INPHI Corp
Form 10-Q
August 07, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

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	**77-0557980**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

3945 Freedom Circle, Suite 1100,

Santa Clara, California 95054

(Address of Principal Executive Offices) (Zip Code)

Registrant s telephone number, including area code: (408) 217-7300

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 x 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 x No ¨

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

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

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

The total number of shares outstanding of the Registrant s common stock, $0.001 par value per share, as of August 2, 2013 was 29,431,290.

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INPHI CORPORATION

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE MONTHS ENDED JUNE 30, 2013

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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, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 29,177	$ 30,161
Investments in marketable securities	89,768	91,107
Accounts receivable, net	11,348	13,717
Inventories	5,641	4,894
Income tax receivable	430	2,412
Prepaid expenses and other current assets	2,790	2,106
Total current assets	139,154	144,397
Property and equipment, net	18,530	13,893
Goodwill	5,875	5,875
Deferred tax charge	4,686	5,138
Other assets, net	1,153	771
Total assets	$ 169,398	$ 170,074
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 5,427	$ 6,888
Deferred revenue	1,520	1,083
Accrued employee expenses	3,154	3,331
Other accrued expenses	1,382	1,261
Other current liabilities	422	524
Total current liabilities	11,905	13,087
Other long-term liabilities	4,801	4,022
Total liabilities	16,706	17,109
Commitments and contingencies (Note 13)		
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; 29,296,459 and 28,730,046 issued and outstanding at June 30, 2013 and December 31, 2012, respectively	29	29
Additional paid-in capital	214,348	205,269
Accumulated deficit	(62,549)	(53,404)
Accumulated other comprehensive income	864	1,071
Total stockholders equity	152,692	152,965

Total liabilities and stockholders equity	$ 169,398	$ 170,074

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

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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,	
	2013	**2012**	**2013**	**2012**
Revenue	$ 24,339	$ 23,308	$ 46,923	$ 43,509
Cost of revenue	8,893	8,332	17,185	15,756
Gross profit	15,446	14,976	29,738	27,753
Operating expense:				
Research and development	12,796	9,910	24,394	18,572
Sales and marketing	3,706	3,745	7,653	7,268
General and administrative	2,842	2,755	5,997	6,367
Total operating expense	19,344	16,410	38,044	32,207
Income (loss) from operations	(3,898)	(1,434)	(8,306)	(4,454)
Other income	213	210	426	448
Income (loss) before income taxes	(3,685)	(1,224)	(7,880)	(4,006)
Provision (benefit) for income taxes	(2,211)	346	1,265	(924)
Net income (loss)	$ (1,474)	$ (1,570)	$ (9,145)	$ (3,082)
Earnings per share:				
Basic	$ (0.05)	$ (0.06)	$ (0.31)	$ (0.11)
Diluted	$ (0.05)	$ (0.06)	$ (0.31)	$ (0.11)
Weighted-average shares used in computing earnings per share:				
Basic	29,216,338	28,321,122	29,075,504	28,179,886
Diluted	29,216,338	28,321,122	29,075,504	28,179,886

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

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INPHI CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss)	$ (1,474)	$ (1,570)	$ (9,145)	$ (3,082)
Other comprehensive income (loss):				
Available for sale investments:				
Change in unrealized gain, net of tax	(170)	9	(170)	254
Realized loss (gain) reclassified into earning, net of tax	(24)	(10)	(37)	(29)
Comprehensive income (loss)	$ (1,668)	$ (1,571)	$ (9,352)	$ (2,857)

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

INPHI CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30,	
	2013	**2012**
Cash flows from operating activities		
Net loss	$ (9,145)	$ (3,082)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,612	2,004
Stock-based compensation	8,317	5,928
Deferred income taxes and deferred tax charge	426	(440)
Excess tax benefit related to stock-based compensation	(462)	
Amortization of premium in marketable securities	513	594
Other noncash items	(35)	205
Changes in assets and liabilities:		
Accounts receivable	2,369	(1,690)
Inventories	(747)	787
Prepaid expenses and other assets	(501)	(120)
Income tax payable/receivable	2,824	(551)
Accounts payable	(51)	749
Accrued expenses	(56)	2,997
Deferred revenue	437	868
Other liabilities	(291)	(160)
Net cash provided by operating activities	7,210	8,089
Cash flows from investing activities		
Purchases of property and equipment	(9,659)	(4,330)
Proceeds from sale of equipment		237
Purchases of marketable securities	(21,763)	(18,555)
Sales and maturities of marketable securities	22,466	17,674
Net cash used in investing activities	(8,956)	(4,974)
Cash flows from financing activities		
Proceeds from exercise of stock options	691	1,156
Excess tax benefit related to stock-based compensation	462	
Minimum tax withholding paid on behalf of employees for restricted stock units	(1,380)	(204)
Proceeds from employee stock purchase plan	989	
Net cash provided by financing activities	762	952
Net increase (decrease) in cash and cash equivalents	(984)	4,067
Cash and cash equivalents at beginning of period	30,161	29,696
Cash and cash equivalents at end of period	$ 29,177	$ 33,763

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 and mixed signal semiconductor solutions for the communications, datacenter 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, datacenter and computing infrastructures. In addition, the 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, 2012, included in the Company s Annual Report on Form 10-K filed with the SEC on March 7, 2013.

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 state fairly the Company s consolidated financial position at June 30, 2013, and its consolidated results of operations for the three and six months ended June 30, 2013 and 2012 and cash flows for the six months ended June 30, 2013 and 2012. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results to be expected for future quarters or the full year.

2. Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued a guidance to improve the reporting reclassifications out of accumulated other comprehensive income of various components. The guidance requires presentation of significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification either parenthetically on the face of the financial statements or in the notes. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company adopted this guidance during the six months ended June 30, 2013.

In July 2013, the FASB issued a guidance on the Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The update provides that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this update do not require new recurring disclosures. The amendments are effective prospectively for reporting periods beginning after December 15, 2013. The Company is currently assessing the potential impact of the adoption of this update on our consolidated financial statements.

3. Investments

The following table summarizes the investments by investment category:

	June 30, 2013		December 31, 2012	
	Cost	Fair Value	Cost	Fair Value
Available-for-sale securities:				
US treasury securities	$ 25,264	$ 25,276	$ 24,696	$ 24,709
Municipal bonds	39,034	39,128	38,378	38,595
Corporate notes/bonds	22,799	22,860	22,154	22,293
Certificate of deposit	1,500	1,503	2,500	2,504
Asset backed securities	1,000	1,001	3,000	3,006
Total investments	$ 89,597	$ 89,768	$ 90,728	$ 91,107

As of June 30, 2013, we had 20 investments that were in an unrealized loss position. The gross unrealized losses on these investments at June 30, 2013 of $72 were determined to be 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.

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Inphi Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

(Dollars in thousands except share and per share amounts)

The realized gain related to the Company s available-for-sale investment which was reclassified from other comprehensive income was included in other income in the consolidated statements of income.

The contractual maturities of available-for-sale securities at June 30, 2013 are presented in the following table:

	Cost	Fair Value
Due in one year or less	$ 46,074	$ 46,220
Due between one and five years	43,523	43,548
	$ 89,597	$ 89,768

4. Inventories

Inventories consist of the following:

	June 30, 2013	December 31, 2012
Raw materials	$ 737	$ 545
Work in process	1,400	1,592
Finished goods	3,504	2,757
	$ 5,641	$ 4,894

Finished goods held by distributors were $467 and $341 as of June 30, 2013 and December 31, 2012, respectively.

5. Property and Equipment, net

Property and equipment consist of the following:

	June 30, 2013	December 31, 2012
Laboratory and production equipment	$ 28,585	$ 22,692
Office, software and computer equipment	6,908	6,206
Furniture and fixtures	833	634
Leasehold improvements	3,911	3,226
	40,237	32,758
Less accumulated depreciation	(21,707)	(18,865)

	$ 18,530	$ 13,893

Depreciation and amortization expense of property and equipment for the three and six months ended June 30, 2013 was $1,928 and $3,612, respectively. Depreciation and amortization expense of property and equipment for the three and six months ended June 30, 2012 was $1,165 and $2,004, respectively.

As of June 30, 2013 and December 31, 2012, computer software costs included in property and equipment were $2,478 and $2,180, respectively. Amortization expense of capitalized computer software costs was $65 and $131 for the three and six months ended June 30, 2013, respectively. Amortization expense of capitalized computer software costs was $66 and $127 for the three and six months ended June 30, 2012, respectively.

Inphi Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

(Dollars in thousands except share and per share amounts)

6. Product Warranty Obligation

As of June 30, 2013 and December 31, 2012, the product warranty liability was $40. 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,	
	2013	2012	2013	2012
Beginning balance	$ 40	$ 1,750	$ 40	$ 1,000
Accruals for warranties				750
Settlements				
	$ 40	$ 1,750	$ 40	$ 1,750

In 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. The Company assessed, provided and accumulated additional warranty reserves based on estimated, probable costs to replace units. In 2012, based on additional investigation and discussions with the customer, the Company booked an additional warranty cost of $750. This amount was recorded as a reduction to revenue. In June 2012, the Company entered into a settlement agreement with the customer in which the Company paid $1,750 in July 2012.

7. Other long-term liabilities

Other long-term liabilities consist of the following:

	June 30, 2013	December 31, 2012
Deferred rent	$ 1,381	$ 1,570
Deferred tax liabilities	588	
Income tax payable	2,832	2,452
	$ 4,801	$ 4,022

8. Income Taxes

The Company normally determines its interim provision using an estimated single annual effective tax rate for all tax jurisdictions. ASC 740 provides that when an entity operates in a jurisdiction that has generated ordinary losses on a year-to-date basis or on the basis of the results anticipated for the full fiscal year and no benefit can be recognized on those losses, a separate effective tax rate should be computed and applied to ordinary income (or loss) in that jurisdiction. The Company incurred pretax loss during the three and six months ended June 30, 2013 and will not recognize tax benefit of the losses due to full valuation allowance established against deferred tax assets in the U.S. and Singapore. Thus, separate effective tax rate was applied to losses from each loss jurisdiction to compute the Company s interim tax expense. The Company recorded an income tax provision (benefit) of ($2,211) and $1,265 in the three and six months ended June 30, 2013, respectively.

For the three and six months ended June 30, 2012, the discrete method was used to calculate the Company s interim tax expense. The Company has determined that a calculation of an annual effective tax rate would not represent a reliable estimate due to the sensitivity of the annual effective tax rate estimate to even minimal changes to forecasted earnings for the year. Under the discrete method, the Company determines its tax expense based upon actual results as if the interim period were an annual period. During the three and six months ended June 30, 2012, the Company recorded an income tax provision (benefit) of $346 and ($924), respectively.

The effective tax rate for the three and six months ended June 30, 2013 was 60% and (16%), respectively from (28%) and 23% in the comparable periods of 2012, respectively. The difference between the effective tax rates and the 35% federal statutory rate resulted primarily due to the change in valuation allowance (originally established in the fourth quarter of 2012), foreign income taxes provided at lower rates, geographic mix in operating results, unrecognized tax benefits and stock-based compensation adjustments.

During the three and six months ended June 30, 2013, the gross amount of the Company s unrecognized tax benefits increased (decreased) by approximately ($500) and $908, respectively as a result of tax positions taken during the current year. Substantially all of the unrecognized tax benefits as of June 30, 2013, if recognized, would affect the Company s effective tax rate. As of June 30, 2013, the Company does not expect any significant increases or decreases to its unrecognized tax benefits within the next 12 months.

Inphi Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

(Dollars in thousands except share and per share amounts)

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.

In June 2013, the Singapore subsidiary received notification from the Inland Revenue Authority of Singapore that the 2010 tax return will be reviewed. The review is on-going as of report date.

9. 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,	
	2013	2012	2013	2012
Numerator				
Net income (loss)	$ (1,474)	$ (1,570)	$ (9,145)	$ (3,082)
Less amount allocable to unvested early exercised options and restricted stock award		1		2
Net income (loss) allocable to common stockholders basic and diluted	(1,474)	(1,569)	(9,145)	(3,080)
Denominator				
Weighted average common stock	29,221,333	28,338,259	29,080,499	28,197,023
Less weighted average unvested common stock subject to repurchase and unvested restricted stock award	(4,995)	(17,137)	(4,995)	(17,137)
Weighted-average common stock basic and diluted	29,216,338	28,321,122	29,075,504	28,179,886
Earnings per share				
Basic	$ (0.05)	$ (0.06)	$ (0.31)	$ (0.11)
Diluted	$ (0.05)	$ (0.06)	$ (0.31)	$ (0.11)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Common stock options	4,597,452	4,870,783	4,610,371	4,825,110
Warrant to purchase common stock	2,142	2,142	2,142	2,142
Restricted stock unit	3,019,543	1,604,164	2,954,604	1,461,603
Restricted stock award	4,995	17,137	4,995	17,137

	7,624,132	6,494,226	7,572,112	6,305,992

10. 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. As of June 30, 2013 and December 31, 2012, there were no unvested shares outstanding subject to the Company s right of repurchase. 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.

Inphi Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

(Dollars in thousands except share and per share amounts)

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 administers 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. In May 2013, the shareholders approved the increase in the number of shares available for grant by 1,000,000. At June 30, 2013, 2,074,921 shares of common stock have been reserved for future grants under the 2010 Plan.

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,	
	2013	2012	2013	2012
Risk-free interest rate	1.15%	1.43%	1.25%	1.39%
Expected life (in years)	6.25	6.25	6.25	6.25
Dividend yield				
Expected volatility	50.00%	50.00%	50.00%	50.00%

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, 2012	4,636,680	$ 8.20	6.39	$ 13,264
Granted	186,400	8.90		
Exercised	(188,247)	3.67		
Canceled	(70,947)	10.07		
Outstanding at June 30, 2013	4,563,886	$ 8.39	6.35	$ 16,504

Exercisable at June 30, 2013	3,054,010	$	6.67	5.21	$ 15,141
Vested at June 30, 2013	2,730,785	$	6.33	5.01	$ 14,593
Vested and expected to vest at June 30, 2013	4,493,961	$	8.34	6.32	$ 16,433

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 grant date fair value of employee options vested during the six months ended June 30, 2013 and 2012 was $4,896 and $1,800, respectively.

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Inphi Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

(Dollars in thousands except share and per share amounts)

The weighted average grant date fair value per share of stock options granted to employees during the six months ended June 30, 2013 and 2012 was $4.35 and $6.65, respectively.

The total intrinsic value of options exercised during the six months ended June 30, 2013 and 2012 was $1,092 and $5,173, 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 $691 and $1,156, respectively, for the six months ended June 30, 2013 and 2012.

Restricted Stock Units and Awards

The Company granted restricted stock units (RSUs) to members of the Board of Directors and employees. Most of the Company s outstanding RSUs vest over four years with vesting contingent upon continuous service. The Company estimates the fair value of RSUs 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, 2012	1,791,291	$ 14.62
Granted	1,678,147	8.96
Vested	(404,147)	15.99
Canceled	(56,638)	12.54
Outstanding at June 30, 2013	3,008,653	$ 11.32
Expected to vest at June 30, 2013	2,847,302	

The Company granted restricted stock awards (RSAs) to certain members of the Board of Directors. The Company estimates the fair value of RSAs using the market price of the common stock on the date of the grant. As of December 31, 2012, the Company had 12,849 outstanding nonvested RSAs, 7,854 of which vested during the six months ended June 30, 2013 resulting to 4,995 nonvested restricted stock awards outstanding as of June 30, 2013.

Employee Stock Purchase Plan

In December 2011, the Company adopted the Employee Stock Purchase Plan (ESPP). Participants purchase the Company s stock using payroll deductions, which may not exceed 15% of their total cash compensation. Pursuant to the terms of the ESPP, the look-back period for the stock purchase price is six months. Offering and purchase periods will begin on February 10 and August 10 of each year. Participants will be granted the right to purchase common stock at a price per share that is 85% of the lesser of the fair market value of the Company s common shares at the beginning or the end of each six-month period.

The ESPP imposes certain limitations upon an employee s right to acquire common stock, including the following: (i) no employee shall be granted a right to participate if such employee immediately after the election to purchase common stock, would own stock possessing 5% or more to the total combined voting power or value of all classes of stock of the Company, and (ii) no employee may be granted rights to purchase more than $25 fair value of common stock for each calendar year. The maximum aggregate number of shares of common stock available for purchase under the ESPP is one million shares. The total common stock issued under the ESPP during the six months ended June 30, 2013 was 125,177.

Inphi Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

(Dollars in thousands except share and per share amounts)

The fair value of employee stock purchase plan is estimated at the start of offering period using the Black-Scholes option pricing model with the following assumptions for the six months ended June 30, 2013 and 2012:

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Risk-free interest rate	0.12%	0.12%
Expected life (in years)	0.49	0.50
Dividend yield		
Expected volatility	47.00%	90.00%
Estimated fair value	$ 2.63	$ 5.90

Stock-Based Compensation Expense

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

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Operating expenses				
Cost of goods sold	$ 281	$ 190	$ 514	$ 319
Research and development	2,256	1,481	4,229	2,647
Sales and marketing	753	840	1,556	1,544
General and administrative	1,001	800	2,018	1,418
	$ 4,291	$ 3,311	$ 8,317	$ 5,928

Total unrecognized compensation cost related to unvested stock options, restricted stock units and awards at June 30, 2013, prior to the consideration of expected forfeitures, is approximately $39,408 and is expected to be recognized over a weighted-average period of 2.71 years.

11. 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, which uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. 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 Company determines the amount of transfers between Levels 1 and 2 or transfers into or out of Level 3 by using the end-of-period fair value. The Company had no transfers among the fair value hierarchy during the three and six months ended June 30, 2013.

Inphi Corporation

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(Dollars in thousands except share and per share amounts)

The following table presents information about assets required to be carried at fair value on a recurring basis:

	Total	Level 1	Level 2
June 30, 2013			
Assets			
Cash equivalents:			
Money market funds	$ 5,899	$	$ 5,899
Investment in marketable securities:			
US treasury securities	25,276	25,276	
Municipal bonds	39,128		39,128
Corporate notes/bonds	22,860		22,860
Certificate of deposit	1,503		1,503
Asset backed securities	1,001		1,001
	$ 95,667	$ 25,276	$ 70,391

	Total	Level 1	Level 2
December 31, 2012			
Assets			
Cash equivalents:			
Money market funds	$ 9,258	$	$ 9,258
Investment in marketable securities:			
US treasury securities	24,709	24,709	
Municipal bonds	38,595		38,595
Corporate notes/bonds	22,293		22,293
Certificate of deposit	2,504		2,504
Asset backed securities	3,006		3,006
	$ 100,365	$ 24,709	$ 75,656

12. 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,

	2013	2012	2013	2012
China	$ 3,728	$ 5,451	$ 8,196	$ 9,132
United States	6,750	6,323	12,180	12,076
Korea	5,523	4,667	11,211	8,827
Other	8,338	6,867	15,336	13,474
	$ 24,339	$ 23,308	$ 46,923	$ 43,509

As of June 30, 2013, $3,783 of long-lived tangible assets are located outside the United States, of which $3,403 are located in Taiwan. As of December 31, 2012, $4,090 of long-lived tangible assets are located outside the United States, of which $3,668 are located in Taiwan.

13. Commitments and Contingencies

Leases

The Company leases its facility 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, 2013, future minimum lease payments under noncancelable operating leases having initial terms in excess of one year are as follows:

2013 (remaining)	$ 2,836
2014	2,268
2015	1,750
2016	1,758
2017	1,810
2018	188
	$ 10,610

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For the three and six months ended June 30, 2013, lease operating expense was $1,379 and $3,043, respectively. For the three and six months ended June 30, 2012, lease operating expense was $878 and $1,798, respectively.

Noncancelable Purchase Obligations

The Company s noncancelable purchase obligation consisted primarily of license fees the Company committed to pay. As of June 30, 2013, the Company s future total noncancelable purchase obligation was $100 which is payable in 2013.

We depend upon third party subcontractors to manufacture our wafers. Our subcontractor relationships typically allow for the cancellation of outstanding purchase orders, but require payment of all expenses incurred through the date of cancellation. As of June 30, 2013, the total value of open purchase orders for wafers was approximately $2,448.

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. In 2010, Company filed *inter partes* requests for reexamination with the United States Patent and Trademark Office (the USPTO), asserting that the patents-in-suit are invalid.

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. On September 27, 2011, the Patent Office issued a First Office Action based on the Netlist 274 Patent Reexamination Request and rejected 91 of its 97 claims. On October 27, 2011, Netlist responded to the USPTO determination by amending some but not all of the claims, adding new claims and making arguments as to the validity of the rejected claims in view of the cited references. The Company provided rebuttable comments to the USPTO on November 28, 2011. On March 12, 2012, the Examiner issued an Action Closing Prosecution, indicating that the claims pending contain allowable subject matter, and Netlist did not respond to the Action Closing Prosecution in the time provided by the USPTO. On June 22, 2012, the USPTO issued a Right of Appeal Notice, and on July 23, 2012, the Company filed a Notice of Appeal. The Company filed its Appeal Brief on September 24, 2012 and Netlist filed its Responsive Brief on October 24, 2012. The parties received an Examiner s Answer dated April 16, 2013 from the USPTO that maintained the rejections set forth on the Right of Appeal Notice dated June 22, 2012. The Company filed a Rebuttal Brief on May 16, 2013 and a Request for Oral Hearing on June 7, 2013. A communication from the USPTO is expected as the next substantive step of the proceeding, as prosecution otherwise remains closed. The proceeding is expected to continue in accordance with established *Inter Partes* Reexamination procedures.

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

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patentability of four claims and reject all the other pending claims. On August 22, 2011, Netlist responded to the Action Closing Prosecution by further amending some claims and making arguments as to the validity of the rejected claims in view of the cited references. The Company submitted rebuttal comments on September 21, 2011. In a further communication dated February 7, 2012, the USPTO issued a Right of Appeal Notice, which also indicated that the previous amendments to claim made by Netlist would be entered, and that the current pending claims, as amended, were patentable. The Company filed a Notice of Appeal at the USPTO on March 8, 2012, within the time period provided for filing the Notice of Appeal and Netlist did not file Notice of Cross-Appeal. The Company filed its Appeal Brief on May 8, 2012, and Netlist filed its Responsive Brief on July 2, 2012. The parties received an Examiner s Answer dated April 16, 2013 from the USPTO that maintained the rejections set forth on the Right of Appeal Notice dated February 7, 2012. The Company filed a Rebuttal Brief on May 16, 2013 and a Request for Oral Hearing on June 7, 2013. A communication from the USPTO is expected as the next substantive step of the proceeding, as prosecution otherwise remains closed. The proceeding is expected to continue in accordance with established *Inter Partes* Reexamination procedures.

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 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. Each of the merged Reexamination Requestors, including the Company, submitted rebuttal comments by August 29, 2011. The USPTO considered this Netlist response and each of the rebuttal comments, and in an Office Action dated October 14, 2011, continued to reject most, but not all of the previously rejected claims, as well as rejected claims that had been added by Netlist in its July 5, 2011 response. After seeking and obtaining an extension of time to respond to the Office Action dated October 14, 2011, Netlist served its response on January 13, 2012, which response made amendments based upon subject matter that had been indicated as allowable in the Office Action dated October 14, 2011, added other new claims and made arguments as to why all of these claims should be allowed. The three different merged Reexamination Requestors, including the Company, timely submitted rebuttal comments on or about February 13, 2012. The USPTO issued a Non-final Office Action on November 13, 2012, rejecting some claims and indicating that others contained allowable subject matter. On January 14, 2013, Netlist filed a Response to the Non-final Office Action which presented further claim amendments and evidence supporting its positions regarding patentability. Rebuttal comments from the Company and the other Requestors were filed on February 13, 2013. The merged proceeding is expected to continue in accordance with established *Inter Partes* Reexamination procedures.

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.

Based on these papers the Court in February 2013 ordered a continued stay of the proceedings until the conclusion of the reexamination and interference proceedings, and in the meantime requested that the parties file papers by January 30, 2014 stating their position on whether the stay should be extended. At this time, the Court could decide to maintain or lift the stay.

While the Company intends to defend the foregoing lawsuits 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.

Based on the nature of the litigation, the Company is currently unable to predict the final outcome of this lawsuit and therefore, cannot determine the likelihood of loss nor estimate a range of possible loss. However, because of the nature and inherent uncertainties of litigation, should the outcome of these actions be unfavorable, the Company s business, financial condition, results of operations or cash flows could be materially and adversely affected.

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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. Accordingly, the Company has no liabilities recorded for these agreements as of June 30, 2013 and December 31, 2012.

14. Related Party Transactions

In 2007, the Company entered into a software subscription and maintenance agreement with Cadence Design Systems, Inc. (Cadence), a related party company. A former 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. In June 2012, the software subscription and maintenance agreement was amended to include new licensed materials effective on September 28, 2012 and will expire on December 31, 2013. Under this amendment, the Company committed to pay $2,129 payable in 5 quarterly payments through November 2013. The member of the Board of Director resigned from the Company on December 31, 2012 and therefore, no longer considered as related party. The Company paid $1,000 in the six months ended June 30, 2012. Operating lease expense related to this agreement included in research and development expense was $500 and $1,042 for the three and six months ended June 30, 2012, respectively.

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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, the terms may, might, will, objective, intend, should, could, can, would, expect, believe, estimate, predict, potential, plan, or the negative of these terms, and similar expressions intended to identify forward-looking statements. These statements relate to future periods and include statements regarding our anticipated trends and challenges in our business and the markets in which we operate, including the market for 40G and 100G high-speed analog semiconductor solutions, our plans for future products, such as our isolation memory buffer, or iMB , clock and data recovery, or CDR, complementary metal oxide semiconductor, or CMOS, and serializer/deserializer, or SerDes, products, our transimpedance amplifier, or TIA products, our quad linear driver products, expansion of our product offerings and enhancements of existing products, our expectations regarding our expenses and 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, repatriation of cash, our anticipated growth and growth strategies, interest rate sensitivity, adequacy of our disclosure controls, customer concentration, foundry constraints, competition, protection of our intellectual property, our dividend policy and our legal proceedings. These forward-looking statements involve 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 results of operations, 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.

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 and mixed signal semiconductor solutions for the communications, datacenter and computing markets. Our 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, datacenter 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 over 170 products as of June 30, 2013, including our 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, or 100 GbE, solutions to address bandwidth bottlenecks in next generation data center and communications infrastructures.

A detailed discussion of our business may be found in Part I, Item 1, Business, of our 2012 Annual Report on Form 10-K.

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Quarterly Update

As discussed in more detail below, for the three and six months ended June 30, 2013 compared to the three and six months ended June 30, 2012, we delivered the following financial performance:

Total revenues increased by $1.0 million, or 4%, to $24.3 million in the three months ended June 30, 2013. In the six months ended June 30, 2013, total revenues increased by $3.4 million, or 8%, to $46.9 million.

Gross profit as a percentage of revenue slightly decreased to 63.5% from 64.3% in the three months ended June 30, 2013. In the six months ended June 30, 2013, gross profit as a percentage of revenue decreased to 63.4% from 63.8%.

Total operating expenses increased by $2.9 million, or 18%, to $19.3 million in the three months ended June 30, 2013. In the six months ended June 30, 2013, total operating expenses increased by $5.8 million, or 18%, to $38.0 million.

Income from operations decreased by $2.5 million, or 172%, to a loss from operations of $3.9 million in the three months ended June 30, 2013. In the six months ended June 30, 2013, income from operations decreased by $3.9 million, or 86%, to a loss from operations of $8.3 million.

Diluted earnings per share increased by $0.01 to ($0.05) in the three months ended June 30, 2013. In the six months ended June 30, 2013, diluted earnings per share decreased by $0.20 to ($0.31).

This increase in our revenue was a result of increase in consumption of our dual, differential linear TIA, iPHY 100Gbe CMOS gearbox products and isolation memory buffer.

Our income from operations decreased due to increased operating expenses. Total operating expenses increased due primarily to an increase in headcount and stock-based compensation expense. Our expenses primarily consist of personnel costs, which include compensation, benefits, payroll related taxes and stock-based compensation. From July 2012 to June 2013, we hired 70 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 and to support the growth of our business. Our diluted earnings per share decreased primarily due to increase in operating expenses.

Our cash and cash equivalents were $29.2 million at June 30, 2013, compared with $30.2 million at December 31, 2012. We generated cash flow from operations of $7.2 million during the six months ended June 30, 2013 compared to $8.1 million during the six months ended June 30, 2012. Cash used in investing activities during the six months ended June 30, 2013 was $9.0 million primarily due to purchases of marketable securities and purchases of property and equipment offset by sales and maturities of marketable securities. We generated cash flow from financing activities of $0.8 million primarily due to proceeds from exercise of stock options and employee stock purchase plan of $1.7 million and excess tax benefit on stock-based compensation of $0.5 million offset by minimum tax withholding paid on behalf of employees of $1.4 million.

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 valuation, 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,

2012. There have been no material changes in any of our critical accounting policies during the six months ended June 30, 2013.

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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 Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Total revenue	100%	100%	100%	100%
Cost of revenue	36	36	37	36
Gross profit	64	64	63	64
Operating expense:				
Research and development	53	42	52	43
Sales and marketing	15	16	16	17
General and administrative	12	12	13	14
Total operating expenses	80	70	81	74
Income (loss) from operations	(16)	(6)	(18)	(10)
Other income	1	1	1	1
Income (loss) before income taxes	(15)	(5)	(17)	(9)
Provision (benefit) for income taxes	(9)	2	3	(2)
Net income (loss)	(6)%	(7)%	(20)%	(7)%

Comparison of Three and Six Months Ended June 30, 2013 and 2012

Revenue

	Three Months Ended June 30,		Change	
	2013	2012	Amount	%
	(dollars in thousands)			
Total revenue	$ 24,339	$ 23,308	$ 1,031	4%

	Six Months Ended June 30,		Change	
	2013	2012	Amount	%
	(dollars in thousands)			
Total revenue	$ 46,923	$ 43,509	$ 3,414	8%

Total revenue for three and six months ended June 30, 2013 increased compared to corresponding 2012 periods due to changes in number of units sold and average selling price. For the three months ended June 30, 2013, number of units sold increased by 10% mainly from sale of our dual, differential linear TIA, iPHY 100Gbe CMOS gearbox products and isolation memory buffer. The increase was offset partially by decrease in average selling price of 5% due to product mix, mainly from reduction of average selling price of our high speed memory interface products. For the six months ended June 30, 2013, number of units sold and average selling price increased by 2% and 4%, respectively. The increase in number of units sold was due to sale of our dual, differential linear TIA, iPHY 100Gbe CMOS gearbox products, isolation memory buffer and high speed memory interface products. The increase in average selling price was due to product mix that resulted in an increase in sales of our higher priced products. The increase in revenue for the six months ended June 30, 2013 was also due to provision of $0.7 million for estimated settlement of a warranty claim with a customer that was several years old, which was recorded as reduction in revenue for the six months ended June 30, 2012.

Cost of Revenue and Gross Profit

	Three Months Ended June 30,		Change	
	2013	2012	Amount	%
	(dollars in thousands)			
Cost of revenue	$ 8,893	$ 8,332	$ 561	7%
Gross profit	$ 15,446	$ 14,976	$ 470	3%
Gross profit as a percentage of revenue	64%	64%		

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	Six Months Ended June 30, 2013	2012	Change Amount	%
	(dollars in thousands)			
Cost of revenue	$ 17,185	$ 15,756	$ 1,429	9%
Gross profit	$ 29,738	$ 27,753	$ 1,985	7%
Gross profit as a percentage of revenue	63%	64%		(1)%

Gross profit for the three and six months ended June 30, 2013 increased primarily due to increases in revenue as described above. Gross profit as a percentage of revenue was relatively unchanged for both periods as compared to the prior year.

Research and Development

	Three Months Ended June 30, 2013	2012	Change Amount	%
	(dollars in thousands)			
Research and development	$ 12,796	$ 9,910	$ 2,886	29%

	Six Months Ended June 30, 2013	2012	Change Amount	%
	(dollars in thousands)			
Research and development	$ 24,394	$ 18,572	$ 5,822	31%

Research and development expenses for three and six months ended June 30, 2013 increased due to the increase in research and development headcount and equity awards, which resulted in $2.1 million and $3.8 million increase in personnel costs and stock-based compensation expense, respectively. In addition, CAD software tool license expense increased by $0.5 million and $0.9 million for the three and six months ended June 30, 2013, respectively, due mainly to increased headcount of engineers. The increase in research and development expense was primarily driven by our strategy to expand our product offerings and enhance our existing products.

Sales and Marketing

	Three Months Ended June 30, 2013	2012	Change Amount	%
	(dollars in thousands)			
Sales and marketing	$ 3,706	$ 3,745	($ 39)	(1%)

	Six Months Ended June 30, 2013	2012	Change Amount	%
	(dollars in thousands)			
Sales and marketing	$ 7,653	$ 7,268	$ 385	5%

Sales and marketing expenses for six months ended June 30, 2013 increased primarily due to an increase in personnel costs, including stock-based compensation expense of $0.1 million, to support sales activities.

General and Administrative

	Three Months Ended June 30, 2013	2012	Change Amount	%
	(dollars in thousands)			
General and administrative	$ 2,842	$ 2,755	$ 87	3%

	Six Months Ended June 30, 2013	2012	Change Amount	%
	(dollars in thousands)			
General and administrative	$ 5,997	$ 6,367	($ 370)	(6%)

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General and administrative expenses for the six months ended June 30, 2013 decreased by $0.4 million. The decrease was due to accrual of provisional costs with regard to employment and other related claims as well as associated costs of $0.7 million we recorded during the six months ended June 30, 2012. The decrease was partially offset by increase in stock-based compensation expense of $0.5 million as a result of equity awards.

Provision (benefit) for Income Taxes

	Three Months Ended June 30,		Change	
	2013	2012	Amount	%
	(dollars in thousands)			
Provision (benefit) for income taxes	($ 2,211)	$ 346	$ (2,557)	(739)%

	Six Months Ended June 30,		Change	
	2013	2012	Amount	%
	(dollars in thousands)			
Provision (benefit) for income taxes	$ 1,265	($ 924)	$ 2,189	237%

We normally determine our interim provision using an estimated single annual effective tax rate for all tax jurisdictions. ASC 740 provides that when an entity operates in a jurisdiction that has generated ordinary losses on a year-to-date basis or on the basis of the results anticipated for the full fiscal year and no benefit can be recognized on those losses, a separate effective tax rate should be computed and applied to ordinary income (or loss) in that jurisdiction. We incurred pretax loss during the three and six months ended June 30, 2013 and will not recognize tax benefit of the losses due to full valuation allowance established against deferred tax assets in the U.S. and Singapore. Thus, separate effective tax rate was applied to losses from each loss jurisdiction to compute the interim tax expense.

The income tax expense (benefit) for the three and six months ended June 30, 2013 reflects an effective tax rate of 60% and (16%), respectively. The effective tax rates for the three and six months ended June 30, 2013 differs from the statutory rate of 35% primarily due to the change in valuation allowance (originally established in the fourth quarter of 2012), foreign income taxes provided at lower rates, geographic mix in profitability, unrecognized tax benefits and stock-based compensation adjustments.

The income tax expense for the three and six months ended June 30, 2012 reflects an effective tax rate of (28%) and 23%, respectively. The effective tax rates for the three and six months ended June 30, 2012 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. For the three and six months ended June 30, 2012, the discrete method was used to calculate the interim tax expense. We determined that a calculation of an annual effective tax rate would not represent a reliable estimate due to the sensitivity of the annual effective tax rate estimate to even minimal changes to forecasted earnings for the year. Under the discrete method, we determine the tax expense based upon actual results as if the interim period were an annual period.

Liquidity and Capital Resources

As of June 30, 2013, we had cash, cash equivalents and investments in marketable securities of $118.9 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.

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

	Six Months Ended June 30,	
	2013	2012
	(in thousands)	
Net cash provided by operating activities	$ 7,210	$ 8,089

Net cash used in investing activities	(8,956)	(4,974)
Net cash provided by financing activities	762	952
Net increase (decrease) in cash and cash equivalents	$ (984)	$ 4,067

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Net Cash Provided by Operating Activities

Net cash provided by operating activities during the six months ended June 30, 2013 primarily reflected a decrease in accounts receivable of $2.4 million, change in income tax payable/receivable of $2.8 million, depreciation and amortization of $3.6 million and stock-based compensation of $8.3 million offset by net loss of $9.1 million and increase in inventories of $0.7 million. Our receivables decreased due to collections. Our inventories increased a result of growing production for expected delivery to customers in the third quarter of 2013.

Net cash provided by operating activities during the six months ended June 30, 2012 primarily reflected an increase in accounts payable and accrued expenses of $3.7 million, an increase in deferred revenue of $0.9 million, decrease in inventory of $0.8 million, depreciation and amortization of $2.0 million and stock-based compensation of $5.9 million offset by net loss of $3.1 million and increases in accounts receivable of $1.7 million and change in income tax payable/receivable of $0.6 million . Our accounts payable and accrued expenses increased as a result of increased production volume, provision for warranty costs, employment and other related claims. Our receivables increased due to shipments made in the last month of the quarter. Our deferred revenue increased as distributors increased their inventory level for shipment to customers in third quarter. Our inventory decreased due to shipments to customers in the last month of the quarter.

Net Cash Used in Investing Activities

Net cash used in investing activities during the six months ended June 30, 2013, consisted of cash used to purchase property and equipment of $9.7 million and purchases of marketable securities of $21.8 million, offset by sales and maturities of marketable securities of $22.5 million.

Net cash used in investing activities during the six months ended June 30, 2012, consisted of cash used to purchase property and equipment of $4.3 million and purchases of marketable securities of $18.6 million, offset by sales and maturities of marketable securities of $17.7 million.

Net Cash Provided by Financing Activities

Net cash provided by financing activities during the six months ended June 30, 2013 consisted of proceeds from exercise of stock options and employee stock purchase plan of $1.7 million and excess tax benefit related to stock-based compensation of $0.5 million, offset by minimum tax withholding paid on behalf of employees for restricted stock units of $1.4 million.

Net cash provided by financing activities during the six months ended June 30, 2012 consisted primarily of proceeds from exercise of stock options of $1.2 million.

Operating and Capital Expenditure Requirements

Our principal source of liquidity as of June 30, 2013 consisted of $118.9 million of cash, cash equivalents and investments in marketable securities, of which $6.7 million is held by our foreign subsidiaries. Based on our current operating plan, we believe that our existing cash and cash equivalents 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.

We do not plan to repatriate cash balances from foreign subsidiaries to fund our operations in the United States. There may be adverse tax effects upon repatriation of these funds to the United States.

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Recent Authoritative Accounting Guidance

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity

We had cash and cash equivalents and investments in marketable securities of $118.9 million and $121.3 million at June 30, 2013 and December 31, 2012, 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, money market funds and debt securities. Our investment portfolio as of June 30, 2013 consisted of money market funds, U.S. Treasuries, municipal bonds, corporate bonds, certificates of deposit, 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, net of applicable taxes, included in accumulated other comprehensive income (loss), reported in a separate component of stockholders equity. Although, we currently expect that our ability to access or liquidate these investments as needed to support our business activities will continue, we cannot ensure that this will not change.

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

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.

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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 are 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.

PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

The information set forth under Note 13 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***

You should carefully consider the risks described in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2012, as our business, financial condition and results of operations could be adversely affected by any of the risks and uncertainties described therein. There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

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Item 6. ***Exhibits***

(a) *Exhibits.* The following Exhibits are attached hereto and incorporated herein by reference:

Exhibit Number	Description
31.1	Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
31.2	Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
32.1(1)	Certificate of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
32.2(1)	Certificate of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
101.INS(2)	XBRL Instance Document
101.SCH(2)	XBRL Taxonomy Extension Schema
101.CAL(2)	XBRL Taxonomy Extension Calculation Linkbase
101.DEF(2)	XBRL Taxonomy Extension Definition Linkbase
101.LAB(2)	XBRL Taxonomy Extension Label Linkbase
101.PRE(2)	XBRL Taxonomy Extension Presentation Linkbase

(1) The material contained in Exhibit 32.1 and Exhibit 32.2 is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.

(2) In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed filed for purpose of Section 18 of the Exchange Act. Such exhibits will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act.

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SIGNATURES

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

INPHI CORPORATION,
(Registrant)

/s/ Ford Tamer
Ford Tamer
Chief Executive Officer
(Principal Executive Officer)
August 7, 2013

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