

INPHI Corp
Form 10-Q
August 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2011

or

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission file number: 001-34942

Inphi Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

3945 Freedom Circle, Suite 1100,

77-0557980
(I.R.S. Employer
Identification No.)

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Santa Clara, California 95054

(Address of Principal Executive Offices) (Zip Code)

(408) 217-7300

(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. 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. (Check one):

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

(Do not check if a smaller reporting company)

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

The total number of shares outstanding of the Registrant's common stock, \$0.001 par value per share, as of August 4, 2011 was 27,374,010.

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QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE MONTHS ENDED JUNE 30, 2011
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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****INPHI CORPORATION****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

	June 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 32,562	\$ 110,172
Short-term investments in marketable securities	86,494	
Accounts receivable, net	10,898	10,052
Inventories	6,269	5,095
Deferred tax assets	1,665	1,665
Income tax receivable	7,218	2,214
Prepaid expenses and other current assets	2,194	1,366
Total current assets	147,300	130,564
Property and equipment, net	8,135	7,206
Goodwill	5,875	5,847
Identifiable intangible assets	1,440	1,624
Deferred tax assets	6,071	6,182
Deferred tax charge	7,822	7,293
Other assets, net	326	241
Total assets	\$ 176,969	\$ 158,957
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 4,919	\$ 6,692
Deferred revenue	2,031	2,647
Accrued employee expenses	1,773	1,749
Other accrued expenses	3,811	1,843
Other current liabilities	137	746
Total current liabilities	12,671	13,677
Other liabilities	3,353	2,594
Total liabilities	16,024	16,271
Commitments and contingencies (Note 15)		
Stockholders equity:		
Preferred stock, \$0.001 par value; 10,000,000 shares authorized; no shares issued		
Common stock, \$0.001 par value; 500,000,000 shares authorized; 27,212,356 and 25,088,122 issued and outstanding at June 30, 2011 and December 31, 2010,	27	25

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respectively		
Additional paid-in capital	189,827	176,505
Accumulated deficit	(29,801)	(34,644)
Accumulated other comprehensive income	892	800
Total stockholders' equity	160,945	142,686
Total liabilities and stockholders' equity	\$ 176,969	\$ 158,957

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

Table of Contents**INPHI CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenue ⁽¹⁾	\$ 24,001	\$ 21,099	\$ 45,505	\$ 40,185
Cost of revenue	8,458	7,344	15,845	14,531
Gross profit	15,543	13,755	29,660	25,654
Operating expense:				
Research and development	7,292	5,126	13,661	10,192
Sales and marketing	3,138	2,049	5,719	4,124
General and administrative	2,377	2,568	4,419	4,471
Total operating expense	12,807	9,743	23,799	18,787
Income from operations	2,736	4,012	5,861	6,867
Other income (expense)	90	(34)	131	(7)
Income before income taxes	2,826	3,978	5,992	6,860
Provision (benefit) for income taxes	383	(3,600)	1,149	(12,717)
Net income	\$ 2,443	\$ 7,578	\$ 4,843	\$ 19,577
Net income to common and participating common securities	\$ 2,443	\$ 832	\$ 4,843	\$ 2,281
Earnings per share:				
Basic	\$ 0.09	\$ 0.37	\$ 0.19	\$ 1.05
Diluted	\$ 0.08	\$ 0.14	\$ 0.16	\$ 0.41
Weighted-average shares used in computing earnings per share:				
Basic	26,701,216	2,195,355	25,965,303	2,099,392
Diluted	29,632,068	5,839,034	29,453,655	5,507,466

(1) Includes related party revenue of \$7,825 and \$14,249 for the three and six months ended June 30, 2010, respectively see Note 16 of notes to the unaudited condensed consolidated financial statements.

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

Table of Contents**INPHI CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Six Months Ended June 30,	
	2011	2010
Cash flows from operating activities		
Net income	\$ 4,843	\$ 19,577
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,601	703
Stock-based compensation	2,943	850
Deferred income taxes	(848)	(14,072)
Excess tax benefit related to stock-based compensation	(6,114)	
Other noncash items	188	24
Changes in assets and liabilities, net of effects of acquisition:		
Accounts receivable	(844)	(1,713)
Inventories	(1,174)	(1,144)
Prepaid expenses and other assets	(529)	(871)
Income tax payable/receivable	1,933	683
Accounts payable	(729)	498
Accrued expenses	1,987	1,103
Deferred revenue	(616)	3,231
Other liabilities	(234)	(155)
Net cash provided by operating activities	2,407	8,714
Cash flows from investing activities		
Purchases of property and equipment	(2,649)	(1,499)
Acquisition, net of cash acquired		(2,499)
Purchases of marketable securities	(87,001)	
Sales and maturities of marketable securities	53	
Proceeds from sale of equipment	7	
Net cash used in investing activities	(89,590)	(3,998)
Cash flows from financing activities		
Proceeds from exercise of stock options and warrants	3,299	390
Excess tax benefit related to stock-based compensation	6,114	
Proceeds from the secondary public offerings, net of issuance costs	1,259	
Costs paid in connection with initial public offering	(1,098)	(36)
Net cash provided by financing activities	9,574	354
Effect of currency exchange rates on cash and cash equivalents	(1)	
Net increase (decrease) in cash and cash equivalents	(77,610)	5,070
Cash and cash equivalents at beginning of period	110,172	19,061

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Cash and cash equivalents at end of period	\$	32,562	\$	24,131
Supplemental Cash Flow Information				
Income taxes paid	\$		\$	672
Noncash investing and financing activities				
Acquisition of Winyatek Technology Inc. in exchange for Series E preferred shares	\$		\$	4,538
Unrealized gain on investments, net of tax		62		

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

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INPHI CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share amounts)

1. Organization and Basis of Presentation

Inphi Corporation (the Company), a Delaware corporation, was incorporated in November 2000. The Company is a fabless provider of high-speed analog semiconductor solutions for the communications and computing markets. The Company's semiconductor solutions are designed to address bandwidth bottlenecks in networks, maximize throughput and minimize latency in computing environments and enable the rollout of next generation communications and computing infrastructures. In addition, the Company's semiconductor solutions provide a vital high-speed interface between analog signals and digital information in high-performance systems such as telecommunications transport systems, enterprise networking equipment, datacenter and enterprise servers, storage platforms, test and measurement equipment and military systems.

The interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP), for interim financial information and with the instructions to Securities and Exchange Commission (SEC), Form 10-Q and Article 10 of SEC Regulation S-X. They do not include all of the information and footnotes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2010, included in the Company's Annual Report on Form 10-K filed with the SEC on March 7, 2011.

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 at June 30, 2011, its consolidated results of operations for the three and six months ended June 30, 2011 and 2010 and its cash flows for the six months ended June 30, 2011 and 2010. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for future quarters or the full year.

In October 2010, the Company's Board of Directors approved a 3-for-7 reverse stock split of the Company's issued and outstanding shares of common stock and preferred stock, which was effected on November 3, 2010. All common stock and preferred stock data and stock option plan information has been adjusted to reflect the split.

2. Recent Accounting Pronouncements

In May 2011, Financial Accounting Standards Board (FASB) issued an amendment to its accounting guidance on fair value measurement. The amendments provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between GAAP and International Financial Reporting Standards. The amendments change certain fair value measurement principles and enhance the disclosure requirements about fair value measurements. This guidance is effective during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Company is currently evaluating the impact of this guidance on the consolidated financial statements.

In June 2011, FASB issued an amendment to its accounting guidance on comprehensive income. The amendments require an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments eliminate the option to present the components of other comprehensive income as part of the statement of equity. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. This guidance will change how the Company presents other comprehensive income.

3. Investments

Investments in marketable securities consist of available-for-sale securities. These investments are recorded at fair value with changes in fair value, net of applicable taxes, recorded as unrealized gains (losses) as a component of accumulated other comprehensive income in stockholders equity. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in Other (expense) income, net. The cost basis for realized gains and losses on available-for-sale securities is determined on a specific identification basis. Investments are made based on our investment policy which restricts the types of investments that can be made. The Company classified available-for-sale securities as short-term as the investments are available to be used in current operations.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except share and per share amounts)

The following table summarizes the investments by investment category as of June 30, 2011:

	Cost	Fair Value
Available-for-sale securities:		
US treasury securities	\$ 23,957	\$ 23,961
Municipal bonds	45,725	45,828
Corporate notes/bonds	12,208	12,204
Certificate of deposit	1,000	1,001
Variable rate demand notes	2,500	2,500
Asset backed securities	1,000	1,000
 Total investments	 \$ 86,390	 \$ 86,494

As of June 30, 2011, we had 16 investments that were in an unrealized loss position. The gross unrealized losses related to these investments were due to changes in interest rates. The Company determined that the gross unrealized losses on these investments at June 30, 2011 are temporary in nature. The Company reviews the investments to identify and evaluate investments that have an indication of possible other-than-temporary impairment. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

4. Concentrations

Financial instruments that subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, investments and trade accounts receivable. The Company extends differing levels of credit to customers and does not require collateral deposits. As of June 30, 2011 and December 31, 2010, the Company maintained an allowance for doubtful accounts of \$68.

The following table summarizes the significant customers' revenue and accounts receivable as a percentage of total revenue and total accounts receivable, respectively:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Revenue				
Customer A	30%	37%	29%	35%
Customer C	17	*	15	*
	June 30,		December 31,	
	2011		2010	
Accounts Receivable				
Customer A	22%		33%	
Customer C	21		11	

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* Less than 10% of total revenue or accounts receivable

The Company has two customers who are distributors that sell the Company's products exclusively to an end customer. In the aggregate, revenue to such end customer, including revenue made through distributors as a percentage of total revenue was 12% and 14% for the three and six months ended June 30, 2010, respectively.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands, except share and per share amounts)****5. Inventories**

Inventories consist of the following:

	June 30, 2011	December 31, 2010
Raw materials	\$ 1,304	\$ 1,028
Work in process	2,016	2,033
Finished goods	2,949	2,034
	\$ 6,269	\$ 5,095

Finished goods include inventories held by distributors of \$521 and \$482 as of June 30, 2011 and December 31, 2010, respectively.

6. Property and Equipment, net

Property and equipment consist of the following:

	June 30, 2011	December 31, 2010
Laboratory and production equipment	\$ 13,386	\$ 11,882
Office, software and computer equipment	3,960	3,655
Furniture and fixtures	615	729
Leasehold improvements	3,099	2,652
	21,060	18,918
Less accumulated depreciation	(12,925)	(11,712)
	\$ 8,135	\$ 7,206

Depreciation and amortization expense of property and equipment for the three and six months ended June 30, 2011 was \$737 and \$1,410, respectively. Depreciation and amortization expense of property and equipment for the three and six months ended June 30, 2010 was \$348 and \$703, respectively.

As of June 30, 2011 and December 31, 2010, laboratory and production equipment includes \$397 in assets that have been capitalized under capital leases. Accumulated amortization of equipment under capital leases was \$397 and \$388 as of June 30, 2011 and December 31, 2010, respectively. Amortization expense in connection with equipment purchased under capital leases was \$2 and \$9 for the three and six months ended June 30, 2011, respectively. Amortization expense in connection with equipment purchased under capital leases was \$14 and \$32 for the three and six months ended June 30, 2010, respectively.

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As of June 30, 2011 and December 31, 2010, computer software costs included in property and equipment were \$1,563 and \$1,471, respectively. Amortization expense of capitalized computer software costs was \$58 and \$113 for the three and six months ended June 30, 2011, respectively. Amortization expense of capitalized computer software costs was \$45 and \$84 for the three and six months ended June 30, 2010, respectively.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands, except share and per share amounts)****7. Goodwill and Identifiable Intangible Assets**

The change in goodwill from December 31, 2010 of \$5,847 to June 30, 2011 of \$5,875 was due to foreign currency translation.

The following table presents details of identifiable intangible assets:

	June 30, 2011			December 31, 2010		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Developed technology	\$ 890	\$ 222	\$ 668	\$ 886	\$ 111	\$ 775
Customer relationships	812	162	650	808	81	727
In-process research and development	122		122	122		122
	\$ 1,824	\$ 384	\$ 1,440	\$ 1,816	\$ 192	\$ 1,624

The change in gross amount of identifiable intangible assets was due to foreign currency translation. Amortization expense for amortizing intangible assets was \$98 and \$191 for the three and six months ended June 30, 2011, respectively.

8. Product Warranty Obligation

As of June 30, 2011 and December 31, 2010, the product warranty liability was \$1,000 and \$602, respectively. The following table sets forth changes in warranty accrual included in other accrued expenses in the Company's consolidated balance sheets:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Beginning balance	\$ 615	\$ 450	\$ 602	\$ 450
Accruals for warranties	385	83	398	83
Settlements		(13)		(13)
	\$ 1,000	\$ 520	\$ 1,000	\$ 520

In September 2010, the Company was informed of a claim related to repair and replacement costs in connection with shipments of over 4,000 integrated circuits made by the Company during the summer and fall of 2009. Of these shipments, approximately 4% were later confirmed or suspected to have random manufacturing process anomalies in the wafer die in the product. These anomalies made the circuitry of a small number of random die per foundry wafer susceptible to failure under certain customer specific system operating conditions. At the time of shipment in 2009 and early 2010, the Company established an initial warranty reserve and added to that accrual as the problem was identified and reliable information became available. The foundry who produced the wafers has informed the Company that the random anomalies are normal in a Gallium Arsenide (GaAs) manufacturing process.

In March 2010, the Company developed additional tests to screen out the wafer die that might be susceptible to this type of failure and resumed shipments to the customer with no subsequent additional reported incidents. Based on its standard warranty provisions, the Company has

provided replacement parts to the customer for the known and suspected failures that had occurred.

In addition and without informing the Company, in the fall of 2009 the customer instituted its own larger scale replacement program that covered the replacement of entire subassemblies in which the Company's product was only one component. In September 2010, the customer made an initial claim for approximately \$18 million against the Company for the costs incurred relative to that program. In an email in June 2011, the customer reduced its initial claim to \$ 6.6 million. Management believes the amount and basis of the claims made to date are without merit as its warranty liability is contractually limited to the repair or replacement of the Company's affected products, which to the extent the customer has requested replacement, has already been completed. A formal claim has yet to be made and discussions with the customer are ongoing. At this time, the Company believes its current warranty reserves are adequate to address the matter and that the Company's obligations under its standard warranty provisions have been fulfilled. However, claims of this nature are subject to various risks and uncertainties and there can be no assurance that this matter will be resolved without further significant costs to the Company, including the potential for arbitration or litigation. If and when the amount of any additional loss, if any, becomes both probable and determinable, the Company may be required to record an incremental reserve.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Dollars in thousands, except share and per share amounts)

9. Income Taxes

The Company recorded an income tax provision of \$383 and \$1,149 in the three and six months ended June 30, 2011, respectively. During the three and six months ended June 30, 2010, the Company recorded a tax benefit of \$3,600 and \$12,717, respectively. The effective tax rate for the three and six months ended June 30, 2011 was 14% and 19%, respectively from (91%) and (185%) in the comparable period of 2010. The difference between the effective tax rates and the 35% federal statutory rate resulted primarily from foreign income taxes provided at lower rates, geographic mix in expected operating results, recognition of research and development credits, unrecognized tax benefits, and release of valuation allowance in 2010. In the three months ended June 30, 2011, the Company recognized significant tax benefits from stock option exercises and disqualifying dispositions. The portion of the tax benefits attributable to cumulative book stock option compensation expense was recorded as a discrete income tax benefit and the excess tax benefit was recorded to additional paid in capital. However, the Company did not record any excess tax benefits that were not expected to reduce income tax payable due to anticipated current year taxable losses.

During the three and six months ended June 30, 2011, the gross amount of the Company's unrecognized tax benefits increased approximately \$356 and \$568, respectively as a result of tax positions taken during the current year. Substantially all of the unrecognized tax benefits as of June 30, 2011, if recognized, would affect the Company's effective tax rate. As of June 30, 2011, the Company does not expect any significant increases or decreases to its unrecognized tax benefits within the next 12 months.

The Company does not provide for U.S. income taxes on undistributed earnings of its controlled foreign corporations that are intended to be invested indefinitely outside the United States.

10. Earnings Per Share

The following shows the computation of basic and diluted earnings per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Numerator				
Net income	\$ 2,443	\$ 7,578	\$ 4,843	\$ 19,577
Less amount allocable to preferred stockholders		(6,746)		(17,296)
Net income allocable to common and participating common securities	2,443	832	4,843	2,281
Less amount allocable to unvested early exercised options and restricted stock award	(3)	(27)	(6)	(74)
Net income allocable to common stockholders - basic	2,440	805	4,837	2,207
Add amount allocable to unvested early exercised options and restricted stock award		21		58
Net income allocable to common stockholders - diluted	\$ 2,440	\$ 826	\$ 4,837	\$ 2,265
Denominator				

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Weighted average common stock	26,735,195	2,268,081	25,999,282	2,166,310
Less weighted average unvested common stock subject to repurchase and unvested restricted stock award	(33,979)	(72,726)	(33,979)	(66,918)
Weighted average common stock basic	26,701,216	2,195,355	25,965,303	2,099,392
Effect of potentially dilutive securities:				
Add options to purchase common stock	2,917,162	3,545,282	3,467,261	3,314,894
Add unvested common stock subject to repurchase, unvested restricted stock award and restricted stock unit	1,519	61,047	2,182	61,047
Add warrants to purchase common stock	12,171	37,350	18,909	32,133
Weighted-average common stock diluted	29,632,068	5,839,034	29,453,655	5,507,466
Earnings per share				
Basic	\$ 0.09	\$ 0.37	\$ 0.19	\$ 1.05
Diluted	\$ 0.08	\$ 0.14	\$ 0.16	\$ 0.41

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands, except share and per share amounts)**

Net income has been allocated to the common stock, convertible participating preferred stock before conversion to common stock, unvested early exercised options and unvested restricted stock awards based on their respective rights to share in dividends.

The following securities were not included in the computation of diluted earnings per share as inclusion would have been anti-dilutive:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Convertible preferred stock		14,485,147		14,483,433
Common stock options	580,464	725,206	304,868	365,671
Warrant to purchase redeemable convertible preferred stock				15,045
Restricted stock unit	564,750		255,758	
Restricted stock award and unvested common stock subject to repurchase	33,979	11,679	33,979	5,872
	1,179,193	15,222,032	594,605	14,870,021

11. Stock-Based Compensation

In 2000, the Company adopted the 2000 Stock Option/Stock Issuance Plan (the "2000 Plan"). Under the provisions of the 2000 Plan, employees, outside directors, consultants and other independent advisors who provide services to the Company may be issued incentive and non-qualified stock options to purchase common stock or may be issued shares of common stock directly. The Board of Directors is authorized to administer the 2000 Plan and establish the stock option terms, including the exercise price and vesting period. Options granted under the plan may have varying vesting schedules; however, options generally vest 25% upon completion of one year of service and thereafter in 36 equal monthly installments. Options granted are immediately exercisable and the shares issued upon exercise of the option are subject to a repurchase right held by the Company. The repurchase price under the repurchase right is the original exercise price and the right lapses in accordance with the option-vesting schedule. There were 4,697 and 32,875 unvested shares subject to the Company's repurchase right as of June 30, 2011 and December 31, 2010, respectively. The proceeds received from the unvested early exercise of options are presented in the balance sheet as liabilities and subsequently classified to equity based on the vesting schedule. The vesting of certain options granted or shares issued under the 2000 Plan is subject to acceleration of vesting upon the occurrence of certain events as defined in the 2000 Plan.

Under the 2000 Plan, the exercise price, in the case of an incentive stock option, can-not be less than 100%, and in the case of a nonqualified stock option, not less than 85%, of the fair market value of such shares on the date of grant. The term of the option is determined by the Board but in no case can exceed 10 years.

In June 2010, the Board of Directors approved the Company's 2010 Stock Incentive Plan (the "2010 Plan"), which became effective in November 2010. Upon completion of the Company's initial public offering, shares originally reserved for issuance under the 2000 Plan but which were not issued or subject to outstanding grants on the effective date of the 2010 Plan, and shares subject to outstanding options or forfeiture restriction under the 2000 Plan on the effective date of the 2010 Plan that are subsequently forfeited or terminated before being exercised, become available for awards under the 2010 Plan, up to 428,571 shares. The 2010 Plan provides for the grants of restricted stock, stock appreciation rights and stock unit awards to employees, non-employee directors, advisors and consultants. The Board of Directors administer the 2010 Plan, including the determination of the recipient of an award, the number of shares subject to each award, whether an option is to be classified as an incentive stock option or nonstatutory option, and the terms and conditions of each award, including the exercise and purchase prices and the vesting or duration of the award. Options granted under the 2010 Plan are exercisable only upon vesting. At June 30, 2011, 2,239,478 shares of common

stock have been reserved for issuance under the 2010 Plan.

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INPHI CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands, except share and per share amounts)

Stock Option Awards

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Risk-free interest rate	2.84%	3.33%	2.84%	3.30%
Expected life (in years)	6.46	6.57	6.45	6.52
Dividend yield				
Expected volatility	50.00%	60.00%	50.00%	60.00%

The following table summarizes information regarding options outstanding:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at December 31, 2010	6,672,249	\$3.85	6.88	\$ 108,369
Granted	625,100	21.88		
Exercised	(1,987,601)	1.65		
Canceled	(239,001)	8.29		
Outstanding at June 30, 2011	5,070,747	\$6.73	7.11	\$ 56,910
Exercisable at June 30, 2011	4,454,147	\$4.63	6.74	\$ 56,910
Vested at June 30, 2011	2,445,395	\$2.37	5.83	\$ 36,770
Vested and expected to vest at June 30, 2011	5,006,699	\$6.64	7.09	\$ 56,554

The intrinsic value of options outstanding, exercisable and vested and expected to vest is calculated based on the difference between the exercise price and the fair value of the Company's common stock as of the respective balance sheet dates.

The total fair value of employee options vested during the six months ended June 30, 2011 and 2010 was \$1,597 and \$383, respectively.

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The weighted average grant date fair value per share of stock options granted to employees during the six months ended June 30, 2011 and 2010 was \$11.48 and \$5.25, respectively.

The total intrinsic value of options exercised during the six months ended June 30, 2011 and 2010 was \$39,271 and \$2,822, respectively. The intrinsic value of exercised options is calculated based on the difference between the exercise price and the fair value of the Company's common stock as of the exercise date. Cash received from the exercise of stock options was \$3,280 and \$390, respectively, for the six months ended June 30, 2011 and 2010.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Dollars in thousands, except share and per share amounts)

Restricted Stock Units and Awards

The Company granted restricted stock units and awards to the board of directors and employees. Most of the Company's outstanding restricted stock units vest over four years with vesting contingent upon continuous service. The Company estimates the fair value of restricted stock units and awards using the market price of the common stock on the date of the grant. The fair value of these awards is amortized on a straight-line basis over the vesting period.

The following table summarizes information regarding outstanding restricted stock units:

	Number of Shares	Weighted Average Grant Date Fair Value (per share)
Outstanding at December 31, 2010		\$
Granted	663,021	21.94
Canceled	(2,000)	22.07
Outstanding at June 30, 2011	661,021	21.94
Expected to vest at June 30, 2011	637,067	

As of December 31, 2010, the Company has 34,284 outstanding nonvested restricted stock awards, 5,000 of which vested during the six months ended June 30, 2011 resulting to 29,284 nonvested restricted stock awards as of June 30, 2011.

Stock-Based Compensation Expense

Stock-based compensation expense is included in the Company's results of operations as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Operating expenses				
Cost of goods sold	\$ 119	\$ 16	\$ 160	\$ 27
Research and development	1,066	240	1,345	362
Sales and marketing	660	93	798	169
General and administrative	470	180	640	292
	\$ 2,315	\$ 529	\$ 2,943	\$ 850

As of June 30, 2011, total unrecognized compensation cost related to unvested stock options and awards at June 30, 2011, prior to the consideration of expected forfeitures, is approximately \$27,875 which is expected to be recognized over a weighted-average period of 3.41 years.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Dollars in thousands, except share and per share amounts)

12. Comprehensive Income

The components of comprehensive income are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net income	\$ 2,443	\$ 7,578	\$ 4,843	\$ 19,577
Foreign currency translation adjustment	152		30	
Unrealized gain on available-for-sale securities, net of tax	62		62	
	\$ 2,657	\$ 7,578	\$ 4,935	\$ 19,577

13. Fair Value Measurements

The guidance on fair value measurements requires fair value measurements to be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability, or

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The Company measures its investments in marketable securities at fair value using the market approach. The Company has cash equivalents which consist of money market funds valued using the amortized cost method, in accordance with Rule 2a-7 under the 1940 Act which approximates fair value.

The following table presents the fair value hierarchy of financial assets measured at fair value on a recurring basis as of June 30, 2011:

	Total	Level 1	Level 2
Assets			
Cash equivalents:			
Money market funds	\$ 12,333	\$	\$ 12,333
Municipal bonds	4,000		4,000
Commercial paper	2,000		2,000
Investment in marketable securities:			
US treasury securities	23,961	23,961	
Municipal bonds	45,828		45,828
Corporate notes/bonds	12,204		12,204

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Certificate of deposit	1,001		1,001
Variable rate demand notes	2,500		2,500
Asset backed securities	1,000		1,000
	\$ 104,827	\$ 23,961	\$ 80,866

There were no transfers between Level 1 and Level 2 securities during the six months ended June 30, 2011. As of December 31, 2010, the Company had cash equivalents held in money market funds of \$80,017 which were categorized as Level 2.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Dollars in thousands, except share and per share amounts)

14. Segment and Geographic Information

The Company operates in one reportable segment. The Company's Chief Executive Officer, who is considered to be the chief operating decision maker, manages the Company's operations as a whole and reviews consolidated financial information for purposes of evaluating financial performance and allocating resources. Revenue by region is classified based on the locations to which the product is transported, which may differ from the customer's principal offices.

The following table sets forth the Company's revenue by geographic region:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
China	\$ 8,206	\$ 6,277	\$ 16,198	\$ 11,535
United States	4,213	3,049	7,731	6,347
Korea	5,427	4,832	8,619	8,712
Taiwan	1,687	1,931	3,601	4,321
Germany	1,627	442	3,859	698
Japan	1,331	1,610	2,563	3,084
Other	1,510	2,958	2,934	5,488
	\$ 24,001	\$ 21,099	\$ 45,505	\$ 40,185

As of June 30, 2011, \$1,768 of long-lived tangible assets are located outside the United States, of which \$1,365 are located in Taiwan. As of December 31, 2010, \$1,280 of long-lived tangible assets are located outside the United States, of which \$864 are located in Taiwan.

15. Commitments and Contingencies**Leases**

The Company leases its facility and certain equipment under noncancelable lease agreements expiring in various years through 2016. The Company also licenses certain software used in its research and development activities under a term license subscription and maintenance arrangement.

As of June 30, 2011, future minimum lease payments under noncancelable operating leases having initial terms in excess of one year are as follows:

2011	\$ 2,004
2012	3,011
2013	1,214
2014	1,220
2015	1,038
2016	768

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\$ 9,255

For the three and six months ended June 30, 2011, lease operating expense was \$836 and \$1,655, respectively. For the three and six months ended June 30, 2010, lease operating expense was \$788 and \$1,494, respectively.

Table of Contents**INPHI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Dollars in thousands, except share and per share amounts)

Noncancelable Purchase Obligations

The Company's noncancelable purchase obligations consisted primarily of license and consulting fees the Company committed to pay under several agreements. As of June 30, 2011, the Company's future noncancelable purchase obligations are as follows:

2011	\$ 342
2012	418
	\$ 760

Legal Proceedings

Netlist, Inc. v. Inphi Corporation, Case No. 09-cv-6900 (C.D. Cal.)

On September 22, 2009, Netlist filed suit in the United States District Court, Central District of California, or the Court, asserting that the Company infringes U.S. Patent No. 7,532,537. Netlist filed an amended complaint on December 22, 2009, further asserting that the Company infringes U.S. Patent Nos. 7,619,912 and 7,636,274, collectively with U.S. Patent No. 7,532,537, the patents-in-suit, and seeking both unspecified monetary damages to be determined and an injunction to prevent further infringement. These infringement claims allege that the Company's iMB and certain other memory module components infringe the patents-in-suit. The Company answered the amended complaint on February 11, 2010 and asserted that the Company does not infringe the patents-in-suit and that the patents-in-suit are invalid. The Company has since filed requests for *Inter Partes* Reexamination with the United States Patent and Trademark Office (the USPTO), asserting that the patents-in-suit are invalid. The USPTO is required to grant or deny the reexamination requests within three months of their effective filing dates, which, due to re-filing of certain papers for procedural compliance, was June 4, 2010 for U.S. Patent No. 7,636,274, June 8, 2010 for U.S. Patent No. 7,619,912 and June 9, 2010 for U.S. Patent No. 7,532,537. The USPTO accepted these filings of the requests for *Inter Partes* Reexamination for U.S. Patent Nos. 7,636,274, 7,619,912 and 7,532,537.

On August 27, 2010, the USPTO ordered the request for *Inter Partes* Reexamination for U.S. Patent No. 7,636,274 and found a substantial new question of patentability based upon each of the different issues that the Company raised as the reexamination requestor. The USPTO had not, however, accompanied its Reexamination Order of U.S. Patent No. 7,636,274 with its own evaluation of the validity of this patent, indicating that such evaluation will be forthcoming at a later time.

On September 8, 2010, the USPTO ordered the request for *Inter Partes* Reexamination for U.S. Patent No. 7,532,537 and found a substantial new question of patentability based upon different issues that the Company raised as the reexamination requestor. The USPTO accompanied this Reexamination Order of U.S. Patent No. 7,532,537 with its own evaluation of the validity of this patent, and rejected some but not all of claims. In a response dated October 8, 2010, Netlist responded to the USPTO determination by amending some but not all of the claims, adding new claims and making arguments as to why the claims were not invalid in view of the cited references. The Company provided rebuttable comments to the USPTO on November 8, 2010 along with a Petition requesting an increase in the number of allowed pages of the rebuttable comments. On January 20, 2011, the USPTO granted the Petition in part. The Company then filed updated rebuttal comments on January 27, 2011 in compliance with the granted Petition. The USPTO has considered these updated rebuttal comments, and in a communication dated June 15, 2011, continued to reject all the previously rejected claims. The USPTO also rejected all the claims newly added in the October 8, 2010 Netlist response. In a further communication dated June 21, 2011, the USPTO issued an Action Closing Prosecution indicating that it would confirm the patentability of four claims and reject all the other pending claims. The proceeding is expected to continue in accordance with established *Inter Partes* Reexamination procedures, with Netlist required to file its response to the June 15, 2011 communication and the Action Closing Prosecution dated June 21, 2011 as the next substantive step.

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On September 8, 2010, the USPTO ordered the request for *Inter Partes* Reexamination for U.S. Patent No. 7,619,912 and found a substantial new question of patentability based upon different issues that the Company raised as the reexamination requestor. The USPTO accompanied this Reexamination Order of U.S. Patent No. 7,619,912 with its own evaluation of the validity of this patent and initially determined that all of the claims were patentable based upon the Company's request for *Inter Partes* Reexamination. Netlist did not comment upon this Reexamination Order. The USPTO on February 28, 2011 also merged the Proceedings of the Company's Reexamination of U.S. Patent No. 7,619,912, bearing Control No. 90/001,339 with *Inter Partes* Reexamination Proceeding 95/000,578 filed October 20, 2010 on behalf of SMART Modular Technologies, Inc. and *Inter Partes* Reexamination Proceeding 95/000,579 filed October 21, 2010 on behalf of Google, Inc. In each of these other Reexamination Proceedings, the USPTO had indicated that there existed a substantial new question of patentability with respect to certain claims of U.S. Patent No. 7,619,912, but had not accompanied the Reexamination Orders related thereto with its own evaluation of the validity of this patent, indicating that such evaluation would be forthcoming at a later time. This further evaluation was received in an Office Action dated April 4, 2011, in which the Examiner rejected a substantial majority of the claims based upon a number of different rejections, including certain of the rejections originally proposed by the Company in its Request for Reexamination. This Office Action also indicated that one claim was deemed to be patentable over the prior art of record in the merged Reexamination Proceedings. After seeking and obtaining an

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INPHI CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands, except share and per share amounts)

extension of time to respond to the Office Action dated April 4, 2011, Netlist served its response on July 5, 2011, which added new claims and made arguments as to why the originally filed claims were not invalid in view of the cited references, as well as a petition requesting additional pages with which to file its response. On July 29, 2011, the USPTO accepted this petition and accorded Requestors 30 days from this date in which respond to the Netlist response served July 5, 2011. The merged Reexamination Proceeding will be conducted in accordance with established procedures for merged Reexamination Proceedings.

The reexamination proceedings could result in a determination that the patents-in-suit, in whole or in part, are valid or invalid, as well as modifications of the scope of the patents-in-suit.

A third party, Sanmina-SCI Corporation, or SSC, has also requested interference proceedings with the USPTO with respect to each of the patents-in-suit. In its April 21, 2010 Request for Continued Examination of U.S. Application No. 11/142,989 (SSC 989 patent application), SSC asserted that it has priority to the inventions claimed by the patents-in-suit and should be granted rights to those inventions. The Company has entered into an agreement with SSC for a non-exclusive license to those rights, if any, that SSC may obtain to the inventions claimed by the patents-in-suit if the USPTO agrees to commence interference proceedings and if SSC prevails in those proceedings.

The USPTO, in a communication dated July 7, 2010, acknowledged that claims were submitted in a filing made in the SSC 989 patent application to invoke an Interference with each of the patents-in-suit, but has declined to declare an Interference at this time. The July 7, 2010 USPTO communication rejected the claims submitted to invoke the Interference based upon 35 USC 112, with the rejection asserting that these claims contain subject matter which was not described in the specification in such a way as to reasonably convey to one skilled in the relevant art that the inventor(s), at the time the application was filed, had possession of the claimed invention. SSC responded to this USPTO communication on December 24, 2010 and provided an updated response on March 23, 2011 to comply with formalities noted by the USPTO. The USPTO, in a communication dated June 8, 2011, continued to reject the claims submitted to invoke the interference based upon the previously made rejections, and SSC now has until December 8, 2011 to respond to this USPTO communication.

In connection with the reexamination requests and the interference proceedings, the Company also filed a motion to stay proceedings with the Court, which was granted on May 18, 2010, whereby the Court stayed the proceedings until at least February 14, 2011, requested that Netlist notify the Court within one week of any action taken by the USPTO in connection with the reexamination or interference proceedings, and requested that the parties file papers by January 31, 2011 stating their position on whether the stay should be extended. The Company filed its paper on January 31, 2011 stating the reasons it believed the stay should be maintained and Netlist, having been given leave to file its paper later, filed its paper on February 21, 2011. Based on these papers the Court ordered a continued stay of the proceedings until at least February 24, 2012 and requested that the parties file papers by January 30, 2012 stating their position on whether the stay should be extended, and continued the request that Netlist notify the Court within one week of any action taken by the USPTO in connection with the reexamination or interference proceedings. At this time, the Court could decide to maintain or lift the stay. While the Company intends to defend the lawsuit vigorously, litigation, whether or not determined in the Company's favor or settled, could be costly and time-consuming and could divert management's attention and resources, which could adversely affect the Company's business.

If this litigation results in an adverse outcome, the Company may be required to cease the manufacture, use or sale of any product held to infringe Netlist's patents, including the Company's iMB product, unless and until the Company or the customers obtain a license from Netlist. A license from Netlist may or may not be available on commercially reasonable terms. An adverse outcome could also result in the Company having to pay damages for infringement and the expenditure of significant resources to redesign any infringing product, including the iMB product, in a non-infringing manner, which may or may not be successful. To date, the Company only sampled the iMB product and, as a result, the Company generated minimal revenue. The Company's ability to generate future revenue from the iMB product, could be adversely affected, though it is currently difficult to estimate the level at which this may affect the Company's revenue.

The Company is unable to assess the possible outcome of this matter. However, because of the nature and inherent uncertainties of litigation, should the outcome of this action be unfavorable, the Company's business, financial condition, results of operations or cash flows could be materially and adversely affected.

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INPHI CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands, except share and per share amounts)

Indemnifications

In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to customers, vendors, lessors, investors, directors, officers, employees and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company's breach of such agreements, services to be provided by the Company, or from intellectual property infringement claims made by third-parties. These indemnifications may survive termination of the underlying agreement and the maximum potential amount of future payments the Company could be required to make under these indemnification provisions may not be subject to maximum loss clauses. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnifications. As a result, the Company believes the estimated fair value of these agreements is immaterial. Accordingly, the Company has no liabilities recorded for these agreements as of June 30, 2011 and December 31, 2010.

16. Related Party Transactions

The Company recognized \$7,302 and \$13,287 in revenue during the three and six months ended June 30, 2011, respectively, from an investor. The Company recognized \$7,825 and \$14,249 in revenue during the three and six months ended June 30, 2010, respectively, from an investor. The receivable balance from the investor as of June 30, 2011 and December 31, 2010 was \$2,379 and \$3,386, respectively. The investor, together with associated entities, held over 13% of the Company's outstanding shares of common stock before the initial public offering. After the initial public offering in November 2010, the investor, together with associated entities, holds less than 10% of the Company's outstanding shares of common stock. As a result of the decline in ownership below 10% of the outstanding common stock, the Company no longer considers the investor a related party.

In 2007, the Company entered into a software subscription and maintenance agreement with Cadence Design Systems, Inc. (Cadence), a related party company. A member of the Company's Board of Directors is also the Chief Executive Officer, President and a director of Cadence. The Company committed to pay \$7,000 payable in 16 quarterly payments through May 2011. In December 2010, the software subscription and maintenance agreement was renewed effective June 30, 2011. Under the new agreement, the Company committed to pay \$5,250 payable in 10 quarterly payments through November 2013. The Company paid \$1,175 and \$1,050 in the six months ended June 30, 2011 and 2010, respectively. Operating lease expense related to this agreement included in research and development expense was \$487 and \$983 for the three and six months ended June 30, 2011, respectively. Operating lease expense related to this agreement included in research and development expense was \$437 and \$875 for the three and six months ended June 30, 2010, respectively.

17. Subsequent Events

In July 2011, the Board of Directors granted 70,865 options to purchase shares of common stock with an exercise price of \$16.63 per share and 49,835 restricted stock units to the Company's employees with a fair value of \$16.63 per share.

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

The following discussion of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and notes to those statements included elsewhere in this Report. This Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this report, terms objective, should, can, believe, expect, estimate, predict, potential, anticipate, will, contemplate, would, project, plan, may, could, intend, likely, might, continue and similar expressions that contemplate future events may identify forward-looking statements, including statements regarding our expectation of revenue and operating expenses, sources of revenue, our tax benefits, the benefits of our products and services, timing of the development of our products, our anticipated cash needs and our estimates regarding our capital requirements and our needs for additional financing, our anticipated growth and growth strategies, our ability to retain and attract customers, particularly in light of our dependence on a limited number of customers for a substantial portion of our revenue, our expectations regarding competition, interest rate sensitivity, adequacy of our disclosure controls, our legal proceedings and warranty claims. These forward-looking statements involved known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these or any other forward-looking statements. These risks and uncertainties include, but are not limited to, those risks discussed below, as well as factors affecting our quarterly results, our ability to manage our growth, our ability to sustain or increase profitability, demand for our solutions, the effect of declines in average selling prices for our products, our ability to compete, our ability to rapidly develop new technology and introduce new products, our ability to safeguard our intellectual property, trends in the semiconductor industry and fluctuations in general economic conditions, and the risks set forth throughout this Report, including the risks set forth under Part II, Item 1A, Risk Factors. Readers are cautioned not to place undue reliance on these forward-looking statements, which are based on current expectations and reflect management's opinions only as of the date hereof. These forward-looking statements speak only as of the date of this Report. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any changes in events, conditions or circumstances on which any such statement is based. Finally, our historic results should not be viewed as indicative of future performance.

All references to Inphi, we, us or our mean Inphi Corporation.

Inphi®, iMB and the Inphi logo are trademarks or service marks owned by Inphi. All other trademarks, service marks and trade names appearing in this report are the property of their respective owners.

Overview*Our Company*

We are a fabless provider of high-speed analog semiconductor solutions for the communications and computing markets. Our analog semiconductor solutions provide high signal integrity at leading-edge data speeds while reducing system power consumption. Our semiconductor solutions are designed to address bandwidth bottlenecks in networks, maximize throughput and minimize latency in computing environments and enable the rollout of next generation communications and computing infrastructures. Our solutions provide a vital high-speed interface between analog signals and digital information in high-performance systems such as telecommunications transport systems, enterprise networking equipment, datacenters and enterprise servers, storage platforms, test and measurement equipment and military systems. We provide 40G and 100G high-speed analog semiconductor solutions for the communications market and high-speed memory interface solutions for the computing market.

We have a broad product portfolio with 17 product lines and over 170 products as of June 30, 2011, including our new 100 GbE CMOS SerDes architecture, or iPHY, which is designed to enable the development of next generation low power and high port density 100 Gigabit Ethernet (100 GbE) solutions to address bandwidth bottlenecks in next generation data center and communications infrastructures. We also introduced in the first quarter of 2011 our 2850TA dual-channel transimpedance amplifier, or TIA, which enables the deployment of industry standard single wavelength 100G coherent transport systems.

A detailed discussion of our business may be found in Part I, Item 1, Business, of our 2010 Annual Report on Form 10-K.

Quarterly Update

As discussed in more detail below, for the three and six months ended June 30, 2011 compared to the three and six months ended June 30, 2010, we delivered the following financial performance:

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Total revenues increased by \$2.9 million, or 14%, to \$24 million in the three months ended June 30, 2011 as compared to three months ended June 30, 2010. In the six months ended June 30, 2011, total revenues increased by \$5.3 million, or 13%, to \$45.5 million as compared to six months ended June 30, 2010.

Total operating expenses increased by \$3.1 million, or 31%, to \$12.8 million in the three months ended June 30, 2011 as compared to three months ended June 30, 2010. In the six months ended June 30, 2011, total operating expenses increased by \$5.0 million, or 27%, to \$23.8 million as compared to six months ended June 30, 2010.

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Income from operations decreased by \$1.3 million, or 32%, to \$2.7 million in the three months ended June 30, 2011 as compared to three months ended June 30, 2010. In the six months ended June 30, 2011, income from operations decreased by \$1.0 million, or 15%, to \$5.9 million as compared to six months ended June 30, 2010.

Diluted earnings per share decreased by \$0.06, or 43%, to \$0.08 in the three months ended June 30, 2011 as compared to three months ended June 30, 2010. In the six months ended June 30, 2011, diluted earnings per share decreased by \$0.25, or 61%, to \$0.16 as compared to six months ended June 30, 2010.

Cash flow from operations decreased by \$6.3 million, or 72%, to \$2.4 million in the six months ended June 30, 2011 as compared to six months ended June 30, 2010.

The increase in our revenue in both periods was a result of increase in demand of our high speed memory interface products and to a lesser degree the sale of our storage products as a result of acquisition of Winyatek Technology Inc. Over the remainder of the fiscal year, we expect revenue will continue to increase due to new products that we plan to introduce in 2011.

Our income from operations decreased due to increased operating expenses in both periods. Total operating expenses increased in both periods compared to the same period in 2010 due primarily to an increase in headcount and stock-based compensation. Our expenses primarily consist of personnel costs, which include compensation, benefits, payroll related taxes and stock-based compensation. The acquisition of Winyatek Technology Inc. on June 30, 2010 increased our headcount by 29. In addition, we also hired 29 new employees, primarily in the engineering department. We expect expenses to continue to increase in absolute dollars as we continue to invest resources to develop more products, to support the growth of our business and the cost associated with being a public company including, compliance with Sarbanes-Oxley Act of 2002. Our diluted earnings per share decreased primarily due to the reversal of deferred tax assets valuation allowance of \$7 million and \$17 million during the three and six months ended June 30, 2010, respectively, new issuance of common stock as a result of initial public offering in November 2010 and due to preferred stock outstanding as of June 30, 2010, which was excluded from the diluted earnings per share calculation as they were antidilutive. Shares of our preferred stock were converted into common stock in November 2010 upon completion of our initial public offering.

Our cash and cash equivalents were \$32.6 million at June 30, 2011, compared with \$110 million at December 31, 2010. We generated cash flow from operations of \$2.4 million during the six months ended June 30, 2011 compared to \$8.7 million during the six months ended June 30, 2010. Cash used in investing activities during the six months ended June 30, 2011 was \$89.6 million primarily due to purchases of marketable securities. We generated cash flow from financing activities of \$9.6 million primarily due to proceeds from exercise of stock options and warrants of \$3.3 million and excess tax benefit on stock-based compensation of \$6.1 million. We received net proceeds of \$1.3 million from the completion of our secondary public offering in April 2011. We also paid \$1 million cost of initial public offering.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles, or GAAP, requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses in the reporting period. We regularly evaluate our estimates and assumptions related to allowances for doubtful accounts, warranty reserves, inventory reserves, stock-based compensation expense, goodwill and purchased intangible asset valuations, deferred income tax asset valuation allowances, uncertain tax positions, litigation and other loss contingencies. We base our estimates and assumptions on current facts, historical experience and various other factors 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 and the recording of revenue, costs and expenses that are not readily apparent from other sources. The actual results experienced by us may differ materially and adversely from our estimates. To the extent there are material differences between our estimates and the actual results, our future results of operations will be affected. For a description of our critical accounting policies and estimates, please refer to the Critical Accounting Policies and Estimates section of our 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, 2010. There have been no material changes in any of our critical accounting policies during the six months ended June 30, 2011.

Table of Contents**Results of Operations**

The following table sets forth a summary of our statement of operations as a percentage of each line item to the revenue:

	Three Months		Six Months	
	Ended June 30, 2011	2010	Ended June 30, 2011	2010
Total revenue	100%	100%	100%	100%
Cost of revenue	35	35	35	36
Gross profit	65	65	65	64
Operating expense:				
Research and development	30	24	30	26
Sales and marketing	13	10	12	10
General and administrative	10	12	10	11
Total operating expenses	53	46	52	47
Income from operations	12	19	13	17
Other income				
Income before income taxes	12	19	13	17
Provision (benefit) for income taxes	2	(17)	2	(32)
Net income	10%	36%	11%	49%

Comparison of Three and Six Months Ended June 30, 2011 and 2010**Revenue**

	Three Months Ended June 30,		Change Amount	%
	2011	2010		
	(dollars in thousands)			
Total revenue	\$24,001	\$21,099	\$2,902	14%

	Six Months Ended June 30,		Change Amount	%
	2011	2010		
	(dollars in thousands)			
Total revenue	\$45,505	\$40,185	\$5,320	13%

Total revenue for three and six months ended June 30, 2011 increased compared to corresponding 2010 periods due to increases in the number of units sold of 55% and 33%, respectively. The increases in number of units sold were mainly due to storage products sold by our Taiwan subsidiary, which we acquired on June 30, 2010 and sale of our high speed memory interface products. The increases were partially offset by a year over year decrease in average selling price of approximately 26% and 15% for three and six months ended June 30, 2011, respectively. The decrease in average selling price was due to change in product mix, mainly from the storage products of our Taiwan subsidiary sold at lower prices.

Cost of Revenue and Gross Profit

Three Months Ended June 30, Change
2011 2010 Amount %
(dollars in thousands)

Cost of revenue	\$8,458	\$7,344	\$1,114	15%
Gross profit	\$15,543	\$13,755	\$1,788	13%
Gross profit as a percentage of revenue	65%	65%		

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	Six Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
Cost of revenue	\$15,845	\$14,531	\$1,314	9%
Gross profit	\$29,660	\$25,654	\$4,006	16%
Gross profit as a percentage of revenue	65%	64%		1%

Cost of revenue for the three and six months ended June 30, 2011 increased primarily due to an increase in the number of units purchased by customers as described above. Product costs as a percentage of revenue were relatively unchanged for both periods as compared to the prior year.

Research and Development

	Three Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
Research and development	\$7,292	\$5,126	\$2,166	42%

	Six Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
Research and development	\$13,661	\$10,192	\$3,469	34%

Research and development expenses for three and six months ended June 30, 2011 increased compared to corresponding 2010 periods due to the increase in research and development headcount and the acquisition of Winyatek Technology Inc. in June 2010, which resulted in increase in personnel costs, including stock-based compensation expense of \$1.5 million and \$2.3 million, respectively. In addition, pre-production engineering mask costs increased by \$0.4 million and \$0.6 million, and consulting fees increased by \$0.2 million and \$0.5 million for the three and six months ended June 30, 2011, respectively. The increase in research and development expense was primarily driven by our strategy to expand our product offerings and enhance our existing products. Specifically, we accelerated the development of our products for next generation communications networks and high-speed memory interfaces.

Sales and Marketing

	Three Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
Sales and marketing	\$3,138	\$2,049	\$1,089	53%

	Six Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
Sales and marketing	\$5,719	\$4,124	\$1,595	39%

Sales and marketing expenses for three and six months ended June 30, 2011 increased compared to corresponding 2010 periods primarily due to an increase in personnel costs, including stock-based compensation expense of \$0.8 million and \$1.0 million, respectively, to support increased sales activities. In addition, commission expense increased by \$0.1 million and \$0.2 million for the three and six months ended June 30, 2011, respectively, as a result of increase in revenue.

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	Three Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
General and administrative	\$2,377	\$2,568	\$(191)	(7)%

	Six Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
General and administrative	\$4,419	\$4,471	\$(52)	(1)%

General and administrative expenses for the three and six months ended June 30, 2011 decreased compared to corresponding 2010 periods primarily due to a reduction in legal fees. Legal fees decreased by \$0.8 million and \$1.2 million for the three and six months ended June 30, 2011, respectively, primarily related to litigation matters described in note 15 of the notes to our financial statements. The decrease was offset by increase in personnel costs, including stock-based compensation expense of \$0.4 million and \$0.6 million for the three and six months ended June 30, 2011, respectively, due to an increase headcount. Our directors' fees increased by \$0.1 million for the three and six months ended June 30, 2011 due to the addition of two directors in 2010 as we transitioned to a public company. In addition, for the six months ended June 30, 2011, other consulting fees increased by \$0.1 million for consulting services in information technology and human resource functions.

Provision (benefit) for Income Tax

	Three Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
Provision (benefit) for income tax	\$383	\$(3,600)	\$3,983	111%

	Six Months Ended June 30,		Change	
	2011	2010	Amount	%
	(dollars in thousands)			
Provision (benefit) for income tax	\$1,149	\$(12,717)	\$13,866	109%

The income tax expense for the three and six months ended June 30, 2011 reflects an effective tax rate of 14% and 19%, respectively. The effective tax rates for the three and six months ended June 30, 2011 differs from the statutory rate of 35% primarily due to foreign income taxes provided at lower rates, geographic mix in profitability, recognition of research and development credits, and unrecognized tax benefits. During the three and six months ended June 30, 2010, we recorded an income tax benefit of \$3.6 million and \$12.7 million that reflects an effective tax rate benefit of 91% and 185%, respectively. The effective tax rate benefit differs from the statutory rate of 35% due to a release of our valuation allowance and, to a lesser extent, foreign income taxes provided at lower rates, geographic mix in profitability, recognition of California research and development credits, and unrecognized tax benefits.

Liquidity and Capital Resources

As of June 30, 2011, we had cash and cash equivalents and investments in marketable securities of \$119.1 million. Our primary uses of cash are to fund operating expenses, purchase inventory and acquire property and equipment. Cash used to fund operating expenses is impacted by the timing of when we pay these expenses, as reflected in the changes in our outstanding accounts payable and accrued expenses. Our primary sources of cash are cash receipts on accounts receivable from our revenue. Aside from the growth in amounts billed to our customers, net cash collections of accounts receivable are impacted by the efficiency of our cash collections process, which can vary from period to period, depending on the payment cycles of our major customers.

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The following table summarizes our cash flows for the periods indicated:

	Six Months Ended June 30,	
	2011	2010
	(in thousands)	
Net cash provided by operating activities	\$ 2,407	\$ 8,714
Net cash used in investing activities	(89,590)	(3,998)
Net cash provided by financing activities	9,574	354
Effect of currency exchange rate on cash	(1)	
Net increase (decrease) in cash and cash equivalents	\$ (77,610)	\$ 5,070

Net Cash Provided by Operating Activities

Net cash provided by operating activities for the six months ended June 30, 2011 primarily reflected net income of \$4.8 million, change in income tax payable/receivable of \$1.9 million, increase in accrued expenses of \$2.0 million, depreciation and amortization of \$1.6 million and stock-based compensation of \$2.9 million, offset by increases to accounts receivable of \$0.8 million and inventories of \$1.2 million, decreases to accounts payable of \$0.7 million and deferred revenue of \$0.6 million, deferred income taxes of \$0.8 million and excess tax benefit related to stock-based compensation of \$6.1 million. Accrued expenses increased as a result of inventories received not yet invoiced by the vendors. Our accounts receivable increased due to higher product shipments in the second quarter of 2011. Our inventories increased as a result of growing production for expected delivery to customers in the third quarter of 2011. Our accounts payable decreased due to payments to vendors. Our deferred revenue decreased as distributors reduced their inventory levels and shipped parts to end customers to meet their demand.

Net cash provided by operating activities during the six months ended June 30, 2010 primarily reflected net income of \$19.6 million, increases to accounts payable and accrued expenses of \$1.6 million, deferred revenue of \$3.2 million, depreciation and amortization of \$0.7 million and stock-based compensation of \$0.8 million offset by increases in inventory of \$1.1 million, accounts receivable of \$1.7 million and deferred income taxes of \$14.1 million. Our accounts payable and accrued expenses increased as a result of increased production volumes. Our deferred revenue increased because of shipments made to distributors close to the end of the period to meet delivery requirements of end customers. Our inventories increased as a result of growing production for immediate delivery to customers in the third quarter of 2010, and accounts receivable increased as a result of increased shipments.

Net Cash Used in Investing Activities

During the six months ended June 30, 2011, net cash used in investing activities consisted of cash used to purchase investments in marketable securities of \$87 million and property and equipment of \$2.6 million mainly for laboratory equipment and leasehold improvements for our offices in California.

Net cash used in investing activities during the six months ended June 30, 2010 consisted of net cash used to acquire all of the outstanding shares of Winyatek Technology Inc. of \$2.5 million and purchases of property and equipment of \$1.5 million.

Net Cash Provided by Financing Activities

Net cash provided by financing activities in 2011 consisted primarily of \$6.1 million excess tax benefit related to stock-based compensation, net proceeds from secondary offering of \$1.3 million and proceeds from the exercise of stock options and warrants of \$3.3 million. In addition, we also paid \$1.1 million of expenses related to initial public offering.

Net cash provided by financing activities during the six months ended June 30, 2010 consisted primarily of \$0.4 million proceeds from the exercise of stock options.

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Operating and Capital Expenditure Requirements

Our principal source of liquidity as of June 30, 2011 consisted of \$119.1 million of cash, cash equivalents and investments in marketable securities. Based on our current operating plan, we believe that our existing cash and cash equivalents and investments in marketable securities from operations will be sufficient to finance our operational cash needs through at least the next 12 to 18 months. In the future, we expect our operating and capital expenditures to increase as we increase headcount, expand our business activities and grow our end customer base which will result in higher needs for working capital. Our ability to generate cash from operations is also subject to substantial risks described in Part II, Item 1A, Risk Factors. If any of these risks occur, we may be unable to generate or sustain positive cash flow from operating activities. We would then be required to use existing cash and cash equivalents to support our working capital and other cash requirements. If additional funds are required to support our working capital requirements, acquisitions or other purposes, we may seek to raise funds through debt financing or from other sources. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders. If we raise additional funds by obtaining loans from third parties, the terms of those financing arrangements may include negative covenants or other restrictions on our business that could impair our operating flexibility, and would also require us to incur interest expense. We can provide no assurance that additional financing will be available at all or, if available, that we would be able to obtain additional financing on terms favorable to us.

Off-Balance Sheet Arrangements

As of June 30, 2011, we have not engaged in any off-balance sheet arrangements, such as the use of structured finance, special purpose entities or variable interest entities.

Recent Authoritative Accounting Guidance

See note 2 of the notes to our unaudited condensed consolidated financial statements for information regarding recently issued accounting pronouncements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

We had cash and cash equivalents and investments in marketable securities of \$119.1 million and \$110.2 million at June 30, 2011 and December 31, 2010, respectively, which was held for working capital purposes. Our exposure to market interest-rate risk relates primarily to our investment portfolio. We do not use derivative financial instruments to hedge the market risks of our investments. We manage our total portfolio to encompass a diversified pool of investment-grade securities to preserve principal and maintain liquidity. We place our investments with high-quality issuers and money market funds and debt securities. Our investment portfolio as of June 30, 2011 consisted of money market funds, U.S. Treasuries, municipal bonds, corporate bonds, commercial papers, certificates of deposit, variable rate demand notes and asset backed securities. Investments in both fixed rate and floating rate instruments carry a degree of interest rate risk. Fixed rate securities may have their market value adversely impacted due to an increase in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or if the decline in fair value of our publicly traded debt investments is judged to be other-than-temporary. We may suffer losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates. However, because any debt securities we hold are classified as available-for-sale, no gains or losses are realized in the income statement due to changes in interest rates unless such securities are sold prior to maturity or unless declines in value are determined to be other-than-temporary. These securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), reported in a separate component of stockholders' equity.

In a declining interest rate environment, as short-term investments mature, reinvestment occurs at less favorable market rates. Given the short-term nature of certain investments, the current interest rate environment may negatively impact our investment income.

Our cash and cash equivalents and investment in marketable securities at June 30, 2011 consisted of \$115.9 million held domestically, with the remaining balance of \$3.2 million held by foreign subsidiaries. There may be adverse tax effects upon repatriation of these funds to the United States.

Foreign Currency Risk

To date, our international customer and vendor agreements have been denominated almost exclusively in United States dollars. Accordingly, we have limited exposure to foreign currency exchange rates and do not currently enter into foreign currency hedging transactions.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15 (e) under the Securities Exchange Act 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief 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, not absolute, assurance that the objectives of the disclosure controls and procedures met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during our most recent fiscal quarter 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 1. Legal Proceedings

The information set forth under Note 15 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report. For an additional discussion of certain risks associated with legal proceedings, see Item 1A, Risk Factors below.

Item 1A. Risk Factors

Risks Related to Our Business

Our revenue and operating results can fluctuate from period to period, which could cause our share price to fluctuate.

Our revenue and operating results have fluctuated in the past and may fluctuate from period to period in the future due to a variety of factors, many of which are beyond our control. Factors relating to our business that may contribute to these fluctuations include the following factors, as well as other factors described elsewhere in this report:

the receipt, reduction or cancellation of orders by customers;

fluctuations in the levels of component inventories held by our customers;

the gain or loss of significant customers;

market acceptance of our products and our customers' products;

our ability to develop, introduce and market new products and technologies on a timely basis;

the timing and extent of product development costs;

new product announcements and introductions by us or our competitors;

incurrence of research and development and related new product expenditures;

fluctuations in sales by module manufacturers who incorporate our semiconductor solutions in their products, such as memory modules;

cyclical fluctuations in our markets;

fluctuations in our manufacturing yields;

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significant warranty claims, including those not covered by our suppliers;

changes in our product mix or customer mix;

intellectual property disputes; and

loss of key personnel or the inability to attract qualified engineers.

As a result of these and other factors, the results of any prior quarterly or annual periods should not be relied upon as indications of our future revenue or operating performance. Fluctuations in our revenue and operating results could cause our share price to decline.

We have an accumulated deficit and have incurred net losses in the past. We may incur net losses in the future.

As of June 30, 2011, we had an accumulated deficit of \$29.8 million. We have incurred net losses in each year through 2008. We generated net income (loss) of \$26.1 million, \$7.3 million and \$(3.4) million for the years ended December 31, 2010, 2009 and 2008, respectively. In the six months ended June 30, 2011, we generated net income of \$4.8 million. We may incur net losses in the future.

We depend on a limited number of customers for a substantial portion of our revenue, and the loss of, or a significant reduction in orders from, one or more of our major customers could negatively impact our revenue and operating results. In addition, if we offer more favorable prices to attract or retain customers, our average selling prices and gross margins would decline.

For the year ended December 31, 2010, our 10 largest customers collectively accounted for 76% of our total revenue. Sales directly to Samsung accounted for 34% and 36% of our total revenue and sales directly and through distributors to Micron accounted for 11% and 17% of our total revenue for the years ended December 31, 2010 and 2009, respectively. Some of our customers, including Samsung and Micron, use our products primarily in high-speed memory devices. We believe our operating results for the foreseeable future will continue to depend on sales to a relatively small number of customers. In the future, these customers may decide not to purchase our products at all, may purchase fewer products than they did in the past or may alter their purchasing patterns.

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In addition, our relationships with some customers may deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer these customers favorable prices on our products. In that event, our average selling prices and gross margins would decline. The loss of a key customer, a reduction in sales to any key customer or our inability to attract new significant customers could negatively impact our revenue and materially and adversely affect our results of operations.

We do not have long-term purchase commitments from our customers and if our customers cancel or change their purchase commitments, our revenue and operating results could suffer.

Substantially all of our sales to date, including sales to Samsung and Micron, have been made on a purchase order basis. We do not have any long-term commitments with any of our customers. As a result, our customers may cancel, change or delay product purchase commitments with little or no notice to us and without penalty. This in turn could cause our revenue to decline and materially and adversely affect our results of operations.

We may face claims of intellectual property infringement, which could be time-consuming, costly to defend or settle and result in the loss of significant rights and which could harm our relationships with our customers and distributors.

The semiconductor industry is characterized by companies that hold patents and other intellectual property rights and that vigorously pursue, protect and enforce intellectual property rights. From time to time, third parties may assert against us and our customers and distributors their patent and other intellectual property rights to technologies that are important to our business.

Claims that our products, processes or technology infringe third-party intellectual property rights, regardless of their merit or resolution, could be costly to defend or settle and could divert the efforts and attention of our management and technical personnel. For example, Netlist, Inc. filed suit against us in the United States District Court, Central District of California, in September 2009, alleging that our iMB and certain other memory module components infringe three of Netlist's patents. For more details, see Note 15 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report.

Infringement claims also could harm our relationships with our customers or distributors and might deter future customers from doing business with us. We do not know whether we will prevail in these proceedings given the complex technical issues and inherent uncertainties in intellectual property litigation. If any pending or future proceedings result in an adverse outcome, we could be required to:

cease the manufacture, use or sale of the infringing products, processes or technology;

pay substantial damages for infringement;

expend significant resources to develop non-infringing products, processes or technology, which may not be successful;

license technology from the third-party claiming infringement, which license may not be available on commercially reasonable terms, or at all;

cross-license our technology to a competitor to resolve an infringement claim, which could weaken our ability to compete with that competitor; or

pay substantial damages to our customers or end users to discontinue their use of or to replace infringing technology sold to them with non-infringing technology, if available.

Any of the foregoing results could have a material adverse effect on our business, financial condition and results of operations.

Winning business is subject to lengthy competitive selection processes that require us to incur significant expenditures prior to generating any revenue or without any guarantee of any revenue related to this business. Even if we begin a product design, a customer may decide to cancel or change its product plans, which could cause us to generate no revenue from a product. If we fail to generate revenue after incurring substantial expenses to develop our products, our business and operating results would suffer.

We are focused on winning more competitive bid processes, known as design wins, that enable us to sell our high-speed analog semiconductor solutions for use in our customers' products. These selection processes typically are lengthy and can require us to incur significant design and development expenditures and dedicate scarce engineering resources in pursuit of a single customer opportunity. We may not win the competitive selection process and may never generate any revenue despite incurring significant design and development expenditures. Failure to obtain a design win could prevent us from offering an entire generation of a product. This could cause us to lose revenue and require us to write off obsolete inventory, and could weaken our position in future competitive selection processes. Even after securing a design win, we may experience delays in generating revenue from our products as a result of the lengthy development cycle typically required. Our customers generally take a considerable amount of time to evaluate our products. Our design cycle from initial engagement to volume shipment is typically two to three years.

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The delays inherent in these lengthy sales cycles increase the risk that a customer will decide to cancel, curtail, reduce or delay its product plans or adopt a competing design from one of our competitors, causing us to lose anticipated revenue. In addition, any delay or cancellation of a customer's plans could materially and adversely affect our financial results, as we may have incurred significant expense without generating any revenue. Finally, our customers' failure to successfully market and sell their products could reduce demand for our products and materially and adversely affect our business, financial condition and results of operations. If we were unable to generate revenue after incurring substantial expenses to develop any of our products, our business would suffer.

Our customers require our products and our third-party contractors to undergo a lengthy and expensive qualification process which does not assure product sales. If we are unsuccessful in or delayed in qualifying any of our products with a customer, our business and operating results would suffer.

Prior to purchasing our products, our customers require that both our products and our third-party contractors undergo extensive qualification processes, which involve testing of our products in the customers' systems, as well as testing for reliability. This qualification process may continue for several months. However, qualification of a product by a customer does not assure any sales of the product to that customer. Even after successful qualification and sales of a product to a customer, a subsequent revision in our third party contractors' manufacturing process or our selection of a new supplier may require a new qualification process with our customers, which may result in delays and in our holding excess or obsolete inventory. After our products are qualified, it can take several months or more before the customer commences volume production of components or systems that incorporate our products. Despite these uncertainties, we devote substantial resources, including design, engineering, sales, marketing and management efforts, to qualifying our products with customers in anticipation of sales. If we are unsuccessful or delayed in qualifying any of our products with a customer, sales of those products to the customer may be precluded or delayed, which may impede our growth and cause our business to suffer.

The complexity of our products could result in undetected defects and we may be subject to warranty claims and product liability, which could result in a decrease in customers and revenue, unexpected expenses and loss of market share. In addition, our product liability insurance may not adequately cover our costs arising from products defects or otherwise.

Our products are sold as components or as modules for use in larger electronic equipment sold by our customers. A product usually goes through an intense qualification and testing period performed by our customers before being used in production. We primarily outsource our product testing to third parties and also perform some testing in our Westlake Village, California, facility. We inspect and test parts, or have them inspected and tested in order to screen out parts that may be weak or potentially suffer a defect incurred through the manufacturing process. From time to time, we are subject to warranty or product liability claims that may require us to make significant expenditures to defend these claims or pay damage awards. For example, in September 2010, we were informed of a claim related to repair and replacement costs in connection with shipments of over 4,000 integrated circuits made by us during the summer and fall of 2009. Of these shipments, approximately 4% were later confirmed or suspected to have random manufacturing process anomalies in the wafer die in the product. Based on our standard warranty provisions, we provided replacement parts to the customer for the known and suspected failures that had occurred. In addition, and without informing us, in the fall of 2009, the customer instituted its own larger scale replacement program that covered the replacement of entire subassemblies in which our product was only one component. In September 2010, the customer made an initial claim for approximately \$18 million against us for the costs incurred relative to that program. In June 2011, the customer sent us an email and reduced their initial claim down to \$ 6.6 million. We believe the amount and the basis of the claims are without merit as our warranty liability is contractually limited to the repair or replacement of the affected Inphi products, which, to the extent the customer has requested replacement, has already been completed. A formal claim has yet to be made and discussions with the customer are ongoing. However, claims of this nature are subject to various risks and uncertainties and there can be no assurance that this matter will be resolved without further significant costs to us, including the potential for arbitration or litigation.

Generally, our agreements seek to limit our liability to the replacement of the part or to the revenue received for the product, but these limitations on liability may not be effective or sufficient in scope in all cases. If a customer's equipment fails in use, the customer may incur significant monetary damages including an equipment recall or associated replacement expenses, as well as lost revenue. The customer may claim that a defect in our product caused the equipment failure and assert a claim against us to recover monetary damages. The process of identifying a defective or potentially defective product in systems that have been widely distributed may be lengthy and require significant resources, and we may incur significant replacement costs and contract damage claims from our customers as well as harm to our reputation. In certain situations, circumstances might warrant that we consider incurring the costs or expense related to a recall of one of our products in order to avoid the potential claims that may be raised should the customer reasonably rely upon our product only to suffer a failure due to a design or manufacturing process defect. Defects in our products could harm our relationships with our customers and damage our reputation. Customers may be reluctant to buy our products, which could harm our ability to retain existing customers and attract new customers and our financial results. In addition, the cost of defending these claims and satisfying any arbitration award or judicial judgment with respect to these claims could harm our business prospects and financial condition. Although we carry product liability insurance, this insurance may not adequately cover our costs arising from defects in our products or otherwise.

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We rely on our relationships with industry and technology leaders to enhance our product offerings and our inability to continue to develop or maintain such relationships in the future would harm our ability to remain competitive.

We develop many of our semiconductor products for applications in systems that are driven by industry and technology leaders in the communications and computing markets. We also work with OEMs, system manufacturers and standards bodies to define industry conventions and standards within our target markets. We believe these relationships enhance our ability to achieve market acceptance and widespread adoption of our products. If we are unable to continue to develop or maintain these relationships, our semiconductor solutions would become less desirable to our customers, our sales would suffer and our competitive position could be harmed.

If we fail to accurately anticipate and respond to market trends or fail to develop and introduce new or enhanced products to address these trends on a timely basis, our ability to attract and retain customers could be impaired and our competitive position could be harmed.

We operate in industries characterized by rapidly changing technologies and industry standards as well as technological obsolescence. We have developed products that may have long product life cycles of 10 years or more, as well as other products in more volatile high growth or rapidly changing areas, which may have shorter life cycles of only two to three years. We believe that our future success depends on our ability to develop and introduce new technologies and products that generate new sources of revenue to replace, or build upon, existing product revenue streams that may be dependent upon limited product life cycles. If we are not able to repeatedly introduce, in successive years, new products that ship in volume, our revenue will likely not grow and may decline significantly and rapidly. In 2009, we successfully introduced and began to ship a new product in production which we identify as product number INSSTE32882-GS04, or the GS04 product, and which consists of an integrated phase lock loop, or PLL, and register buffer. Sales of the GS04 product comprised 18% and 43% of our total revenue in 2010 and 2009, respectively. In 2010, we also began to ship in production volume a new low voltage version of our integrated PLL and register buffer, which is shipping in the form of product number INSSTE32882LV-GS02, or the GS02 product. Sales of the GS02 product comprised 32% of our total revenue during the year ended December 31, 2010. There were no other products that generated more than 10% of our total revenue in 2010, 2009 or 2008. As we continued to grow our business in 2011, the GS04 product matured. As a result, sales of the GS04 product are now declining in volume. We currently expect that in 2011 the GS04 product will no longer be material to our total revenue. This underscores the importance of the need for us to continually develop and introduce new products to diversify our revenue base as well as generate new revenue to replace and build upon the success of previously introduced products which may be rapidly maturing.

To compete successfully, we must design, develop, market and sell new or enhanced products that provide increasingly higher levels of performance and reliability while meeting the cost expectations of our customers. The introduction of new products by our competitors, the delay or cancellation of a platform for which any of our semiconductor solutions are designed, 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 uncompetitive from a pricing standpoint, obsolete and otherwise unmarketable. Our failure to anticipate or timely develop new or enhanced products or technologies in response to technological shifts could result in decreased revenue and our competitors winning design wins. 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. Although we believe our products are fully compliant with applicable industry standards, proprietary enhancements may not in the future result in full conformance with existing industry standards under all circumstances. Due to the interdependence of various components in the systems within which our products and the products of our competitors operate, customers are unlikely to change to another design, once adopted, until the next generation of a technology. As a result, if we fail to introduce new or enhanced products that meet the needs of our customers or penetrate new markets in a timely fashion, and our designs do not gain acceptance, we will lose market share and our competitive position, very likely on an extended basis, and operating results will be adversely affected.

If sufficient market demand for 100G solutions does not develop or develops more slowly than expected, or if we fail to accurately predict market requirements or market demand for 100G solutions, our business, competitive position and operating results would suffer.

We are currently investing significant resources to develop semiconductor solutions supporting 100G data transmission rates in order to increase the number of such solutions in our product line. If we fail to accurately predict market requirements or market demand for 100G semiconductor solutions, or if our 100G semiconductor solutions are not successfully developed or competitive in the industry, our business will suffer. If 100G networks are deployed to a lesser extent or more slowly than we currently anticipate, we may not realize any benefits from our investment. As a result, our business, competitive position, market share and operating results would suffer.

Our target markets may not grow or develop as we currently expect and are subject to market risks, any of which could materially harm our business, revenue and operating results.

To date, a substantial portion of our revenue has been attributable to demand for our products in the communications and computing markets and the growth of these overall markets. These markets have fluctuated in size and growth in recent times. Our operating results are impacted by various trends in these markets. These trends include the deployment and broader market adoption of next generation technologies, such as 40

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gigabits per second, or Gbps or G, and 100G, in communications and enterprise networks, timing of next generation network upgrades, the introduction and broader market adoption of next generation server platforms, timing of enterprise upgrades and the introduction and deployment of high-speed memory interfaces in computing platforms. We are unable to predict the timing or direction of the development of

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these markets with any accuracy. For example, we expect that the deployment of different types of memory devices for which our iMB product is designed will be substantially dependent on the development of next generation server platforms. We have not generated any significant revenue from our iMB product to date, and if the development or adoption of next generation server platforms is delayed, or if these server platforms do not interoperate with memory devices for which our iMB product is designed, we may not realize revenue from our iMB product. In addition, because some of our products are not limited in the systems or geographic areas in which they may be deployed, we cannot always determine with accuracy how, where or into which applications our products are being deployed. If our target markets do not grow or develop in ways that we currently expect, demand for our semiconductor products may decrease and our business and operating results could suffer.

We rely on a limited number of third parties to manufacture, assemble and test our products, and the failure to manage our relationships with our third-party contractors successfully could adversely affect our ability to market and sell our products and our reputation. Our revenue and operating results would suffer if these third parties fail to deliver products or components in a timely manner and at reasonable cost or if manufacturing capacity is reduced or eliminated as we may be unable to obtain alternative manufacturing capacity.

We operate an outsourced manufacturing business model. As a result, we rely on third-party foundry wafer fabrication and assembly and test capacity. We also perform testing in our Westlake Village, California, facility. We generally use a single foundry for the production of each of our various semiconductors. Currently, our principal foundries are GCS, SEDI, TSMC, TowerJazz Semiconductor Ltd., UMS and WIN Semiconductors. We also use third-party contract manufacturers for a significant majority of our assembly and test operations, including Kyocera, Natel, OSE, Presto, Signetics and STATS ChipPAC.

Relying on third-party manufacturing, assembly and testing presents significant risks to us, including the following:

failure by us, our customers or their end customers to qualify a selected supplier;

capacity shortages during periods of high demand;

reduced control over delivery schedules and quality;

shortages of materials;

misappropriation of our intellectual property;

limited warranties on wafers or products supplied to us; and

potential increases in prices.

The ability and willingness of our third-party contractors to perform is largely outside our control. If one or more of our contract manufacturers or other outsourcers fails to perform its obligations in a timely manner or at satisfactory quality levels, our ability to bring products to market and our reputation could suffer. For example, if that manufacturing capacity is reduced or eliminated at one or more facilities, including as a response to the recent worldwide decline in the semiconductor industry, or any of those facilities are unable to keep pace with the growth of our business, we could have difficulties fulfilling our customer orders and our revenue could decline. In addition, if these third parties fail to deliver quality products and components on time and at reasonable prices, we could have difficulties fulfilling our customer orders, our revenue could decline and our business, financial condition and results of operations would be adversely affected.

Additionally, as many of our fabrication and assembly and test contractors are located in the Pacific Rim region, principally in Taiwan, our manufacturing capacity may be similarly reduced or eliminated due to natural disasters, political unrest, war, labor strikes, work stoppages or public health crises, such as outbreaks of H1N1 flu. This could cause significant delays in shipments of our products until we are able to shift our manufacturing, assembly or test from the affected contractor to another third-party vendor. There can be no assurance that alternative

capacity could be obtained on favorable terms, if at all.

Our costs may increase substantially if the wafer foundries that supply our products do not achieve satisfactory product yields or quality.

The wafer fabrication process is an extremely complicated process where the slightest changes in the design, specifications or materials can result in material decreases in manufacturing yields or even the suspension of production. From time to time, our third-party wafer foundries have experienced, and are likely to experience manufacturing defects and reduced manufacturing yields related to errors or problems in their manufacturing processes or the interrelationship of their processes with our designs. In some cases, our third-party wafer foundries may not be able to detect these defects early in the fabrication process or determine the cause of such defects in a timely manner. We may incur substantial research and development expense for prototype or development stage products as we qualify the products for production.

Generally, in pricing our semiconductors, we assume that manufacturing yields will continue to increase, even as the complexity of our semiconductors increases. Once our semiconductors are initially qualified with our third-party wafer foundries, minimum acceptable yields are established. We are responsible for the costs of the wafers if the actual yield is above the minimum. If actual yields are below the minimum we are not required to purchase the wafers. The minimum acceptable yields for our new products are generally lower at first and increase as we achieve full production. Unacceptably low product yields or other product manufacturing problems could substantially increase the overall production

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time and costs and adversely impact our operating results on sales of our products. Product yield losses will increase our costs and reduce our gross margin. In addition to significantly harming our operating results and cash flow, poor yields may delay shipment of our products and harm our relationships with existing and potential customers.

We do not have any long-term supply contracts with our contract manufacturers or suppliers, and any disruption in our supply of products or materials could have a material adverse affect on our business, revenue and operating results.

We currently do not have long-term supply contracts with any of our third-party contract manufacturers. We make substantially all of our purchases on a purchase order basis, and our contract manufacturers are not required to supply us products for any specific period or in any specific quantity. We expect that it would take approximately nine to 12 months to transition from our current foundry or assembly services to new providers. Such a transition would likely require a qualification process by our customers or their end customers. We generally place orders for products with some of our suppliers several months prior to the anticipated delivery date, with order volumes based on our forecasts of demand from our customers. Accordingly, if we inaccurately forecast demand for our products, we may be unable to obtain adequate and cost-effective foundry or assembly capacity from our third-party contractors to meet our customers' delivery requirements, or we may accumulate excess inventories. On occasion, we have been unable to adequately respond to unexpected increases in customer purchase orders and therefore, were unable to benefit from this incremental demand. None of our third-party contract manufacturers have provided any assurance to us that adequate capacity will be available to us within the time required to meet additional demand for our products.

Our foundry vendors and assembly and test vendors may allocate capacity to the production of other companies' products while reducing deliveries to us on short notice. In particular, other customers that are larger and better financed than us or that have long-term agreements with our foundry vendor or assembly and test vendors may cause our foundry vendor or assembly and test vendors to reallocate capacity to those customers, decreasing the capacity available to us. We do not have long-term supply contracts with our third-party contract manufacturers and if we enter into costly arrangements with suppliers that include nonrefundable deposits or loans in exchange for capacity commitments, commitments to purchase specified quantities over extended periods or investment in a foundry, our operating results could be harmed. We may not be able to make any such arrangement 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 foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results. To date, we have not entered into such arrangements with our suppliers. If we need another foundry or assembly and test subcontractor because of increased demand, or if we are unable to obtain timely and adequate deliveries from our providers, we might not be able to cost effectively and quickly retain other vendors to satisfy our requirements.

Many of our customers depend on us as the sole source for a number of our products. If we are unable to deliver these products as the sole supplier or as one of a limited number of suppliers, our relationships with these customers and our business would suffer.

A number of our customers do not have alternative sources for our semiconductor solutions and depend on us as the sole supplier or as one of a limited number of suppliers for these products. Since we outsource our manufacturing to third-party contractors, our ability to deliver our products is substantially dependent on the ability and willingness of our third-party contractors to perform, which is largely outside our control. A failure to deliver our products in sufficient quantities or at all to our customers that depend on us as a sole supplier or as one of a limited number of suppliers may be detrimental to their business and, as a result, our relationship with the customer would be negatively impacted. If we are unable to maintain our relationships with these customers after such failure, our business and financial results may be harmed.

If we are unable to attract, train and retain qualified personnel, particularly our design and technical personnel, we may not be able to execute our business strategy effectively.

Our future success depends on our ability to attract and retain qualified personnel, including our management, sales and marketing, and finance, and particularly our design and technical personnel. We do not know whether we will be able to retain all of these personnel as we continue to pursue our business strategy. Historically, we have encountered difficulties in hiring qualified engineers because there is a limited pool of engineers with the expertise required in our field. Competition for these personnel is intense in the semiconductor industry. As the source of our technological and product innovations, our design and technical personnel represent a significant asset. The loss of the services of one or more of our key employees, especially our key design and technical personnel, or our inability to attract and retain qualified design and technical personnel, could harm our business, financial condition and results of operations.

We may not be able to effectively manage our growth, and we may need to incur significant expenditures to address the additional operational and control requirements of our growth, either of which could harm our business and operating results.

To effectively manage our growth, we must continue to expand our operational, engineering and financial systems, procedures and controls and to improve our accounting and other internal management systems. This may require substantial managerial and financial resources, and our

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efforts in this regard may not be successful. Our current systems, procedures and controls may not be adequate to support our future operations. If we fail to adequately manage our growth, or to improve our operational, financial and management information systems, or fail to effectively motivate or manage our new and future employees, the quality of our products and the management of our operations could suffer, which could adversely affect our operating results.

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We face intense competition and expect competition to increase in the future. If we fail to compete effectively, it could have an adverse effect on our revenue, revenue growth rate, if any, and market share.

The global semiconductor market in general, and the communications and computing markets in particular, are highly competitive. We compete or plan to compete in different target markets to various degrees on the basis of a number of principal competitive factors, including product performance, power budget, features and functionality, customer relationships, size, ease of system design, product roadmap, reputation and reliability, customer support and price. We expect competition to increase and intensify as more and larger semiconductor companies enter our markets. Increased competition could result in price pressure, reduced profitability and loss of market share, any of which could materially and adversely affect our business, revenue and operating results.

Currently, our competitors range from large, international companies offering a wide range of semiconductor products to smaller companies specializing in narrow markets. Our primary competitors include Broadcom Corporation, Hittite Microwave Corporation, Integrated Device Technology, Inc. and Texas Instruments Incorporated, as well as other analog signal processing companies. We expect competition in the markets in which we participate to increase in the future as existing competitors improve or expand their product offerings. In addition, as we develop our 100G semiconductor solution, we may face competition from companies such as Broadcom and NetLogic Microsystems, Inc.

Our ability to compete successfully depends on elements both within and outside of our control, including industry and general economic trends. During past periods of downturns in our industry, competition in the markets in which we operate intensified as our customers reduced their purchase orders. Many of our competitors have substantially greater financial and other resources with which to withstand similar adverse economic or market conditions in the future. These developments may materially and adversely affect our current and future target markets and our ability to compete successfully in those markets.

We use a significant amount of intellectual property in our business. Monitoring unauthorized use of our intellectual property can be difficult and costly and if we are unable to protect our intellectual property, our business could be adversely affected.

Our success depends in part upon our ability to protect our intellectual property. To accomplish this, we rely on a combination of intellectual property rights, including patents, copyrights, trademarks and trade secrets in the United States and in selected foreign countries where we believe filing for such protection is appropriate. Effective protection of our intellectual property rights may be unavailable, limited or not applied for in some countries. Some of our products and technologies are not covered by any patent or patent application, as we do not believe patent protection of these products and technologies is critical to our business strategy at this time. A failure to timely seek patent protection on products or technologies generally precludes us from seeking future patent protection on these products or technologies. We cannot guarantee that:

any of our present or future patents or patent claims will not lapse or be invalidated, circumvented, challenged or abandoned;

our intellectual property rights will provide competitive advantages to us;

our ability to assert our intellectual property rights against potential competitors or to settle current or future disputes will not be limited by our agreements with third parties;

any of our pending or future patent applications will be issued or have the coverage originally sought;

our intellectual property rights will be enforced in jurisdictions where competition may be intense or where legal protection may be weak;

any of the trademarks, copyrights, trade secrets or other intellectual property rights that we presently employ in our business will not lapse or be invalidated, circumvented, challenged or abandoned; or

we will not lose the ability to assert our intellectual property rights against or to license our technology to others and collect royalties or other payments.

In addition, our competitors or others may design around our protected patents or technologies. Effective intellectual property protection may be unavailable or more limited in one or more relevant jurisdictions relative to those protections available in the United States, or may not be applied for in one or more relevant jurisdictions. If we pursue litigation to assert our intellectual property rights, an adverse decision in any of these legal actions could limit our ability to assert our intellectual property rights, limit the value of our technology or otherwise negatively impact our business, financial condition and results of operations.

Monitoring unauthorized use of our intellectual property is difficult and costly. Unauthorized use of our intellectual property may have occurred or may occur in the future. Although we have taken steps to minimize the risk of this occurring, any such failure to identify unauthorized use and otherwise adequately protect our intellectual property would adversely affect our business. Moreover, if we are required to commence

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litigation, whether as a plaintiff or defendant, not only would this be time-consuming, but we would also be forced to incur significant costs and divert our attention and efforts of our employees, which could, in turn, result in lower revenue and higher expenses.

We also rely on contractual protections with our customers, suppliers, distributors, employees and consultants, and we implement security measures designed to protect our trade secrets. We cannot assure you that these contractual protections and security measures will not be breached, that we will have adequate remedies for any such breach or that our suppliers, employees or consultants will not assert rights to intellectual property arising out of such contracts.

In addition, we have a number of third-party patent and intellectual property license agreements. Some of these license agreements require us to make one-time payments or ongoing royalty payments. We cannot guarantee that the third-party patents and technology we license will not be licensed to our competitors or others in the semiconductor industry. In the future, we may need to obtain additional licenses, renew existing license agreements or otherwise replace existing technology. We are unable to predict whether these license agreements can be obtained or renewed or the technology can be replaced on acceptable terms, or at all.

Average selling prices of our products often decrease over time, which could negatively impact our revenue and gross margins.

Our operating results may be impacted by a decline in the average selling prices of our semiconductors. If competition increases in our target markets, we may need to reduce the average unit price of our products in anticipation of competitive pricing pressures, new product introductions by us or our competitors and for other reasons. If we are unable to offset any reductions in our average selling prices by increasing our sales volumes or introducing new products with higher margins, our revenue and gross margins will suffer. To maintain our revenue and gross margins, we must develop and introduce new products and product enhancements on a timely basis and continually reduce our costs as well as our customers' costs. Failure to do so would cause our revenue and gross margins to decline.

We are subject to order and shipment uncertainties, and differences between our estimates of customer demand and product mix and our actual results could negatively affect our inventory levels, sales and operating results.

Our revenue is generated on the basis of purchase orders with our customers rather than long-term purchase commitments. In addition, our customers can cancel purchase orders or defer the shipments of our products under certain circumstances. Our products are manufactured using semiconductor foundries according to our estimates of customer demand, which requires us to make separate demand forecast assumptions for every customer, each of which may introduce significant variability into our aggregate estimates. It is difficult for us to forecast the demand for our products, in part because of the complex supply chain between us and the end-user markets that incorporate our products. Due to our lengthy product development cycle, it is critical for us to anticipate changes in demand for our various product features and the applications they serve to allow sufficient time for product development and design. We have limited visibility into future customer demand and the product mix that our customers will require, which could adversely affect our revenue forecasts and operating margins. Moreover, because some of our target markets are relatively new, many of our customers have difficulty accurately forecasting their product requirements and estimating the timing of their new product introductions, which ultimately affects their demand for our products. Our failure to accurately forecast demand can lead to product shortages that can impede production by our customers and harm our customer relationships. Conversely, our failure to forecast declining demand or shifts in product mix can result in excess or obsolete inventory. For example, some of our customers may cancel purchase orders or delay the shipment of their products that incorporate our products as a result of component shortages they may experience due to the recent earthquakes and tsunami in Japan, which may result in excess or obsolete inventory and impact our sales and operating results. In addition, the rapid pace of innovation in our industry could also render significant portions of our inventory obsolete. Excess or obsolete inventory levels could result in unexpected expenses or increases in our reserves that could adversely affect our business, operating results and financial condition. In contrast, if we were to underestimate customer demand or if sufficient manufacturing capacity were unavailable, we could forego revenue opportunities, potentially lose market share and damage our customer relationships. In addition, any significant future cancellations or deferrals of product orders or the return of previously sold products due to manufacturing defects could materially and adversely impact our profit margins, increase our write-offs due to product obsolescence and restrict our ability to fund our operations.

We rely on third-party sales representatives and distributors to assist in selling our products. If we fail to retain or find additional sales representatives and distributors, or if any of these parties fail to perform as expected, it could reduce our future sales.

In 2010, we derived 79% of our total revenue from sales by our direct sales team and third-party sales representatives. In addition, in 2010 and 2009, approximately 21% and 22% of our sales were made through third-party distributors, respectively. Two of our distributors, which sell solely to Micron, accounted for 11% and 17% of our total revenue in 2010 and 2009, respectively. We are unable to predict the extent to which these third-party sales representatives and distributors will be successful in marketing and selling our products. Moreover, many of these third-party sales representatives and distributors also market and sell competing products, which may affect the extent to which they promote our products. Even where our relationships are formalized in contracts, our third-party sales representatives and distributors often have the right to terminate their relationships with us at any time. Our future performance will also depend, in part, on our ability to attract additional third-party

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sales representatives and distributors who will be able to market and support our products effectively, especially in markets in which we have not previously sold our products. If we cannot retain our current distributors or find additional or replacement third-party sales representatives and distributors, our business, financial condition and results of operations could be harmed. Additionally, if we terminate our relationship with a

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distributor, we may be obligated to repurchase unsold products. We record a reserve for estimated returns and price credits. If actual returns and credits exceed our estimates, our operating results could be harmed.

The facilities of our third-party contractors and distributors are located in regions that are subject to earthquakes and other natural disasters.

The facilities of our third-party contractors and distributors are subject to risk of catastrophic loss due to fire, flood or other natural or man-made disasters. A number of our facilities and those of our contract manufacturers are located in areas with above average seismic activity and also subject to typhoons and other Pacific storms. Several foundries that manufacture our wafers are located in Taiwan, Japan and California, and a majority of our third-party contractors who assemble and test our products are located in Asia. In addition, our headquarters are located in California. The risk of an earthquake in the Pacific Rim region or California is significant due to the proximity of major earthquake fault lines. For example, Japan recently experienced a major earthquake and tsunami. Although we have not received any reports of damage to the foundry we use in Japan, it did experience a temporary suspension of production. If there is a shortage or interruption in the availability to us of any wafers manufactured by this foundry or shortages in other components or materials, and we cannot timely obtain a commercially and technologically suitable substitute or make sufficient and timely design or other product modifications to permit the use of such a substitute, we may not be able to timely deliver sufficient quantities of our products to satisfy our contractual obligations and revenue expectations. In addition, one of our principal packaging and assembly contractors is located in Japan. As a result of the effects of the earthquake and tsunami, this contractor may be unable to ship our products in sufficient quantities or in a timely manner, which could have a material adverse affect on our results of operations. Any further catastrophic loss to any of these facilities would likely disrupt our operations, delay production, shipments and revenue and result in significant expenses to repair or replace the facility. In particular, any catastrophic loss at our California locations would materially and adversely affect our business.

We rely on third-party technologies for the development of our products and our inability to use such technologies in the future would harm our ability to remain competitive.

We rely on third parties for technologies that are integrated into our products, such as wafer fabrication and assembly and test technologies used by our contract manufacturers, as well as licensed architecture technologies. If we are unable to continue to use or license these technologies on reasonable terms, or if these technologies fail to operate properly, we may not be able to secure alternatives in a timely manner or at all, and our ability to remain competitive would be harmed. In addition, if we are unable to successfully license technology from third parties to develop future products, we may not be able to develop such products in a timely manner or at all.

Our business would be adversely affected by the departure of existing members of our senior management team and other key personnel.

Our success depends, in large part, on the continued contributions of our senior management team, in particular, the services of Young K. Sohn, our President and Chief Executive Officer, as well as other key personnel, including Dr. Loi Nguyen, one of our founders and our Vice President of Networking, Communications and Multi-Market Products. In February 2011, our Chief Technology Officer resigned and we promoted our Vice President of Engineering for New Business Initiatives to serve as our new Chief Technology Officer. This change could negatively affect our operations and our relationships with our customers, employees and market leaders. In addition, we have not entered into non-compete agreements with members of our senior management team. The loss of any member of our senior management team or key personnel could harm our ability to implement our business strategy and respond to the rapidly changing market conditions in which we operate.

Potential future acquisitions could be difficult to integrate, divert attention of key personnel, disrupt our business, dilute stockholder value and impair our operating results.

As part of our business strategy, we have pursued and may continue to pursue acquisitions in the future that we believe will complement our business, semiconductor solutions or technologies. For example, we recently acquired all of the outstanding shares of Winyatek Technology Inc., a Taiwanese company. Any acquisition involves a number of risks, many of which could harm our business, including:

difficulties in integrating the operations, technologies, products, existing contracts, accounting and personnel of the target company;

realizing the anticipated benefits of any acquisition;

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difficulties in transitioning and supporting customers, if any, of the target company;

diversion of financial and management resources from existing operations;

the price we pay or other resources that we devote may exceed the value we realize, or the value we could have realized if we had allocated the purchase price or other resources to another opportunity;

potential loss of key employees, customers and strategic alliances from either our current business or the target company's business;

assumption of unanticipated problems or latent liabilities, such as problems with the quality of the target company's products;

inability to generate sufficient revenue to offset acquisition costs;

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dilutive effect on our stock as a result of any equity-based acquisitions;

inability to successfully complete transactions with a suitable acquisition candidate; and

in the event of international acquisitions, risks associated with accounting and business practices that are different from applicable U.S. practices and requirements.

Acquisitions also frequently result in the recording of goodwill and other intangible assets that are subject to potential impairments, which could harm our financial results. As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate. The failure to successfully evaluate and execute acquisitions or investments or otherwise adequately address these risks could materially harm our business and financial results.

Tax benefits that we receive may be terminated or reduced in the future, which would increase our costs.

In 2010, we began to expand our international presence to take advantage of the opportunity to recruit additional engineering design talent, as well as to more closely align our operations geographically with our customers and suppliers in Asia. In certain international jurisdictions, we have also entered into agreements with local governments to provide us with, among other things, favorable local tax rates if certain minimum criteria are met. These agreements may require us to meet several requirements as to investment, headcount and activities to retain this status. We currently believe that we will be able to meet all the terms and conditions specified in these agreements. However, if adverse changes in the economy or changes in technology affect international demand for our products in an unforeseen manner or if we fail to otherwise meet the conditions of the local agreements, we may be subject to additional taxes, which in turn would increase our costs.

Changes in our effective tax rate may harm our results of operations. A number of factors may increase our future effective tax rates, including:

the jurisdictions in which profits are determined to be earned and taxed;

the resolution of issues arising from tax audits with various tax authorities;

changes in the valuation of our deferred tax assets and liabilities and in deferred tax valuation allowances;

changes in the value of assets or services transferred or provided from one jurisdiction to another;

adjustments to income taxes upon finalization of various tax returns;

increases in expenses not deductible for tax purposes, including write-offs of acquired in-process research and development and impairments of goodwill in connection with acquisitions;

changes in available tax credits;

changes in tax laws or the interpretation of such tax laws, and changes in U.S. generally accepted accounting principles; and

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a decision to repatriate non-U.S. earnings for which we have not previously provided for U.S. taxes.

We are subject to additional regulatory compliance requirements, including Section 404 of the Sarbanes-Oxley Act of 2002, as a result of being a public company and our management has limited experience managing a public company.

As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. The individuals who constitute our management team have limited experience managing a publicly traded company, and limited experience complying with the increasingly complex and changing laws pertaining to public companies. Our management team and other personnel will need to devote a substantial amount of time to new compliance initiatives and we may not successfully or efficiently manage our transition into a public company. We expect rules and regulations such as the Sarbanes-Oxley Act of 2002 to increase our legal and finance compliance costs and to make some activities more time-consuming and costly. We will need to hire a number of additional employees with public accounting and disclosure experience in order to meet our ongoing obligations as a public company. For example, Section 404 of the Sarbanes-Oxley Act of 2002 requires that our management report on, and our independent registered public accounting firm attest to, the effectiveness of our internal control over financial reporting in our annual report on Form 10-K for the fiscal year ending December 31, 2011. Section 404 compliance may divert internal resources and will take a significant amount of time and effort to complete. We may not be able to successfully complete the procedures and certification and attestation requirements of Section 404 by the time we will be required to do so. If we fail to do so, or if in the future our Chief Executive Officer, Chief Financial Officer or independent registered public accounting firm determines that our internal controls over financial reporting are not effective as defined under Section 404, we could be subject to sanctions or investigations by The New York Stock Exchange, or NYSE, the Securities and Exchange Commission, or the SEC, or other regulatory authorities. Furthermore, investor perceptions of our company may suffer, and this could cause a decline in the market price of our stock. Irrespective of compliance with Section 404, any failure of our internal controls could have a material adverse effect on our stated results of operations and harm our reputation. If we are unable to implement these changes effectively or efficiently, it could harm our operations, financial reporting or financial results and could result in an adverse opinion on internal controls from our independent auditors.

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Our insiders who are significant stockholders may control the election of our board and may have interests that conflict with those of other stockholders.

Our directors and executive officers, together with members of their immediate families and affiliated funds, beneficially owned, in the aggregate, more than 25.74% of our outstanding capital stock as of June 30, 2011. In addition, entities affiliated with Walden International and Tallwood I, L.P. beneficially owned 11.45% and 8.29%, respectively, of our outstanding capital stock as of June 30, 2011. Lip-Bu Tan and Diosdado Banatao, who are affiliated with Walden International and Tallwood I, L.P., respectively, are currently two of the eight members of our board of directors. As a result, acting together, this group has the ability to exercise significant control over most matters requiring our stockholders' approval, including the election and removal of directors and significant corporate transactions.

Risks Related to Our Industry

We may be unable to make the substantial and productive research and development investments which are required to remain competitive in our business.

The semiconductor industry requires substantial investment in research and development in order to develop and bring to market new and enhanced technologies and products. Many of our products originated with our research and development efforts and have provided us with a significant competitive advantage. Our research and development expense was \$23.8 million in 2010, \$17.8 million in 2009 and \$17.5 million in 2008. For the six months ended June 30, 2011, our research and development expense was \$13.7 million. We are committed to investing in new product development in order to remain competitive in our target markets. We do not know whether we will have sufficient resources to maintain the level of investment in research and development required to remain competitive. In addition, we cannot assure you that the technologies which are the focus of our research and development expenditures will become commercially successful.

Our business, financial condition and results of operations could be adversely affected by worldwide economic conditions, as well as political and economic conditions in the countries in which we conduct business.

Our business and operating results are impacted by worldwide economic conditions, including the current European debt crisis. Uncertainty about current global economic conditions may cause businesses to continue to postpone spending in response to tighter credit, unemployment or negative financial news. This in turn could have a material negative effect on the demand for our semiconductor products or the products into which our semiconductors are incorporated. Although the United States economy has recently shown signs of recovery, the strength and duration of any economic recovery will be impacted by the European debt crisis and the reaction to any efforts to address the crisis. Multiple factors relating to our international operations and to particular countries in which we operate could negatively impact our business, financial condition and results of operations. These factors include:

changes in political, regulatory, legal or economic conditions;

restrictive governmental actions, such as restrictions on the transfer or repatriation of funds and foreign investments and trade protection measures, including export duties and quotas and customs duties and tariffs;