ENTROPIC COMMUNICATIONS INC
Form 10-Q
October 27, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2009

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______.

Commission file number: 001-33844

ENTROPIC COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0947630**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

6290 Sequence Drive

San Diego, CA 92121

(Address of Principal Executive Offices, Including Zip Code)

(858) 768-3600

(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ¨ Yes ¨ No

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

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

There were 70,827,220 shares of the registrant s common stock, par value $0.001 per share, issued and outstanding as of the close of business on October 26, 2009, the latest practicable date.

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ENTROPIC COMMUNICATIONS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009

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PART I FINANCIAL INFORMATION

Item 1. *Financial Statements*

Entropic Communications, Inc.

Unaudited Condensed Consolidated Balance Sheets

(in thousands)

	September 30, 2009	December 31, 2008(1)
Assets		
Current assets:		
Cash and cash equivalents	$ 34,329	$ 30,071
Marketable securities		4,339
Accounts receivable, net	15,648	13,915
Inventory	14,067	18,693
Prepaid expenses and other current assets	2,625	2,785
Total current assets	66,669	69,803
Property and equipment, net	11,757	13,046
Intangible assets, net	2,028	3,469
Other long-term assets	258	284
Total assets	$ 80,712	$ 86,602
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 5,882	$ 5,166
Accrued payroll and benefits	3,373	3,498
Accrued expenses and other current liabilities	2,652	2,707
Deferred revenues	165	467
Total current liabilities	12,072	11,838
Stock repurchase liability	431	784
Other long-term liabilities	3,052	3,231
Stockholders equity:		
Common stock	71	69
Additional paid-in capital	308,058	299,305
Accumulated deficit	(242,928)	(228,667)
Accumulated other comprehensive (loss) income	(44)	42
Total stockholders equity	65,157	70,749
Total liabilities and stockholders equity	$ 80,712	$ 86,602

(1) The condensed consolidated balance sheet at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

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

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Entropic Communications, Inc.

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except per share data)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net revenues	$ 30,958	$ 31,678	$ 81,227	$ 116,502
Cost of net revenues	15,332	17,308	40,437	64,014
Gross profit	15,626	14,370	40,790	52,488
Operating expenses:				
Research and development	10,824	13,902	34,249	42,892
Sales and marketing	3,345	3,991	10,377	12,590
General and administrative	2,642	2,798	8,043	9,862
Write off of in-process research and development				1,300
Amortization of intangibles		713	16	2,022
Restructuring charges	70	209	2,173	1,278
Impairment of goodwill and intangible assets			208	
Total operating expenses	16,881	21,613	55,066	69,944
Loss from operations	(1,255)	(7,243)	(14,276)	(17,456)
Other income, net	26	156	115	149
Loss before income taxes	(1,229)	(7,087)	(14,161)	(17,307)
Income tax provision	9	37	100	119
Net loss attributable to common stockholders	$ (1,238)	$ (7,124)	$ (14,261)	$ (17,426)
Net loss per share attributable to common stockholders basic and diluted	$ (0.02)	$ (0.11)	$ (0.21)	$ (0.26)
Weighted average number of shares used to compute loss per share attributable to common stockholders	70,146	67,669	69,473	67,378

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

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Entropic Communications, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30,	
	2009	**2008**
Operating activities:		
Net loss	$ (14,261)	$ (17,426)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,547	2,375
Amortization of intangible assets	1,233	6,442
Impairment of goodwill and intangible assets	208	
Stock-based compensation to consultants	18	92
Stock-based compensation to employees	7,208	10,362
Interest expense attributable to amortization of debt issuance costs		476
In-process research and development		1,300
Impairment of assets related to restructuring charge	94	259
Loss on disposal of assets		8
Changes in operating assets and liabilities:		
Restricted cash		58
Accounts receivable	(1,733)	4,800
Inventory	4,627	(6,909)
Prepaid expenses and other current assets	160	686
Other long-term assets	25	44
Accounts payable	716	(5,499)
Accrued payroll and benefits	(209)	(309)
Accrued expenses and other liabilities	(55)	(913)
Deferred revenues	(302)	(303)
Other long-term liabilities	(180)	1,296
Net cash provided by (used in) operating activities	96	(3,161)
Investing activities:		
Purchases of property and equipment	(1,352)	(5,741)
Purchases of marketable securities		(17,144)
Sales/maturities of marketable securities	4,339	13,249
Net cash used in acquisitions		(6,113)
Net cash provided by (used in) investing activities	2,987	(15,749)
Financing activities:		
Principal payments on software license and capital lease obligations		(9,180)
Net proceeds from the issuance of common stock, net of issuance costs	1,182	1,859
Purchases of common stock	(7)	
Net cash provided by (used in) financing activities	1,175	(7,321)
Net increase (decrease) in cash and cash equivalents	4,258	(26,231)
Cash and cash equivalents at beginning of period	30,071	51,475
Cash and cash equivalents at end of period	$ 34,329	$ 25,244

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

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ENTROPIC COMMUNICATIONS, INC.

Notes to Unaudited Condensed Consolidated Financial Statements

September 30, 2009

1. Organization and Summary of Significant Accounting Policies

Business

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

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC). They do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2008 included in the Company s Annual Report on Form 10-K (Annual Report) filed on February 23, 2009 with the SEC.

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

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation. In preparing the accompanying unaudited condensed consolidated financial statements, the Company evaluated subsequent events after the balance sheet date of September 30, 2009 through October 27, 2009, the date that these financial statements are issued.

Use of Estimates

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

Foreign Currency Translation

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

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Revenue Recognition

The Company s revenues are generated principally by sales of its semiconductor products. During each of the three and nine month periods ended September 30, 2009 and 2008, product revenues represented approximately 99% of the Company s total net revenues. The Company also generates service revenues from development contracts.

The Company recognizes product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and (iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment. However, the Company does not recognize revenue until all customer acceptance requirements have been met, when applicable.

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

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

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

The Company derives revenues from development contracts that involve new and unproven technologies. Revenues under these contracts are deferred until customer acceptance is obtained and other contract-specific terms have been completed. Provisions for losses related to development contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. The costs associated with development contracts are included in cost of service revenue. The Company defers the cost of services provided under its development contracts.

The Company has a development agreement that provides for royalties in exchange for an exclusive right to manufacture and sell certain products. The Company has determined that it is not able to estimate reliably the royalties earned in the period the sales occur. Thus, the Company records revenues based on cash receipts. The royalty revenues recorded during the three months ended September 30, 2009 and 2008 and the nine months ended September 30, 2009 and 2008 were $384,000, $533,000, $1,554,000 and $2,299,000, respectively.

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

The Company allocates revenue for transactions that include multiple elements to each unit of accounting based on its relative fair value and recognizes revenue for each unit of accounting when revenue recognition criteria have been met. The price charged when the element is sold separately generally determines fair value. When the Company has objective evidence of the fair values of undelivered elements but not delivered elements, the Company allocates revenue first to the fair value of the undelivered elements, and the residual revenue is then allocated to the delivered elements. If the fair value of any undelivered element included in a multiple element arrangement cannot be objectively determined, revenue is deferred until all elements are delivered or services have been performed, or until fair value can objectively be determined for any remaining undelivered elements.

Concentration of Credit Risk

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

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

Inventories

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

Goodwill and Intangible Assets

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

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

During the three months ended March 31, 2009, the Company implemented a restructuring plan (see Note 2). As part of the restructuring plan, the Company closed its Kfar Saba, Israel office and terminated all of the employees at that location. As a result of this location closure, the Company reassessed the intangible assets associated with the Company s Kfar Saba, Israel office and recorded an impairment charge for the remaining $208,000 of developed technology intangible assets associated with the Company s 2007 acquisition of Arabella Software, Ltd. (Arabella).

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Guarantees and Indemnifications

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

Rebates

The Company provides rebates on its products to certain customers. At the time of the sale, the Company accrues 100% of the potential rebate as a reduction to revenue and does not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. The Company reverses the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when the Company believes unclaimed rebates are no longer subject to payment and will not be paid. For the three months ended September 30, 2009 and 2008 and the nine months ended September 30, 2009 and 2008, the Company reduced net revenues by $98,000, $146,000, $327,000 and $496,000, respectively, in connection with its rebate programs.

Warranty Accrual

The Company generally provides a warranty on its products for a period of one year; however, it may be longer for certain customers. Accordingly, the Company establishes provisions for estimated product warranty costs at the time revenue is recognized as cost of net revenues. The warranty accrual is based on management s best estimate of expected costs associated with product failure and historical product failures. When the actual product failure rates, cost of replacements and rework costs differ from the Company s estimates, revisions to the estimated warranty accrual are made. Actual claims are charged against the warranty reserve.

Research and Development Costs

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

Income Taxes

The Company estimates income taxes based on the various jurisdictions where the Company conducts business. Significant judgment is required in determining the Company s worldwide income tax provision. The Company estimates the current tax liability and assesses temporary differences that result from differing treatments of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are reflected in the Company s balance sheets. The Company then assesses the likelihood that deferred tax assets will be realized. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized. When a valuation allowance is established or increased, the Company records a corresponding tax expense in the Company s statements of operations. The Company reviews the need for a valuation allowance each interim period to reflect uncertainties about whether the Company will be able to utilize deferred tax assets before they expire. The valuation allowance analysis is based on estimates of taxable income for the jurisdictions in which the Company operates and the periods over which the Company s deferred tax assets will be realizable. Changes in the Company s valuation allowance could result in material increases or decreases in the Company s income tax expense in the period such changes occur, which could have a material impact on the Company s operating results.

The Company recognizes and measures benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not of being sustained upon audit, the second step is to measure the tax benefit as the largest amount that has more than a 50% chance of being realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. The Company evaluates uncertain tax positions on a quarterly basis. The evaluations are based upon a number of factors, including changes in facts or circumstances, changes in tax law, correspondence with tax authorities during the course of audits and effective settlement of audit issues. Changes in the recognition or measurement of uncertain tax positions could result in material increases or decreases in the Company s income tax expense in the period such changes occur, which could have a material impact on the Company s effective tax rate and operating results.

Stock-Based Compensation

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

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

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

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

Segment Reporting

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

Recently Issued Accounting Standards

In December 2007, the Financial Accounting Standards Board (FASB) revised the authoritative guidance for business combinations, which establishes the principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008. The impact of this guidance on the Company s consolidated financial statements will ultimately depend on the terms of any future business transactions.

On February 6, 2008, the FASB issued guidance for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in issued financial statements on a recurring basis. This guidance is effective for financial statements issued for fiscal years beginning after November 15, 2008. The adoption of this guidance did not have a material impact on the Company s consolidated financial statements.

In March 2008, the FASB issued authoritative guidance which requires enhanced disclosure related to derivatives and hedging activities to improve the transparency of financial reporting. In accordance with this guidance, entities are required to provide enhanced disclosures relating to: (i) how and why an entity uses derivative instruments; (ii) how an entity accounts for derivative instruments and related hedge items; and (iii) how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. This guidance must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items, and for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008. At this time, the Company does not invest in derivative instruments or hedging activities, and accordingly, the adoption of this guidance did not have a material impact on the Company s consolidated financial statements, and will not have a material impact on the Company s future consolidated financial statements, unless the Company invests in derivative instruments or engages in hedging activities in the future.

In June 2008, the FASB reached a consensus on the determination of whether an instrument (or embedded feature) is indexed to an entity s own stock, which became effective for fiscal years beginning after December 15, 2008. The guidance requires companies to adopt a two-step approach, separately evaluating the instrument s contingent exercise provisions first and the instrument s settlement provisions second. This consensus did not have a material impact on the Company s consolidated financial statements.

In November 2008, the FASB ratified authoritative guidance on accounting for defensive intangible assets that are acquired in a business combination. Defensive intangible assets are assets that an entity does not intend to use actively but intends to hold to prevent its competitors from obtaining access to them. As these assets are separately identifiable, the guidance requires an acquiring entity to account for defensive intangible assets as a separate unit of accounting which should be amortized to expense over the period in which such assets diminish in value. Defensive intangible assets must be recognized at fair value in accordance with authoritative guidance that establishes the principles and requirements for how the acquirer of a business recognizes and measures the identifiable assets acquired in its financial statements. This new guidance on accounting for defensive intangible assets, which the Company adopted on January 1, 2009, is effective for financial statements issued for fiscal years beginning after December 15, 2008. In the first nine months of 2009, the Company did not acquire any intangible assets and its adoption of this guidance did not have a material impact on the Company s consolidated financial statements.

In April 2009, the FASB amended authoritative guidance which addresses the initial recognition, measurement and subsequent accounting for assets and liabilities arising from contingencies in a business combination, and requires that such assets acquired or liabilities assumed be initially recognized at fair value at the acquisition date if fair value can be determined during the measurement period. If the fair value as of the acquisition date cannot be determined, the asset acquired or liability assumed arising from a contingency is recognized only if certain criteria are met. This guidance also requires that a systematic and rational basis for subsequently measuring and accounting for the assets or liabilities be developed depending on their nature. This guidance is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is during or after 2010. The Company does not anticipate the adoption of this guidance to have a material impact on its future consolidated financial statements, absent any material business combinations.

In April 2009, the FASB amended existing guidance on determining whether an impairment for investments in debt securities is other than temporary. The Company adopted the revised guidance on a prospective basis beginning April 1, 2009. The application of the revised guidance did not have an impact on the Company s consolidated financial statements.

In May 2009, the FASB issued authoritative guidance establishing general standards of accounting and disclosure for events that occur subsequent to the balance sheet date but before financial statements are issued or are available to be issued, which the Company adopted on a prospective basis beginning April 1, 2009. The guidance requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date. The application of this guidance did not have an impact on the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance to improve financial reporting by enterprises involved with variable interest entities. The guidance is effective for interim and annual periods beginning after November 15, 2009, with earlier adoption permitted. The Company does not anticipate the adoption of this guidance to have a material impact on its future consolidated financial statements, absent any variable interest entities which require consolidation.

In June 2009, the FASB issued authoritative guidance establishing the Hierarchy of Generally Accepted Accounting Principles. The guidance provides for the FASB Accounting Standards Codification (the Codification) to become the single official source of authoritative, nongovernmental GAAP. The Codification did not change GAAP but reorganizes the literature. The Company adopted the guidance for the interim period ended September 30, 2009. The application of this guidance did not have a material impact on the Company s consolidated financial statements.

In August 2009, the FASB issued authoritative guidance that provides clarification for circumstances in which a quoted price in an active market for an identical liability is not available. The guidance is intended to reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. The guidance is effective for the first interim reporting period beginning after issuance. The Company does not anticipate the adoption of this guidance to have a material impact on the Company s future consolidated financial statements.

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In October 2009, the FASB issued authoritative guidance for arrangements with multiple deliverables. The guidance will allow companies to allocate arrangement consideration in multiple deliverable arrangements in a manner that better reflects the transaction s economics. The guidance also removes non-software components of tangible products and certain software components of tangible products from the scope of existing software revenue guidance. The new guidance requires expanded qualitative and quantitative disclosures and is effective for fiscal years beginning on or after June 15, 2010. Early adoption of the guidance is permitted. The Company is currently evaluating the impact of adopting this guidance on the Company s future consolidated financial statements.

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2. Supplemental Financial Information

Fair Value of Financial Instruments

The Company holds certain financial assets, including cash equivalents and marketable securities, which are required to be measured at fair value on a recurring basis. Cash equivalents include commercial paper and corporate bonds of high credit quality. Marketable securities include corporate debt and asset backed securities, are carried at amortized cost which approximates fair value and mature in one year or less. Accounting guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The following table presents the Company s fair value hierarchy for financial assets measured as of September 30, 2009 (in thousands):

	Fair Value Measurements as of September 30, 2009			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	$ 34,329	$ 34,329	$	$
Marketable securities				
Total	$ 34,329	$ 34,329	$	$

During the nine months ended September 30, 2009, no transfers were made into or out of the Level 3 category.

Inventory

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

	As of September 30, 2009	As of December 31, 2008
Work-in-process	$ 6,755	$ 7,561
Finished goods	7,312	11,132
Total inventory	$ 14,067	$ 18,693

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Property and Equipment

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

	Useful Lives (in years)	As of September 30, 2009	As of December 31, 2008
Office and laboratory equipment	5	$ 8,788	$ 8,148
Computer equipment	3 - 5	2,348	2,111
Furniture and fixtures	6 - 7	1,550	1,579
Leasehold improvements	Lease term	5,040	4,938
Licensed software	1 - 3	1,194	1,235
Construction in progress		250	125
		19,170	18,136
Accumulated depreciation		(7,413)	(5,090)
Property and equipment, net		$ 11,757	$ 13,046

Depreciation and amortization expense for the three months ended September 30, 2009 and 2008 and the nine months ended September 30, 2009 and 2008 was $829,000, $861,000, $2,547,000 and $2,375,000, respectively.

Intangible Assets

Intangible assets consisted of the following (in thousands):

	As of September 30, 2009			
	Gross	Accumulated Amortization	Impairment	Net
Developed technology	$ 24,800	$ (8,657)	$ (14,115)	$ 2,028

As of September 30, 2009, the estimated future amortization expenses of intangible assets expected to be charged to cost of net revenues for the remainder of the fiscal year ending December 31, 2009, and periods thereafter, are as follows (in thousands):

Years Ending December 31,	Cost of Net Revenues
Remainder of 2009	$ 406
2010	1,622
Total	$ 2,028

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Accrued Warranty

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

	As of September 30, 2009
Liability as of December 31, 2008	$ 348
Expirations	(386)
Accruals for warranties issued during the nine months ended September 30, 2009	327
Settlements made during the nine months ended September 30, 2009	(99)
Liability as of September 30, 2009	$ 190

Accrued Management Bonuses

The Company maintains a discretionary management bonus plan. The potential bonus payments made under the plan are based significantly on the achievement of operational, financial and business development objectives for the calendar year. As of September 30, 2009, the Company believed the achievement of certain performance targets for the management bonuses is probable. As of September 30, 2009, the Company has recorded $798,000 in expense for these bonuses.

Restructuring Activity

In March 2009, the Company implemented a restructuring plan that resulted in a reduction-in-force which impacted 55 employees worldwide. Most of the U.S. employees were terminated immediately and received severance payments upon the signing of a separation agreement. Employees in the Company s Israel and France offices were required by contract or law to receive notice period payments in addition to severance payments.

The Company believes that the statutory notice period payments given to the terminated Israel and France employees represent a one-time termination benefit since the Company is required by law to pay these employees their notice period payment as part of their termination regardless of whether they continued to work for the Company through their actual termination date. The Company s restructuring plan also included vacating certain facilities, for which the Company recorded restructuring charges related to the termination of operating leases and other contract costs as restructuring costs in the period in which the Company ceased to use rights conveyed by the applicable contract.

As a result of the March 2009 restructuring plan, the Company recorded restructuring charges of $70,000 and $2,173,000 during the three and nine months ended September 30, 2009, respectively. The Company does not expect to record additional material charges, if any, in the future with respect to the March 2009 restructuring plan.

The following table presents the Company s restructuring liability in the interim condensed consolidated balance sheets (in thousands) as of September 30, 2009:

	Operating lease commitments	Impairment of property, equipment and related expenses	Impairment of other long-term assets	Employee Separation Expenses	Total
Liability as of December 31, 2008					
Additions	6	199	2	1,966	2,173
Non-cash charges	(6)	(94)	(2)		(102)
Cash payments		(21)		(1,786)	(1,807)

Liability as of September 30, 2009	$		$	84	$		$	180	$	264

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The intangible assets associated with the acquisition of Arabella in 2007 were determined to be fully impaired as of March 31, 2009, as the core technology acquired will no longer be used in the Company s ongoing business operations and there are no future cash flows associated with this technology. The Company made a decision in March 2009 to cease use of the technology and does not have any plans to use it in future operations. As a result, an impairment charge of $208,000 was recorded in the first quarter of 2009.

In August 2008, the Company implemented a restructuring plan to improve its operating cost structure. The Company provided severance pay and other related benefits to the employees terminated as a result of this restructuring plan. The Company recorded a $209,000 restructuring charge related to this plan.

In February 2008, the Company implemented a restructuring plan to exit the operating lease for its former corporate headquarters in San Diego, California. The Company recorded a $1,069,000 restructuring charge, including $815,000 for the exited facility and $254,000 related to the impairment of property and equipment and other long-term assets.

The following table presents the Company s restructuring liability in the interim condensed consolidated balance sheets (in thousands) as of September 30, 2008:

	Operating lease commitments	Impairment of property, equipment and related expenses	Impairment of other long-term assets	Employee Separation Expenses	Total
Liability as of December 31, 2007	$	$	$	$	$
Additions	820	190	64	209	1,283
Restructuring liability adjustment	(5)				(5)
Non-cash charges		(190)	(64)		(254)
Cash payments	(815)			(190)	(1,005)
Liability as of September 30, 2008	$	$	$	$ 19	$ 19

Debt

The Company has access to a $10,000,000 revolving credit line under the terms of its Loan and Security Agreement, as amended, with Silicon Valley Bank (SVB). The Company s credit line will expire on April 21, 2010. Under the terms of this agreement, the Company may not transfer assets or collateral to, or make investments in, certain of its subsidiaries in an amount that exceeds $400,000 per month in the aggregate. In addition, the Company is required to pay SVB a fee equal to 0.25% per annum (the Unused Revolving Line Fee Percentage) of the average unused portion of the credit line on a monthly basis, in arrears, and the interest rate applicable to amounts outstanding under the credit line is at prime rate plus 0.5%. However, if the liquidity ratio is less than 1.75 to 1, then the Unused Revolving Line Fee Percentage will be increased to 0.5% per annum and the interest rate will be prime rate plus 2.0%. The amount available under the credit line cannot exceed 80% of the value of the Company s eligible accounts receivable and may be decreased by certain commitments, such as the $1,160,000 and $35,000 standby letters of credit that secure the Company s performance under its headquarters facility lease and its San Jose, California facility lease, respectively. As of September 30, 2009, there were no other amounts outstanding under the credit line and $8.8 million was available under the credit line.

Deferred Rent

The Company recognizes rent expense on a straight-line basis over the lease term and also records landlord allowances for tenant improvements as deferred rent. The deferred rent is amortized over the lease term as a reduction of rent expense. As of September 30, 2009 and December 31, 2008, there was $2,343,000 and $2,524,000, respectively, of unamortized deferred rent recorded as a component of other long-term liabilities.

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Purchase Commitments

The Company had firm purchase order commitments for the acquisition of inventory as of September 30, 2009 and December 31, 2008 of $11,725,000 and $4,303,000, respectively.

Stock-Based Compensation

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

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

Stock-based compensation expense recognized in the Company s statement of operations for the three and nine months ended September 30, 2009 and 2008, included compensation expense for stock-based options and awards granted subsequent to December 31, 2005, based on the grant date fair value. For options and awards granted during the three and nine months ended September 30, 2009 and 2008, expenses are amortized under the straight-line method. Stock-based compensation expense recognized in the statement of operations for the three and nine months ended September 30, 2009 and 2008 have been reduced for estimated forfeitures of options that are subject to vesting. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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

The Company continues to use the simplified method of accounting for stock option expense costs because it is unable to rely on its historical exercise data to provide a reasonable basis to estimate expected term due to the limited period of time its equity shares have been publicly traded. The Company uses the simplified approach on all of its grants.

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The following assumptions are used to value options and awards granted under the Company s equity incentive plans for the three and nine months ended September 30, 2009 and 2008:

	Employee Stock Options				Employee Stock Purchase Plan			
	Three Months Ended September 30,		Nine Months Ended September 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008	2009	2008	2009	2008
Expected life (years)	6.1	6.1	6.1	6.0 - 6.1	0.5 - 1.0	0.5 -1.0	0.5 - 1.0	0.0 - 1.0
Risk-free interest rate	3.15%	3.60%	2.4 - 3.18%	3.2 - 4.0%	0.16 - 0.92%	1.74 - 1.98%	0.16 - 0.92%	0.8 - 1.98%
Expected volatility	104%	68%	76 - 104%	68%	151 - 180%	77%	151 - 180%	77%
Expected dividend yield								

The following table shows total stock-based compensation expense included in the unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2009 and 2008 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Cost of net revenues	$ 41	$ 63	$ 102	$ 173
Research and development	1,006	1,834	3,524	5,421
Sales and marketing	354	647	1,048	1,881
General and administrative	797	914	2,552	2,979
	$ 2,198	$ 3,458	$ 7,226	$ 10,454

For the three months ended September 30, 2009 and 2008 and the nine months ended September 30, 2009 and 2008, the Company recorded stock-based compensation expense for non-employees of $9,000, $8,000, $18,000 and $92,000, respectively. For the three months ended September 30, 2009 and 2008 and the nine months ended September 30, 2009 and 2008, the Company recorded stock-based compensation expense for the ESPP totaling $78,000, $378,000, $337,000 and $799,000, respectively.

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

As of September 30, 2009 and 2008, the Company estimates there were $23,247,000 and $30,513,000, respectively, in total unrecognized stock-based compensation costs related to unvested employee stock option agreements, which are expected to be recognized over a weighted-average period of 3.0 and 2.9 years, respectively. As of September 30, 2009, the Company estimates there were $51,000 of unrecognized stock-based compensation costs related to the shares expected to be purchased through the ESPP, which are expected to be recognized over a weighted-average period of 4.2 months.

In May 2009, the Company completed an offer to exchange (the Offer to Exchange) certain employee stock options to purchase shares of the Company s common stock that were outstanding under the Company s 2007 Plan, 2001 Stock Option Plan and RF Magic Inc. 2001 Incentive Stock Plan on a three-for-two basis for replacement options granted under the 2007 Plan at an exercise price of $1.99 per share, which was the closing price of the Company s common stock on May 15, 2009, as reported by The NASDAQ Global Market. At the expiration of the Offer to Exchange, the Company accepted elections to exchange options to purchase 1,600,000 shares of common stock and, as a result, the Company granted replacement options to purchase 1,000,000 shares of common stock. The replacement options have new vesting schedules with vesting dates that are determined by adding an additional vesting period of 12 months, or a shorter duration upon a change of control, to each vesting date under the existing vesting schedule of the options being replaced. However, no replacement option will vest sooner than 12 months from its date of grant, unless a change of control occurs. The Company accounted for the Offer to Exchange as a modification of the original option awards. The incremental value attributed to the option awards resulted in a charge of approximately $60,000, which will be recognized over the vesting period of the new option awards.

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3. Income Taxes

The effective tax rates for the three and nine months ended September 30, 2009 were (0.7)% compared to (0.5)% and (0.7)% for the three and nine months ended September 30, 2008, respectively. The effective tax rates are expressed as negative rates because the Company recorded tax expense while in a loss position. The tax expense (benefit) related to foreign taxes during the three months ended September 30, 2009 and 2008 and nine months ended September 30, 2009 and 2008, was $9,000, $(20,000), $98,000 and $61,000, respectively. There was no tax benefit recorded for the losses during the periods since the Company has a full valuation allowance for its deferred tax assets.

On January 1, 2007, the Company adopted guidance that prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, the guidance provides clarity on de-recognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The unrecognized tax benefit was $7,293,000 as of December 31, 2008. No adjustments have been made during the nine months ended September 30, 2009 for any uncertain tax positions and the Company does not expect its unrecognized tax benefits to change significantly over the next 12 months. There were no accrued interest and penalties associated with uncertain tax positions as of September 30, 2009 or December 31, 2008. The Company does not expect any impact to its operating results should the unrecognized tax benefits become recognized given it has a full valuation allowance.

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

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4. Net Loss Per Share of Common Stock

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Numerator:				
Net loss attributable to common stockholders basic and diluted	$ (1,238)	$ (7,124)	$ (14,261)	$ (17,426)
Denominator:				
Weighted average number of common shares outstanding	70,577	68,943	70,019	68,735
Less: Restricted stock	(431)	(1,274)	(546)	(1,357)
Weighted average number of shares used in computing net loss per common share basic and diluted	70,146	67,669	69,473	67,378
Net loss per share basic and diluted				
Net loss per share attributable to common stockholders basic and diluted	$ (0.02)	$ (0.11)	$ (0.21)	$ (0.26)

As of September 30, 2009 and 2008, the Company had securities outstanding that could potentially dilute basic loss per share in the future, but that were excluded from the computation of diluted net loss per share in the periods presented as their effect would have been antidilutive. Potentially dilutive outstanding securities that were not included in the diluted net loss per share calculation consist of the following (in thousands):

	As of September 30,	
	2009	2008
Stock options outstanding	9,163	8,799
Stock reserved for issuance under put and call option agreements	35	162
Restricted stock	429	1,095
Total	9,627	10,056

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

Cash Flow

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

	Nine Months Ended September 30,	
	2009	2008
Cash paid for interest	$	$ 220

Non-Cash Activity

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

	Nine Months Ended September 30,	
	2009	2008
Currency translation	$ 85	$
Vesting of early exercised stock options	353	783
Assets assumed in connection with acquisition of Vativ Technologies, Inc., net of liabilities assumed		4,287

6. Significant Customer and Geographic Information

Customers

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

	Net Revenues				Accounts Receivable	
	Three Months Ended September 30,		Nine Months Ended September 30,		As of September 30,	
	2009	2008	2009	2008	2009	2008
Actiontec Electronics, Inc.	18%	18%	19%	21%	13%	26%
Jabil Circuit (Wuxi) Co., Ltd.	*	13	*	*	11	15
Motorola, Inc.	37	28	28	39	43	18
Westell, Inc.	*	13	*	*	*	*
Wistron NeWeb Corporation	*	*	10	*	*	11

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

Geographic Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008

Asia	92%	93%	93%	95%
Europe	1	2	2	3
United States of America	4	5	4	2
Other North America	3	*	1	*
	100%	100%	100%	100%

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

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this Quarterly Report on Form 10-Q, or Quarterly Report, and our consolidated financial statements and related notes as of and for the year ended December 31, 2008 and the related Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2008, or Annual Report, filed with the Securities and Exchange Commission, or SEC, on February 23, 2009.

Forward-Looking Statements

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

In this Quarterly Report, Entropic Communications, Inc. , Entropic Communications , Entropic , the Company , we , us and our refer to Entropic Communications, Inc. and its subsidiaries, taken as a whole, unless otherwise noted.

Overview

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

In December 2004, we introduced and commenced commercial shipments of our home networking products. In the first quarter of 2006, we began commercially shipping our broadband access solutions. Our largest acquisition to date was completed in June 2007 when we acquired RF Magic Inc., or RF Magic, a provider of digital broadcast satellite, or DBS, outdoor unit and silicon tuner solutions. Since inception, we have invested heavily in product development and have not yet achieved profitability on a quarterly or annual basis. Our revenues have grown from $41.5 million in 2006 to $122.5 million in 2007 to $146.0 million in 2008, driven primarily by demand for our home networking products. Our revenues have decreased from $116.5 million during the nine months ended September 30, 2008 to $81.2 million during the nine months ended September 30, 2009, driven primarily by softness in demand for our home networking products and a significant downturn in the overall economy.

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

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

For the nine months ended September 30, 2009, 10 customers accounted for 88% of our net revenues, with Motorola, Inc., or Motorola, Actiontec Electronics, Inc., or Actiontec, and Wistron NeWeb Corporation, or Wistron, accounting for 28%, 19% and 10%, respectively. For the nine months ended September 30, 2008, 10 customers accounted for 95% of our net revenues, with Motorola and Actiontec accounting for 39% and 21%, respectively. We expect to continue to have major concentrations of sales to a relatively small number of ODM and OEM customers.

For the nine months ended September 30, 2009, 93% of our net revenues were derived from Asia, 4% were derived from the United States, 2% were derived from Europe and 1% was derived from other North American countries. For the nine months ended September 30, 2008, 95% of our net revenues were derived from Asia, 3% were derived from Europe and 2% were derived from the United States and other North American countries. Many of our ODM and OEM customers in Asia incorporate our chipsets into products that they sell to U.S.-based service providers.

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

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

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

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Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Consolidated Statements of Operations Data:				
Net revenues	100%	100%	100%	100%
Cost of net revenues	50	55	50	55
Gross profit	50	45	50	45
Operating expenses:				
Research and development	35	43	42	37
Sales and marketing	11	13	13	11
General and administrative	8	9	10	8
Write off of in-process research and development				1
Amortization of intangible assets		2		2
Restructuring charge		1	3	1
Total operating expenses	54	68	68	60
Loss from operations	(4)	(23)	(18)	(15)
Other income, net		1		
Income tax expense				
Net loss	(4)	(22)	(18)	(15)
Net loss attributable to common stockholders	(4)%	(22)%	(18)%	(15)%

Comparison of Three and Nine Months Ended September 30, 2009 and 2008

(Tables presented in thousands, except percentage amounts)

Net Revenues

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	% Change	2009	2008	% Change
Net revenues	$ 30,958	$ 31,678	(2)%	$ 81,227	$ 116,502	(30)%

Net revenues decreased during the three months ended September 30, 2009 compared to the same period in 2008 driven primarily by a difficult economic environment where our direct OEM customers and end customers continued to maintain tight inventory levels.

Net revenues decreased during the nine months ended September 30, 2009 compared to the same period in 2008 driven primarily by softness in demand for our home networking products and a difficult economic environment where our direct OEM customers and end customers continued to maintain tight inventory levels.

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Gross Profit/Gross Margin

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% Change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% Change
Gross profit	$ 15,626	$ 14,370	9%	$ 40,790	$ 52,488	(22)%
% of net revenues	50%	45%		50%	45%	

Gross profit and gross margin were positively impacted by a reduction in intangible asset amortization in 2009. Cost of net revenues included amortization of developed technology in the amounts of $0.4 million and $1.2 million for the three and nine months ended September 30, 2009, respectively, and $1.6 million and $4.4 million for the three and nine months ended September 30, 2008, respectively. The reductions in the amortization of developed technology of $1.2 million during the three months ended September 30, 2009 compared to the same period in 2008, and $3.2 million during the nine months ended September 30, 2009 compared to the same period in 2008 were primarily driven by the impairment of our intangible assets which occurred in December 2008. As a result of the impairment, most intangible assets were written down to a net value of zero and the carrying amount of our remaining intangibles was greatly reduced, which in turn resulted in lower amortization in 2009.

More specifically, gross profit increased during the three months ended September 30, 2009 compared to the same period in 2008 driven primarily by the $1.2 million reduction in intangible asset amortization in 2009.

Gross profit decreased during the nine months ended September 30, 2009 compared to the same period in 2008 driven primarily by lower home networking product revenues for the nine months ended September 30, 2009. This decrease was primarily offset by the $3.2 million reduction in intangible asset amortization in 2009.

Gross margin increased during the three months ended September 30, 2009 compared to the same period in 2008 driven primarily by the $1.2 million reduction in intangible asset amortization in 2009. Additionally, gross margin increased from our home networking products primarily due to manufacturing costs improvements.

Gross margin increased during the nine months ended September 30, 2009 compared to the same period in 2008 driven by the $3.4 million reduction in intangible asset amortization in 2009 and our gross margin from our home networking products increased primarily due to manufacturing costs improvements.

Research and Development Expenses

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% Change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% Change
Research and development	$ 10,824	$ 13,902	(22)%	$ 34,249	$ 42,892	(20)%
% of net revenues	35%	43%		42%	37%	

The decrease in research and development expenses during the three months ended September 30, 2009, compared to the three months ended September 30, 2008, was primarily due to decreased personnel costs of $2.6 million (of which $0.8 million was due to stock-based compensation) primarily related to a 23% decrease in the number of employees engaged in research and development activities as a result of the implementation of our March 2009 restructuring plan. Other factors contributing to the decrease in research and development expense include a $0.3 million reduction in development tools and supply costs, which include outside services, masks costs and licenses that fluctuate in timing and amount from period to period, and a $0.1 million reduction in overhead allocations and depreciation, all of which resulted from a general decrease in research and development activities as a result of the March 2009 restructuring plan, including the suspension of the development of our advanced network processor architecture and an associated product which was being staffed primarily out of our Kfar Saba, Israel location.

The decrease in research and development expenses during the nine months ended September 30, 2009, compared to the nine months ended September 30, 2008, was primarily due to decreased personnel costs of $7.1 million (of which $1.9 million was due to stock-based compensation) primarily related to a 23% decrease in the number of employees engaged in research and development activities as a result of the implementation of our March 2009 restructuring plan. Other factors contributing to the decrease in research and development expense include a $0.9 million reduction in development tools and supply costs, which include outside services, masks costs and licenses that fluctuate in timing and amount from period to period, all of which resulted from a general decrease in research and development activities as a result of the March 2009 restructuring plan, including the suspension of the development of our advanced network processor architecture and an associated product which was being staffed primarily out of our Kfar Saba, Israel location.

Sales and Marketing Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	**2008**	**% Change**	**2009**	**2008**	**% Change**
Sales and marketing	$ 3,345	$ 3,991	(16)%	$ 10,377	$ 12,590	(18)%
% of net revenues	11%	13%		13%	11%	

The decrease in sales and marketing expenses for the three months ended September 30, 2009, compared to the three months ended September 30, 2008, included decreased personnel costs of $0.2 million. This decrease included approximately $0.5 million (of which $0.3 million was due to stock-based compensation) attributable to a 5% decrease in the number of employees engaged in sales and marketing activities at the end of the periods and was offset by an increase of $0.3 million in management bonuses, which was primarily due to the cancellation of the management bonus program during the three months ended September 30, 2008. The decrease in sales and marketing personnel resulted primarily from a reduction-in-force in March 2009. The remainder of the decrease in sales and marketing expenses, including decreases in travel related costs of $0.2 million, and marketing and trade show costs of $0.2 million, was primarily due to a general decrease in business activities.

The decrease in sales and marketing expenses for the nine months ended September 30, 2009, compared to the nine months ended September 30, 2008, included decreased personnel costs of $1.6 million (of which $0.8 million was due to stock-based compensation), attributable to a 5% decrease in the number of employees engaged in sales and marketing activities at the end of the periods. The decrease in sales and marketing personnel resulted primarily from a reduction-in-force in March 2009. The remainder of the decrease in sales and marketing expenses, including decreases in travel related costs of $0.3 million, marketing and trade show costs of $0.2 million and overhead allocations of $0.2 million, was primarily due to a general decrease in business activities.

General and Administrative Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	**2008**	**% Change**	**2009**	**2008**	**% Change**
General and administrative	$ 2,642	$ 2,798	(6)%	$ 8,043	$ 9,862	(18)%
% of net revenues	8%	9%		10%	8%	

The $0.2 million decrease in general and administrative expenses for the three months ended September 30, 2009, compared to the three months ended September 30, 2008 was primarily driven by a general decrease in business activities primarily attributable to a 7% decrease in the number of employees engaged in general and administrative activities at the end of the three months ended September 30, 2009 compared to the same period in 2008. The decrease in general and administrative personnel resulted primarily from a reduction-in-force in March 2009.

The $1.8 million decrease in general and administrative expenses for the nine months ended September 30, 2009, compared to the nine months ended September 30, 2008, was partly due to decreased personnel costs of $0.3 million primarily attributable to a 7% decrease in the number of employees engaged in general and administrative activities at the end of the nine months ended September 30, 2009 compared to the same period in 2008. The decrease in general and administrative personnel resulted primarily from a reduction-in-force in March 2009. The remainder of the decrease in general and administrative expenses was primarily driven by outside services of $0.7 million, legal fees of $0.4 and recruiting fees of $0.3 million, primarily due to a general decrease in business activities.

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Write Off of In-Process Research and Development

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% Change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% Change
Write off of in-process research and development	$	$	%	$	$ 1,300	(100)%
% of net revenues	%	%		%	1%	

During the nine months ended September 30, 2008, as a result of the acquisition of Vativ Technologies, Inc., or Vativ, in April 2008, we incurred a write off of in-process research and development, or IPR&D, related to Vativ s High Definition Multimedia Interface switch product.

The IPR&D was written-off on the acquisition date because the acquired technology had not yet reached technological feasibility and had no alternative future uses. A discounted cash flow approach was utilized in valuing the IPR&D. The value of the technology was the sum of the present value of projected debt-free net income, in excess of returns on requisite assets, over the economic life of the IPR&D.

Amortization of Intangibles

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% Change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% Change
Amortization of intangibles	$	$ 713	(100)%	$ 16	$ 2,022	(99)%
% of net revenues	%	2%		%	2%	

Amortization of intangible assets decreased during the three and nine months ended September 30, 2009 compared to the same periods in 2008 primarily driven by the impairment of our intangible assets which occurred in the three months ended December 31, 2008. As a result of the impairment, most intangible assets were determined to be impaired and written down to a net value of zero. The reduced carrying amount of our intangible assets resulted in lower amortization in the three and nine months ended September 30, 2009.

Restructuring Charges

In March 2009, we implemented a restructuring plan that resulted in a reduction-in-force which impacted 55 employees worldwide. Most of the U.S. employees were terminated immediately and received severance payments upon the signing of a separation agreement. Employees in our Israel and France offices were required by contract or law to receive notice period payments in addition to severance payments.

We believe that the statutory notice period payments given to the terminated Israel and France employees represent a one-time termination benefit since we are required by law to pay these employees their notice period payment as part of their termination regardless of whether they continued to work for us through their actual termination date. Our restructuring plan also included vacating certain facilities, for which we record restructuring charges related to the termination of operating leases and other contract costs as restructuring costs in the period in which we cease to use rights conveyed by the applicable contract.

As a result of our March 2009 restructuring plan, we recorded restructuring charges of $0.1 million and $2.2 million during the three and nine months ended September 30, 2009, respectively. We do not expect to record additional material charges, if any, in the future with respect to the March 2009 restructuring plan.

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The following table presents our restructuring liability in the consolidated balance sheets (in thousands) as of September 30, 2009:

	Operating lease commitments	Impairment of property, equipment and related expenses	Impairment of other long-term assets	Employee Separation Expenses	Total
Liability as of December 31, 2008					
Additions	6	199	2	1,966	2,173
Non-cash charges	(6)	(94)	(2)		(102)
Cash payments		(21)		(1,786)	(1,807)
Liability as of September 30, 2009	$	$ 84	$	$ 180	$ 264

The intangible assets associated with the acquisition of Arabella Software, Ltd. in 2007 were determined to be fully impaired as of March 31, 2009, as the core technology acquired will no longer be used in our ongoing business operations and there are no future cash flows associated with this technology. We made a decision in March 2009 to cease use of the technology and we do not have any plans to use it in future operations. As a result, an impairment charge of $0.2 million was recorded in the first quarter of 2009.

In August 2008, we implemented a restructuring plan to improve our operating cost structure. We provided severance pay and other related benefits to the employees terminated as a result of this restructuring plan. We recorded a $209,000 restructuring charge related to this plan.

In February 2008, we implemented a restructuring plan to exit the operating lease for our former corporate headquarters in San Diego, California. We recorded a $1,069,000 restructuring charge, including $815,000 for the exited facility and $254,000 related to the impairment of property and equipment and other long-term assets.

The following table presents our restructuring liability in the consolidated balance sheets (in thousands) as of September 30, 2008:

	Operating lease commitments	Impairment of property, equipment and related expenses	Impairment of other long-term assets	Employee Separation Expenses	Total
Liability as of December 31, 2007	$	$	$	$	$
Additions	820	190	64	209	1,283
Restructuring liability adjustment	(5)				(5)
Non-cash charges		(190)	(64)		(254)
Cash payments	(815)			(190)	(1,005)
Liability as of September 30, 2008	$	$	$	$ 19	$ 19

Liquidity and Capital Resources

As of September 30, 2009 and December 31, 2008, we had cash and cash equivalents of $34.3 million and $30.1 million, respectively, and marketable securities of $0 million and $4.3 million, respectively.

We have access to a $10 million revolving credit line under the terms of our Loan and Security Agreement, as amended, with SVB. Our credit line will expire on April 21, 2010. Under the terms of this agreement, we are restricted from the ability to transfer assets or collateral to, or make investments in, certain of our subsidiaries in an amount that exceeds $400,000 per month in the aggregate. In addition, we are required to pay SVB a fee equal to 0.25% per annum, or the Unused Revolving Line Fee Percentage, of the average unused portion of the credit line on a monthly basis, in arrears, and the interest rate applicable to amounts outstanding under the credit line is at prime rate plus 0.5%. However, if the liquidity ratio is less than 1.75 to 1, then the Unused Revolving Line

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Fee Percentage will be increased to 0.5% per annum and the interest rate will be prime rate plus 2.0%. The amount available under the credit line cannot exceed 80% of the value of our eligible accounts receivable and may be decreased by certain commitments, such as the $1,160,000 and $35,000 standby letters of credit that secure our performance under our headquarters facility lease and our San Jose facility lease, respectively. As of September 30, 2009, there were no other amounts outstanding under the credit line and $8.8 million was available under the credit line.

The following table shows our cash flows from operating activities, investing activities and financing activities for the nine months ended September 30, 2009 and 2008 (in thousands):

	Nine Months Ended September 30,	
	2009	2008
Net cash provided by (used in) operating activities	$ 96	$ (3,161)
Net cash provided by (used in) investing activities	2,987	(15,749)
Net cash provided by (used in) financing activities	1,175	(7,321)
Total increase (decrease) in cash and cash equivalents	$ 4,258	$ (26,231)

Cash Flows from Operating Activities

Net cash provided by operating activities was $0.1 million for the nine months ended September 30, 2009, primarily resulting from a net loss of $14.3 million and an increase in accounts receivable of $1.7 million due to an increase of sales during the third quarter of 2009, offset by $7.2 million in stock compensation expenses, a $4.6 million decrease in inventory primarily due to reduction of our inventory that was built in 2008 in preparation for the ramp of our Channel Stacking Switch product into the DIRECTV deployment, as well as increased demand for our MoCA products mainly related to our Verizon FiOS deployment at September 30, 2009, and $3.8 million in depreciation and amortization expenses, including $1.2 million attributable to amortization of developed technology.

Our operating activities used $3.2 million of cash in the nine months ended September 30, 2008. Cash flow used in operating activities for the nine months ended September 30, 2008 resulted primarily from a net loss of $17.4 million, a $6.9 million increase in inventory primarily due to our inventory build in preparation for the ramp of our Channel Stacking Switch product into the DIRECTV deployment, as well as from softness in demand for our MoCA products mainly related to our Verizon FiOS deployment and a $7.0 million decrease in accounts payable and other short-term liabilities driven primarily by a decrease in inventory. These changes were partially offset by a decrease in accounts receivable of $4.8 million primarily driven by a decrease in sales during the three months ended September 30, 2008, stock-based compensation of $10.5 million, depreciation and amortization of $8.8 million, primarily due to the RF Magic acquisition, including $4.4 million attributable to amortization of developed technology, a $1.3 million increase in other long-term liabilities related to deferred rent for our new leased facilities in San Diego, California, a $1.3 million non-cash IPR&D charge resulting from the Vativ acquisition and a $0.7 million decrease in prepaid expenses.

Cash Flows from Investing Activities

Net cash provided by investing activities was $3.0 million for the nine months ended September 30, 2009, primarily due to $4.3 million sales of marketable securities offset by $1.3 million purchases of property and equipment primarily consisting of operations and research and development equipment.

We used $15.7 million of cash for investing activities during the nine months ended September 30, 2008. Our increase in cash available for investing activities resulted primarily from the net proceeds received from the sale of our common stock upon the completion of our IPO in December 2007. Our investing activities primarily consisted of the net $3.9 million purchases and maturities of marketable securities, $5.7 million purchases of property and equipment mainly consisting of tenant improvements and equipment for our currently leased facilities in San Diego, California and $6.1 million used in the acquisition of Vativ in April 2008.

Cash Flows from Financing Activities

Net cash provided by financing activities was $1.2 million for the nine months ended September 30, 2009, due primarily to proceeds from the issuance of common stock in connection with stock option exercises and stock purchases made under our 2007 Employee Stock Purchase Plan, or the ESPP.

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Our financing activities used cash of $7.3 million in the nine months ended September 30, 2008 which was primarily driven by the payoff of outstanding debt in the amount of $8.9 million. This amount was offset by cash provided by the $1.9 million net proceeds from warrant exercises and purchase of common stock, primarily under the ESPP.

We expect to experience an increase in our operating expenses in absolute dollars, particularly in research and development expenses, but also in sales and marketing, and general and administrative expenses, for the foreseeable future in order to execute our business strategy and to support our growth. As a result, we anticipate that operating expenses, as well as planned capital expenditures, will constitute a material use of our cash resources.

We believe that our cash, cash equivalents and marketable securities of $34.3 million, together with the $8.8 million available to us under our existing credit line as of September 30, 2009, will be sufficient to fund our projected operating requirements for at least the next 12 months. We intend to continue spending substantial amounts in connection with the growth of our business and we may need to obtain additional financing to pursue our business strategy, develop new products, respond to competition and market opportunities, and acquire complementary businesses or technologies. We may not be able to obtain such financing on favorable terms or at all. If we were to raise additional capital through further sales of our equity securities, our stockholders would suffer dilution of their equity ownership. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, prohibit us from paying dividends, repurchasing our stock or making investments and force us to maintain specified liquidity or other ratios, any of which could harm our business, operating results and financial condition.

Indemnities

In the ordinary course of business, we have entered into agreements with customers that include indemnity provisions. Based on historical experience and information known as of September 30, 2009, we have not recorded any indemnity obligations.

In 2007 and 2008, we were contacted by Motorola requesting that we indemnify Motorola against claims that third parties might amend ongoing patent infringement actions against Motorola to add allegations that products sold by Motorola which incorporate our products infringe one or more of the third parties patents. No particular amounts of indemnity have been sought by Motorola. We are in the process of evaluating Motorola s requests for indemnity and the underlying potential third-party claims regarding Motorola s products that incorporate our products. At the present time, we are unable to predict the ultimate outcome of these matters.

Off-Balance Sheet Arrangements

During the periods presented, we did not have, nor do we currently have, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and the results of operations are based on our financial statements which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies are discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and there have been no material changes to such policies.

Recent Accounting Pronouncements

In December 2007, the FASB revised the authoritative guidance for business combinations, which establishes the principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008. The impact of this guidance on our consolidated financial statements will ultimately depend on the terms of any future business transactions.

On February 6, 2008, the FASB issued guidance for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in issued financial statements on a recurring basis. This guidance is effective for financial statements issued for fiscal years beginning after November 15, 2008. We do not believe this guidance will have any material impact on our future consolidated financial statements.

In March 2008, the FASB issued authoritative guidance which requires enhanced disclosure related to derivatives and hedging activities to improve the transparency of financial reporting. In accordance with this guidance, entities are required to provide enhanced disclosures relating to: (i) how and why an entity uses derivative instruments; (ii) how an entity accounts for derivative instruments and related hedge items; and (iii) how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. This guidance must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items, and for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008. At this time, we do not invest in derivative instruments or hedging activities, and accordingly, the adoption of this guidance will have no impact on our future consolidated financial statements unless we invest in derivative instruments or engage in hedging activities in the future, if ever.

In June 2008, the FASB reached a consensus on the determination of whether an instrument (or embedded feature) is indexed to an entity s own stock, which became effective for fiscal years beginning after December 15, 2008. The guidance requires companies to adopt a two-step approach, separately evaluating the instrument s contingent exercise provisions first and the instrument s settlement provisions second. This consensus did not have a material impact on our consolidated financial statements.

In November 2008, the FASB ratified authoritative guidance on accounting for defensive intangible assets that are acquired in a business combination. Defensive intangible assets are assets that an entity does not intend to use actively but intends to hold to prevent its competitors from obtaining access to them. As these assets are separately identifiable, the guidance requires an acquiring entity to account for defensive intangible assets as a separate unit of accounting which should be amortized to expense over the period in which such assets diminish in value. Defensive intangible assets must be recognized at fair value in accordance with authoritative guidance that establishes the principles and requirements for how the acquirer of a business recognizes and measures the identifiable assets acquired in its financial statements. This new guidance on accounting for defensive intangible assets, which we adopted on January 1, 2009, is effective for financial statements issued for fiscal years beginning after December 15, 2008. In the first nine months of 2009, we did not acquire any intangible assets and our adoption of this guidance did not have a material impact on our consolidated financial statements.

In April 2009, the FASB amended authoritative guidance which addresses the initial recognition, measurement and subsequent accounting for assets and liabilities arising from contingencies in a business combination, and requires that such assets acquired or liabilities assumed be initially recognized at fair value at the acquisition date if fair value can be determined during the measurement period. If the fair value as of the acquisition date cannot be determined, the asset acquired or liability assumed arising from a contingency is recognized only if certain criteria are met. This guidance also requires that a systematic and rational basis for subsequently measuring and accounting for the assets or liabilities be developed depending on their nature. This guidance is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is during or after 2010. We do not anticipate the adoption of this guidance to have a material impact on our future consolidated financial statements, absent any material business combinations.

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In April 2009, the FASB amended existing guidance on determining whether an impairment for investments in debt securities is other than temporary. We adopted the revised guidance on a prospective basis beginning April 1, 2009. The application of the revised guidance did not have an impact on our financial statements.

In May 2009, the FASB issued authoritative guidance establishing general standards of accounting and disclosure for events that occur subsequent to the balance sheet date but before financial statements are issued or are available to be issued, which we adopted on a prospective basis beginning April 1, 2009. The guidance requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date. The application of this guidance did not have an impact on our consolidated financial statements.

In June 2009, the FASB issued authoritative guidance to improve financial reporting by entities involved with variable interest entities. The guidance is effective for interim and annual periods beginning after November 15, 2009, with earlier adoption permitted. We do not anticipate the adoption of this guidance to have a material impact on our future consolidated financial statements, absent any variable interest entities which require consolidation.

In June 2009, the FASB issued authoritative guidance establishing the Hierarchy of Generally Accepted Accounting Principles. The guidance provides for the Codification, to become the single official source of authoritative, nongovernmental U.S. GAAP. The Codification did not change GAAP but reorganizes the literature. We adopted the guidance for the interim period ended September 30, 2009. The application of this guidance did not have a material impact on our consolidated financial statements.

In August 2009, the FASB issued authoritative guidance that provides clarification for circumstances in which a quoted price in an active market for an identical liability is not available. The guidance is intended to reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. The guidance is effective for the first interim reporting period beginning after issuance. We do not anticipate the adoption of this guidance to have a material impact on our future consolidated financial statements.

In October 2009, the FASB issued authoritative guidance for arrangements with multiple deliverables. The guidance will allow companies to allocate arrangement consideration in multiple deliverable arrangements in a manner that better reflects the transaction s economics. The guidance also removes non-software components of tangible products and certain software components of tangible products from the scope of existing software revenue guidance. The new guidance requires expanded qualitative and quantitative disclosures and is effective for fiscal years beginning on or after June 15, 2010. Early adoption of the guidance is permitted. We are currently evaluating the impact of adopting this guidance on our future consolidated financial statements.

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Item 3. ***Quantitative and Qualitative Disclosures About Market Risk.***

Foreign Currency Risk

Our sales have been historically denominated in U.S. dollars and an increase in the value of U.S. dollar relative to the currencies of the countries in which our customers operate could materially affect the demand of our non-U.S. customers for our products, leading to a reduction in orders placed by these customers, which would adversely affect our business. Our international sales and marketing operations incur expenses that are denominated in foreign currencies. These expenses could be materially affected by currency fluctuations; however, we do not consider this currency risk to be material as the related costs do not constitute a significant portion of our total spending. We outsource our wafer manufacturing, assembly, testing, warehousing and shipping operations; however all expenses related thereto are denominated in U.S. dollars. If the value of the U.S. dollar decreases relative to the currencies of the countries in which such contractors operate, the prices we are charged for their services may increase, which would adversely affect our business. Currently, we have not implemented any hedging strategies to mitigate risks related to the impact of fluctuations in currency exchange rates.

Interest Rate Risk

We maintain an investment portfolio of various holdings, types and maturities. We do not use derivative financial instruments. We place our cash investments in deposits and money market funds with major financial institutions, U.S. government obligations and debt securities of corporations with strong credit ratings in a variety of industries that meet high credit quality standards, as specified in our investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issue, issuer or type of instrument.

Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of September 30, 2009, the carrying value of our cash and cash equivalents approximated fair value. A change in market interest rates of 1.0% on an annualized basis would have impacted our net income from these investments by less than $0.1 million for the three months ended September 30, 2009.

Marketable Securities Risk

Our marketable securities, consisting of U.S. Treasury and agency obligations, commercial paper, corporate notes and bonds, time deposits, foreign notes and certificates of deposits, are generally classified as held-to-maturity and are stated at cost, adjusted for amortization of premiums and discounts to maturity. In the past, certain of our short-term marketable securities were classified as available-for-sale and were stated at fair value, which was equal to cost due to the short-term maturity of these securities. In the event that there were to be a difference between fair value and cost in any of our available-for-sale securities, unrealized gains and losses on these investments would be reported as a separate component of accumulated other comprehensive income (loss).

Our investment policy for marketable securities requires that all securities mature in two years or less, with a weighted average maturity of no longer than 12 months. As of September 30, 2009, we did not carry any marketable securities. When we do invest in marketable securities, the fair value of our marketable securities will fluctuate based on changes in market conditions and interest rates and will be affected by the credit condition of the U.S. financial sector. Absent the unprecedented turmoil and upheaval in the U.S. financial sector, given the short-term maturities of our marketable securities, we do not believe these instruments will be subject to significant market or interest rate risk. However, the current unstable credit environment of the U.S. financial sector may lead us to incur significant realized, unrealized or impairment losses associated with our future investments.

Investments in fixed rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their market value adversely impacted due to rising interest rates. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates.

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Item 4. ***Controls and Procedures.***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports filed with the SEC are recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and no evaluation of controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, prior to filing this Quarterly Report, we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this Quarterly Report. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report.

An evaluation was also performed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of any change in our internal control over financial reporting that occurred during our fiscal quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. That evaluation did not identify any change in our internal control over financial reporting that occurred during our fiscal quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1A. *Risk Factors*

Investing in our common stock involves a high degree of risk. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described below in addition to the other cautionary statements and risks described, and the other information contained, elsewhere in this Quarterly Report, in our Annual Report and in our other filings with the SEC. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs, our business, financial condition, results of operations and/or liquidity could be seriously harmed. In that event, the trading price of our common stock could decline, and you could lose some or all of your investment.

The risk factors set forth below with an asterisk (*) next to the title are new risk factors or risk factors containing changes from the risk factors previously disclosed in our Annual Report.

Risks Related to Our Business

We have a history of losses and may not achieve or sustain profitability in the future.*

We have never been profitable on any quarterly or annual basis. We incurred net losses attributable to common stockholders of $136.4 million, $32.1 million and $7.2 million for the years ended December 31, 2008, 2007 and 2006, respectively. For the three and nine months ended September 30, 2009, we incurred a net loss attributable to common stockholders of $1.2 million and $14.3 million, respectively. As of September 30, 2009, we had an accumulated deficit of $242.9 million. Accordingly, there can be no assurance if or when we may achieve profitability. You should not rely on our operating results for any prior quarterly or annual periods as an indication of our future operating performance. Moreover, we expect to make significant expenditures related to the development of our products and the expansion of our business, including research and development, sales and marketing, and general and administrative expenses. We also incur significant legal, accounting and other expenses related to our status as a public company. Additionally, we may encounter unforeseen difficulties, complications, product delays or other unknown factors that may require additional expenditures, or unforeseen difficulties or costs associated with the integration of acquired assets or businesses. As a result of these expenditures, we may have to generate and sustain substantially increased revenue to achieve profitability. If we are unable to achieve adequate revenue growth, we may not achieve or sustain profitability and our stock price could decline.

We face intense competition and expect competition to increase in the future, with many of our competitors being larger, more established and better capitalized than we are.*

The markets for our products are extremely competitive and have been characterized by rapid technological change, evolving industry standards, rapid changes in customer requirements, short product life cycles and frequent introduction of next generation and new products, as well as competing technologies. This competition could make it more difficult for us to sell our products, and result in increased pricing pressure, reduced gross profit as a percentage of revenues or gross margins, increased sales and marketing expenses and failure to increase or the loss of market share or expected market share. Semiconductor products in particular have a history of declining prices driven by customer insistence on lower prices as the cost of production is reduced and as demand falls when competitive products or newer, more advanced products are introduced. If market prices decrease faster than product costs, our gross margins and operating margins would be adversely affected. Moreover, we expect increased competition from other established and emerging companies both domestically and internationally. In particular, we expect to face future competition in the sale of MoCA-compliant chipsets. For example, Broadcom Corporation, or Broadcom, has recently announced the availability of engineering samples of several multi-format video decoded system-on-a-chip solutions with integrated MoCA functionality and that Broadcom s home networking reference design platform has achieved MoCA 1.0 and MoCA 1.1 certification from the MoCA certification board. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties. If so, competitors or alliances that include our competitors may emerge that could acquire significant market share. We expect these trends to continue as companies attempt to strengthen or maintain their market positions in an evolving industry. In addition, our competitors could develop products or technologies that cause our products and technologies to become non-competitive or obsolete, or cause us to reduce substantially our prices.

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Currently, we face competition from a number of established companies that offer products based on competing technologies, such as Data over Cable Service Interface Specifications, versions of Digital Subscriber Line, Ethernet, HomePNA, HomePlug AV, Wi-Fi, WiMedia, which is based on ultra-wide band technology, and WiMAX, also known as Worldwide Interoperability for Microwave Access. The adoption of remote storage digital video recorders, or DVRs, could also replace the need for in-home storage of home media, which, in turn, may replace or reduce the need for home networking applications such as multi-room DVRs for which some of our products are designed. Many of our competitors and potential competitors are substantially larger and have longer operating histories, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than we. Given their capital resources, many of these larger organizations are in a better position to withstand any significant reduction in capital spending by customers or market downturns in the markets in which we compete. Many of our competitors also have broader product lines and market focus, allowing them to bundle their products and services and effectively use other products to subsidize lower prices for those products that compete with ours or to provide integrated product solutions that offer cost advantages to customers. In addition, many of our competitors have been in operation much longer than we and therefore have better name recognition and more long-standing and established relationships with service providers, ODMs and OEMs.

Our ability to compete depends on a number of factors, including:

- the adoption of our products and technologies by service providers, ODMs and OEMs;
- the performance and cost effectiveness of our products relative to our competitors products;
- our ability to deliver high quality and reliable products in large volumes and on a timely basis;
- our ability to build close relationships with service providers, ODMs and OEMs;
- our success in developing and utilizing new technologies to offer products and features previously not available in the marketplace that are technologically superior to those offered by our competitors;
- our ability to identify new and emerging markets and market trends;
- our ability to recruit design and application engineers and other technical personnel;
- our ability to protect our intellectual property and obtain licenses to the intellectual property of others on commercially reasonable terms; and
- availability of substitute goods offered at a lower price than ours.

Our inability to address any of these factors effectively, alone or in combination with others, could seriously harm our business, operating results and financial condition.

In addition, consolidation by industry participants or acquisitions of our competitors by our customers or suppliers could result in competitors with increased market share, larger customer bases, greater diversified product offerings and greater technological and marketing expertise, which would allow them to compete more effectively against us. Current and potential competitors may also gain such competitive advantages by establishing financial or strategic relationships with existing or potential customers, suppliers or other third-parties. These new competitors or alliances among competitors could emerge rapidly and acquire significant market share. In addition, some of our suppliers and customers offer or may offer products that compete with our products. Depending on the participants, industry consolidation or the formation of strategic relationships could have a material adverse effect on our business and results of operations by reducing our ability to compete successfully in our current markets and the markets we are seeking to serve.

We depend on a limited number of customers, and ultimately service providers, for a substantial portion of our revenues, and the loss of, or a significant shortfall in, orders from any of these parties could significantly impair our financial condition and results of operations.*

We derive a substantial portion of our revenues from a limited number of customers. For example, during the nine months ended September 30, 2009, 10 customers accounted for 88% of our revenues. During the nine months ended September 30, 2009, Motorola, Actiontec and Wistron accounted for 28%, 19% and 10%, respectively, of our revenues. Our inability to generate anticipated revenues from our key existing or targeted customers, or a significant shortfall in sales to these customers would significantly reduce our revenues and adversely affect our operating results. Our operating results in the foreseeable future will continue to depend on our ability to effect sales to existing and other large customers.

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In addition, we depend on a limited number of service providers that purchase products from our customers. To date, only a limited number of major service providers, such as Verizon, Time Warner Cable Inc., or Time Warner, Cox Communications, Inc., or Cox, and Bright House Networks LLC, or BHN, have publicly announced their intentions to use the MoCA standard for home networking. We also primarily rely on two major service providers, DISH and DIRECTV, to deploy products using our digital broadcast satellite outdoor unit solutions. During the nine months ended September 30, 2009 and the year ended December 31, 2008, products sold to our customers that were incorporated into products purchased by Verizon, DISH and DIRECTV accounted for substantially all of our revenues. If these service providers, or other service providers that elect to use our products, reduce or eliminate purchases of our customers products which incorporate our products, this would significantly reduce our revenues and adversely affect our operating results. Due to weakness in the current economic outlook, some service providers may reduce or delay spending or taking delivery of our customers products which incorporate our products to respond to rapidly changing economic conditions. This may lead to an inventory build up by our customers who may, in turn, reschedule taking delivery of our products or wait to clear their existing inventory before ordering more products from us, which, in turn, may adversely affect our operating results. Our operating results in the foreseeable future will continue to depend on a limited number of service providers demand for products which incorporate our products.

We may have conflicts with our customers or the service providers that purchase products from our customers that incorporate our products. Any such conflict could result in events that have a negative impact on our business, including:

- reduced purchases of our products or our customers products that incorporate them;
- uncertainty regarding ownership of intellectual property rights;
- litigation or the threat of litigation; or
- settlements or other business arrangements imposing obligations on us or restrictions on our business, including obligations to license intellectual property rights or make cash payments.

If we fail to develop and introduce new or enhanced products on a timely basis, our ability to attract and retain customers could be impaired, and our competitive position may be harmed.

To compete successfully, we must design, develop, market and sell new or enhanced products that provide increasingly higher levels of performance and reliability and meet the cost expectations of our customers. The introduction of new products by our competitors, the market acceptance of products based on new or alternative technologies, or the emergence of new industry standards could render our existing or future products obsolete. Our failure to anticipate or timely develop new or enhanced products or technologies in response to technological shifts could result in decreased revenues and an increase in design wins by our competitors. In particular, we may experience difficulties with product design, manufacturing, marketing or certification that could delay or prevent our development, introduction or marketing of new or enhanced products. If we fail to introduce new or enhanced products that meet the needs of our customers or penetrate new markets in a timely fashion, we will lose market share and our operating results will be adversely affected.

Our results could be adversely affected if our customers or the service providers who purchase their products are unable to successfully compete in their respective markets.

Our customers and the service providers that purchase products from our customers face significant competition from their competitors. We rely on these customers and service providers ability to develop products and/or services that meet the needs of their customers in terms of functionality, performance, availability and price. If these customers and service providers do not successfully compete, they may lose market share, which would negatively impact the demand for our products. For example, for our home networking products, there is intense competition among service providers to deliver video and other multimedia content into and throughout the home. For the sale of our home networking products, we are currently dependent on Verizon s ability to compete in the market for the delivery of HD video and other multimedia content. Therefore, factors influencing Verizon s ability to compete in this market, such as laws and regulations regarding local cable franchising, could have an adverse effect on our current ability to sell home networking products. In addition, our digital broadcast satellite outdoor unit products are primarily supplied to digital

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broadcast satellite service providers by our ODM and OEM customers. Digital broadcast satellite service providers are facing significant competition from telecommunications carriers and cable multiple service operators as they compete for customers in terms of video, voice and data services. Moreover, ODMs and OEMs who market satellite set-top boxes using our silicon tuners are competing with a variety of internet protocol-based video delivery solutions, including versions of Digital Subscriber Line technology and certain fiber optic-based solutions. Many of these technologies compete effectively with satellite set-top boxes and do not require tuners such as the ones we sell. If our customers and the service providers who purchase products from our customers that incorporate our products do not successfully compete, they may lose market share, which would reduce their demand for our products.

If the market for HD video and other multimedia content delivery solutions based on the MoCA standard does not develop as we anticipate, our revenues may decline or fail to grow, which would adversely affect our operating results.*

We derive, and expect to continue to derive for the foreseeable future, a significant portion of our revenues from sales of our home networking products based on the MoCA standard. The market for such multimedia content delivery solutions based on the MoCA standard is relatively new, still evolving and difficult to predict. For example, while service providers are currently deploying products based on the MoCA 1.0 and MoCA 1.1 standard, MoCA is currently working on a new version of the standard, MoCA 2.0. It is uncertain when products based on the MoCA 2.0 standard will be available or how quickly service providers will begin to deploy such products. It is uncertain whether the MoCA standard will achieve and sustain high levels of demand and market acceptance. We believe our primary competition in this market currently comes from companies that offer products based on non-MoCA home networking solutions, such as Ethernet, HomePNA, Home Plug AV, Wi-Fi and WiMedia, but we expect products from Broadcom will begin to compete with our MoCA home networking chips in the next 12 months and we expect other semiconductor manufacturers to compete with us in the manufacture and sale of MoCA-compliant chipsets in the future. Moreover, deployment of services or electronic devices utilizing MoCA-based solutions may be delayed or slower than we anticipate. If the market for MoCA-based solutions does not continue to develop or develops more slowly than we expect, or if we make errors in predicting adoption and deployment rates for these solutions, our revenues may be significantly adversely affected.

Our success will depend to a substantial extent on the willingness of service providers, ODMs and OEMs to adopt the MoCA standard for multimedia content delivery. As of September 30, 2009, only a limited number of major service providers, such as Verizon, Time Warner, Cox and BHN had publicly announced their intentions to use the MoCA standard for home networking. Some service providers, ODMs and OEMs have adopted and others may adopt multimedia content delivery solutions that rely on technologies other than the MoCA standard or may choose to wait for the introduction of products and technologies that serve as a replacement or substitute for, or represent an improvement over, MoCA-based solutions. It is critical to our success that additional service providers, including telecommunications carriers, digital broadcast satellite service providers and cable operators, adopt the MoCA standard for home networking.

Even if service providers, ODMs and OEMs adopt multimedia content delivery solutions based on the MoCA standard, we may not compete successfully in the market for MoCA-compliant chipsets.

As a member of MoCA, we are required to license any of our patent claims that are essential to implement the MoCA specifications to other MoCA members on reasonable and non-discriminatory terms. As a result, we are required to license some of our important intellectual property to other MoCA members, including other semiconductor manufacturers that may compete with us in the sale of MoCA-compliant chipsets. If we are unable to differentiate our MoCA-compliant chipsets from other MoCA-compliant chipsets by offering superior pricing and features outside MoCA specifications, we may not be able to compete effectively in the market for such chipsets. Moreover, although we are currently and actively involved in the ongoing development of the MoCA standard, we cannot guarantee that future MoCA specifications will incorporate technologies or product features we are developing or that our products will be compatible with future MoCA specifications. As additional members, including our competitors, continue to join MoCA, they and existing members may exert greater influence on MoCA and the development of the MoCA standard in a manner that is adverse to our interests. If our home networking products fail to comply with future MoCA specifications, the demand for these products could be severely reduced.

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The semiconductor and communications industries have historically experienced cyclical behavior and prolonged downturns, which could impact our operating results, financial condition and cash flows.*

The semiconductor and communications industries, which have historically exhibited cyclical behavior, are both currently experiencing industry downturns and are likely to experience recessionary periods in the future. The economic turmoil that has arisen in the credit markets has had an adverse effect on the ability of businesses to obtain short and long term funding for working capital and has caused a rapid deterioration of the global economic conditions. As a result, some service providers, OEMs and ODMs may slow down their research and development activities, cancel or delay new product development, reduce their inventories and/or take a cautious approach to acquiring products, which may lead to a significant negative impact to our business. Because a significant portion of our expenses is fixed in the near term or is incurred in advance of anticipated sales, we may not be able to decrease our expenses rapidly enough to offset any unanticipated shortfall in revenues during industry downturns, which could adversely affect our operating results.

Even during periods of increased demand and industry growth, we may experience production constraints which could limit our ability to produce sufficient quantities of our products to meet the increased demand. We may also have difficulty in obtaining sufficient manufacturing, assembly and test resources from our manufacturers. Any factor adversely affecting either the semiconductor or communications industry in general, or the particular segments of any of these industries that our products target, may adversely affect our ability to generate revenue and could negatively impact our operating results, cash flow and financial condition. In addition, our operating results may also fluctuate significantly from period to period as we adjust our inventory and production requirements to meet the changing demands of our customers during this period and in the future, which may increase the volatility of the price of our stock.

Our operating results may be harmed if our restructuring plans do not achieve the anticipated results or cause undesirable consequences.*

In the last 12 months, we have implemented restructuring plans which resulted in us reducing our workforce by a total of 55 individuals. These restructuring plans may yield unintended consequences, such as attrition beyond our intended reduction in workforce and reduced employee morale, which may cause our employees who were not affected by the reduction in workforce to seek alternate employment. Additional attrition could impede our ability to meet our operational goals, which could have a material adverse effect on our financial performance. In addition, as a result of the reductions in our workforce, we face an increased risk of employment litigation. Furthermore, employees whose positions were eliminated in connection with these restructuring plans may seek future employment with our competitors. Although all our employees are required to sign a confidentiality agreement with us at the time of hire, we cannot assure you that the confidential nature of our proprietary information will be maintained in the course of such future employment. We cannot assure you that we will not undertake additional restructuring activities, that any of our restructuring efforts will be successful, or that we will be able to realize the cost savings and other anticipated benefits from our previous or any future restructuring plans. In addition, if we continue to reduce our workforce, it may adversely impact our ability to respond rapidly to any new growth or revenue opportunities.

Our operating results have fluctuated significantly in the past and we expect them to continue to fluctuate in the future, which could lead to volatility in the price of our common stock.

Our operating results have fluctuated in the past and are likely to continue to fluctuate, on an annual and a quarterly basis, as a result of a number of factors, many of which are outside of our control. These fluctuations in our operating results may cause our stock price to fluctuate as well. The primary factors that are likely to affect our quarterly and annual operating results include:

- changes in demand for our products or those offered by service providers and our customers;
- the timing and amount of orders, especially from significant service providers and customers;
- the seasonal nature of our sales;
- the level and timing of capital spending of service providers, both in the United States and in international markets;

competitive market conditions, including pricing actions by us or our competitors;

adverse market perception of MoCA-compliant products;

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our unpredictable and lengthy sales cycles;

the mix of products and product configurations sold;

our ability to successfully define, design and release new products on a timely basis that meet customers or service providers needs;

costs related to acquisitions of complementary products, technologies or businesses;

new product introductions and enhancements, or the market anticipation of new products and enhancements, by us or our competitors;

the timing of revenue recognition on sales arrangements, which may include multiple deliverables, and the effect of our use of inventory hubbing arrangements;

unexpected changes in our operating expenses;

general economic conditions (including the current industry and economic downturn) and political conditions in the countries where we operate or our products are sold or used;

our ability to attain and maintain production volumes and quality levels for our products, including adequate allocation of wafer, assembly and test capacity for our products by our subcontractors;

our customers ability to obtain other components needed to manufacture their products;

the cost and availability of components and raw materials used in our products, including, without limitation, increases in the price of gold;

changes in manufacturing costs, including wafer, test and assembly costs, manufacturing yields and product quality and reliability;

productivity of our sales and marketing force;

our inability to reduce operating expenses in a particular quarter if revenues for that quarter fall below expectations;

future accounting pronouncements and changes in accounting policies;

costs associated with litigation; and

- changes in domestic and international regulatory environments.

Unfavorable changes in any of the above factors, many of which are beyond our control, could significantly harm our business and results of operations. You should not rely on the results of prior periods as an indication of our future performance.

Adverse U.S. and international economic conditions have affected and may continue to adversely affect our revenues, margins and profitability.*

Since September 2008, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. These events, together with the current adverse economic conditions facing the broader economy and, in particular, the semiconductor and communications industries, have, and may continue to adversely affect our business as service providers cut back or delay deployments that include our products and to the extent that consumers decrease their discretionary spending for enhanced video offerings from service providers, which may in turn lead to cautious or reduced spending by service providers and, in turn, may lead to a decrease in orders for our products, thereby adversely affecting our operating results.

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We may also experience adverse conditions in our cost base due to changes in foreign currency exchange rates that reduce the purchasing power of the U.S. dollar, increase research and development expenses and other factors. These conditions may harm our margins and prevent us from achieving or sustaining profitability if we are unable to increase the selling prices of our products or reduce our costs sufficiently to offset the effects of effective increases in our costs. Our attempts to offset the effects of cost increase through controlling our expenses, passing cost increases on to our customers or any other method may not succeed.

The market for our broadband access products is limited and these products may not be widely adopted.

Our broadband access products are designed to meet broadband access requirements in areas characterized by fiber optic network deployments that terminate within one kilometer of customer premises. We believe the primary geographic markets for our broadband access products are currently in certain Asian countries such as China, Japan and Korea, and parts of Europe where there are many multi-dwelling units and fiber optic networks that extend to or near a customer premises. We do not expect to generate significant revenues from sales of our broadband access products in North America, which is generally characterized by low-density housing, or in developing nations which do not generally have extensive fiber optic networks. To the extent our efforts to sell our broadband access products into currently targeted markets are unsuccessful, the demand for these products may not develop as anticipated or decline, either of which could adversely affect our future revenues. Moreover, these markets have a large number of service providers and varying regulatory standards, both of which may delay any widespread adoption of our products and increase the time during which competing technologies could be introduced and displace our products.

In addition, if areas characterized by fiber optic networks that terminate within one kilometer of customer premises do not continue to grow, or we are unable to develop broadband access products that are competitive outside of these areas, the demand for our broadband access products may not grow and our revenues may be limited. Even if the markets in which our broadband access products are targeted continue to grow or we are able to serve additional markets, customers and service providers may not adopt our technology. There are a growing number of competing technologies for delivering high-speed broadband access from the service provider s network to the customer s premises. For example, our broadband access products face competition from products using DOCSIS, versions of DSL, Ethernet and WiMAX-based solutions. Moreover, there are many other access technologies that are currently in development including some low cost proprietary solutions. If service providers adopt competing products or technologies, the demand for our broadband access products will decline and we may not be able to generate significant revenues from these products.

The success of our digital broadcast satellite outdoor unit products depends on the demand for our products within the satellite digital television market and the growth of this overall market.

In addition to our home networking products, we also derive a significant portion of our revenues from sales of our digital broadcast satellite outdoor unit products into markets served by digital broadcast satellite providers and their ODM and OEM partners. The digital broadcast satellite market may not grow in the future as anticipated or a significant market slowdown may occur, which would in turn reduce the demand for applications or devices, such as set-top boxes and low-noise block converters that rely on our digital broadcast satellite outdoor unit products. Because of the intense competition in the satellite, terrestrial and cable digital television markets, the unproven technology of many products addressing these markets and the short product life cycles of many consumer applications or devices, it is difficult to predict the potential size and future growth rate of the markets for our digital broadcast satellite outdoor unit products. If the demand for our digital broadcast satellite outdoor unit products is not as great as we expect, or if we are unable to produce competitive products to meet that demand, our revenues could be adversely affected.

Market-specific risks affecting the digital television, digital television set-top boxes and digital television peripheral markets could impair our ability to successfully sell our silicon tuners.

The market for digital television applications in digital televisions, digital television set-top boxes and digital television peripherals is characterized by certain market-specific risks, any of which may adversely affect our ability to sell our silicon tuners. For example, sellers of module tuners that offer similar or better functionality than our silicon tuner solutions may dramatically lower their prices and become more competitive than we in the tuner market. In addition, our silicon tuners may not have the feature sets desired by our customers or may not be architecturally compatible with other components in the customers designs. Our efforts to penetrate the digital television market, in particular, will depend on our ability to overcome these and other challenges. To the extent our efforts are adversely affected by any of these risks or are otherwise unsuccessful, the demand for our silicon tuner products may not develop as anticipated or decline which would adversely affect our revenues, financial condition and results of operations.

The success of our silicon tuners is highly dependent on our relationships with demodulator manufacturers.

Our silicon tuners are designed to be interoperable with various specific demodulator integrated circuit products that are designed and manufactured by other companies. Historically, we have relied on strategic relationships with various demodulator manufacturers to enable both parties to offer an interoperable tuner/demodulator solution to mutual end customers. Although we work in concert with third party demodulator manufacturers to complete highly functional reference designs, we have no control over their future product plans and product roadmaps and could be effectively designed out of future customer applications by the refusal of a demodulator manufacturer to continue to support our products. Likewise, our ability to acquire new customers is dependent on the cooperation of third party demodulator manufacturers. If such third party manufacturers decide to partner with one of our competitors or to provide their own tuner solutions, we would effectively be prevented from selling our products to potential new customers. Furthermore, our dependence on these third party demodulator manufacturers often limits our strategic direction. If we were to design products that were competitive with any of such demodulator manufacturers, they may choose to stop working with us. Our current principal demodulator relationship is with STMicroelectronics N.V. in the DVB-T, or digital video broadcasting terrestrial, and DVB-C, or digital video broadcasting cable, markets; Advanced Television Systems Committee, or ATSC; and digital broadcast satellite markets. In the digital broadcast satellite market, our tuners are currently marketed with a STMicroelectronics demodulator; however, in 2008, STMicroelectronics released its own radio frequency silicon tuner that will replace some of the tuners we sell, and STMicroelectronics may continue to release other competing tuners in the future or require us to reduce our prices on the tuners we sell with their demodulators.

If any of the current or prospective demodulator manufacturers with whom we have or intend to have relationships were to stop working with us in favor of other tuner manufacturers or in favor of deploying their own tuner products, we would be effectively designed out of current and potential customers products and the demand for our silicon tuners would be substantially reduced.

We intend to expand our operations and increase our expenditures in an effort to grow our business. If we are not able to manage this expansion and growth, or if our business does not grow as we expect, we may not be able to realize a return on the resources we devote to expansion.*

We have grown significantly in a short period of time, in part, as a result of our various acquisitions, including our 2007 acquisition of RF Magic. For example, our headcount increased from 83 full-time employees as of December 31, 2006 to 255 as of September 30, 2009. We anticipate that we will continue to expand our infrastructure and grow our headcount to accommodate changes in our research and development strategy and achieve planned expansion of our product offerings, projected increases in our customer base and anticipated growth in the number of our product deployments. The rapid change in the size of our organization has placed, and will continue to place, a significant strain on our administrative and operational infrastructure. Our success in managing our operations and changes in size will be dependent upon our ability to:

- enhance our operational, financial and management controls, reporting systems and procedures;
- expand our facilities and equipment and develop new sources of supply for the manufacture, assembly and testing of our semiconductor products;
- successfully hire, train, motivate and productively deploy additional employees, including technical personnel; and
- expand our international resources.

Our inability to address effectively any of these factors, alone or in combination with others, could seriously harm our ability to execute our business strategy.

Further, we continue to intend to grow our business by entering new markets, developing new product offerings and pursuing new customers. If we fail to timely or efficiently expand operational and financial systems in connection with such growth or if we fail to implement or maintain effective internal controls and procedures, resulting operating inefficiencies could increase costs and expenses more than we planned and might cause us to lose the ability to take advantage of market opportunities, enhance existing

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products, develop new products, satisfy customer requirements, respond to competitive pressures, control our inventory or otherwise execute our business plan. Failure to implement or maintain such controls and procedures could also impact our ability to produce timely and accurate financial statements. Additionally, if we increase our operating expenses in anticipation of the growth of our business and such growth does not meet our expectations, our financial results likely would be negatively impacted.

We may not realize the anticipated financial and strategic benefits from the businesses we have acquired or be able to successfully integrate such businesses with ours.*

We will need to overcome significant challenges in order to realize the benefits or synergies from the acquisitions we have completed to date. These challenges include the following:

- integrating businesses, operations and technologies;
- retaining and assimilating key personnel;
- retaining existing customers and attracting additional customers;
- creating uniform standards, controls, procedures, policies and information systems;
- meeting the challenges inherent in efficiently managing an increased number of employees, including some at geographic locations distant from our headquarters and senior management; and
- implementing appropriate systems, policies, benefits and compliance programs.

Integration in particular may involve considerable risks and may not be successful. These risks include the following:

- the potential disruption of our ongoing business and distraction of our management;
- the potential strain on our financial and managerial controls and reporting systems and procedures;
- unanticipated expenses and potential delays related to integration of the operations, technology and other resources of the acquired companies;
- the impairment of relationships with employees, suppliers and customers; and
- potential unknown or contingent liabilities.

The inability to integrate successfully any businesses we acquire, or any significant delay in achieving integration, could delay introduction of new products and require expenditure of additional resources to achieve integration. For example, although we recorded significant amounts of goodwill and other intangible assets in connection with the acquisitions we completed in 2007 and 2008, as a result of the recent industry and economic turmoil and its effects on our market value and business outlook, we had to reduce the carrying amount of all of these long-lived assets and, as of September 30, 2009, we have recorded an aggregate impairment charge of $113.4 million against our goodwill and intangible assets carrying value related to these acquisitions.

Investors should not rely on attempts to combine our historical financial results with those of any of our acquired businesses as separate operating entities to predict our future results of operations as a combined entity.

Any acquisition, strategic relationship, joint venture or investment could disrupt our business and harm our financial condition.*

We intend to continue to pursue actively acquisitions, strategic relationships, joint ventures, collaborations or investments that we believe may allow us to complement our growth strategy, increase market share in our current markets or expand into adjacent markets, or broaden our technology and intellectual property. Such transactions may be complex, time consuming and expensive, and may present numerous challenges and risks including:

difficulties in assimilating any acquired workforce and merging operations;

- attrition and the loss of key personnel;

- an acquired company, asset or technology, or a strategic collaboration or licensed asset or technology not furthering our business strategy as anticipated;

- our overpayment for a company, asset or technology or changes in the economic or market conditions or assumptions underlying our decision to make an acquisition;

- difficulties entering and competing in new product or geographic markets and increased competition, including price competition;

- significant problems or liabilities, including increased intellectual property and employment related litigation exposure, associated with acquired businesses, assets or technologies;

- in connection with any such transaction, the need to use a significant portion of our available cash, issue additional equity securities that would dilute the then-current stockholders percentage ownership or incur substantial debt or contingent liabilities;

- requirements to devote substantial managerial and engineering resources to any strategic relationship, joint venture or collaboration, which could detract from our other efforts or significantly increase our costs;

- lack of control over the actions of our business partners in any strategic relationship, joint venture or collaboration, which could significantly delay the introduction of planned products or otherwise make it difficult or impossible to realize the expected benefits of such relationship; and

- requirements to record substantial charges and amortization expense related to certain intangible assets, deferred stock compensation and other items.

Any one of these challenges or risks could impair our ability to realize any benefit from our acquisitions, strategic relationships, joint ventures or investments after we have expended resources on them.

In addition, from time to time we may enter into negotiations for acquisitions, relationships, joint ventures or investments that are not ultimately consummated. These negotiations could result in significant diversion of management time, as well as substantial out-of-pocket costs.

We cannot forecast the number, timing or size of future acquisitions, strategic relationships, joint ventures or investments, or the effect that any such transactions might have on our operating or financial results. Any such transaction could disrupt our business and harm our operating results and financial condition.

The average selling prices of our products have historically decreased over time and will likely do so in the future, which may reduce our revenues and gross margin.*

Our products and products sold by other companies in our industry have historically experienced a decrease in average selling prices over time. We anticipate that the average selling prices of our products will continue to decrease in the future in response to competitive pricing pressures, increased sales discounts and new product introductions by our competitors. For example, we expect that other chipset manufacturers who are members of MoCA will produce competing chipsets and create pricing pressure for such products. Our future operating results may be harmed due to the decrease of our average selling prices. To maintain our current gross margins or increase our gross margins in the future, we must develop and introduce on a timely basis new products and product enhancements, continually reduce our product costs and manage product transitions in a timely and cost-effective manner. Our failure to do so would likely cause our revenues and gross margins to decline, which could have a material adverse effect on our operating results and cause the value of our common stock to decline.

Our product development efforts are time-consuming, require substantial research and development expenditures and may not generate an acceptable return.*

Our product development efforts require substantial research and development expense. Our research and development expense was $34.2 million and $42.9 million for the nine months ended September 30, 2009 and 2008, respectively. There can be no assurance that we will achieve an acceptable return on our research and development efforts.

The development of our products is also highly complex. Due to the relatively small size of our product design teams, our research and development efforts in our core technologies may lag behind those of our competitors, some of whom have substantially greater financial and technical resources. We occasionally have experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. Unanticipated problems in developing products could also divert substantial engineering resources, which may impair our ability to develop new products and enhancements and could substantially increase our costs. Furthermore, we may expend significant amounts on a research and development program that may not ultimately result in a commercially successful product, and we have in the past terminated ongoing research and development programs before they could be brought to successful conclusions. As a result of these and other factors, we may be unable to develop and introduce new products successfully and in a cost-effective and timely manner, and any new products we develop and offer may never achieve market acceptance. Any failure to develop successfully future products would have a material adverse effect on our business, financial condition and results of operations.

Our products typically have lengthy sales cycles, which may cause our operating results to fluctuate, and a service provider, ODM or OEM customer may decide to cancel or change its service or product plans, which could cause us to lose anticipated sales.*

Our products typically have lengthy sales cycles. A service provider must first evaluate our products. This initial evaluation period can vary considerably based on the service provider and product being evaluated, and could take a significant amount of time to complete. Products incorporating new technologies generally require longer periods for evaluation. After this initial evaluation period, if a service provider decides to adopt our products, that service provider and the applicable ODM or OEM customers will need to further test and evaluate our products prior to completing the design of the equipment that will incorporate our products. Additional time is needed to begin volume production of equipment that incorporates our products. Due to these lengthy sales cycles, we may experience significant delays from the time we incur research and development and sales expenses until the time, if ever, that we generate sales from these products. The delays inherent in these lengthy sales cycles increase the risk that a customer will decide to cancel or change its product plans. From time to time, we have experienced changes, delays and cancellations in the purchase plans of our customers. A cancellation or change in plans by a service provider, ODM or OEM customer could prevent us from realizing anticipated sales. In addition, our anticipated sales could be lost or substantially reduced if a significant service provider, ODM or OEM customer reduces or delays orders during our sales cycle or chooses not to release equipment that contains our products. We may invest significant time and effort in marketing to a particular customer that does not ultimately result in a sale to that customer. As a result of these lengthy and uncertain sales cycles for our products, it is difficult for us to predict if or when our customers may purchase products in volume from us, and our operating results may vary significantly from quarter to quarter, which may negatively affect our operating results for any given quarter.

Fluctuations in the mix of products we sell may adversely affect our financial results.

Because of differences in selling prices and manufacturing costs among our products, the mix and types of products sold affect the average selling price of our products and have a substantial impact on our revenues and profit margins. To the extent our sales mix shifts toward increased sales of our lower-margin products, our overall gross margins will be negatively affected. Fluctuations in the mix and types of our products sold may also affect the extent to which we are able to recover our costs and expenditures that are associated with a particular product, and as a result can negatively impact our financial results.

If we do not complete our design-in activities before a customer s design window closes, we will lose the design opportunity, which could adversely affect our future sales and revenues and harm our customer relationships.

The timing of our design-in activities with key customers and prospective customers may not align with their open design windows, which may or may not be known to us, making design win predictions more difficult. If we miss a particular customer s design window, we may be forced to wait an entire year or even longer for the next opportunity to compete for the customer s next design. The loss of a particular design opportunity could eliminate or substantially delay revenues from certain target customers and markets, which could have a material adverse effect on our results of operations and future prospects as well as our customer relationships.

Our products must interoperate with many software applications and hardware found in service providers networks and other devices in the home, and if they do not interoperate properly, our business would be harmed.*

Our products must interoperate with service providers networks and other devices in the home, which often have varied and complex specifications, utilize multiple protocol standards, software applications and products from multiple vendors, and contain multiple generations of products that have been added over time. As a result, we must continually ensure that our products interoperate properly with existing and planned future networks. To meet these requirements, we must undertake development efforts that involve significant expense and the dedication of substantial employee resources. We may not accomplish these development efforts quickly or cost-effectively, if at all. If we fail to maintain or anticipate compatibility with products, software or equipment found in our customers networks, we may face substantially reduced demand for our products, which would adversely affect our business, operating results and financial condition.

From time to time, we may enter into technical collaborations or interoperability arrangements with equipment and software vendors providing for the use, integration or interoperability of their technology with our products. These arrangements would give us access to and enable interoperability with various products or technologies in the connected home entertainment market. If these relationships fail to achieve their goals, we would have to devote substantially more resources to the development of alternative products and the support of our products, or the addressable market for our products may be limited. In many cases, these parties are either companies that we compete with directly in other areas or companies that have extensive relationships with our existing and potential customers and may have influence over the purchasing decisions of these customers. A number of our competitors have stronger relationships than we do with some of our existing and potential customers and, as a result, our ability to have successful arrangements with these companies may be harmed. Our failure to establish or maintain key relationships with third party equipment and software vendors may harm our ability to successfully sell and market our products. We are currently devoting significant resources to the development of these relationships. Our operating results could be adversely affected if these efforts do not result in the revenues necessary to offset these investments.

In addition, if we find errors in the software or hardware used in service providers networks or problematic network configurations or settings we may have to modify our products so that they will interoperate with service providers networks. This could cause longer installation times for our products and order cancellations, either of which would adversely affect our business, operating results and financial condition.

Our customers may cancel their orders, change production quantities or delay production, and if we fail to forecast demand for our products accurately, we may incur product shortages, delays in product shipments or excess or insufficient product inventory.

We sell our products to customers who integrate them into their products. We do not obtain firm, long-term purchase commitments from our customers. We have limited visibility as to the volume of our products that our customers are selling or carrying in their inventory. In addition, our sales have been seasonal in nature. Because production lead times often exceed the amount of time required to fulfill orders, we often must build inventory in advance of orders, relying on an imperfect demand forecast to project volumes and product mix. Our demand forecast accuracy can be adversely affected by a number of factors, including inaccurate forecasting by our customers, changes in market conditions, adverse changes in our product order mix and demand for our customers products. We have in the past had customers dramatically decrease and increase their requested production quantities with little or no advance notice. Even after an order is received, our customers may cancel these orders, postpone taking delivery or request a decrease in production quantities. Any such cancellation, postponement of delivery or decrease in production quantity subjects us to a number of risks, most notably that our projected sales will not materialize on schedule or at all, leading to unanticipated revenue shortfalls, reduced profit margins and excess or obsolete inventory which we may be unable to sell to other customers or which we must sell at reduced prices, or that any resulting disputes with our customers may adversely impact our future relationships with those customers. Alternatively, if we are unable to project customer requirements accurately, we may not build enough products, which could lead to delays in product shipments and lost sales opportunities in the near term, as well as force our customers to identify alternative sources of supply, which could affect our ongoing relationships with these customers and potentially reduce our market share. If we do not timely fulfill customer demands, our customers may cancel their orders and we may be subject to customer claims for cost of replacement.

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Our ability to accurately predict revenues and inventory needs, and to effectively manage inventory levels, may be adversely impacted due to our use of inventory hubbing arrangements.

We have entered into an inventory hubbing arrangement with Motorola and we may enter into similar arrangements with other customers in the future. Pursuant to these arrangements, we ship our products to a designated third party warehouse, or hub, rather than shipping them directly to the customer. The products generally remain in the hub until the customer removes them for incorporation into its own products. Prior to the implementation of this hubbing arrangement with Motorola, we recognized revenues on sales of our products to Motorola upon shipment of those products to Motorola or its ODM partners. Under the hubbing arrangement, however, we maintain ownership of our products in the hub, and therefore do not recognize the related revenue, until the date Motorola removes them from the hub. As a result, our ability to accurately predict future revenues recognized from sales to Motorola or any other customers with which we implement hubbing arrangements may be impaired, and we may experience significant fluctuations in our quarterly operating results depending on when Motorola or any such other customers remove our products from the hub, which they may do with little or no lead time. In the short term, we may experience an increase in operating expenses as we build and ship inventory to the hub and may not recognize revenues from sales of this inventory, if at all, until Motorola or any such other customers remove it from the hub at a later time. Furthermore, because we continue to own but do not maintain control over our products after they are shipped to the hub, our ability to effectively manage inventory levels may be impaired as our shipments under the hubbing arrangement increase and we may be exposed to additional risk that the inventory in the hub becomes obsolete before sales are recognized.

We extend credit to our customers, sometimes in large amounts, but there is no guarantee every customer will be able to pay our invoices when they become due.

As part of our routine business, we extend credit to customers purchasing our products. While our customers may have the ability to pay on the date of shipment or on the date credit is granted, their financial condition could change and there is no guarantee that customers will ever pay the invoices. Rapid changes in our customers financial conditions and risks associated with extending credit to our customers can subject us to a higher financial risk and could have a material adverse effect on our business, financial condition and results of operations.

We depend on a limited number of third parties to manufacture, assemble and test our products which reduces our control over key aspects of our products and their availability.

We do not own or operate a manufacturing, assembly or test facility for our products. Rather, we outsource the manufacture, assembly and testing of our products to third party subcontractors including Taiwan Semiconductor Manufacturing Company, Jazz Technologies, Inc., United Microelectronics Corp., Amkor Technologies, Inc. and Giga Solution Tech. Co., Ltd. Accordingly, we are greatly dependent on a limited number of suppliers to deliver quality products on time. Our reliance on sole or limited suppliers involves several risks, including susceptibility to increased manufacturing costs if competition for foundry capacity intensifies and reduced control over the following:

- supply of our products available for sale;
- pricing, quality and timely delivery of our products;
- prices and availability of components for our products; and
- production capacity for our products.

Because we rely on a limited number of third party manufacturers, if we were required to change contract manufacturers or one of our contract manufacturers became unable or unwilling to continue manufacturing our products, we may sustain lost revenues, increased costs and damage to our customer relationships. In addition, we would need to expend significant time and effort to locate and qualify new third party manufacturers, if available.

Manufacturing defects may not be detected by the testing process performed by our subcontractors. If defects are discovered after we have shipped our products, we may be exposed to warranty and consequential damages claims from our customers. Such claims may have a significant adverse impact on our revenues and operating results. Furthermore, if we are unable to deliver quality products, our reputation would be harmed, which could result in the loss of future orders and business with our customers.

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When demand for manufacturing capacity is high, we may take various actions to try to secure sufficient capacity, which may be costly and negatively impact our operating results.

The ability of each of our subcontractors manufacturing facilities to provide us with chipsets is limited by their available capacity and existing obligations. Although we have purchase order commitments to supply specified levels of products to our customers, we do not have a guaranteed level of production capacity from any of our subcontractors facilities to produce our products. Facility capacity may not be available when we need it or at reasonable prices. In addition, our subcontractors may allocate capacity to the production of other companies products and thereby reduce deliveries to us on short notice.

In order to secure sufficient manufacturing facility capacity when demand is high and mitigate the risks associated with an inability to meet our customers demands for our products, we may enter into various arrangements with subcontractors that could be costly and harm our operating results, including:

- option payments or other prepayments to a subcontractor;
- nonrefundable deposits with or loans to subcontractors in exchange for capacity commitments;
- contracts that commit us to purchase specified quantities of components over extended periods; and
- purchase of testing equipment for specific use at the facilities of our subcontractors.

We may not be able to make any such arrangements in a timely fashion or at all, and any arrangements may be costly, reduce our financial flexibility and not be on terms favorable to us. Moreover, if we are able to secure capacity, we may be obligated to use all of that capacity or incur penalties. These penalties and obligations may be expensive and require significant capital and could harm our business.

We believe that transitioning certain of our silicon products to newer or better manufacturing process technologies will be important to our future competitive position. If we fail to make this transition efficiently, our competitive position could be seriously harmed.

We continually evaluate the benefits, on a product-by-product basis, of migrating to higher performance or lower cost process technologies in order to produce higher performance, more efficient or better integrated circuits because we believe this migration is required to remain competitive. Other companies in our industry have experienced difficulty in migrating to new process technologies and, consequently, have suffered reduced yields, delays in product deliveries and increased expense levels. We may experience similar difficulties. Moreover, we are dependent on our relationships with subcontractors to successfully migrate to newer or better process technologies. Our third party manufacturers may not make newer or better process technologies available to us on a timely or cost-effective basis, if at all. If our third party manufacturers do not make newer or better manufacturing process technologies available to us on a timely or cost-effective basis, or if we experience difficulties in migrating to these processes, it could have a material adverse effect on our competitive position and business prospects.

We rely on sales representatives to assist in selling our products, and the failure of these representatives to perform as expected could reduce our future sales.

We sell our products to some of our customers through third party sales representatives. Our relationships with some of these third party sales representatives are relatively new and we are unable to predict the extent to which our third party sales representatives will be successful in marketing and selling our products. Moreover, many of our third party sales representatives also market and sell competing products. Our third party sales representatives may terminate their relationships with us at any time, or with short notice and may give greater attention to the products sold by our competitors. Our future performance will also depend, in part, on our ability to attract additional third party sales representatives that will be able to market our products effectively, especially in markets in which we have not previously distributed our products. If we cannot retain our current third party sales representatives and recruit additional or replacement third party sales representatives, our revenues and operating results could be harmed.

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Our products may contain defects or errors which may adversely affect their market acceptance and our reputation and expose us to product liability claims.

Our products are very complex and may contain defects or errors, especially when first introduced or when new versions are released. Despite testing, errors may occur. Product errors could affect the performance of our products, delay the development or release of new products or new versions of products, adversely affect our reputation and our customers willingness to buy products from us, and adversely affect market acceptance or perception of our products. Any such errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance could cause us to lose revenue or market share, increase our service costs, cause us to incur substantial costs in redesigning our products, subject us to liability for damages and divert our resources from other tasks. Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a device or application in which our product is used, it may be difficult to identify the sources of these problems. The occurrence of hardware and software errors, whether or not caused by our products, could result in the delay or loss of market acceptance of our products, and therefore delay our ability to recognize revenue from sales, and any necessary revisions may cause us to incur significant expenses. Moreover, since one of the key benefits of our home networking products is reduction of the need for service providers to dispatch service vehicles to customer premises, often referred to as truck rolls, problems with our products would likely result in a greater number of truck rolls and this in turn could adversely affect our sales. The occurrence of any such problems could harm our business, operating results and financial condition.

Any limitation of liability provisions in our standard terms and conditions of sale may not fully or effectively protect us from claims as a result of federal, state or local laws or ordinances or unfavorable judicial decisions in the United States or other countries. The use of our products also entails the risk of product liability claims. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not adequately cover any claim asserted against us. In addition, even claims that ultimately are unsuccessful could result in our expenditure of funds in litigation and divert management s time and other resources.

We depend on key personnel to operate our business, and if we are unable to retain our current personnel and hire additional qualified personnel, our ability to develop and successfully market our products could be harmed.*

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering and sales and marketing personnel. Even during the recent economic downturn, there continues to be competition for qualified personnel in the markets in which we compete. In addition, the cost of living in the San Diego, California area, where our corporate headquarters is located, has proved to be an obstacle to attracting new employees in the past, and we expect that this will continue to impact, to some extent, our ability to attract and retain employees in the future. We do not have employment agreements with most of our executive or key employees and the unexpected loss of any key employees, including Patrick Henry, our president and chief executive officer, other members of our senior management or our senior engineering personnel, or an inability to attract additional qualified personnel, including engineers and sales and marketing personnel, could delay the development, introduction and sale of our products and our ability to execute our business strategy may suffer. In addition, in the event that there is a loss of key personnel, there is a potential for loss of important historical knowledge that may delay or negatively impact development or sale of our product and our ability to execute on our business strategy. We do not currently have any key person life insurance covering any executive officer or employee.

If we fail to comply with environmental regulatory requirements, our operating results could be adversely affected.*

We face increasing complexity in our product design and procurement operations as we adjust to requirements relating to the materials composition of many of our products. The European Union has adopted certain directives to facilitate the recycling of electrical and electronic equipment sold in the European Union, including the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment, or RoHS, directive that restricts the use of lead, mercury and certain other substances in electrical and electronic products placed on the market in the European Union after July 1, 2006, and many other countries, including China, Taiwan and Korea, where the great majority of our products are manufactured and packaged and sold into, have also adopted similar directives banning or limiting the use of specified substances in products introduced into its domestic market. We have incurred costs in connection with our compliance with these environmental laws and regulations, such as costs related to eliminating lead from our semiconductor product packaging. Other environmental regulations may be enacted in the future, including in the United States, that require us to reengineer our products to utilize components that are compatible with these regulations, and this reengineering and component substitution may result in additional costs to us or disrupt our operations or logistics. If we or the third party manufacturers of our products are unable to meet future environmental regulations in a timely manner, it could have a material adverse effect on our business, results of operations and financial condition.

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Certain of our customers products and service providers services are subject to governmental regulation.

Governmental regulation could place constraints on our customers and service providers services and consequently reduce our customers demand for our products. For example, the Federal Communications Commission has broad jurisdiction over products that emit radio frequency signals in the United States. Similar governmental agencies regulate these products in other countries. Moreover, laws and regulations regarding local cable franchising could have an adverse effect on Verizon s and other service providers ability to compete in the HD video and multimedia content delivery market. Although most of our products are not directly subject to current regulations of the Federal Communications Commission or any other federal or state communications regulatory agency, much of the equipment into which these products are incorporated is subject to direct governmental regulation. Accordingly, the effects of regulation on our customers or the industries in which they operate may, in turn, impede sales of our products. For example, demand for these products will decrease if equipment into which they are incorporated fails to comply with the specifications of the Federal Communications Commission.

Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products could reduce our ability to compete and could harm our business.*

We intend to continue spending substantial amounts in connection with our expansion in order to grow our business. We may need to obtain additional financing to pursue our business strategy, develop new products, respond to competition and market opportunities and acquire complementary businesses or technologies. We may not be able to obtain such financing on favorable terms or at all. Although we currently have access to a $10.0 million line of credit under the terms of our existing Loan and Security Agreement, as amended, with SVB, of which $8.8 million was available at September 30, 2009, the current turmoil in the credit markets may affect SVB s willingness or ability to provide us with full access to our line of credit when needed or renew the term of the credit line when it expires in April 2010.

If we were to raise additional capital through further sales of our equity securities, our stockholders would suffer dilution of their equity ownership. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, prohibit us from paying dividends, repurchasing our stock or making investments, and force us to maintain specified liquidity or other ratios, any of which could harm our business, operating results and financial condition. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop or enhance our products;
- continue to expand our product development and sales and marketing organizations;
- acquire complementary technologies, products or businesses;
- expand operations, in the United States or internationally;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Our failure to do any of these things could seriously harm our ability to execute our business strategy and may force us to curtail our research and development plans or existing operations.

Our costs have increased significantly as a result of operating as a public company, and our management is required to devote substantial time to comply with public company regulations.

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, as well as new rules subsequently implemented by the SEC and The NASDAQ Stock

Market, or NASDAQ, have imposed various requirements on public companies, including changes in corporate governance practices that did not previously exist. The Sarbanes-Oxley Act requires us to maintain effective disclosure controls and procedures and internal controls for financial reporting. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal controls over financial reporting, significant resources and management oversight are required. Our management and other personnel now devote a substantial amount of time to these new requirements. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly.

For example, as required by the Sarbanes-Oxley Act, commencing in year 2008, we must now perform system and process evaluation and testing of our internal controls over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our compliance with Section 404 requires that we incur substantial expense and expend significant management efforts. If we identify deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to sanctions or investigations by the NASDAQ, SEC or other regulatory authorities.

Our effective tax rate may increase or fluctuate, and we may not derive the anticipated tax benefits from the planned expansion of our international operations.

Our effective tax rate could be adversely affected by various factors, many of which are outside of our control. Our effective tax rate is directly affected by the relative proportions of revenue and income before taxes in the various domestic and international jurisdictions in which we operate. We are also subject to changing tax laws, regulations, and interpretations in multiple jurisdictions in which we operate as well as the requirements of certain tax rulings. Changes in applicable tax laws may cause fluctuations between reporting periods in which the changes take place. We are in the process of expanding our international operations and staff to better support our expansion into international markets. We anticipate that this expansion will include the implementation of an international organizational structure. As a result of this anticipated change and an expanding international customer base, we expect that an increasing percentage of our consolidated pre-tax income will be derived from, and reinvested in, our international operations. Moreover, we anticipate that this pre-tax income will be subject to foreign tax at relatively lower tax rates when compared to the U.S. federal statutory tax rate and as a consequence, our future effective income tax rate is expected to be lower than the U.S. federal statutory rate. There can be no assurance that significant pre-tax income will be derived from or reinvested in our international operations, or that our international operations and sales will result in a lower effective income tax rate. In addition, our future effective income tax rate could be adversely affected if tax authorities challenge our international tax structure or if the relative mix of U.S. and international income changes for any reason. Accordingly, there can be no assurance that our effective income tax rate will be less than the U.S. federal statutory rate.

If we fail to manage our exposure to global financial and securities market risk successfully, our operating results could be adversely impacted.

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates, credit markets and prices of marketable equity and fixed-income securities. We do not use derivative financial instruments for speculative or trading purposes.

The primary objective of most of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, a majority of our marketable investments are investment grade, liquid, fixed-income securities and money market instruments denominated in U.S. dollars. If the carrying value of our investments exceeds the fair value, and the decline in fair value is deemed to be other-than-temporary, we will be required to further write down the value of our investments, which could materially harm our results of operations and financial condition. Moreover, the performance of certain securities in our investment portfolio is affected by the credit condition of the U.S. financial sector. With the current unstable credit environment of the U.S. financial sector, we might incur significant realized, unrealized or impairment losses associated with these investments.

Risks Related to Our Intellectual Property

Our ability to compete and our business could be jeopardized if we are unable to secure or protect our intellectual property.

We rely on a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights. However, these legal means afford only limited protection and may not adequately protect our rights or permit us to gain or keep any competitive advantage. Our patent applications may not issue as patents at all or they may not issue as patents in a form that will be advantageous to us. Our issued patents and those that may issue in the future may be challenged, invalidated or circumvented, which could limit our ability to stop competitors from marketing related products. Although we have taken steps to protect our intellectual property and proprietary technology, there is no assurance that third parties will not be able to invalidate or design around our patents. Furthermore, although we have entered into confidentiality agreements and intellectual property assignment agreements with our employees, consultants and advisors, such agreements may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements. Moreover, we are required to license any of our patent claims that are essential to implement MoCA specifications to other MoCA members, who could potentially include our competitors, on reasonable and non-discriminatory terms. In addition, in connection with commercial arrangements with our customers and the service providers who deploy equipment containing our products, we may be required to license our intellectual property to third parties, including competitors or potential competitors.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our technology is difficult and we cannot be certain that the steps we have taken to prevent such unauthorized use will be successful, particularly in foreign countries where the laws may not protect our proprietary rights as comprehensively as in the United States. In addition, if we become aware of a third party s unauthorized use or misappropriation of our technology, it may not be practicable, effective or cost-efficient for us to enforce our intellectual property and contractual rights, particularly where the initiation of a claim might harm our business relationships or risk a costly and protracted lawsuit, including a potential countersuit by a competitor with patents that may implicate our products. If competitors engage in unauthorized use or misappropriation of our technology, our ability to compete effectively could be harmed.

Our participation in patent pools and standards setting organizations, or other business arrangements, may require us to license our patents to competitors and other third parties and limit our ability to enforce or collect royalties for our patents.

In addition to our existing obligations to license our patent claims that are essential to implement the MoCA specifications to other MoCA members, in the course of participating in patent pools and other standards setting organizations or pursuant to other business arrangements, we may agree to license certain of our technologies on a reasonable and non-discriminatory basis and, as a result, our control over the license of such technologies may be limited. We may also be unable to limit to whom we license some of our technologies, and may be unable to restrict many terms of the license. Consequently, our competitors may obtain the right to use our technology. In addition, our control over the application and quality control of our technologies that are included in patent pools or otherwise necessary for implementing industry standards may be limited.

Any dispute with a MoCA member regarding what patent claims are necessary to implement MoCA specifications could result in litigation which could have an adverse effect on our business.

We are required to grant to other MoCA members a non-exclusive and world-wide license on reasonable and non-discriminatory terms to any of our patent claims that are essential to implement MoCA specifications. If we had a disagreement with a MoCA member regarding which of our patent claims are necessary to implement MoCA specifications, this could result in a lawsuit. Any such lawsuit, regardless of its merits, could be time-consuming, expensive to resolve, divert our management s time and attention and harm our reputation. In addition, any such litigation could result in us being required to license on reasonable and non-discriminatory terms certain of our patent claims which we previously believed did not need to be licensed under our MoCA agreement. This could have an adverse effect on our business and harm our competitive position.

Possible third party claims of infringement of proprietary rights against us, our customers or the service providers that purchase products from our customers, or other intellectual property claims or disputes, could have a material adverse effect on our business, results of operation or financial condition.

The semiconductor industry is characterized by a relatively high level of litigation based on allegations of infringement of proprietary rights. Numerous U.S. and foreign issued patents and pending patent applications owned by third parties exist in the fields in which we are selling and developing products. Because patent applications take many years to issue, currently pending applications, known or unknown to us, may later result in issued patents that we infringe. In addition, third parties continue to actively seek new patents in our field. It is difficult or impossible to keep fully abreast of these developments, and therefore, as we develop new and enhanced products, we may sell or distribute products that inadvertently infringe patents held by third parties.

We have in the past received and we, our customers or the service providers that purchase products from our customers may in the future receive inquiries from other patent holders and may become subject to claims that we infringe their intellectual property rights. Any intellectual property claim or dispute, regardless of its merits, could force us, our customers or the service providers that purchase our products from our customers to license the third party s patents for substantial royalty payments or cease the sale of the alleged infringing products or use of the alleged infringing technologies, or force us to defend ourselves and possibly our customers or contract manufacturers in litigation. Any cessation of product sales by us, our customers or the service providers that purchase products from our customers could have a substantial negative impact on our revenues. Any litigation, regardless of its outcome, could result in substantial expense and significant diversion of our management s time and other resources. Moreover, any such litigation could subject us, our customers or the service providers that purchase our products from our customers to significant liability for damages (including treble damages), temporary or permanent injunctions, or the invalidation of proprietary rights or require us, our customers or the service providers that purchase products from our customers to license the third party patents for substantial royalty or other payments.

In addition, we may also be required to indemnify our customers and contract manufacturers for damages they suffer as a result of such infringement or litigation.

Our use of open source and third party software could impose limitations on our ability to commercialize our products.

We incorporate open source software into our products, including certain open source code which is governed by the GNU General Public License, Lesser GNU General Public License and Common Development and Distribution License. The terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that these licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to seek licenses from third parties in order to continue offering our products, make our proprietary code generally available in source code form (for example, proprietary code that links in particular ways to certain open source modules), which would result in our trade secrets being disclosed to the public and the potential loss of intellectual property rights in our software, re-engineer our products, discontinue the sale of our products if re-engineering cannot be accomplished on a cost-effective and timely basis, or become subject to other consequences, any of which could adversely affect our business, operating results and financial condition.

In addition to technologies we have already licensed, we may find that we need to incorporate certain proprietary third party technologies, including software programs, into our products in the future. However, licenses to relevant third party technologies may not be available to us on commercially reasonable terms, if at all. Therefore, we could face delays in product releases until alternative technology can be identified, licensed or developed, and integrated into our current products. Such alternative technology may not be available to us on reasonable terms, if at all, and may ultimately not be as effective as the preferred technology. Any such delays or failures to obtain licenses, if they occur, could materially adversely affect our business, operating results and financial condition.

Because we license some of our software source code directly to customers, we face increased risks that our trade secrets will be exposed through inadvertent or intentional disclosure, which could harm our competitive position or increase our costs.

We license some of our software source code to our customers, which increases the number of people who have access to some of our trade secrets and other proprietary rights. Contractual obligations of our licensees not to disclose or misuse our source code may not be sufficient to prevent such disclosure or misuse. The costs of enforcing contractual rights could substantially increase our operating costs and may not be cost-effective, reasonable under the circumstances or ultimately succeed in protecting our proprietary rights. If our competitors access our source code, they may gain further insight into the technology and design of our products, which would harm our competitive position.

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Risks Related to International Operations

We expect a significant portion of our future revenues to come from our international customers, and, as a result, our business may be harmed by political and economic conditions in foreign markets and the challenges associated with operating internationally.*

We have derived, and expect to continue to derive, a significant portion of our revenues from international markets. Revenues outside of the United States comprised 96% and 98% of our total revenues for the nine months ended September 30, 2009 and 2008, respectively. International business activities involve certain risks, including:

- difficulties involved in the staffing and management of geographically dispersed operations;
- longer sales cycles in certain countries, especially on initial entry into a new geographical market;
- greater difficulty evaluating a customer s ability to pay, longer accounts receivable payment cycles and greater difficulty in the collection of past-due accounts;
- general economic conditions in each country;
- challenges associated with operating in diverse cultural and legal environments;
- seasonal reductions in business activity specific to certain markets;
- loss of revenue, property and equipment from expropriation, nationalization, war, insurrection, terrorism and other political risks;
- foreign taxes and the overlap of different tax structures, including modifications to the United States tax code as a result of international trade regulations;
- foreign technical standards;
- changes in currency exchange rates; and
- import and export licensing requirements, tariffs, and other trade and travel restrictions.

To the extent our international sales are adversely affected by any of these risks or are otherwise unsuccessful, we could experience a reduction in revenue and our operating results could suffer.

In addition, certain foreign countries where we sell our products, such as China and Korea, have historically limited recognition and enforcement of contractual and intellectual property rights. In particular, we may have difficulty preventing ODMs and OEMs in these countries from incorporating our technologies, copyrights or trademarks into their products without our authorization or without paying us licensing fees. We may also experience difficulty enforcing our intellectual property rights in these countries, where intellectual property rights are not as respected as they are in the United States, Japan and Europe. Unauthorized use of our technologies and intellectual property rights may dilute or undermine the strength of our brand. Further, if we are not able to adequately monitor the use of our technologies by foreign-based ODMs and

OEMs, or enforce our intellectual property rights in foreign countries, our revenue potential could be adversely affected.

Our products are subject to export and import controls that could subject us to liability or impair our ability to compete in international markets.

Our products are subject to U.S. export controls and may be exported outside the United States only with the required level of export license or through an export license exception, in most cases because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or could limit our customers ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, or change in the countries, persons or technologies targeted by such regulations or legislation, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers internationally.

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In addition, we may be subject to customs duties and export quotas, which could have a significant impact on our revenue and profitability. The future imposition of significant increases in the level of customs duties or export quotas could have a material adverse effect on our business.

Our third party contractors are concentrated primarily in areas subject to earthquakes and other natural disasters. Any disruption to the operations of these contractors could cause significant delays in the production or shipment of our products.

Substantially all of our products are manufactured by third party contractors located in the Pacific Rim. The risk of an earthquake in these areas is significant due to the proximity of major earthquake fault lines to the facilities of our foundry, assembly and test subcontractors. The occurrence of earthquakes or other natural disasters could result in the disruption of our foundry or assembly and test capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling or testing from the affected contractor to another third party vendor. We may not be able to obtain alternate capacity on favorable terms, if at all.

Risks Related to Ownership of Our Common Stock

Our stock price is volatile and may decline regardless of our operating performance, and you may not be able to resell your shares at or above the price at which you purchased such shares.

The market price for our common stock is volatile and may fluctuate significantly in response to a number of factors, most of which we cannot control, including:

- price and volume fluctuations in the overall stock market;
- market conditions or trends in our industry or the economy as a whole;
- changes in operating performance and stock market valuations of other technology companies generally, or those that sell semiconductor products in particular;
- the timing of customer or service provider orders that may cause quarterly or other periodic fluctuations in our results that may, in turn, affect the market price of our common stock;
- the seasonal nature of our sales;
- the timing of revenue recognition on sales arrangements, which may include multiple deliverables, and the effect of our use of inventory hubbing arrangements;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- changes in financial estimates or ratings by any securities analysts who follow our common stock, our failure to meet these estimates or failure of those analysts to initiate or maintain coverage of our common stock;
- the public s response to press releases or other public announcements by us or third parties, including our filings with the SEC and announcements relating to product development, litigation and intellectual property impacting us or our business;

the sustainability of an active trading market for our common stock;

future sales of our common stock by our executive officers, directors and significant stockholders;

announcements of mergers or acquisition transactions;

our inclusion or deletion from certain stock indices;

announcements of technical innovations, new products or design wins by our competitors or customers;

announcements of changes in our senior management;

other events or factors, including those resulting from war, incidents of terrorism, natural disasters or responses to these events; and

changes in accounting principles.

In addition, the stock markets, and in particular The NASDAQ Global Market, have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were involved in securities litigation, we could incur substantial costs and our resources and the attention of management could be diverted from our business.

Future sales of our common stock or the issuance of securities convertible into or exercisable for shares of our common stock may depress our stock price.

A significant number of shares of our common stock are held by a small number of stockholders. Sales of a substantial number of shares of our common stock, the issuance of securities convertible into or exercisable for shares of our common stock or the expectation or perception in the market that the holders of a large number of our shares of common stock intend to sell their shares, could significantly reduce the market price of our common stock. In addition, because the average daily trading volume of our common stock is low, our common stock is less liquid than the stock of companies with broader public ownership and, as a result, the trading of a relatively small volume of our common stock may have a greater impact on the trading price for our stock and lead to increased volatility in our stock price.

Holders of a significant number of shares of our common stock, from investments made when we were a private company, have rights, subject to some conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or other stockholders. These rights will terminate in December 2009 or, for any particular holder with registration rights who holds less than one percent of our outstanding capital stock, at any time when all securities held by that stockholder that are subject to registration rights may be sold pursuant to Rule 144 under the Securities Act of 1933, as amended, or the Securities Act, within a single 90 day period. If shares of our common stock are sold in the public market after they are registered for resale, the sales could reduce the trading price of our common stock and impede our ability to raise future capital.

Anti-takeover provisions in our charter documents and Delaware law might deter acquisition bids for us that you might consider favorable.

Our amended and restated certificate of incorporation and bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors. These provisions:

establish a classified board of directors so that not all members of our board are elected at one time;

authorize the issuance of undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval, and which may include rights superior to the rights of the holders of common stock;

prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;

provide that the board of directors is expressly authorized to make, alter, or repeal our bylaws;

establish advance notice requirements for nominations for elections to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings; and

provide that in addition to any vote required by law or by our amended and restated certificate of incorporation, the approval by holders of at least 66 2/3% of our then outstanding common stock is required to adopt, amend or repeal any provision of our amended and restated bylaws.

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In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law which, subject to certain exceptions, prohibits stockholders owning in excess of 15% of our outstanding voting stock from merging or combining with us. These anti-takeover provisions and other provisions under Delaware law could discourage, delay or prevent a transaction involving a change in control of our company, even if doing so would benefit our stockholders. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take other corporate actions you desire.

Our principal stockholders, executive officers and directors have substantial control over the company, which may prevent you and other stockholders from influencing significant corporate decisions and may harm the market price of our common stock.*

As of September 30, 2009, our executive officers, directors and holders of five percent or more of our outstanding common stock, beneficially owned, in the aggregate, 25% of our outstanding common stock. These stockholders may have interests that conflict with our other stockholders and, if acting together, have the ability to substantially influence or determine the outcome of matters submitted to our stockholders for approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these stockholders, acting together, may have the ability to control our management and affairs. Accordingly, this concentration of ownership may harm the market price of our common stock by:

- delaying, deferring or preventing a change in control;
- impeding a merger, consolidation, takeover or other business combination involving us; or
- discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

If securities or industry analysts publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

We do not expect to pay any cash dividends for the foreseeable future.

The continued expansion of our business will require substantial funding. Accordingly, we do not anticipate that we will pay any cash dividends on shares of our common stock for the foreseeable future. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board of directors deems relevant. Investors seeking cash dividends in the foreseeable future should not purchase or hold our common stock.

Our stock may be delisted from The NASDAQ Global Market if the closing bid price for our common stock is not maintained at $1.00 per share or higher.*

Our common stock must trade at or above $1.00 to meet NASDAQ s minimum bid requirement for continued listing on The NASDAQ Global Market. If the closing bid price of our common stock falls below $1.00, NASDAQ may make a determination to delist our common stock. Any such delisting could adversely affect the market liquidity of our common stock and the market price of our common stock could decrease and could also adversely affect our ability to obtain financing for the continuation of our operations and/or result in the loss of confidence by investors, customers, suppliers and employees. In the last 12 months, our common stock has traded at below $1.00 per share at closing for an extended period of time although NASDAQ took no action to delist our common stock at the time as it had suspended its enforcement of the rules requiring a minimum $1.00 closing bid price in response to the ongoing turmoil in the stock markets at the time.

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Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds.***

Recent Sales of Unregistered Securities

The following sets forth information regarding all unregistered securities of the Company that were sold during the three months ended September 30, 2009:

(1) As of September 30, 2009, options to purchase up to 2,763,030 shares of our common stock were outstanding under our 2001 Stock Option Plan, or 2001 Plan. Of these options, during the three months ended September 30, 2009, options exercisable for up to 46,348 shares of common stock were cancelled without being exercised and options to purchase 360,377 shares of common stock were exercised at a weighted average exercise price of $1.47 per share. As of September 30, 2009, options to purchase up to 2,356,305 shares of our common stock remained outstanding under the 2001 Plan.

(2) As of September 30, 2009, options to purchase up to 1,277,382 shares of our common stock were outstanding under our RF Magic Plan, Inc. 2000 Incentive Stock Plan, or RF Magic Plan. During the three months ended September 30, 2009, none of these options were cancelled without being exercised and options to purchase 103,547 shares of common stock were exercised at a weighted average exercise price of $0.89 per share. As of September 30, 2009, options to purchase up to 1,173,835 shares of our common stock remained outstanding under the RF Magic Plan.

All of the offers, sales and issuances of the securities described in paragraphs (1) and (2) were deemed to be exempt from registration under the Securities Act in reliance on Rule 701 in that the transactions were under compensatory benefit plans and contracts relating to compensation as provided under Rule 701. The recipients of such securities were our employees, directors or bona fide consultants and received the securities under the 2001 Plan or RF Magic Plan, as the case may be. Appropriate legends were affixed to the securities issued in these transactions. Each of the recipients of securities in these transactions had adequate access, through employment, business or other relationships, to information about us.

Issuer Purchases of Equity Securities

Pursuant to the terms of the 2001 Plan, options may be exercised prior to vesting. Shares of common stock issued prior to vesting that remain unvested are subject to a repurchase option in our favor that lapses in accordance with the original vesting schedule for the option. The following table provides information with respect to purchases made by us of shares of our common stock during the three months ended September 30, 2009:

Period	**Total Number of Shares Purchased (1)**	**Average Price Paid Per Share**	**Total Value Paid by Company**
September 1, 2009 through September 30, 2009	12,180	$ 0.68	$ 8,313
August 1, 2009 through August 31, 2009			
July 1, 2009 through July 31, 2009			
	12,180		$ 8,313

(1) All shares were originally purchased from us by directors, employees and consultants pursuant to exercises of unvested stock options. The shares repurchased by us during the months listed above represent shares that were repurchased from our directors, employees and consultants within 60 days of the termination of their employment or consulting relationship with us pursuant to our right to repurchase unvested shares at the original exercise price under the terms of our 2001 Plan and the related stock option agreements.

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Working Capital Restrictions and Other Limitations upon the Payment of Dividends

Under the terms of our Loan and Security Agreement, as amended, with SVB, we are not permitted to pay cash dividends without SVB s prior consent. Accordingly, we do not anticipate that we will pay any cash dividends on shares of our common stock for the foreseeable future. Any determination to pay dividends in the future will be at the discretion of our board and will depend upon our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board deems relevant.

Item 6. ***Exhibits.***

The exhibits listed in the accompanying *Index to Exhibits* are filed with, or incorporated by reference into, this Quarterly Report. The exhibit numbers on the *Index to Exhibits* that are followed by an asterisk (*) indicate exhibits filed with this Quarterly Report. All other exhibit numbers indicate exhibits filed by incorporation by reference.

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SIGNATURES

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

	ENTROPIC COMMUNICATIONS, INC.	
Date: October 27, 2009	By:	/s/ David Lyle David Lyle *Chief Financial Officer* (Duly Authorized Officer and Principal Financial Officer)

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INDEX TO EXHIBITS

Exhibit Number	Description of Document
3.1 (1)	Amended and Restated Certificate of Incorporation of the Registrant.
3.2 (2)	Amended and Restated Bylaws of the Registrant.
4.1	Reference is made to Exhibits 3.1 and 3.2 above.
4.2 (3)	Form of Common Stock Certificate of the Registrant.
4.3 (4)	Third Amended and Restated Investor Rights Agreement dated June 30, 2007, as amended, by and among the Registrant and certain of its stockholders.
10.1(5)	Transition and Separation Agreement and General Release of All Claims dated October 6, 2009 by and between the Registrant and Michael Economy.
31.1 *	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 *	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32 *	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated herein by reference to the Registrant s Current Report on Form 8-K filed with the SEC on December 13, 2007.

(2) Incorporated herein by reference to the Registrant s Current Report on Form 8-K filed with the SEC on December 5, 2008.

(3) Incorporated herein by reference to the Registrant s Registration Statement on Form S-1 (No. 333-144899), as amended, filed with the SEC.

(4) Incorporated herein by reference to the Registrant s Annual Report on Form 10-K filed with the SEC on March 3, 2008.

(5) Incorporated herein by reference to the Registrant s Current Report on Form 8-K filed with the SEC on October 6, 2009.