	40,078
Other assets	5,449	3,987
Total assets	\$ 382,860	\$ 393,108
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 37,857	\$ 49,675
Accrued wages and bonuses	8,693	8,101
Deferred income	3,073	5,308
2023 convertible senior notes, net	36,623	97,548
Other accrued liabilities	10,890	8,915
Total current liabilities	97,136	169,547
Long-term liabilities:		
2013 convertible senior notes	55,000	
Revolving line of credit	20,000	
Other long-term liabilities	3,260	3,585
Total long-term liabilities	78,260	3,585
Total liabilities	175,396	173,132
Shareholders' equity:		
Preferred stock - \$.01 par value, 5,664 shares authorized; none issued or outstanding		
Common stock - no par value, 100,000 shares authorized; 22,848 and 22,312 shares issued and outstanding at September 30, 2008 and December 31, 2007	227,918	226,873
Accumulated deficit	(20,643)	(11,285)
Accumulated other comprehensive income:		

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Cumulative currency translation adjustments	4,395	4,388
Unrealized loss on hedge instruments	(246)	
Unrealized loss on available-for-sale investments	(3,960)	
Total accumulated other comprehensive income	189	4,388
Total shareholders' equity	207,464	219,976
Total liabilities and shareholders' equity	\$ 382,860	\$ 393,108

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

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## RADISYS CORPORATION

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands, unaudited)

	Common stock		Accumulated Other	Accumulated	Total	Total
	Shares	Amount	Comprehensive Income	Deficit		Comprehensive Loss (1)
Balances, December 31, 2007	22,312	\$ 226,873	\$ 4,388	\$ (11,285)	\$ 219,976	
Shares issued pursuant to benefit plans	506	4,163			4,163	
Stock-based compensation associated with employee benefit plans		7,426			7,426	
Restricted share cancellations and forfeitures for tax settlements	(44)	(390)			(390)	
Vesting of restricted stock units	74					
Impairment of available-for-sale investments, net of tax			(3,960)		(3,960)	(3,960)
Net adjustment for fair value of hedge derivatives			(246)		(246)	(246)
Purchase of capped call on 2013 convertible senior notes		(10,154)			(10,154)	
Translation adjustments			7		7	7
Net loss for the period				(9,358)	(9,358)	(9,358)
Balances, September 30, 2008	22,848	\$ 227,918	\$ 189	\$ (20,643)	\$ 207,464	

Comprehensive loss for the nine months ended  
September 30, 2008

\$ (13,557)

- (1) For the three months ended September 30, 2008, total comprehensive loss amounted to \$1.9 million and consisted of net loss for the period of \$246,000, net losses from currency translation adjustments of \$273,000, net losses from adjustments for fair value of hedge derivatives of \$254,000 and an impairment of available-for-sale investments, net of tax, of \$1.2 million. For the three months ended September 30, 2007, total comprehensive loss amounted to \$2.2 million and consisted of net loss for the period of \$2.4 million, net gains from currency translation adjustments of \$240,000 and a net loss from the liquidation of a subsidiary of \$32,000. For the nine months ended September 30, 2007, total comprehensive loss amounted to \$14.9 million and consisted of net loss for the period of \$15.2 million and net gains from translation adjustments of \$284,000 and a net loss from the liquidation of a subsidiary in the amount of \$32,000.

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

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**RADISYS CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands, unaudited)

	For the Nine Months Ended September 30,	
	2008	2007
<b>Cash flows from operating activities:</b>		
Net loss	\$ (9,358)	\$ (15,162)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	20,534	19,245
Inventory valuation allowance	2,872	5,179
Deferred income taxes	70	(4,976)
Gain on early extinguishment of debt	(37)	
Stock-based compensation expense	7,426	7,425
Provisions for allowance for doubtful accounts	170	7
Other	531	111
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	21,284	(17,690)
Other receivables	683	1,478
Inventories	(11,122)	3,624
Other current assets	2,077	1,571
Accounts payable	(11,827)	3,209
Accrued wages and bonuses	608	(127)
Deferred income	(2,294)	1,614
Other accrued liabilities	1,607	475
Net cash provided by operating activities	23,224	5,983
<b>Cash flows from investing activities:</b>		
Proceeds from the sale of auction rate securities	10,025	50,100
Purchase of auction rate securities		(17,850)
Capital expenditures	(4,951)	(3,759)
Acquisition of MCPD		(32,032)
Proceeds from the sale of property and equipment		3,032
Purchase of long-term assets	(280)	(106)
Net cash provided by investing activities	4,794	(615)
<b>Cash flows from financing activities:</b>		
Financing costs	(2,539)	
Proceeds from issuance of 2013 convertible senior notes	55,000	
Purchase of capped call	(10,154)	
Repurchase of 2023 convertible senior notes	(60,916)	
Final payment of convertible subordinated notes		(2,416)
Payments on capital lease obligation	(101)	
Borrowings on revolving line of credit	20,000	
Net settlement of restricted shares	(390)	(301)
Proceeds from issuance of common stock	4,163	3,614
Net cash provided by financing activities	5,063	897



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Effect of exchange rate changes on cash	73	246
Net increase in cash and cash equivalents	33,154	6,511
Cash and cash equivalents, beginning of period	50,522	23,734
Cash and cash equivalents, end of period	\$ 83,676	\$ 30,245
<b>Supplemental disclosures of non-cash investing and financing activities:</b>		
Capital lease obligation	\$ 204	\$
Unrealized loss on assets measured at fair value, net	\$ 3,960	\$

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

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**RADISYS CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*(Unaudited)*

**Note 1 Significant Accounting Policies**

RadiSys Corporation (the Company or RadiSys) has adhered to the accounting policies set forth in its Annual Report on Form 10-K for the year ended December 31, 2007 in preparing the accompanying interim consolidated financial statements. The preparation of these statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Additionally, the accompanying financial data as of September 30, 2008 and for the three and nine months ended September 30, 2008 and 2007 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

The financial information included herein reflects all normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the results for interim periods.

For the three and nine months ended September 30, 2008, there have been no significant changes to these accounting policies except for the following:

*Derivatives*

During 2008, the Company began to enter into forward foreign currency exchange contracts to reduce the impact of foreign currency exchange risks where natural hedging strategies could not be effectively employed.

The Company does not hold or issue derivative financial instruments for trading purposes. The purpose of the Company's hedging activities is to reduce the risk that the eventual cash flows of the underlying assets, liabilities and firm commitments will be adversely affected by changes in exchange rates. In general, the Company's hedging activities do not create foreign currency exchange rate risk because fluctuations in the value of the instruments used for hedging purposes are offset by fluctuations in the value of the underlying exposures being hedged. Counterparties to derivative financial instruments expose the Company to credit-related losses in the event of nonperformance. Due to the current economic issues and factors affecting the viability of financial institutions, the Company continues to review the economic stability of the institutions with which it conducts its hedging activities. The Company does not believe there is a significant credit risk associated with its hedging activities because the counterparties are all large financial institutions with high credit ratings.

All derivatives, including foreign currency exchange contracts are recognized on the balance sheet at fair value. When specific criteria required by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) have been met, changes in the fair values of hedge contracts related to anticipated transactions are recorded in other comprehensive income (loss) rather than net income (loss) until the underlying hedged transaction affects net income. One of the criteria for this accounting treatment is that the forward foreign currency exchange contract amount should not be in excess of specifically identified anticipated transactions. By their nature, estimates of anticipated transactions may fluctuate over time and may ultimately vary from actual transactions. If anticipated transaction estimates or actual transaction amounts decrease below hedged levels, or when the timing of transactions change significantly, the Company would reclassify a portion of the cumulative changes in fair values of the related hedge contracts from other comprehensive income (loss) to other income (expense) during the quarter in which the changes occur.

The Company has adopted SFAS No. 157, Fair Value Measurements, (SFAS 157); however the adoption did not have a material impact on the Company's results of operations.

*Revenue Recognition*

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During 2007, the Company began to defer revenue associated with sales made to distributors brought over from its acquisition of certain assets of the Modular Communications Platform Division ( MCPD ) of Intel Corporation ( Intel ). Because of frequent sales price reductions and rapid technology obsolescence in the industry, sales made to some distributors under agreements allowing price protection and/or right of return are deferred until the distributors sell the merchandise. During the first quarter of 2008, the Company entered into new arrangements with its significant distributors servicing the MCPD business. For a few of these distributors,

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the Company eliminated some of the price adjustment programs. For those distributors where significant price adjustment programs remain in place, the Company will continue to defer revenue until the distributors sell the merchandise.

**Recent Accounting Pronouncements**

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133, ( SFAS 161 ). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities, including (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under SFAS 133, and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This standard becomes effective for the Company on January 1, 2009. Earlier adoption of SFAS 161 and, separately, comparative disclosures for earlier periods at initial adoption are encouraged. SFAS 161 requires enhanced disclosures, which will be provided in the Company's 2009 Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, ( SFAS 141R ) and SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51*, ( SFAS 160 ). These statements require significant changes in the accounting and reporting for business acquisitions and the reporting of non-controlling interests in subsidiaries. Among many changes under SFAS 141R, an acquirer will record 100% of all assets and liabilities at fair value for partial acquisitions, contingent consideration will be recognized at fair value at the acquisition date with changes possibly recognized in earnings, and acquisition related costs will be expensed rather than capitalized. SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary. Key changes under the standard are that non-controlling interests in a subsidiary will be reported as part of equity, losses allocated to a non-controlling interest can result in a deficit balance, and changes in ownership interests that do not result in a change of control are accounted for as equity transactions and, upon a loss of control, gain or loss is recognized and the remaining interest is remeasured at fair value on the date control is lost. SFAS 141R will apply prospectively to the Company's business combinations occurring on or after January 1, 2009. The Company will also apply SFAS 160 beginning January 1, 2009. Adoption of these statements will affect the Company's accounting for any business acquisitions occurring after the effective date and the reporting of any non-controlling interests in subsidiaries existing on or after the effective date.

In May 2008, the FASB issued FASB Staff Position ( FSP ) No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* ( FSP APB 14-1 ). FSP APB 14-1 requires that issuers of such instruments separately account for the liability and equity components related to convertible debt instruments in a manner that will reflect the issuer's nonconvertible debt borrowing rate when interest expense is recognized in subsequent periods. Early adoption is not permitted and FSP APB 14-1 becomes effective for the Company on January 1, 2009. Based on preliminary analysis, the Company has determined that the new guidance should only affect its 1.375% convertible senior notes due November 15, 2023 (the 2023 convertible senior notes ). It is expected that by the time of adoption of FSP APB 14-1 the Company's 2023 convertible senior notes will be retired, but the Company will still be required to retrospectively apply FSP APB 14-1 in all periods presented that include the Company's 2023 convertible senior notes. As a result of this retrospective adoption, the Company's opening accumulated deficit balance and paid in capital balance will increase, however the Company is still assessing the magnitude.

**Reclassifications**

Certain reclassifications have been made to amounts in prior years to conform to current year presentation.

**Note 2 Investments**

Short-term and long-term investments consisted of the following (in thousands):

	September 30, 2008	December 31, 2007
Short-term available for sale investments	\$	\$ 72,750
Long-term available for sale investments	\$ 56,522	\$

The Company currently holds investments in auction rate securities ( ARS ), which are highly rated debt instruments with a long-term nominal maturity for which the interest rate is set through a Dutch Auction process. The majority of the Company's ARS investments represent interests in collateralized debt obligations supported by pools of government-backed student loans with S&P AAA or Moody's Aaa ratings at the time of

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purchase. These investments have been classified as available-for-sale investments. Available-for-sale securities are recorded at fair value, and unrealized holding gains and losses are recorded, net of tax, as a separate component of accumulated other comprehensive income. For the three and nine months ended September 30, 2008, there were no realized gains or losses on the sales of available-for-sale investments.

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Between December 31, 2007 and February 7, 2008, the Company sold at par value \$10.0 million in ARS of the total ARS balance of \$72.8 million which was held at December 31, 2007. During the first quarter of 2008, due to liquidity issues experienced in the global credit and capital markets, the Company's entire remaining portfolio of ARS investments experienced multiple failed auctions as the amount of securities submitted for sale exceeded the amount of purchase orders. An auction failure, which is not a default in the underlying debt instrument, occurs when there are more sellers than buyers at a scheduled interest rate auction date and parties desiring to sell their auction rate securities are unable to do so. When an auction fails, the interest rate is adjusted according to the provisions of the associated security agreement, which may result in an interest rate that is higher than the interest rate the issuer pays in connection with successful auctions. The Company will not be able to liquidate the investments until a successful auction occurs, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. Due to the uncertainty of when it will be able to liquidate the investments, the Company reclassified the investments to long-term assets during the first quarter of 2008 and continues to hold them as such.

The Company recorded the ARS at fair value in accordance with SFAS 157. The Company considered various inputs, as defined in *Note 3 Fair Value of Financial Instruments*, to estimate the fair value of its ARS, including the issuer's credit quality, maturity, probability to be called, lack of liquidity, future cash flows based on maximum rate formulas and comparable securities of the issuer, if any. As of September 30, 2008, the Company determined that its investments were impaired by 9.9% or \$6.2 million, primarily due to the lack of liquidity. The Company believes declines in ARS fair values due to the lack of liquidity to be temporary as it has the ability and intent to hold these investments until they are sold or are called by the issuer at par. As such, the Company does not consider the impairment to be permanent and has recorded an unrealized loss of \$6.2 million gross, \$4.0 million net of tax, under other comprehensive income in the shareholders' equity section of the accompanying Consolidated Balance Sheets at September 30, 2008.

During October of 2008, the Company's investment bank announced it had agreed to settlements with the Securities and Exchange Commission and other state regulatory agencies to restore liquidity to eligible holders of auction-rate securities. Subsequently, during the fourth quarter of 2008, the Company accepted an offer from its investment bank which gives the Company a non-transferrable right to require the bank to purchase, at par value, \$62.7 million in ARS investments at any time between June 30, 2010 and June 30, 2012. The agreement allows the investment bank to purchase the ARS investments sooner than June 30, 2010, but is under no obligation to do so. If the bank has not purchased the investments by June 30, 2010, the Company plans to exercise its non-transferrable right to require the purchase at that time. In addition, under the terms of the offer, the Company is also eligible for a no net interest loan of up to 75% of the market value of its ARS until the time of purchase. Consequently, in accordance with the Company's policy as well as the provisions of SFAS No. 115, the Company plans to transfer its ARS investments from available-for-sale to trading securities during the fourth quarter of 2008, as it plans to sell them on June 30, 2010. As such, at the time of transfer, the Company will be required to recognize in results of operations any unrealized loss, which was \$4.0 million, net of tax, at September 30, 2008. Concurrently, the Company will elect the fair value option under SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities* for the non-transferrable right, upon initial recognition. In electing the fair value option, the Company will record the changes in fair value of the non-transferrable right through results of operations until it is exercised. While the Company believes the fair value of the non-transferrable right will approximate the realized loss to be recognized when its ARS are transferred to trading securities, it is still determining the full impact.

**Note 3 Fair Value of Financial Instruments**

The Company measures at fair value certain financial assets and liabilities, including cash equivalents, long-term investments, and deferred compensation. SFAS No. 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1 Quoted prices for identical instruments in active markets

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

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The following table summarizes the fair value measurements as of September 30, 2008, for the Company's financial instruments, including its ARS (in thousands):

	Fair Value Measurements as of September 30, 2008			
	September 30, 2008	Level 1	Level 2	Level 3
Cash equivalents	\$ 48,178	\$ 48,178	\$	\$
Long-term available-for-sale-investments	\$ 56,522	\$	\$	\$ 56,522
Non-qualified deferred compensation assets	\$ 3,073	\$ 3,073	\$	\$
Non-qualified deferred compensation liabilities	\$ 2,507	\$ 2,507	\$	\$
<b>Total</b>	<b>\$ 110,280</b>	<b>\$ 53,758</b>	<b>\$</b>	<b>\$ 56,522</b>

The following table contains a rollforward of the fair value of the Company's ARS, where fair value is determined using Level 3 inputs:

	Fair Value
Balance as of December 31, 2007	\$
Fair value transferred in from Level 1 securities	62,750
Sales of ARS	(25)
Temporary impairment charge reflected as a component of other comprehensive income (A)	(6,203)
<b>Balance as of September 30, 2008</b>	<b>\$ 56,522</b>

(A) For the three and nine months ended September 30, 2008, the Company recognized in other comprehensive income temporary impairment charges of \$1.8 and \$6.2 million, respectively.

**Note 4 Accounts Receivable and Other Receivables**

Accounts receivable consists of trade accounts receivable. Accounts receivable balances consisted of the following (in thousands):

	September 30, 2008	December 31, 2007
Accounts receivable, gross	\$ 50,170	\$ 71,432
Less: allowance for doubtful accounts	(1,041)	(884)
<b>Accounts receivable, net</b>	<b>\$ 49,129</b>	<b>\$ 70,548</b>

The Company recorded additional provisions of \$13,000 and \$170,000 for allowance for doubtful accounts during the three and nine months ended September 30, 2008. The Company recorded additional provisions for allowance for doubtful accounts of \$40,000 and \$46,000 during the three and nine months ended September 30, 2007.

As of September 30, 2008 and December 31, 2007, the balance in other receivables was \$2.0 million and \$2.7 million, respectively. Other receivables consisted primarily of non-trade receivables including receivables for inventory sold to the Company's contract manufacturing partners. Sales to the Company's contract manufacturing partners are based on terms and conditions similar to the terms offered to the Company's regular customers. There is no revenue recorded in association with sales of non-trade receivables.

**Note 5 Inventories**

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Inventories consisted of the following (in thousands):

	September 30, 2008	December 31, 2007
Raw materials	\$ 31,597	\$ 28,752
Work-in-process	3,006	1,762
Finished goods	8,727	4,405
	43,330	34,919
Less: inventory valuation allowance	(11,979)	(11,818)
Inventories, net	\$ 31,351	\$ 23,101



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During the three months ended September 30, 2008 and 2007, the Company recorded provisions for excess and obsolete inventory of \$1.4 million and \$1.5 million, respectively. During the nine months ended September 30, 2008 and 2007, the Company recorded provisions for excess and obsolete inventory of \$2.9 million and \$5.2 million, respectively.

**Note 6 Accrued Restructuring and Other Charges**

Accrued restructuring and other charges, which is included in other accrued liabilities in the accompanying Consolidated Balance Sheets as of September 30, 2008 and December 31, 2007, respectively, consisted of the following (in thousands):

	September 30, 2008	December 31, 2007
Fourth quarter 2006 restructuring charge	\$ 29	\$ 57
Second quarter 2007 restructuring charge		11
Second quarter 2008 restructuring charge	136	
Total	\$ 165	\$ 68

The Company evaluates the adequacy of the accrued restructuring charges on a quarterly basis. The Company records certain reclassifications between categories as well as reversals to accrued restructuring charges based on the results of the evaluation. The total accrued restructuring charges for each restructuring event are not affected by reclassifications. Reversals are recorded in the period in which the Company determines that expected restructuring obligations are less than the amounts accrued.

**Fourth Quarter 2006 Restructuring**

During the fourth quarter of 2006, the Company initiated a restructuring plan that included the elimination of 12 positions primarily supporting the Company's contract manufacturing operations as a result of the termination of the relationship with one of the Company's contract manufacturers in North America. The restructuring plan also includes closing the Charlotte, North Carolina manufacturing support office. The Company expects this office closure to be completed by December 31, 2008.

**Second Quarter 2007 Restructuring**

During the second quarter of 2007, the Company incurred employee-related expenses associated with skill set changes for approximately 20 employees. The changes involved creating an integrated structure with the media server business along with some skill set changes in certain selling, general and administrative and engineering groups. The costs incurred in this restructuring event include employee severance and medical benefits, and associated legal costs. All restructuring activities were completed by March 31, 2008.

**Second Quarter 2008 Restructuring**

During the second quarter of 2008, the Company initiated a restructuring plan that included the elimination of 23 positions. The restructuring was primarily initiated with the intent to return the Company's engineering spend to levels which align with targeted profitability as well as refocus the Company's skill sets in new product deployment and provide enhanced service and support to existing customers. The Company expects to complete all activities associated with the restructuring by March 31, 2009.

The following table summarizes the changes to the second quarter 2008 restructuring costs (in thousands):

	Employee Termination and Related Costs
Restructuring and other costs	\$ 598
Expenditures	(48)

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Balance accrued as of June 30, 2008	550
Expenditures	(379)
Reversals	(35)
Balance accrued as of September 30, 2008	136

**Note 7 Borrowings**

On August 7, 2008, the Company entered into a secured revolving line of credit agreement ( the Agreement ) with Silicon Valley Bank, as the Lender, which has replaced its previous line of credit facility. The Agreement provides the Company with a two-year secured revolving credit facility of up to \$30.0 million, which is subject to a borrowing base and secured by the Company s

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accounts receivable. Borrowings under the Agreement will bear interest at either the prime rate, which was 5.0% as of September 30, 2008, or the LIBOR rate, which was 4.45% as of September 30, 2008, plus 1.25%, with either interest rate determined by the Company. The Company is required to make interest payments monthly. The Company is further required to pay a commitment fee equal to 0.08% of the \$30.0 million maximum borrowing limit on an annual basis, and to pay quarterly in arrears an unused facility fee in an amount equal to 0.375% per year of the unused amount of the facility. In addition, the credit facility provides sub-facilities for letters of credit and foreign exchange contracts to be issued on the Company's behalf.

The credit facility requires the Company to make and maintain the following financial covenants, representations, warranties and other agreements that are customary in credit agreements of this type:

The Company's Current ratio (current assets divided by the sum of current liabilities less deferred income plus the amount of outstanding advances and letters of credit) must be above 1.3 through the third quarter of 2008, which rises to a ratio of 1.5 during quarterly periods thereafter.

Quarterly EBITDA (earnings before interest, taxes, depreciation, amortization, and stock based compensation, as defined in the Agreement) loss may not exceed \$2.5 million in any one quarter

Quarterly EBITDA may not be negative for any two consecutive quarters for the duration of the Agreement.

EBITDA may not be negative for the nine months ended September 30, 2008 and the year ended December 31, 2008.

For quarterly periods beginning after January 1, 2009, the Company must maintain a positive rolling four quarter EBITDA.

Capital expenditures may not exceed \$12.0 million in any fiscal year.

Amounts borrowed and repaid are available for re-borrowing during the term of the facility. Outstanding amounts are due in full on the maturity date of August 6, 2010. Upon the occurrence of certain events of default specified in the Agreement, amounts due under the Agreement may be declared immediately due and payable.

As of September 30, 2008, the Company owed \$20.0 million on the line of credit, while there were no outstanding balances on the standby letter of credit. As of December 31, 2007 there were no outstanding balances on the Company's previous line of credit or letters of credit issued on its behalf.

**Note 8 Convertible Debt**

***2023 Convertible Senior Notes***

During November 2003, the Company completed a private offering of \$100 million in aggregate principal amount of the 2023 convertible senior notes due November 15, 2023 to qualified institutional buyers. The discount at issuance on the 2023 convertible senior notes amounted to \$3 million.

Convertible senior notes are unsecured obligations convertible into the Company's common stock and rank equally in right of payment with all existing and future obligations that are unsecured and unsubordinated. Interest on the 2023 convertible senior notes accrues at 1.375% per year and is payable semi-annually on May 15 and November 15. The 2023 convertible senior notes are convertible, at the option of the holder, at any time on or prior to maturity under certain circumstances unless previously redeemed or repurchased, into shares of the Company's common stock at a conversion price of \$23.57 per share, which is equal to a conversion rate of 42.4247 shares per \$1,000 principal amount of the 2023 convertible senior notes. The 2023 convertible senior notes are convertible if (i) the closing price of the Company's common stock on the trading day prior to the conversion date reaches 120% or more of the conversion price of the notes on such trading date, (ii) the trading price of the notes

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falls below 98% of the conversion value or (iii) certain other events occur. Upon conversion, the Company will have the right to deliver, in lieu of common stock, cash or a combination of cash and common stock. The Company may redeem all or a portion of the 2023 convertible senior notes at its option on or after November 15, 2006 but before November 15, 2008 provided that the closing price of the Company's common stock exceeds 130% of the conversion price for at least 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date of the notice of the provisional redemption. On or after November 15, 2008, the Company may redeem the notes at any time. The accretion of the discount on the 2023 convertible senior notes is calculated using the effective interest method.

As of September 30, 2008 and December 31, 2007, the Company had outstanding 2023 convertible senior notes with a face value of \$37.5 million and \$100 million, and a book value of \$36.6 million and \$97.5 million, net of unamortized discount of \$880,000 and \$2.5 million, respectively. Amortization of the discount on the 2023 convertible senior notes was \$12,000 and \$34,000 for the three months ended September 30, 2008 and 2007, respectively. Amortization of the discount on the 2023 convertible senior notes was \$57,000 and \$101,000 for the nine months ended September 30, 2008 and 2007, respectively. The estimated fair value of the convertible senior notes was \$33.4 million and \$99.8 million at September 30, 2008 and December 31, 2007, respectively.

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During the first quarter of 2008, the Company repurchased \$52.5 million aggregate principal amount of the 2023 convertible senior notes, with an associated discount of \$1.3 million. The Company repurchased the notes in the open market for \$51.1 million and, as a result, recorded a gain of \$68,000.

During the second quarter of 2008, the Company repurchased \$10.0 million aggregate principal amount of the 2023 convertible senior notes, with an associated discount of \$240,000. The Company repurchased the notes in the open market for \$9.8 million and, as a result, recorded a loss of \$31,000.

On November 15, 2008, November 15, 2013, and November 15, 2018, holders of the 2023 convertible senior notes will have the right to require the Company to purchase, in cash, all or any part of the notes held by such holder at a purchase price equal to 100% of the principal amount of the notes being purchased, together with accrued and unpaid interest and additional interest, if any, up to but excluding the purchase date. If required, the Company has sufficient cash to repurchase its 2023 convertible senior notes on November 15, 2008 and anticipates incurring a loss of up to approximately \$871,000 related to the write-off of the associated unamortized discount.

***2013 Convertible Senior Notes***

On February 6, 2008, the Company offered and sold in a public offering pursuant to the shelf registration statement \$55.0 million aggregate principal amount of 2.75% convertible senior notes due 2013 (the "2013 convertible senior notes"). Interest on the 2013 convertible senior notes is payable semi-annually, in arrears, on each August 15 and February 15, beginning on August 15, 2008, to the holders of record at the close of business on the preceding August 1 and February 1, respectively. The 2013 convertible senior notes mature on February 15, 2013. Holders of the 2013 convertible senior notes may convert their notes into a number of shares of the Company's common stock determined as set forth in the indenture governing the notes at their option on any day to and including the business day prior to the maturity date. The 2013 convertible senior notes are initially convertible into 76.7448 shares of the Company's common stock per \$1,000 principal amount of the notes (which is equivalent to a conversion price of approximately \$13.03 per share), subject to adjustment upon the occurrence of certain events. Upon the occurrence of a fundamental change, holders of the 2013 convertible senior notes may require the Company to repurchase some or all of their notes for cash at a price equal to 100% of the principal amount of the notes being repurchased, plus accrued and unpaid interest, if any. In addition, if certain fundamental changes occur, the Company may be required in certain circumstances to increase the conversion rate for any 2013 convertible senior notes converted in connection with such fundamental changes by a specified number of shares of the Company's common stock. The 2013 convertible senior notes are the Company's general unsecured obligations and rank equal in right of payment to all of its existing and future senior indebtedness, including the Company's 2023 convertible senior notes, and senior in right of payment to the Company's future subordinated debt. The Company's obligations under the 2013 convertible senior notes are not guaranteed by, and are effectively subordinated in right of payment to all existing and future obligations of its subsidiaries and are effectively subordinated in right of payment to its future secured indebtedness to the extent of the assets securing such debt.

In connection with the issuance of the 2013 convertible senior notes, the Company entered into a capped call transaction with a hedge counterparty. The capped call transaction is expected to reduce the potential dilution upon conversion of the 2013 convertible senior notes in the event that the market value per share of the Company's common stock, as measured under the terms of the capped call transaction, at the time of exercise is greater than the strike price of the capped call transaction of approximately \$13.03, which corresponds to the initial conversion price of the 2013 convertible senior notes and is subject to certain adjustments similar to those contained in the notes. If, however, the market value per share of the Company's common stock exceeds the cap price of the capped call transaction of \$23.085, as measured under the terms of the capped call transaction, the dilution mitigation under the capped call transaction will be limited, which means that there would be dilution to the extent that the then market value per share of the Company's common stock exceeds the cap price of the capped call transaction.

As of September 30, 2008, the Company had outstanding 2013 convertible senior notes with a face value and fair value of \$55.0 million and \$45.3 million, respectively. The cost of the capped call transaction was approximately \$10.2 million and was recorded as a charge to shareholders' equity.

The aggregate maturities of long-term liabilities for each of the years in the five year period ending December 31, 2012 and thereafter are as follows (in thousands):

For the Years Ending December 31,	2023 Convertible Senior Notes	2013 Convertible Senior Notes
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2008 (remaining three months) (A)	\$ 37,503	\$
2009		
2010		
2011		
2012		
Thereafter		55,000
	37,503	55,000
Less: unamortized discount	(880)	
Less: current portion	(36,623)	
Long-term liabilities	\$	\$ 55,000

- (A) The Company may redeem the 2023 convertible senior notes at any time on or after November 15, 2008. On November 15, 2008, November 15, 2013, and November 15, 2018, holders of the 2023 convertible senior notes will have the right to require the Company to purchase, in cash, all or any part of the notes held by such holder at a purchase price equal to 100% of the principal amount of the notes being purchased, together with accrued and unpaid interest and additional interest, if any, up to but excluding the purchase date.

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**Table of Contents****Note 9 Commitments and Contingencies*****Adverse Purchase Commitments***

The Company is contractually obligated to reimburse its contract manufacturers for the cost of excess inventory used in the manufacture of the Company's products, if there is no alternative use. This liability, referred to as adverse purchase commitments, is provided for in other accrued liabilities in the accompanying Consolidated Balance Sheets. Estimates for adverse purchase commitments are derived from reports received on a quarterly basis from the Company's contract manufacturers. Increases to this liability are charged to cost of goods sold. When and if the Company takes possession of inventory reserved for in this liability, the liability is transferred from other accrued liabilities to the excess and obsolete inventory valuation allowance. Adverse purchase commitments amounted to \$1.7 million and \$1.9 million at September 30, 2008 and December 31, 2007, respectively. For the three months ended September 30, 2008 and 2007, the Company recorded a net provision for adverse purchase commitments of \$179,000 and \$148,000, respectively. For the nine months ended September 30, 2008 and 2007, the Company recorded a net provision for adverse purchase commitments of \$1.4 million and \$1.0 million, respectively.

***Guarantees and Indemnification Obligations***

As permitted under Oregon law, the Company has agreements whereby it indemnifies its officers, directors and certain finance employees for certain events or occurrences while the officer, director or employee is or was serving in such capacity at the request of the Company. The term of the indemnification period is for the officer's, director's or employee's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and enables the Company to recover a portion of any future amounts paid. To date, the Company has not incurred any costs associated with these indemnification agreements and, as a result, management believes the estimated fair value of these indemnification agreements is minimal. Accordingly, the Company has not recorded any liabilities for these agreements as of September 30, 2008.

The Company enters into customary indemnification agreements in the ordinary course of business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally the Company's business partners or customers, in connection with patent, copyright or other intellectual property infringement claims by any third party with respect to the Company's current products, as well as claims relating to property damage or personal injury resulting from the performance of services by the Company or its subcontractors. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is generally limited. Historically, the Company's costs to defend lawsuits or settle claims relating to such indemnity agreements have been minimal and accordingly management believes the estimated fair value of these agreements is immaterial.

The Company provides for the estimated cost of product warranties at the time it recognizes revenue. Products are generally sold with warranty coverage for a period of 24 months after shipment. Parts and labor are covered under the terms of the warranty agreement. The workmanship of the Company's products produced by contract manufacturers is covered under warranties provided by the contract manufacturer for a specified period of time ranging from 12 to 15 months. The warranty provision is based on historical experience by product family. The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its components suppliers; however, ongoing failure rates, material usage and service delivery costs incurred in correcting product failure, as well as specific product class failures out of the Company's baseline experience affect the estimated warranty obligation. If actual product failure rates, material usage or service delivery costs differ from estimates, revisions to the estimated warranty liability would be required.

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The following is a summary of the change in the Company's warranty liability for the nine months ended September 30, 2008 and 2007 (in thousands):

	<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Warranty liability balance, beginning of the period	\$ 2,494	\$ 2,000
Product warranty accruals	4,269	2,368
Utilization of accrual	(3,490)	(2,465)
Warranty liability balance, end of the period	\$ 3,273	\$ 1,903

The warranty liability balance is included in other accrued liabilities in the accompanying Consolidated Balance Sheets as of September 30, 2008 and December 31, 2007, and amounted to \$3.3 million and \$2.5 million, respectively.



**Table of Contents****Note 10 Basic and Diluted Net Loss per Share**

A reconciliation of the numerator and the denominator used to calculate basic and diluted loss per share is as follows (in thousands, except per share amounts):

	<b>For the Three Months Ended September 30, 2008</b>		<b>For the Nine Months Ended September 30, 2007</b>	
<b>Numerator Basic</b>				
Net loss, basic	\$ (246)	\$ (2,446)	\$ (9,358)	\$ (15,162)
<b>Numerator Diluted</b>				
Net loss, basic	(246)	(2,446)	(9,358)	(15,162)
Interest on convertible notes, net of tax benefit (A)				
Net loss, diluted	\$ (246)	\$ (2,446)	\$ (9,358)	\$ (15,162)
<b>Denominator Basic</b>				
Weighted average shares used to calculate loss per share, basic	22,653	21,937	22,442	21,808
<b>Denominator Diluted</b>				
Weighted average shares used to calculate income loss per share, basic	22,653	21,937	22,442	21,808
Effect of convertible notes (A), (B)				
Effect of dilutive stock options, ESPP, and unvested restricted stock (C)				
Weighted average shares used to calculate loss per share, diluted	22,653	21,937	22,442	21,808
<b>Net loss per share:</b>				
Basic	\$ (0.01)	\$ (0.11)	\$ (0.42)	\$ (0.70)
Diluted (A)	\$ (0.01)	\$ (0.11)	\$ (0.42)	\$ (0.70)

(A) For the three and nine months ended September 30, 2008 as-if converted shares associated with the 2023 and 2013 convertible senior notes were excluded from the calculation as the Company was in a loss position and their effect would have been anti-dilutive. For the three and nine months ended September 30, 2007, as-if converted shares associated with the 2023 convertible senior notes and the Company's previously outstanding convertible subordinated notes were excluded from the calculation as their effect would have been anti-dilutive. For the three and nine months ended September 30, 2008, the total number of as-if converted shares associated with the 2023 convertible senior notes was 1.6 million and 2.3 million, respectively. For the three and nine months ended September 30, 2007, the total number of as-if converted shares associated with the 2023 convertible senior notes was 4.2 million. For the three and nine months ended September 30, 2008, the total number of as-if converted shares associated with the 2013 convertible senior notes was 4.2 and 3.5 million, respectively.

(B) For the three and nine months ended September 30, 2008, options amounting to 3.5 million shares, were excluded from the calculation as the Company was in a loss position and their effect would have been anti-dilutive. For the three and nine months ended September 30, 2007, options amounting to 3.3 million shares, were excluded from the calculation as the Company was in a loss position and their effect would have been anti-dilutive.

**Note 11 Income Taxes**

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The Company's effective tax rate for the three months ended September 30, 2008 and 2007 differs from the statutory rate primarily due to the following:

Discrete items related to the revaluation of certain net deferred tax assets due to changes in foreign currency exchange rates,

Changes in foreign tax rates and taxes on foreign income that differ from U.S. tax rate.

Impact of stock option expense under SFAS 123R,

Canadian scientific research and experimental development claims,

Federal research tax credits, and

Amortization of goodwill for tax purposes,

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The expensing of stock options will create differences in book and taxable income on both a permanent and temporary basis. The Company is projecting a tax effected permanent difference of approximately \$1.8 million attributable to statutory options and stock option expense related to all non U.S. employees for the year ending 2008. The annual effective tax rate impact for this permanent difference is projected to be approximately 15.1%.

The Company's unrecognized tax benefits decreased by \$136,000 during the three months ended September 30, 2008 primarily due to a German tax audit and the change in certain foreign currency rates. The Company's liability for potential interest and penalties associated with uncertain tax positions increased by \$21,000 and \$81,000 for the three and nine months ended September 30, 2008, respectively. The cumulative potential interest and penalty balance as of September 30, 2008 was \$707,000. The Company does not anticipate that total unrecognized tax benefits that include accrued interest and penalties will significantly change due to the settlement of examinations or the expiration of the statute of limitations within the next twelve months.

**Note 12 Stock-based Compensation**

During the three months ended September 30, 2008, 15,000 stock options and 4,000 restricted stock units were issued to employees under the 2007 Stock Plan. During the nine months ended September 30, 2008, 551,000 stock options and 198,000 restricted stock units were issued to employees under the 2007 Stock Plan.

For the three and nine months ended September 30, 2008 and 2007, stock-based compensation was recognized and allocated as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Cost of sales	\$ 254	\$ 195	\$ 768	\$ 727
Research and development	746	716	2,343	2,030
Selling, general and administrative	1,378	1,633	4,315	4,668
Total	2,378	2,544	7,426	7,425

**Note 13 Hedging**

The Company's activities expose it to a variety of market risks, including the effects of changes in foreign currency exchange rates. During the first quarter of 2008, the Company entered into forward exchange contracts, designated as foreign-currency cash flow hedges, to reduce the potentially adverse effects of foreign currency exchange rate fluctuations that occur in the normal course of business.

These derivatives are recognized on the balance sheet at their fair value. Unrealized gain positions are recorded as other current assets and unrealized loss positions are recorded as other current liabilities as all maturity dates are less than one year. Changes in the fair values of the outstanding derivatives that are highly effective are recorded in other comprehensive income until net income is affected by the variability of the cash flows of the hedged transaction. Changes in the fair values of the derivatives not effective as hedging instruments are recognized in earnings in the current period. Results of hedges are recorded in the expense line item being hedged, which is primarily research, development and engineering ( R&D ), when the underlying hedged transaction affects net income (loss).

The Company evaluates, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives are expected to remain highly effective in future periods.

For the three and nine months ended September 30, 2008, the Company had a net foreign exchange hedge-related transaction loss of \$23,000 and a gain of \$44,000, respectively. As of September 30, 2008, the Company had forward contracts of \$8.4 million that mature monthly over the next fourteen months. For the three and nine months ended September 30, 2008, the Company had recorded as other comprehensive income, unrealized losses of \$254,000 and \$246,000 (net of tax), respectively, on outstanding derivatives. The majority of these amounts are expected to be reclassified from other comprehensive (loss) income to other (expense) income within the next twelve months. As of September 30, 2008, the Company had no ineffective hedges because forward foreign currency contract amounts were less than the specifically identified anticipated

transactions being hedged.

**Table of Contents****Note 14 Segment Information**

The Company has adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information ( SFAS 131 ). SFAS 131 establishes standards for the reporting by public business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method for determining what information to report is based upon the way that management organizes the segments within the Company for making operating decisions and assessing financial performance. The Company is one operating segment according to the provisions of SFAS 131.

Revenues on a product and services basis are as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Hardware	\$ 95,862	\$ 79,513	\$ 272,064	\$ 214,807
Software royalties and licenses	2,485	1,937	7,433	6,511
Software maintenance	1,004	1,307	2,583	2,060
Engineering and other services	907	873	1,836	2,635
<b>Total revenues</b>	<b>\$ 100,258</b>	<b>\$ 83,630</b>	<b>\$ 283,916</b>	<b>\$ 226,013</b>

Generally, the Company's customers are not the end-users of its products. The Company ultimately derives its revenues from two end markets as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Communications Networking	\$ 78,321	\$ 64,134	\$ 223,544	\$ 168,076
Commercial Systems	21,937	19,496	60,372	57,937
<b>Total revenues</b>	<b>\$ 100,258</b>	<b>\$ 83,630</b>	<b>\$ 283,916</b>	<b>\$ 226,013</b>

Information about the Company's geographic revenues and long-lived assets by geographical area is as follows (in thousands):

**Geographic Revenues**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
United States	\$ 31,487	\$ 20,350	\$ 81,215	\$ 70,470
Other North America	1,653	3,024	5,856	6,836
<b>North America</b>	<b>33,140</b>	<b>23,374</b>	<b>87,071</b>	<b>77,306</b>
Europe, the Middle East and Africa ( EMEA )	37,274	36,385	109,526	91,679
Asia Pacific	29,844	23,871	87,319	57,028
<b>Total</b>	<b>\$ 100,258</b>	<b>\$ 83,630</b>	<b>\$ 283,916</b>	<b>\$ 226,013</b>



**Table of Contents****Long-lived assets by Geographic Area**

	September 30, 2008	December 31, 2007
<b>Property and equipment, net</b>		
United States	\$ 9,434	\$ 9,459
Other North America	790	987
EMEA	77	99
Asia Pacific	1,456	688
Total	\$ 11,757	\$ 11,233
<b>Goodwill</b>		
United States	\$ 37,033	\$ 37,033
Other North America	30,611	30,611
Total	67,644	67,644
<b>Intangible assets, net</b>		
United States	9,546	13,684
Other North America	3,684	9,838
EMEA	9,720	15,257
Total	\$ 22,950	\$ 38,779

For the three and nine months ended September 30, 2008 and 2007, the following customer accounted for more than 10% of total revenues:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Nokia Siemens Networks	38.4%	52.0%	43.2%	42.1%

As of September 30, 2008 and December 31, 2007, only one customer, Nokia Siemens Networks accounted for more than 10% of accounts receivable. This customer accounted for 38.0% and 39.4% of accounts receivable as of September 30, 2008 and December 31, 2007, respectively.

**Note 15 Legal Proceedings**

In the normal course of business, the Company may become involved in litigation. As of September 30, 2008, RadiSys had no pending litigation.

**Note 16 Subsequent Events**

During the fourth quarter of 2008, the Company accepted an offer from its investment bank, UBS, which gives the Company a non-transferrable right to require the bank to purchase, at par value, \$62.7 million in ARS investments between June 30, 2010 and June 30, 2012. Refer to *Note 2 Investments* for further detail regarding the non-transferrable right.

During the fourth quarter of 2008, the Company repurchased \$5.0 million aggregate principal amount of the 2013 convertible senior notes, with an associated discount of \$196,000. The Company repurchased the notes in the open market for \$3.1 million and, as a result, will record a net gain of \$1.7 million.

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On October 15th, 2008, the Company notified holders of the 2023 convertible senior notes of their right to require the Company to repurchase the notes on November 15, 2008 at a purchase price equal to 100% of the principal amount of the notes being purchased together with accrued and unpaid interest and additional interest, if any, up to but excluding the purchase date. The Company expects that all or substantially all of the holders will exercise this right. If required, the Company has sufficient cash to repurchase its 2023 convertible senior notes on November 15, 2008 and anticipates incurring a loss of up to approximately \$871,000 related to the write-off of the associated unamortized discount. Refer to *Note 8 Convertible Debt*.



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

#### **Introduction and Overview**

RadiSys Corporation is a leading provider of advanced embedded solutions for the communications networking and commercial systems markets. Through innovative product planning, intimate customer collaboration, and the combination of innovative technologies and industry leading architecture, we help original equipment manufacturers (OEMs), systems integrators and solution providers bring better products to market faster and more economically. Our products include embedded boards, application enabling platforms and turn-key systems, which are used in today's complex computing, processing and network intensive applications. Unless context otherwise requires, or as otherwise indicated, we, us, our and similar terms, as well as references to the Company and RadiSys refer to RadiSys Corporation and include all of our consolidated subsidiaries.

#### **Our Markets**

We provide application enabling solutions to the following two distinct markets:

*Communications Networking* The communications networking market consists primarily of networking infrastructure and applications for deployment within the wireless and IP networking and messaging markets. Applications in these markets include 2, 2.5 and 3G wireless infrastructure products, IP media server platforms, packet-based switches, unified messaging solutions, voice messaging, multimedia messaging, video distribution, network access, security and switching applications.

*Commercial Systems* The commercial systems market includes the following sub-markets: medical systems, military equipment, test and measurement equipment, transaction terminals and industrial automation equipment. Examples of products that incorporate our commercial embedded solutions include ultrasound equipment, X-Ray machines, MRI scanners, immunodiagnostics and hematology systems, CAT scan imaging equipment, network and production test equipment, consumer transaction terminals, semiconductor manufacturing equipment and electronics assembly equipment.

#### **Market Drivers**

We believe there are a number of fundamental drivers for growth in the embedded solutions market, including:

Increasing desire by OEMs to utilize standards-based, merchant-supplied modular building blocks and platforms to develop their new systems. We believe OEMs are combining their internal development efforts with merchant-supplied building blocks and platforms, from partners like RadiSys, to deliver a larger number of more valuable new products to market faster at a lower total cost.

Increasing usage levels of general purpose technologies, such as Ethernet, IP, Linux, media processing and central processing units (CPUs), graphics processing units and network processing units (NPU's), to provide programmable, intelligent and networked functionality to a wide variety of applications, including wireless, wireline and data communications, network security, image processing, transaction and monitoring and control.

Increasing demand for standards-based solutions, such as ATCA, Session Initiation Protocol, IP Multimedia Subsystem (IMS) and Computer-on-Module Express (COM Express), which motivates system makers to take advantage of proven and validated standards-based products.

Continued emergence, growth and evolution of applications utilizing next generation technologies and standards such as long term evolution (LTE) and worldwide interoperability for microwave access (WiMAX), both of which are supported by ATCA.

#### **Our Solutions**

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We provide our customers with standards-based and custom advanced embedded solutions that enable them to focus their resources and development efforts on their key areas of differentiation and allow them to provide higher value systems with a time-to-market advantage and a lower total cost.

Key benefits of our solutions include:

*Broad portfolio of embedded solution products.* Our product lines include a large portfolio of embedded solutions, integrated platforms and turnkey systems. Our product portfolio allows us to address a range of customer requirements and applications. We believe that over time many of our customers will increasingly rely on a smaller set of vendors who can address a broader set of their embedded solution needs.

*Deep pool of technical resources.* Our research and development staff has extensive experience in designing embedded hardware and software solutions. Our customers benefit from the broad array of standards-based solutions that our R&D staff continues to develop and support, as well as our staff's experience in designing perfect fit solutions for our customers.

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*Reduced time to market.* We offer standards-based, ready-made solutions such as ATCA-based solutions for the communications networking market and COM Express solutions for the commercial market. These standards-based solutions combined with our strong technical resources provide our OEM customers with more flexibility and reduced time-to-market than if they developed these solutions internally.

*Leading, high-performance technology.* We have been the first to market with many technological advancements such as the industry's first 10-Gigabit common managed platform, and we are a leader in areas such as IP conferencing and COM Express new product development. Our design capabilities extend to CPUs, NPU, digital signal processing and integrated software managed platforms, such as media and application servers, as well as many other areas.

### **Our Strategy**

*Build market leadership in standards-based advanced embedded solutions in our target markets.* We believe this strategy enables our customers to focus their resources and development efforts on their key areas of competency allowing them to provide higher value systems with a time-to-market advantage and a lower total cost. We are currently one of the leading vendors in ATCA and COM Express embedded solutions, as well as IP Media Servers. We intend to continue to invest significant research and development and sales and marketing resources to build our presence in these market segments.

*Develop our offering of higher value platform solutions.* Historically, the majority of our revenues have been from the sale of boards or blades. While we will continue to focus on these products, we have spent and continue spending considerable resources developing turnkey platform solutions that incorporate complete hardware systems as well as embedded software developed by us or third parties. These platforms provide an additional revenue opportunity for us, and we believe revenues from these products have the potential to generate higher average selling prices and higher gross margins than those provided from the sale of boards or blades alone.

*Expand our global customer base.* We continue to expand the number of customers that we work with, particularly as more customers become aware of the benefits of standards-based embedded solutions. Our global reach allows us to market our solutions to most leading system vendors in our target markets. In addition, our acquisitions of Convedia Corporation ( Convedia ) and certain assets of the MCPD business from Intel provide us access to additional customers to whom we intend to market our full product line.

*Explore new partnerships and strategic acquisitions as a means to build leadership in our target markets.* We continue to investigate partnerships and strategic relationships which can expand the number of solutions we offer and increase our market reach. We also continue to evaluate potential acquisition opportunities to acquire new capabilities, which can help us achieve our strategic goals. For example, in the last two years, we acquired Convedia, a closely-held vendor of IP media servers, and the Intel MCPD business which included ATCA and compact PCI product lines.

In the following discussion of our financial condition and results of operations, we intend to provide information that will assist in understanding our consolidated financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes. This discussion should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this filing and in our annual report on Form 10-K for the year ended December 31, 2007.

Certain statements made in this section of the report are forward-looking statements. Please see the information contained herein under the sections entitled *Forward-looking Statements* and *Risk Factors*.

### **Overview**

*Promentum® ATCA Product Line* During the first half of 2008, we introduced two new products in our Promentum® ATCA product portfolio. First was the Promentum® ATCA-4310, a 10 Gigabit ATCA single-slot processor blade. We believe this product provides enhanced features for compute-intensive applications where transaction and subscriber load can increase dramatically in short intervals, such as IMS, IPTV and Wireless Control Plan based applications. The second was the Promentum® ATCA-7220 Dual OCTEON® PLUS Packet Processing Module, the industry's first blade to enable highest density of Gigabit Ethernet interfaces in a single slot with significantly higher processing power and bandwidth access when compared to other platforms available today.

During the second quarter of 2008, we received the 2007 Communications Solutions Product of the Year Award for the Promentum ATCA MCPBL0050 CPU blade and the Promentum ATCA 7220 CPU blade with smart front-end architecture. The Communications Solutions Product of the Year Awards recognize the most innovative products that facilitate voice, data and video communications, or combinations thereof.

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During the third quarter of 2008, we announced two new application ready platforms. The first is the SYS-6016 platform, which is a fully integrated high-capacity 16-slot solution that provides the maximum number of billable application slots in an ATCA carrier-grade platform, and delivers industry-leading 10-Gigabit switching, packet processing, and media processing capabilities. The

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second is the SYS-6002, which is a low-profile 2-slot integrated platform that provides a compact cost-effective solution ideally suited for an array of specialized appliances such as sophisticated security and traffic handling applications. The SYS-6016 increases payload capacity for maximum subscriber density while the SYS-6002 addresses lower-density subscriber areas. In addition, RadiSys launched a lab for use by global ecosystem partners and customers so that they may remotely perform validation, testing, and demonstrations of their unique solutions on our ATCA systems.

*Procelerant COM Express Product Line* During the first half of 2008, we introduced two new products in our Procelerant portfolio. First was the Procelerant Quad-core server, the industry's first embedded server to incorporate the latest Intel® Quad-core Xeon® processors. Intended for medical and other imaging, test and measurement, and other digital signal processing applications, the Procelerant RMS420-5000XSL Quad-core server supports superior image processing at a higher resolution and with greater speed compared to previous embedded servers. Second was the Procelerant CE945GM2A COM Express module that targets value-priced industrial automation, gaming and test and measurement applications. The Procelerant CE945GM2A replaces older ETX technology at a comparable price point, enabling high-speed serial interface options such as PCI Express, Serial ATA (SATA) and gigabit ethernet.

During the second quarter of 2008, we introduced CEGM45, with the Intel® Core 2 Duo processor T9400 for high-performance portable implementations in medical and machine imaging, test and measurement, and communications. This product is early to market and brings lower power and increased processing capability.

During the third quarter of 2008, we announced the availability of four new COM Express modules all powered by Intel Core 2 Duo Processor technology and the Mobile Intel GS45/GM45 Express chipsets. The new compact COMs are ideal for developers designing portable devices for such applications as medical and machine imaging that mandate processing performance, large file transfers, high-throughput communications and low power.

*Convedia® Media Server Product Line* In the second quarter of 2008, we announced the addition of continuous presence (CP) capabilities in our Convedia® media server family. More specifically, our new continuous presence (CP) video conferencing mode will support multiple real-time video streams within a unified multi-pane display and deliver an immersive video experience for desktop conferencing users. This new capability will benefit our customers who wish to add feature-rich video conferencing capabilities to their communications solutions.

In addition, in the second quarter of 2008, we announced that our Convedia® media server family now supports automatic speech recognition (ASR), or converting human speech to computer data, and text-to-speech (TTS) capabilities in multiple languages for IP contact center application developers and service providers. This new capability will not only allow our customers to accelerate the introduction of new services, but will also competitively differentiate their products in next-generation IP contact centers.

During the third quarter of 2008, we announced a rich feature set targeted to the contact center market with the RadiSys market-leading IP media server platform. The Convedia product family has real-time audio, video, and new embedded fax media processing capabilities that provide a common, feature-rich platform that fulfills next-generation contact center business requirements.

### ***Financial Results***

Total revenue was \$100.3 million and \$83.6 million for the three months ended September 30, 2008 and 2007, respectively. Total revenue was \$283.9 million and \$226.0 million for the nine months ended September 30, 2008 and 2007, respectively. Backlog was approximately \$41.2 million and \$33.8 million at September 30, 2008 and December 31, 2007, respectively. Backlog includes all purchase orders scheduled for delivery within 12 months. The increase in revenues for the three and nine months ended September 30, 2008 compared to the same periods in 2007 is primarily due to increases in next-generation communications revenue, which includes ATCA and media server products. In addition, increased medical and other commercial market sales attributed to the growth over the prior year.

Net loss was \$246,000 and \$2.4 million for the three months ended September 30, 2008 and 2007, respectively. Net loss per share was \$0.01 and \$0.11 for the three months ended September 30, 2008 and 2007, respectively. Net loss was \$9.4 million and \$15.2 million for the nine months ended September 30, 2008 and 2007, respectively. Net loss per share was \$0.42 and \$0.70 for the nine months ended September 30, 2008 and 2007, respectively. The decrease in net loss from 2007 to 2008 is primarily due to increased revenues from next-generation communication products, including ATCA and media server products, as well as increased revenues from medical and other commercial market sales. Gross margin increased favorably for the three and nine months ended September 30, 2008 primarily due to an increased mix of revenues from higher margin next generation communication products. Gross margin for the nine months was also favorably impacted by operational improvements leading to lower excess and obsolete charges as well as increased leverage of fixed costs as volumes have increased. In addition, gross margin improved favorably due to the absence of significant charges associated with the transition from our North Carolina manufacturer, which occurred in 2007. These increases were slightly offset by increased warranty charges and amortization of intangible assets.



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Cash and cash equivalents and investments amounted to \$140.2 million and \$123.3 million at September 30, 2008 and December 31, 2007, respectively. The increase in cash and cash equivalents and investments during the nine months ended September 30, 2008 is primarily due to net proceeds from the issuance of our 2013 convertible senior notes of \$42.3 million, cash provided by operating activities of \$23.2 million and a borrowing on our new line of credit in the amount of \$20.0 million. These increases have been offset by the purchase of \$60.9 million of our 2023 senior convertible notes along with a temporary impairment charge of \$6.2 million recognized during the nine months ended September 30, 2008 to record our auction rate securities ( ARS ) at fair value.

***Convertible Debt***

On February 6, 2008, we offered and sold in a public offering pursuant to a shelf registration statement \$55.0 million aggregate principal amount of our 2013 convertible senior notes. In connection with the issuance of the 2013 convertible senior notes, we entered into a capped call transaction with a hedge counterparty. The net proceeds from the sale of the 2013 convertible senior notes were approximately \$42.3 million, after deducting underwriting discounts and commissions, estimated offering expenses and the cost of the capped call transaction.

Also during the first quarter of 2008, we repurchased \$52.5 million aggregate principal amount of our 2023 convertible senior notes, with an associated discount of \$1.3 million. We repurchased the notes in the open market for \$51.1 million and, as a result, recorded a gain of \$68,000. During the second quarter of 2008, we repurchased \$10.0 million aggregate principal amount of our 2023 convertible senior notes, with an associated discount of \$240,000. We repurchased the notes in the open market for \$9.8 million and, as a result, recorded a loss of \$31,000.

On October 15, 2008, we notified holders of the 2023 convertible senior notes of their right to require us to repurchase the notes on November 15, 2008 at a purchase price equal to 100% of the principal amount of the notes being purchased together with accrued and unpaid interest and additional interest, if any, up to but excluding the purchase date. We expect that all or substantially all of the holders will exercise this right. If required, we have sufficient cash to repurchase our 2023 convertible senior notes on November 15, 2008 and anticipate incurring a loss of up to approximately \$871,000 related to the write-off of the associated unamortized discount.

**Critical Accounting Policies and Estimates**

We reaffirm our critical accounting policies and use of estimates as reported in our Annual Report on Form 10-K for the year ended December 31, 2007. There have been no significant changes during the three and nine months ended September 30, 2008 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 except as follows:

***Derivatives***

During 2008 we began to enter into forward foreign currency exchange contracts to reduce the impact of foreign currency exchange risks where natural hedging strategies could not be effectively employed.

We do not hold or issue derivative financial instruments for trading purposes. The purpose of our hedging activities are to reduce the risk that the eventual cash flows of the underlying assets, liabilities and firm commitments will be adversely affected by changes in exchange rates. In general, our hedging activities do not create foreign currency exchange rate risk because fluctuations in the value of the instruments used for hedging purposes are offset by fluctuations in the value of the underlying exposures being hedged. Counterparties to derivative financial instruments expose us to credit-related losses in the event of nonperformance. We do not believe there is a significant credit risk associated with our hedging activities because the counterparties are all large financial institutions with high credit ratings.

All derivatives, including foreign currency exchange contracts are recognized on the balance sheet at fair value. When specific criteria required by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ) have been met, changes in the fair values of hedge contracts related to anticipated transactions are recorded in other comprehensive income (loss) rather than net income (loss) until the underlying hedged transaction affects net income. One of the criteria for this accounting treatment is that the forward foreign currency exchange contract amount should not be in excess of specifically identified anticipated transactions. By their nature, estimates of anticipated transactions may fluctuate over time and may ultimately vary from actual transactions. If anticipated transaction estimates or actual transaction amounts decrease below hedged levels, or when the timing of transactions change significantly, we would reclassify a portion of the cumulative changes in fair values of the related hedge contracts from other comprehensive income (loss) to other income (expense) during the quarter in which the changes occur.

We adopted SFAS No. 157, Fair Value Measurements, ( SFAS 157 ); however the adoption did not have a material impact on our results of operations.





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***Revenue Recognition***

During 2007, we began to defer revenue associated with sales made to distributors brought over from our acquisition of certain MCPD assets of Intel. Because of frequent sales price reductions and rapid technology obsolescence in the industry, sales made to some distributors under agreements allowing price protection and/or right of return are deferred until the distributors sell the merchandise. During the first quarter of 2008, we entered into new arrangements with our significant distributors servicing the MCPD business. For a few of these distributors, we eliminated some of the price adjustment programs. For those distributors where significant price adjustment programs remain in place, we will continue to defer revenue until the distributors sell the merchandise.

Our revenue reporting for these distributors is highly dependent on receiving pertinent and accurate data from our distributors in a timely fashion. Distributors provide us periodic data regarding the product, price, quantity, and end customer when products are resold as well as the quantities of our products they still have in stock. We must use estimates and apply judgments to reconcile distributors' reported inventories to their activities. Any error in our judgment could lead to inaccurate reporting of our revenues, deferred income on sales to distributors, and net income.

Our ATCA products include software that is considered more than incidental and therefore we account for ATCA revenue under AICPA Statement of Positions 97-2, *Software Revenue Recognition*. Our ATCA arrangements generally include multiple elements such as hardware, technical support services as well as specified software upgrades or enhancements. During the third quarter of 2008 we recognized approximately \$7.2 million in ATCA revenue that had been billed in previous quarters. This revenue was deferred as of the second quarter as we had not met all revenue recognition criteria and was recognized when these criteria were met in the third quarter. The execution of technical support agreements as well as the delivery of specified upgrades or enhancements during the third quarter of 2008 allowed us to recognize revenue.

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The following table sets forth certain operating data as a percentage of revenues for the three and nine months ended September 30, 2008 and 2007 (in thousands, except percentages).

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of sales:				
Cost of sales	69.5	72.9	70.9	73.2
Amortization of purchased technology	3.8	4.2	4.2	4.4
Total cost of sales	73.3	77.1	75.1	77.6
Gross margin	26.7	22.9	24.9	22.4
Research and development	11.9	14.1	13.2	15.1
Selling, general, and administrative	12.7	14.2	13.6	15.5
Intangible assets amortization	1.3	1.3	1.4	1.4
Restructuring and other charges	0.0	(0.2)	0.2	0.6
Income (loss) from operations	0.8	(6.5)	(3.5)	(10.2)
Interest expense	(0.7)	(0.5)	(0.7)	(0.6)
Interest income	0.7	2.0	0.9	2.2
Other income (expense) income, net	0.0	(0.0)	0.0	(0.1)
Income (loss) before income tax benefit	0.8	(5.0)	(3.3)	(8.7)
Income tax provision (benefit)	1.0	(2.1)	(0.0)	(2.0)
Net loss	(0.2)%	(2.9)%	(3.3)%	(6.7)%

**Comparison of Three and Nine Months Ended September 30, 2008 and 2007****Revenues**

Revenues increased by \$16.7 million or 19.9%, from \$83.6 million in the three months ended September 30, 2007 to \$100.3 million in the three months ended September 30, 2008. Revenues increased by \$57.9 million or 25.6%, from \$226.0 million in the nine months ended September 30, 2007 to \$283.9 million in the nine months ended September 30, 2008.

The increase in revenues for the three and nine months ended September 30, 2008 compared to the same periods in 2007 is primarily due to increases in the communications networking market of \$14.2 million and \$55.5 million, respectively, along with increases in the commercial systems market of \$2.4 million for the three and nine months ended September 30, 2008.

The following table sets forth our revenues by market (in thousands):

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2008	2007	Change	2008	2007	Change
Wireless	\$ 38,011	\$ 42,953	\$ (4,942)	\$ 117,107	\$ 94,689	\$ 22,418

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IP Networking and Messaging	13,065	15,879	(2,814)	38,843	55,382	(16,539)
Other Communications Networking	27,245	5,302	21,943	67,594	18,005	49,589
Total Communications Networking	\$ 78,321	\$ 64,134	\$ 14,187	\$ 223,544	\$ 168,076	\$ 55,468
Medical	\$ 8,418	\$ 7,574	\$ 844	\$ 21,908	\$ 25,389	\$ (3,481)
Other Commercial Systems	13,519	11,922	1,597	38,464	32,548	5,916
Total Commercial	\$ 21,937	\$ 19,496	\$ 2,441	\$ 60,372	\$ 57,937	\$ 2,435
Total Company	\$ 100,258	\$ 83,630	\$ 16,628	\$ 283,916	\$ 226,013	\$ 57,903

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**Table of Contents*****Communications Networking Market***

Revenues in the communications networking market increased in the three and nine months ended September 30, 2008 compared to the same periods in 2007 primarily due to increases in next generation communication revenues, which include the realization of a full three and nine months, respectively, of the acquired Intel MCPD revenues as well increases in revenues from organic ATCA and media server products. In addition, increases in MCPD and ATCA revenues were driven by the recognition of revenue which was previously deferred. The majority of these sales occurred in the second quarter of 2008. Offsetting the increases seen in the three months ended September 30, 2008, were decreased wireless revenues driven by timing of end customer deployments programs, which were especially strong for the same period in 2007. For the nine months ended September 30, 2008, wireless revenues increased due to increased market share as compared to the same period in 2007. Further offsetting these increases, were decreased revenues from legacy enterprise products in the IP networking and messaging submarket, as various legacy enterprise products approach end of life.

***Commercial Systems Market***

Revenues in the commercial systems market increased in the three months ended September 30, 2008 compared to the same period in 2007, primarily due to increased revenues in the other commercial and medical markets. The increased revenues during the three months ended September 30, 2008 were driven by increased demand in the commercial medical market along with increased revenues for new products associated with military applications. For the nine months ended September 30, 2008, revenues in the commercial systems market increased due to consistent increases in the other commercial market for new products associated with military and industrial applications. This increase was slightly offset by the absence of a significant last time buy which occurred during the same periods in 2007, coupled with decreased revenues from medical products due to slower demand experienced in the second quarter of 2008.

Given the dynamics of these markets, we may experience general fluctuations in the percentage of revenue attributable to each market and, as a result, the quarter to quarter comparisons of our markets often are not indicative of overall economic trends affecting the long-term performance of our markets. We currently expect that each of our markets will continue to represent a significant portion of total revenues.

***Revenue by Geography***

From a geographic perspective, for the three and nine months ended September 30, 2008 compared to the same periods in 2007 the percentage of non-US revenues by delivery destination increased as a percentage of total revenues. Revenues from the EMEA and Asia Pacific regions increased by \$0.9 million and \$6.0 million, respectively for the three months ended September 30, 2008, as compared to the three months ended September 30, 2007. Revenues from the EMEA and Asia Pacific regions increased by \$17.8 million and \$30.3 million, respectively for the nine months ended September 30, 2008 as compared to the nine months ended September 30, 2007. The increase in revenues in the Asia Pacific region is primarily due to the addition of MCPD revenues along with increases in revenues from media server and ATCA products. The increase in revenues from the EMEA region is primarily due to higher organic ATCA revenues from wireless, IP networking and messaging, other products and MCPD revenues, all of which were partially offset by decreases in revenues from our legacy enterprise products. For the three and nine months ended September 30, 2008, revenues from North America increased \$9.8 million compared to the same periods in 2007 primarily driven by increased MCPD and organic ATCA revenues. We currently expect continued fluctuations in the percentage of revenue from each geographic region.

***Gross Margin***

Gross margins as a percentage of revenues were 26.7% and 22.9% for the three months ended September 30, 2008 and 2007, respectively. Gross margins as a percentage of revenues were 24.9% and 22.4% for the nine months ended September 30, 2008 and 2007, respectively. The increase in gross margin as a percentage of revenues for the three and nine months ended September 30, 2008 compared to the same periods in 2007 is primarily due to increased sales of higher margin next generation products. Gross margin for the nine months ended September 30, 2008, was also favorably impacted by operational improvements leading to lower excess and obsolete charges as well as increased leverage of fixed costs as volumes have increased. In addition, gross margin improved favorably due to the absence of significant charges associated with the transition from our North Carolina manufacturer, which occurred in 2007. Further improvements were driven by favorable variances realized in the allocation of fixed charges. These increases were slightly offset by increased warranty charges and amortization of intangible assets.

***Research and Development***

R&D expenses consist primarily of salary, bonuses and benefits for product development staff, and cost of design and development supplies and equipment, net of reimbursements for nonrecurring engineering services. R&D expenses increased \$121,000, or 1.0%, from \$11.8 million for the three months ended September 30, 2007 to \$11.9 million for the three months ended September 30, 2008. R&D expenses increased \$3.5

million, or 10.3%, from \$34.1 million for the nine months ended September 30,

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2007 to \$37.6 million for the nine months ended September 30, 2008. This increase, compared to the same period in 2007, is primarily due to the addition of the MCPD business, which includes headcount and integration expenses as well as stock-based compensation expense and increased incentive compensation costs. These increases were partially offset by decreased compensation costs resulting from the restructuring activities undertaken by us in the second quarter of 2008.

***Selling, General, and Administrative***

Selling, general and administrative ( SG&A ) expenses consist primarily of salary, commissions, bonuses and benefits for sales, marketing, executive and administrative personnel, as well as professional services and costs of other general corporate activities. SG&A expenses increased by \$0.9 million or 7.4%, from \$11.9 million for the three months ended September 30, 2007 to \$12.8 million for the three months ended September 30, 2008. SG&A expenses increased by \$3.6 million or 10.2%, from \$35.1 million for the nine months ended September 30, 2007 to \$38.7 million for the nine months ended September 30, 2008. This increase, as compared to the same period in 2007, is primarily due to increased incentive compensation and sales commission costs, including direct representative costs. These increases in costs are primarily the result of increased revenue, new product design wins and improved operating results. The increase in SG&A from the same period in 2007 was further driven by the purchase of the MCPD business.

***Stock-based Compensation Expense***

Stock-based compensation expense consists of amortization of stock-based compensation associated with stock options, restricted shares and shares issued to employees as a result of the employee stock purchase plan ( ESPP ). Stock-based compensation expense decreased by \$166,000 or 0.7%, from \$2.5 million for the three months ended September 30, 2007 to \$2.4 million for the three months ended September 30, 2008. Stock-based compensation expense remained flat for the nine months ended September 30, 2008 as compared to the nine months ended September 30, 2007.

We recognized stock-based compensation expense as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Cost of sales	\$ 254	\$ 195	\$ 768	\$ 727
Research and development	746	716	2,343	2,030
Selling, general and administrative	1,378	1,633	4,315	4,668
Total	2,378	2,544	7,426	7,425

***Deferred Compensation Expense***

On September 1, 2006, all outstanding Convedia stock options vested and were considered exercised immediately. The proceeds of which were distributed as follows: 75% of the purchase price per share less the exercise price was paid to the option holder at closing and the remaining 25% will be paid in full to those Convedia employees still employed by RadiSys after one year of service. The 75% paid at the time of the acquisition is included in the purchase price and is allocated to goodwill. The remaining 25% is recorded as deferred compensation and amortized through the Consolidated Statement of Operations for the life of the asset (one year). Pursuant to the purchase agreement any forfeitures are reallocated to the remaining Convedia employees. We paid the remaining 25% of the proceeds calculation on September 30, 2007.

We recognized deferred compensation expense as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Cost of sales	\$	\$ 17	\$	\$ 67

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Research and development		106		426
Selling, general and administrative		193		757
Total		\$ 316	\$	1,250

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***Intangible Assets Amortization***

Intangible assets consist of purchased technology, patents and other identifiable intangible assets. Intangible assets amortization expense included within operating expenses was \$1.3 million and \$1.1 million for the three months ended September 30, 2008 and 2007, respectively. Intangible assets amortization expense included within operating expenses was \$3.9 million and \$3.1 million for the nine months ended September 30, 2008 and 2007, respectively. Intangible asset amortization increased as a full three and nine months of charges were recognized for those assets acquired in our MCPD acquisition, which was completed at the end of the third quarter of 2007.

We test goodwill for impairment on an annual basis, or more often if events or circumstances indicate potential impairment. Goodwill impairment testing is performed at the reporting unit level in a two-step process, which consists of, first, comparing our fair value to our carrying value, including goodwill. If our fair value exceeds our carrying value, applicable goodwill is not considered to be impaired. If our carrying value exceeds our fair value, there is an indication of impairment, upon which time we would perform the second step, which includes a further and more detailed analysis in order to corroborate any such impairment.

We completed our annual goodwill impairment analysis during the third quarter of 2008. Our annual goodwill impairment analysis consists of, first, comparing our book value of our sole reporting unit to its fair value. The estimated fair value of our sole reporting unit was calculated considering the trading price of our common stock on September 30, 2008, the average trading price during the third quarter of 2008, as well as the average trading price of incremental time periods near the end of the third quarter of 2008. At September 30, 2008, our share price declined to \$8.60 per share from \$12.45 at September 30, 2007, the date of our last annual impairment test. This compares to a book value per share of \$9.08 and \$9.87 per share at September 30, 2008 and 2007, respectively. Our analysis showed that the average share price remained above book value per share when calculating the average using the entire third quarter as well as calculating the average for the last 15 trading days of the quarter. We believe that it is important to look at the stock price near the end of the quarter, but using a time period of less than 15 days would not accurately reflect the fair market value of the stock given the duration of the time period as well as the volatility in the market at this time. Nevertheless, if the trading price of our common stock were to remain below the book value per share for a sustained period, an additional analysis would be performed to measure the potential goodwill impairment. During the three and nine months ended September 30, 2008, our stock price has closed below its book value per share at September 30, 2008 for a limited number of trading days. Based on the limited number of trading days involved and the absence of any other triggering events, we concluded as part of our annual goodwill impairment test that goodwill was not impaired as of September 30, 2008.

We will continue to monitor the relationship between our market capitalization and our book value, as well as any other triggering events, in order to evaluate the carrying value of goodwill. Based on current economic conditions combined with our stock price, which has remained below our book value per share since September 30, 2008, we anticipate performing a goodwill impairment test during the fourth quarter of 2008. If at any time management has determined that an impairment exists, we will be required to reflect the impaired value as a part of operating income, resulting in a reduction in earnings and a corresponding reduction in our net asset value in the period such impairment is identified. Any future impairment charges could have a material adverse effect on our financial condition, earnings and results of operations and may cause our stock price to decline.

***Restructuring and Other Charges***

We evaluate the adequacy of the accrued restructuring and other charges on a quarterly basis. As a result, we record certain reclassifications and reversals to the accrued restructuring and other charges based on the results of the evaluation. The total accrued restructuring and other charges for each restructuring event are not affected by reclassifications. Reversals are recorded in the period in which we determine that expected restructuring and other obligations are less than the amounts accrued. Tables summarizing the activity in the accrued liability for each restructuring event are contained in Note 6 *Accrued Restructuring and Other Charges* of the Notes to the Unaudited Consolidated Financial Statements.

***Fourth Quarter 2006 Restructuring***

During the fourth quarter of 2006, we initiated a restructuring plan that included the elimination of 12 positions primarily supporting our contract manufacturing operations as a result of the termination of our relationship with one of our contract manufacturers in North America. The restructuring plan also includes closing our Charlotte office, which we expect to be completed in December 2008. During the three and nine months ended September 30, 2007, we incurred \$14,000 and \$127,000 of additional severance and other employee-related separation costs. During the three and nine months ended September 30, 2007, we incurred \$64,000 of facility-related costs to close the Charlotte, North Carolina manufacturing support office. During the nine months ended September 30, 2008, we amortized costs of \$28,000 associated with the closing of our Charlotte office.



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### *Second Quarter 2007 Restructuring*

During the three and nine months ended September 30, 2007, we incurred employee-related expenses of \$59,000 and \$1.5 million associated with skill set changes for approximately 20 employees. No such charges were incurred in the three or nine months

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ended September 30, 2008. The changes involved creating an integrated structure with the media server business along with some skill set changes in certain selling, general and administrative and engineering groups. The costs incurred in this restructuring event include employee severance and medical benefits, and associated legal costs. All restructuring activities were completed by March 31, 2008.

*Second Quarter 2008 Restructuring*

During the second quarter of 2008, we initiated a restructuring plan that included the elimination of 23 positions primarily initiated with the intent to return our engineering spend to levels which align with targeted profitability as well as refocus our skill sets in order to promote new product growth and provide enhanced service and support to existing customers. During the three and nine months ended September 30, 2008, we reversed \$35,000 of charges previously recognized as part of this restructure. We expect to complete all activities associated with the restructuring by March 31, 2009.

*Interest Expense*

Interest expense includes interest incurred on the convertible senior notes as well as our revolving line of credit. Interest expense increased \$256,000 or 61.5%, from \$416,000 for the three months ended September 30, 2007 to \$672,000 for the three months ended September 30, 2008. Interest expense increased \$654,000 or 51.1%, from \$1.3 million for the nine months ended September 30, 2007 to \$1.9 million for the nine months ended September 30, 2008. The increase in the interest expense for the three and nine months ended September 30, 2008 compared to the same periods in 2007 is due to the issuance of \$55.0 million of our 2013 convertible senior notes with an interest rate of 2.75% on February 6, 2008 along with interest charges incurred from a withdrawal on our revolving line of credit. These increases were partially offset by the repurchase of \$62.5 million of our 2023 convertible senior notes, with an interest rate of 1.375%, during the nine months ended September 30, 2008. We currently expect to repurchase our 2023 convertible senior notes in November, at which time the holders have the right to require us to repurchase the notes. As such, we expect interest expense to decrease slightly going forward.

*Interest Income*

Interest income decreased \$1.1 million, or 64.2%, from \$1.7 million for the three months ended September 30, 2007 to \$605,000 for the three months ended September 30, 2008. Interest income decreased \$2.3 million, or 48.3%, from \$4.9 million for the nine months ended September 30, 2007 to \$2.6 million for the nine months ended September 30, 2008. Interest income decreased as a result of a lower average balance of cash, cash equivalents and investments for the three and nine months ended September 30, 2008 compared to the same period in 2007 as well as a decline in the average yield on investment holdings. The decline in cash, cash equivalents and investments was due to the repurchase of \$60.9 million in aggregate principal amount of the 2023 convertible senior notes, along with our Intel MCPD acquisition.

The decline in our average investment yield was driven primarily by lower reset interest rates associated with our ARS interest rates coupled with a shift in our investment portfolio.

*Income Tax*

We recorded a tax provision of \$1.0 million and a tax benefit of \$1.7 million during the three months ended September 30, 2008 and 2007, respectively. We recorded a tax provision of \$45,000 and a tax benefit of \$4.4 million during the nine months ended September 30, 2008 and 2007, respectively. The increase in the effective tax rate for the nine months ended September 30, 2008, from the tax rate for the year ended December 31, 2007, is primarily due to revaluation of our Canadian subsidiary's net deferred tax assets, caused by changes in foreign currency exchange rates, and taxes on foreign income that differ from U.S. tax rate.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 was signed into law which extended the research and development tax credit through December 31, 2009. Congress has reinstated the tax credit retroactive to January 1, 2008. As the Bill was signed into law after September 30, we have not recognized a tax benefit for the federal research and development tax credit in our tax provision for the three months ended September 30, 2008. We will evaluate the tax benefit associated with the research and development tax credit during the fourth quarter of 2008.

The 2008 estimated effective tax rate is based on current tax law and current expected income and assumes that we continue to receive tax benefits associated with certain income associated with foreign jurisdictions. The tax rate may be affected by potential acquisitions, restructuring events or divestitures, the jurisdictions in which profits are determined to be earned and taxed, and the ability to realize deferred tax assets.



**Table of Contents****Liquidity and Capital Resources**

The following table summarizes selected financial information as of the dates indicated and for the nine months ended September 30, 2008 and 2007 and for the year ended December 31, 2007:

	September 30, 2008	December 31, 2007	September 30, 2007
(Dollar amounts in thousands)			
Cash and cash equivalents	\$ 83,676	\$ 50,522	\$ 30,245
Short-term investments	\$	\$ 72,750	\$ 70,000
Long-term investments, net	\$ 56,522	\$	\$ 10,000
Cash and cash equivalents and investments	\$ 140,198	\$ 123,272	\$ 110,245
Working capital	\$ 79,292	\$ 61,840	\$ 142,722
Accounts receivable, net	\$ 49,129	\$ 70,548	\$ 60,255
Inventories, net	\$ 31,351	\$ 23,101	\$ 26,381
Accounts payable	\$ 37,857	\$ 49,675	\$ 42,924
Revolving line of credit	\$ 20,000	\$	\$
2023 convertible senior notes, net	\$ 36,623	\$ 97,548	\$ 97,513
2013 convertible senior notes	\$ 55,000	\$	\$
Convertible subordinated notes	\$	\$	\$
Days sales outstanding (A)	45	79	66
Days to pay (B)	50	76	64
Inventory turns (C)	8.9	8.2	9.2
Inventory turns days (D)	41	29	40
Cash cycle time days (E)	36	32	42

(A) Based on ending net trade receivables divided by daily revenue (quarterly revenue, annualized and divided by 365 days).

(B) Based on ending accounts payable divided by daily cost of sales excluding amortization of purchased technology (quarterly cost of sales, annualized and divided by 365 days).

(C) Based on quarterly cost of sales excluding amortization of purchased technology, annualized divided by ending inventory.

(D) Based on ending inventory divided by daily cost of sales excluding amortization of purchased technology (quarterly cost of sales, annualized and divided by 365 days).

(E) Days sales outstanding plus inventory turns - days, less days to pay.

Cash and cash equivalents increased by \$33.2 million from \$50.5 million at December 31, 2007 to \$83.7 million at September 30, 2008. Activities impacting cash and cash equivalents are as follows:

**Cash Flows**

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	For the Nine Months Ended	
	September 30,	
	2008	2007
	(In thousands)	
Cash provided by operating activities	\$ 23,224	\$ 5,983
Cash provided by (used in) investing activities	4,794	(615)
Cash provided by financing activities	5,063	897
Effects of exchange rate changes	73	246
<b>Net increase in cash and cash equivalents</b>	<b>\$ 33,154</b>	<b>\$ 6,511</b>

During the nine months ended September 30, 2008 and 2007, we used \$5.0 million and \$3.8 million, respectively, for capital expenditures. During the nine months ended September 30, 2008, capital expenditures were primarily associated with integrating the MCPD business as well as various purchases made to upgrade our internal infrastructure. During the nine months ended September 30, 2007, capital expenditures were primarily associated with integrating the media server business, upgrading our internal infrastructure as well as increasing manufacturing capabilities in our Hillsboro facility.

During the nine months ended September 30, 2008 and 2007, we received \$4.2 million and \$3.6 million, in each period, in proceeds from the issuance of common stock through our stock compensation plans.

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Changes in foreign currency rates impacted beginning cash balances during the nine months ended September 30, 2008 by \$73,000. Due to our international operations where transactions are recorded in functional currencies other than the U.S. Dollar, the effects of changes in foreign currency exchange rates on existing cash balances during any given period results in amounts on the consolidated statements of cash flows that may not reflect the changes in the corresponding accounts on the Consolidated Balance Sheets.

As of September 30, 2008 and December 31, 2007 working capital was \$79.3 million and \$61.8 million, respectively. Working capital increased by \$17.5 million due primarily to a borrowing on our revolving line of credit coupled with increased cash flows from operations; both of which were partially offset by the reclassification of short-term investments to long.

**Investments**

Investments consisted of the following (in thousands):

	September 30, 2008	December 31, 2007
Short-term available for sale investments	\$	\$ 72,750
Long-term available for sale investments	\$ 56,522	\$

We currently hold investments in ARS, which are highly rated debt instruments with a long-term nominal maturity for which the interest rate is set through a Dutch Auction process. The majority of our ARS investments represent interests in collateralized debt obligations supported by pools of government-backed student loans with S&P AAA ratings or Moody's Aaa ratings at the time of purchase. These investments have been classified as available-for-sale investments. Available-for-sale securities are recorded at fair value, and unrealized holding gains and losses are recorded, net of tax, as a separate component of accumulated other comprehensive income.

Between December 31, 2007 and February 7, 2008, we sold at par value \$10.0 million in ARS of the total ARS balance of \$72.8 million which was held at December 31, 2007. During the first quarter of 2008, due to liquidity issues experienced in the global credit and capital markets, our remaining portfolio of ARS investments experienced multiple failed auctions as the amount of securities submitted for sale exceeded the amount of purchase orders. An auction failure, which is not a default in the underlying debt instrument, occurs when there are more sellers than buyers at a scheduled interest rate auction date and parties desiring to sell their auction rate securities are unable to do so. When an auction fails, the interest rate is adjusted according to the provisions of the associated security agreement, which may result in an interest rate that is higher than the interest rate the issuer pays in connection with successful auctions. We will not be able to liquidate the investments until a successful auction occurs, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. Due to the uncertainty of when we will be able to liquidate the investments, we reclassified the investments to long-term assets during the first quarter of 2008 and we will continue to hold our ARS investments as such.

We considered various inputs to estimate the fair value of its ARS, including the issuer's credit quality, maturity, probability to be called, lack of liquidity, future cash flows based on maximum rate formulas and comparable securities of the issuer, if any. As of September 30, 2008 we determined that our investments were impaired by 9.9% or \$6.2 million, primarily due to the lack of liquidity. We believe declines in ARS fair values due to the lack of liquidity to be temporary as we have the ability and intent to hold these investments until they are sold or are called by the issuer at par. As such, we do not consider the impairment to be permanent and have recorded an unrealized loss of \$6.2 million, gross or \$4.0 million, net of tax in other comprehensive income in the shareholders' equity section of the Consolidated Balance Sheet at September 30, 2008.

During October of 2008, our investment bank announced it had agreed to settlements with the Securities and Exchange Commission and other state regulatory agencies to restore liquidity to eligible holders of auction-rate securities. Subsequently, during the fourth quarter of 2008, we accepted an offer from our investment bank which gives us a non-transferrable right to require the bank to purchase, at par value, \$62.7 million in ARS investments at any time between June 30, 2010 and June 30, 2012. The agreement allows the investment bank to purchase the ARS investments sooner than June 30, 2010, but is under no obligation to do so. If the bank has not purchased the investments by June 30, 2010, we plan to exercise our non-transferrable right to require the purchase at that time. In addition, under the terms of the offer, we are also eligible for a no net interest loan of up to 75% of the market value of our ARS until the time of purchase. Consequently, in accordance with our policy as well as the provisions of SFAS No. 115, we plan to transfer our ARS investments from available-for-sale to trading securities during the fourth quarter of 2008, as we plan to sell them on June 30, 2010. As such, at the time of transfer, we will be required to recognize in results of operations any unrealized loss, which was \$4.0 million, net of tax, at September 30, 2008. Concurrently, we will elect the fair value option under SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities* for the non-transferrable right, upon initial

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recognition. In electing the fair value option, we will record the changes in fair value of the non-transferrable right through results of operations until it is exercised. While we believe the fair value of the non-transferrable right will approximate the realized loss to be recognized when our ARS are transferred to trading securities, we are still determining the full impact.

**Table of Contents*****Line of Credit***

On August 7, 2008, we entered into a secured revolving line of credit agreement ( the Agreement ) with Silicon Valley Bank, as the Lender, which has replaced our previous line of credit facility with our investment bank. The Agreement provides us with a two-year secured revolving credit facility of \$30.0 million, which is subject to a borrowing base and secured by our accounts receivable. Borrowings under the Agreement will bear interest at the prime rate, currently at 5.00% or the LIBOR rate, currently at 4.45%, plus 1.25%, with either interest rate determined by our election. We are required to make interest payments monthly. We are further required to pay a commitment fee equal to 0.08% of the \$30.0 million maximum borrowing limit on an annual basis, and to pay quarterly in arrears an unused facility fee in an amount equal to 0.375% per year of the unused amount of the facility. In addition, the credit facility provides sub-facilities for letters of credit and foreign exchange contracts to be issued on our behalf.

The credit facility requires us to make and maintain certain financial covenants, representations, warranties and other agreements that are customary in credit agreements of this type. The Agreement requires us to maintain a minimum current ratio (current assets divided by the sum of current liabilities less deferred income plus the amount of outstanding advances and letters of credit) of 1.3 through the third quarter of 2008, which rises to a ratio of 1.5 during quarterly periods thereafter. Additionally, any quarterly EBITDA (earnings before interest, taxes, depreciation, amortization, and stock based compensation, as defined in the Agreement) loss may not exceed \$2.5 million in any one quarter, and quarterly EBITDA may not be negative for any two consecutive quarters for the duration of the Agreement. Further, our EBITDA may not be negative for the nine months ended September 30, 2008 and the year ended December 31, 2008. For quarterly periods beginning after January 1, 2009, we must maintain a positive rolling four quarter EBITDA. In addition, capital expenditures may not exceed \$12.0 million in any fiscal year.

Based on our current position we do not believe we will have any difficulties meeting these covenants. Given current economic conditions a sudden dramatic down turn in our business could result in non-compliance with one or more of these covenants.

Amounts borrowed and repaid are available for re-borrowing during the term of the facility. Outstanding amounts are due in full on the maturity date of August 6, 2010. Upon the occurrence of certain events of default specified in the Agreement, amounts due under the Agreement may be declared immediately due and payable.

As of September 30, 2008, we owed \$20.0 million on the line of credit, while there were no outstanding balances on the standby letter of credit. As of December 31, 2007 there were no outstanding balances on the line of credit or letters of credit issued on our behalf.

***2023 Convertible Senior Notes***

During November 2003, we completed a private offering of \$100 million aggregate principal amount of 1.375% convertible senior notes due November 15, 2023 (the 2023 convertible senior notes ) to qualified institutional buyers. The discount on the 2023 convertible senior notes amounted to \$3 million.

Convertible senior notes are unsecured obligations convertible into our common stock and rank equally in right of payment with all existing and future obligations that are unsecured and unsubordinated. Interest on the 2023 convertible senior notes accrues at 1.375% per year and is payable semi-annually on May 15 and November 15. The 2023 convertible senior notes are convertible, at the option of the holder, at any time on or prior to maturity under certain circumstances, unless previously redeemed or repurchased, into shares of our common stock at a conversion price of \$23.57 per share, which is equal to a conversion rate of 42.4247 shares per \$1,000 principal amount of notes. The 2023 convertible senior notes are convertible if (i) the closing price of our common stock on the trading day prior to the conversion date reaches 120% or more of the conversion price of the notes on such trading date; (ii) the trading price of the notes falling below 98% of the conversion value or (iii) certain other events occur. Upon conversion, we will have the right to deliver, in lieu of common stock, cash or a combination of cash and common stock. We may redeem all or a portion of the 2023 convertible senior notes at our option on or after November 15, 2006 but before November 15, 2008 provided that the closing price of our common stock exceeds 130% of the conversion price for at least 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date of the notice of the provisional redemption. On or after November 15, 2008, we may redeem the 2023 convertible senior notes at any time. The accretion of the discount on the 2023 convertible senior notes is calculated using the effective interest method.

As of September 30, 2008 we had outstanding 2023 convertible senior notes with a face value of \$37.5 million and a book value of \$36.6 million, net of unamortized discount of \$0.9 million. As of December 31, 2007, we had outstanding 2023 convertible senior





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notes with a face value of \$100 million and a book value of \$97.5 million, net of unamortized discount of \$2.5 million. The estimated fair value of the 2023 convertible senior notes was \$33.4 million and \$99.8 million at September 30, 2008 and December 31, 2007, respectively.

During the first quarter of 2008, we repurchased \$52.5 million aggregate principal amount of the 2023 convertible senior notes, with an associated discount of \$1.3 million. We repurchased the notes in the open market for \$51.1 million and, as a result, recorded a gain of \$68,000.

During the second quarter of 2008, we repurchased \$10.0 million aggregate principal amount of the 2023 convertible senior notes, with an associated discount of \$240,000. We repurchased the notes in the open market for \$9.8 million and, as a result, recorded a net loss of \$31,000.

On November 15, 2008, November 15, 2013, and November 15, 2018, holders of the 2023 convertible senior notes will have the right to require us to purchase, in cash, all or any part of the notes held by such holder at a purchase price equal to 100% of the principal amount of the notes being purchased, together with accrued and unpaid interest and additional interest, if any, up to but excluding the purchase date. If required, we have sufficient cash to repurchase its 2023 convertible senior notes on November 15, 2008 and anticipates incurring a loss of up to approximately \$871,000 related to the write-off of the associated unamortized discount.

***2013 Convertible Senior Notes***

On February 6, 2008, we offered and sold in a public offering pursuant to the shelf registration statement \$55.0 million aggregate principal amount of our 2013 convertible senior notes. Interest on the 2013 convertible senior notes is payable semi-annually, in arrears, on each August 15 and February 15, beginning on August 15, 2008, to the holders of record at the close of business on the preceding August 1 and February 1, respectively. The 2013 convertible senior notes mature on February 15, 2013. Holders of the 2013 convertible senior notes may convert their notes into a number of shares of our common stock determined as set forth in the indenture governing the notes at their option on any day to and including the business day prior to the maturity date. The 2013 convertible senior notes are initially convertible into 76.7448 shares of our common stock per \$1,000 principal amount of the notes (which is equivalent to a conversion price of approximately \$ 13.03 per share), subject to adjustment upon the occurrence of certain events. Upon the occurrence of a fundamental change, holders of the 2013 convertible senior notes may require us to repurchase some or all of our notes for cash at a price equal to 100% of the principal amount of the notes being repurchased, plus accrued and unpaid interest, if any. In addition, if certain fundamental changes occur, we may be required in certain circumstances to increase the conversion rate for any 2013 convertible senior notes converted in connection with such fundamental changes by a specified number of shares of our common stock. The 2013 convertible senior notes are our general unsecured obligations and rank equal in right of payment to all of our existing and future senior indebtedness, including our 2023 convertible senior notes, and senior in right of payment to our future subordinated debt. Our obligations under the 2013 convertible senior notes are not guaranteed by, and are effectively subordinated in right of payment to all existing and future obligations of, our subsidiaries and are effectively subordinated in right of payment to our future secured indebtedness to the extent of the assets securing such debt.

In connection with the issuance of the 2013 convertible senior notes, we entered into a capped call transaction with a hedge counterparty. The capped call transaction is expected to reduce the potential dilution upon conversion of the 2013 convertible senior notes in the event that the market value per share of our common stock, as measured under the terms of the capped call transaction, at the time of exercise is greater than the strike price of the capped call transaction of approximately \$13.03, which corresponds to the initial conversion price of the 2013 convertible senior notes and is subject to certain adjustments similar to those contained in the notes. If, however, the market value per share of our common stock exceeds the cap price of the capped call transaction of \$23.085, as measured under the terms of the capped call transaction, the dilution mitigation under the capped call transaction will be limited, which means that there would be dilution to the extent that the then market value per share of our common stock exceeds the cap price of the capped call transaction. The cost of the capped call transaction was approximately \$10.2 million and was recorded as a charge to shareholders' equity.

As of September 30, 2008, we had outstanding 2013 convertible senior notes with a face value and fair value of \$55.0 million and \$45.3 million, respectively.

**Table of Contents****Contractual Obligations**

The following summarizes our contractual obligations at September 30, 2008 and the effect of such on our liquidity and cash flows in future periods (in thousands).

	2008*	2009	2010	2011	2012	Thereafter
Future minimum lease payments	\$ 1,117	\$ 3,664	\$ 3,327	\$ 1,786	\$	\$
Purchase obligations(A)	35,817					
Interest on convertible senior notes	258	2,028	2,028	2,028	2,028	6,429
2023 convertible senior notes(B)	37,503					
2013 convertible senior notes						55,000
Total	\$ 74,695	\$ 5,692	\$ 5,355	\$ 3,814	\$ 2,028	\$ 61,429

\* Remaining three months.

(A) Purchase obligations include agreements or purchase orders to purchase goods or services that are enforceable and legally binding and specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

(B) The 2023 convertible senior notes are shown at their face value, gross of unamortized discount amounting to \$0.9 million at September 30, 2008. We may redeem the 2023 convertible senior notes at any time. On November 15, 2008, November 15, 2013, and November 15, 2018, holders of the 2023 convertible senior notes will have the right to require us to purchase, in cash, all or any part of the notes held by such holders at a purchase price equal to 100% of the principal amount of the notes being purchased, together with accrued and unpaid interest and additional interest, if any, up to but excluding the purchase date.

In addition to the above, as discussed in Note 11 *Income Taxes* of the Notes to the Consolidated Financial Statements, we have approximately \$2.6 million associated with unrecognized tax benefits and related interest and penalties. These liabilities are primarily included as a component of other long-term liabilities in our Consolidated Balance Sheets as we do not anticipate that settlement of the liabilities will require payment of cash within the next twelve months. We are not able to reasonably estimate when we would make any cash payments required to settle these liabilities, but do not believe that the ultimate settlement of our obligations will materially affect our liquidity.

**Off-Balance Sheet Arrangements**

We do not engage in any activity involving special purpose entities or off-balance sheet financing.

**Liquidity Outlook**

We believe that our current cash, cash equivalents and investments, net, amounting to \$140.2 million at September 30, 2008, of which \$56.5 million consisted of ARS, the cash generated from operations and our line of credit facility will satisfy our short and long-term expected working capital needs, capital expenditures, stock repurchases, other liquidity requirements associated with our existing business operations, and the repurchase of all or part of our 2023 convertible senior notes as required by the holders on November 15, 2008 even if we are required to hold our ARS until maturity. Capital expenditures are expected to range from \$1.5 million to \$2.0 million per quarter as we make additional R&D and IT capital investments.

**FORWARD-LOOKING STATEMENTS**

This Quarterly Report contains forward-looking statements. Some of the forward-looking statements contained in this Quarterly Report include:

expectations and goals for revenues, gross margin, R&D expenses, selling, general, administrative expenses and profits;

estimates and impact of stock-based compensation expense;

the impact of our restructuring events on future operating results;

currency exchange rate fluctuations, changes in tariff and trade policies and other risks associated with foreign operations;

our projected liquidity; and

matters affecting the computer manufacturing industry including changes in industry standards, changes in customer requirements and new product introductions, as well as other risks described in **Risk Factors** in our Annual Report on Form 10-K for the year ended December 31, 2007 and as updated in this Quarterly Report.

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All statements that relate to future events or to our future performance are forward-looking statements. In some cases, forward-looking statements can be identified by terms such as may, will, should, expect, plans, seeks, anticipate, believe, estimate, predict, seek to continue, intends, or other comparable terminology. These forward-looking statements are made pursuant to safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results or our industries' actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements.

Forward-looking statements in this Quarterly Report on Form 10-Q include discussions of our goals, including those discussions set forth in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. We cannot provide assurance that these goals will be achieved.

Although forward-looking statements help provide additional information about us, investors should keep in mind that forward-looking statements are only predictions, at a point in time, and are inherently less reliable than historical information. In evaluating these statements, you should specifically consider the risks outlined above and those listed under Risk Factors in Item 1a. These risk factors may cause our actual results to differ materially from any forward-looking statement.

We do not guarantee future results, levels of activity, performance or achievements and we do not assume responsibility for the accuracy and completeness of these statements. The forward-looking statements contained in this Quarterly Report are made and based on information as of the date of this report. We assume no obligation to update any of these statements based on information after the date of this report.

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We are exposed to market risk from changes in interest rates, foreign currency exchange rates, and equity trading prices, which could affect our financial position and results of operations.

*Interest Rate Risk.* We invest excess cash in debt instruments of or supported by the U.S. Government and its agencies, and those of high-quality corporate issuers. We attempt to protect and preserve our invested funds by limiting default, market, and reinvestment risk. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair value adversely affected due to a rise in interest rates while floating rate securities may produce less income than expected if interest rates decline. Due to the short duration of most of the investment portfolio, an immediate 10% change in interest rates would not have a material effect on the fair value of our investment portfolio. Additionally, the interest rate changes affect the fair market value but do not necessarily have a direct impact on our earnings or cash flows. Therefore, we would not expect our operating results or cash flows to be affected, to any significant degree, by the effect of a sudden change in market interest rates on the securities portfolio. The estimated fair value of our debt investments at September 30, 2008 and December 31, 2007 was \$78.7 million and \$95.1 million, respectively. The effect of an immediate 10% change in interest rates would not have a material effect on our operating results or cash flows.

*Foreign Currency Risk.* We pay the expenses of our international operations in local currencies, namely, the British Pound Sterling, Canadian Dollar, Chinese Yuan, Euro, Japanese Yen, Malaysian Ringgit and Israeli New Shekel. The international operations are subject to risks typical of an international business, including, but not limited to: differing economic conditions, changes in political climate, differing tax structures, foreign exchange rate volatility and other regulations and restrictions. Accordingly, future results could be materially and adversely affected by changes in these or other factors. We are also exposed to foreign exchange rate fluctuations as the balance sheets and income statements of our foreign subsidiaries are translated into U.S. Dollars during the consolidation process. Because exchange rates vary, these results, when translated, may vary from expectations and adversely affect overall expected profitability.

Based on our policy, we have established a foreign currency exposure management program which uses derivative foreign exchange contracts to address nonfunctional currency exposures that are expected to be settled in one year or less. During the first quarter of 2008, in order to reduce the potentially adverse effects of foreign currency exchange rate fluctuations, we began to enter into forward exchange contracts. These hedging transactions primarily limit our exposure to changes in the U.S. Dollar/Canadian Dollar exchange rate.

Holding other variables constant, a 10% adverse fluctuation of the U.S. Dollar relative to the Canadian Dollar would result in a \$1.1 million loss as of September 30, 2008. Holding other variables constant, a 10% favorable fluctuation of the U.S. Dollar relative to the Canadian Dollar would result in a \$604,000 gain as of September 30, 2008. We do not expect a 10% fluctuation to have any impact on our operating results as the underlying hedged transactions will move in an equal and opposite direction.

*Convertible Notes.* The fair value of the convertible senior notes are sensitive to interest rate changes. Interest rate changes would result in an increase or decrease in the fair value of the convertible notes due to differences between market interest rates and rates in effect at the inception of the obligation. Unless we elect to repurchase our senior convertible notes in the open market, changes in the fair value of the senior convertible notes have no impact on our cash flows or Consolidated Financial Statements. The estimated fair value of the 2023 convertible senior notes was \$33.4 million and \$99.8 million at September 30, 2008 and December 31, 2007, respectively, and the estimated fair value of the 2013 convertible senior notes was \$45.3 million at September 30, 2008.

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**Item 4. Controls and Procedures**

Based on their evaluation as of the end of the period covered by this Quarterly Report, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective.

In connection with the evaluation described above, we identified no change in our internal control over financial reporting, aside from those associated with our acquisition of the MCPD business, that occurred during the three months ended September 30, 2007, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

During the third quarter of 2008, we completed the process of incorporating our internal controls and procedures into the MCPD business, which was acquired effective September 12, 2007.

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**Table of Contents****PART II. OTHER INFORMATION****Item 1A. Risk Factors**

There are many factors that affect our business and the results of our operations, many of which are beyond our control. In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in this Quarterly Report and our Annual Report on Form 10-K for the year ended December 31, 2007, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

*Impairment charges associated with our goodwill and other intangible assets could adversely affect our future results of operations and financial position and may cause our stock price to decline.*

Under statement of SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and intangible assets deemed to have indefinite lives are not amortized but instead are subject to annual impairment tests or sooner when events or circumstances warrant such testing. As of September 30, 2008, we had goodwill of approximately \$67.6 million, and intangible assets, net of accumulated amortization, of approximately \$23.0 million. In accordance with the statement, we will test for impairment at least annually, and historically have done so in the third quarter of each year. In addition, we will test goodwill for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. Such tests may result in a determination that these assets have been impaired.

At September 30, 2008, our share price declined to \$8.60 per share from \$12.45 at September 30, 2007, the date of our last annual impairment test. This compares to a book value per share of \$9.08 and \$9.87 per share at September 30, 2008 and 2007, respectively. Our analysis showed that the average share price remained above book value per share when calculating the average using the entire third quarter as well as calculating the average for the last 15 trading days of the quarter. We believe that it is important to look at the stock price near the end of the quarter, but using a time period of less than 15 days would not accurately reflect the fair market value of the stock given the duration of the time period as well as the volatility in the market at this time. Nevertheless, if the trading price of our common stock were to remain below the book value per share for a sustained period, an additional analysis would be performed to measure the potential goodwill impairment. During the three and nine months ended September 30, 2008, the Company's stock price closed below its book value per share at September 30, 2008 for only a limited number of trading days. Based on the limited number of trading days involved and the absence of any other triggering events, we concluded as part of our annual goodwill impairment test that goodwill was not impaired as of September 30, 2008.

We will continue to monitor the relationship between our market capitalization and our book value, as well as any other triggering events, in order to evaluate the carrying value of goodwill. Based on current economic conditions combined with our stock price, which has remained below our book value per share since September 30, 2008, we anticipate performing a goodwill impairment test during the fourth quarter of 2008. If at any time management has determined that an impairment exists, we will be required to reflect the impaired value as a part of operating income, resulting in a reduction in earnings and a corresponding reduction in our net asset value in the period such impairment is identified. Any future impairment charges could have a material adverse effect on our financial condition, earnings and results of operations, may cause a covenant default associated with our revolving line of credit which could trigger repayment of any outstanding borrowings, and may cause our stock price to decline.

*There are a number of trends and factors affecting our markets, including economic conditions in the United States, Europe and globally, which are beyond our control. These trends and factors may result in increasing upward pressure on the costs of products and an overall reduction in demand.*

There are trends and factors affecting our markets and our sources of supply that are beyond our control and may negatively affect our cost of sales. Such trends and factors include: adverse changes in the cost of raw commodities and increasing freight, energy, and labor costs in developing regions such as China. Our business strategy has been to provide customers with faster time-to-market and greater value solutions in order to help them compete in an industry that generally faces downward pricing pressure. In addition, our competitors have in the past lowered, and may again in the future lower, prices in order to increase their market share, which would ultimately reduce the price we may realize from our customers. If we are unable to realize prices that allow us to continue to compete on this basis of performance, our profit margin, market share, and overall financial condition and operating results may be materially and adversely affected.

*Our operating results may be adversely impacted by worldwide political and macro- economic uncertainties and fears.*



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Recently general worldwide economic conditions have experienced a downturn due to the credit conditions impacted by the subprime-mortgage turmoil and other factors, slower economic activity, concerns about inflation and deflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity, the ongoing effects of the war in Iraq, recent international conflicts and terrorist and military activity, and the impact of natural disasters and public

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health emergencies. These conditions make it extremely difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and they could cause U.S. and foreign businesses to slow spending on our products and services, which would delay and lengthen sales cycles. Furthermore, during challenging economic times our customers may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts and our days sales outstanding would be negatively impacted. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, worldwide, or in the markets in which we operate. If the economy or markets in which we operate do not continue at their present levels, our business, financial condition and results of operations could be materially and adversely affected. All the aforementioned macro-economic challenges and conditions could have a synergistic negative impact on the results of our operations.

***Other Risk Factors Related to Our Business***

Other risk factors include, but are not limited to, changes in the mix of products sold, changes in regulatory and tax legislation, changes in effective tax rates, inventory risks due to changes in market demand or our business strategies, potential litigation and claims arising in the normal course of business, credit risk of customers and other risk factors.

**Item 5. Other Information**

Effective November 17, 2008, Julia Harper, the Company's Vice President of Corporate Operations, will be transitioning into the role of Vice President of Corporate Administration. Concurrently, the Company has hired John Major, 49, to assume the role of Vice President of Global Operations.

Prior to joining the Company, Mr. Major served as Vice President of Global Operations for Planar Systems since January 2008, and Vice President of Supply Chain and Manufacturing Operations for Tektronix from October 2003 to January 2008, where he was responsible for worldwide operations, including the deployment of Lean Sigma. Prior to joining Tektronix, Mr. Major served as Vice President of Customer Support and Service for Xerox Office Printing Business from June 2000 to October 2003. Earlier in his career, Mr. Major served in a number of manufacturing leadership roles at Tektronix and Digital Equipment Corporation. Mr. Major holds a Bachelor of Science degree in Mechanical Engineering and an Executive MBA from the University of Washington.

Under the terms of the offer of employment made to Mr. Major, he will have a base salary of \$260,000, plus an incentive compensation plan annual target amount of \$160,000 at 100% of plan payout. Additionally, subject to Board approval, Mr. Major will participate in the Company's Long-Term Incentive Plan, and will be granted an equity award of 45,000 stock options, which will vest over a three-year period from the grant date. He will also be eligible to participate in other benefit plans generally available to executive officers.

On November 4, 2008, the Company entered into a Change of Control Agreement with Mr. Major in connection with his appointment as Vice President of Global Operations. Mr. Major's Change of Control Agreement provides that if we terminate his employment with us (other than for cause, death or disability), or if his employment terminates as a result of a requirement that he accept a position greater than 25 miles from his current work location or a position of less total compensation, in each case within 12 months following a change of control or within 3 months preceding a change of control, Mr. Major would be entitled to receive severance pay in a cash amount equal to 9 months of his annual base pay at the highest annual rate in effect at any time within the 9-month period preceding the date of termination. Upon such termination, and in addition to severance pay, he would also be entitled to receive COBRA benefits for 9 months.

On November 4, 2008, the Company agreed to enter into a Severance Agreement with Mr. Major. If his employment with us is terminated other than for cause, death or disability, he will be entitled to (i) a payment of six months base pay and (ii) up to six months of continued coverage pursuant to COBRA under the Company's group health plan.

Except as set forth above, there are no relationships between the Company and Mr. Major or between Mr. Major and any director or executive officer of the Company.

**Table of Contents****Item 6. Exhibits**(a) *Exhibits*

<b>Exhibit No</b>	<b>Description</b>
3.1	Second Restated Articles of Incorporation and amendments thereto. Incorporated by reference from Exhibit 4.1 to the Company's Registration Statement on Form S-8, filed on September 1, 2006, SEC File No. 333-137060, as amended by the Articles of Amendment incorporated by reference from Exhibit 3.1 in the Company's Current Report on Form 8-K filed on January 30, 2008.
3.2	Restated Bylaws. Incorporated by reference from Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q, filed on May 8, 2007.
4.1	Indenture, dated February 12, 2008, by and between the Company and The Bank of New York Trust Company, N.A. Incorporated by reference from Exhibit 4.1 in the Company's Current Report on Form 8-K, filed on February 12, 2008.
4.2	First Supplemental Indenture, dated February 12, 2008, by and between the Company and The Bank of New York Trust Company, N.A. Incorporated by reference from Exhibit 4.2 in the Company's Current Report on Form 8-K, filed on February 12, 2008.
4.3	Form of Global Security for the 2.75% Convertible Senior Notes due 2013 (included in Exhibit 4.2).
10.1	Loan and Security Agreement, dated August 7, 2008, between the Company and Silicon Valley Bank. Incorporated by reference from Exhibit 10.3 in the Company's Quarterly Report on Form 10-Q, filed on August 8, 2008.
10.2	Severance Agreement, dated August 6, 2008, between the Company and Scott Grout. Incorporated by reference from Exhibit 10.4 in the Company's Quarterly Report on Form 10-Q, filed on August 8, 2008.
31.1*	Certification of the Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith

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**SIGNATURES**

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

**RADISYS CORPORATION**

Dated: November 7, 2008

By: */s/ SCOTT C. GROUT*  
Scott C. Grout  
*President and Chief Executive Officer*

Dated: November 7, 2008

By: */s/ BRIAN BRONSON*  
Brian Bronson  
*Chief Financial Officer*

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