WIND RIVER SYSTEMS INC
Form 10-Q
December 10, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended October 31, 2007

or

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

Commission file number 001-33061

WIND RIVER SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2873391**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

500 Wind River Way, Alameda, California 94501

(Address of principal executive offices)

(510) 748-4100

(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 x No ¨

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

As of November 30, 2007, there were 87,291,372 shares of the registrant s $0.001 par value common stock outstanding.

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WIND RIVER SYSTEMS, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2007

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Unless stated otherwise, references in this report to Wind River, we, our, us or the Company refer to Wind River Systems, Inc., a Delaware corporation, and its consolidated subsidiaries.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WIND RIVER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2007	2006	2007	2006
Revenues, net:				
Product	$ 29,735	$ 27,009	$ 89,924	$ 85,953
Subscription	30,886	25,698	89,939	71,542
Service	21,022	17,838	64,458	51,736
Total revenues, net	81,643	70,545	244,321	209,231
Cost of revenues:				
Product	586	762	1,778	2,254
Subscription	4,288	4,094	13,046	11,921
Service	14,403	10,868	42,754	32,879
Amortization of purchased intangibles	691	317	1,896	829
Total cost of revenues	19,968	16,041	59,474	47,883
Gross profit	61,675	54,504	184,847	161,348
Operating expenses:				
Selling and marketing	32,852	27,474	98,163	83,492
Product development and engineering	20,588	18,673	61,288	54,541
General and administrative	9,050	10,203	28,612	26,908
Amortization of other intangibles	145	84	417	212
Restructuring charges (reversals)	642	(40)	642	(198)
Total operating expenses	63,277	56,394	189,122	164,955
Loss from operations	(1,602)	(1,890)	(4,275)	(3,607)
Other income (expense):				
Interest income	2,615	2,402	7,128	6,510
Interest expense	(131)	(573)	(335)	(1,825)
Other expense, net	(53)	(134)	(454)	(231)
Total other income, net	2,431	1,695	6,339	4,454
Income (loss) before income taxes	829	(195)	2,064	847
Provision for income taxes	927	477	2,400	511
Net income (loss)	$ (98)	$ (672)	$ (336)	$ 336

Net income (loss) per share:				
Basic and diluted	$ (0.00)	$ (0.01)	$ (0.00)	$ 0.00
Shares used in per share calculation:				
Basic	87,081	85,138	86,174	85,483
Diluted	87,081	85,138	86,174	86,795

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

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WIND RIVER SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

	October 31, 2007	January 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 78,344	$ 71,316
Short-term investments	22,473	38,959
Accounts receivable, net	73,586	74,763
Prepaid and other current assets	17,157	17,239
Total current assets	191,560	202,277
Long-term investments	122,189	92,704
Property and equipment, net	78,029	74,997
Goodwill	114,390	108,354
Other intangibles, net	8,708	3,721
Other assets	17,612	16,512
Total assets	$ 532,488	$ 498,565
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,670	$ 7,131
Accrued and other current liabilities	21,599	15,892
Accrued compensation	23,159	20,093
Income taxes payable	1,617	1,376
Deferred revenues	102,705	112,161
Total current liabilities	155,750	156,653
Long-term deferred revenues	13,161	14,868
Other long-term liabilities	6,753	2,910
Total liabilities	175,664	174,431
Stockholders equity:		
Common stock	91	88
Additional paid-in-capital	858,458	825,570
Treasury stock	(51,097)	(46,233)
Accumulated other comprehensive income (loss)	4,473	(1,867)
Accumulated deficit	(455,101)	(453,424)
Total stockholders equity	356,824	324,134
Total liabilities and stockholders equity	$ 532,488	$ 498,565

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

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WIND RIVER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended October 31, 2007	Nine Months Ended October 31, 2006
Cash flows from operating activities:		
Net income (loss)	$ (336)	$ 336
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	9,387	8,154
Amortization of bond issuance costs		252
Stock-based compensation expense	16,118	16,780
401(k) common stock match	1,645	1,569
Non-cash restructuring charges	333	
Realized loss from sales of available-for-sale securities, net	51	230
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	4,247	898
Accounts payable	(1,272)	(391)
Accrued liabilities	4,536	(96)
Accrued compensation	1,854	2,077
Income taxes payable	1,147	(1,822)
Deferred revenues	(15,466)	12,424
Other assets and liabilities	1,108	(453)
Net cash provided by operating activities	23,352	39,958
Cash flows from investing activities:		
Acquisitions of property and equipment	(7,990)	(3,567)
Acquisitions, net of cash acquired	(11,484)	(17,432)
Purchases of investments	(79,604)	(56,489)
Sales of investments	665	2,114
Maturities of investments	66,691	72,285
Net cash used in investing activities	(31,722)	(3,089)
Cash flows from financing activities:		
Issuance of common stock	16,800	5,838
Repurchase of common stock	(6,536)	(13,878)
Repayment of loan		(77)
Net cash provided by (used in) in financing activities	10,264	(8,117)
Effect of exchange rate changes on cash and cash equivalents	5,134	737
Net increase in cash and cash equivalents	7,028	29,489
Cash and cash equivalents at beginning of period	71,316	59,279
Cash and cash equivalents at end of period	$ 78,344	$ 88,768

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

WIND RIVER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1: The Company and Summary of Significant Accounting Policies

The Company. Wind River Systems, Inc. (Wind River or the Company) is a global leader in Device Software Optimization (DSO). Wind River s software is used to develop, run and manage devices faster, better, at lower cost and more reliably. Wind River s software and development tools are used to optimize the functionality of devices as varied as set-top boxes, automobile braking and navigation systems, mobile handsets, Internet routers, avionics control panels, and coronary pacemakers. Wind River offers customers DSO solutions to enhance product performance, standardize designs across projects and throughout the enterprise, reduce research and development costs and shorten product development cycles. Wind River was incorporated in California in February 1983 and reincorporated in Delaware in April 1993.

Wind River markets its products and services in North America, EMEA (comprising Europe, the Middle East and Africa), Japan and the Asia Pacific region, primarily through its own direct sales organization, which consists of sales persons and field engineers. Wind River also licenses distributors, primarily in international regions, to serve customers in regions not serviced by its direct sales force.

Basis of Presentation. Wind River has prepared the condensed consolidated financial statements included herein, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, Wind River believes that the disclosures are adequate to ensure the information presented is not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in Wind River s Annual Report on Form 10-K for the fiscal year ended January 31, 2007 filed with the SEC on May 1, 2007.

Wind River believes that all necessary adjustments, which consist of normal recurring items, have been included in the accompanying consolidated financial statements to state fairly the results of the interim periods. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for Wind River s fiscal year ending January 31, 2008.

The condensed consolidated financial statements include the financial information of Wind River and its subsidiaries. All significant inter-company accounts and transactions have been eliminated.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Specifically, estimates are used for, but not limited to, the accounting for stock-based compensation, the allowance for doubtful accounts, sales returns and other allowances, valuation of investments, goodwill and purchased intangibles, deferred tax assets and liabilities and income taxes and any associated valuation allowance or reserves, percentage of completion accounting, accrued compensation and other accruals, and the outcome of litigation and other contingencies. Wind River bases its estimates on historical experience and various other assumptions that are believed to be reasonable based on the specific circumstances. Wind River s management has discussed these estimates with the Audit Committee of the Board of Directors. These estimates and assumptions form the basis for making judgments about the carrying value of certain assets and liabilities. Actual results could differ from these estimates.

Revenue Recognition Allocation Policy. For consolidated statement of operations classification purposes only, the Company allocates the revenue first to those elements for which it has established VSOE of fair value, and any remaining recognized revenue is then allocated to those items for which it lacks VSOE of fair value. If the elements for which the Company has no fair value include fixed price services, it allocates revenue to these services based upon expected hours to be incurred plus a normal margin. Any remaining revenues would be allocated to product or subscription revenues, depending on the type of license purchased.

Recent Accounting Adoptions. On February 1, 2007, the Company adopted the consensus reached in Emerging Issues Task Force (EITF) Issue No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences* (EITF 06-2). EITF 06-2 provides recognition guidance on the accrual of employees rights to compensated absences under a sabbatical or other similar benefit arrangement. Prior to the adoption of EITF 06-2, the Company recorded a liability for sabbatical leave upon employee vesting in the benefit, which occurred only at the end of a five-year service period. Under EITF 06-2, the Company accrues an estimated liability for sabbatical leave over the requisite five-year service period, as employee services are rendered. The adoption of EITF 06-2 resulted in a $1.3 million increase to accumulated deficit and accrued compensation and other long-term liabilities as of February 1, 2007.

On February 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The adoption of FIN 48 did not result in a material adjustment to accumulated deficit and decreased income taxes payable and other assets by $308,000 and $313,000, respectively, as of February 1, 2007. See Note 6, Income Taxes, for further information.

Recent Accounting Pronouncements. In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 provides accounting guidance on the definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 will be effective beginning in the first quarter of fiscal year 2009. The Company is evaluating the impact that this statement will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS 159 is to provide opportunities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply hedge accounting provisions. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 will be effective in the first quarter of fiscal year 2009. The Company is evaluating the impact that this statement will have on its consolidated financial statements.

In June 2007, the FASB reached a consensus on EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* (EITF 07-3). EITF 07-3 requires non-refundable advance payments for goods and services to be used in future research and development activities to be recorded as an asset and the payments to be expensed when the research and development activities are performed. EITF 07-3 will be effective in the first quarter of fiscal year 2009. The Company is evaluating the impact that this statement will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R), which replaced SFAS 141. SFAS 141R retains the fundamental requirements of SFAS 141, but revises certain principles, including the definition of a business combination, the recognition and measurement of assets acquired and liabilities assumed in a business combination, the accounting for goodwill, and financial statement disclosure. SFAS 141R will be effective on February 1, 2009 and is applicable to business combinations that occur on or after this date. The Company is evaluating the impact that this statement will have on its consolidated financial statements.

Note 2: Acquisitions, Goodwill and Intangible Assets

Acquisition of S.C. Comsys S.R.L.

In August 2007, Wind River acquired all of the outstanding shares of S.C. Comsys S.R.L. (Comsys), a privately held professional services company based in Romania. The acquisition will enable the Company to increase the number of skilled consultants in its professional services organization and to expand its service offerings throughout Europe and globally. The Company paid cash consideration of approximately $1.3 million, comprised of $1.2 million in cash consideration, plus acquisition related costs. In addition, the Company agreed to pay Comsys former shareholders a potential earn-out distribution of up to $250,000, which will be payable if certain specified future performance criteria are met. The performance criteria consist of post-acquisition services to be provided to the Company and, accordingly, the distribution amount will be accrued as compensation expense over the contingency period, provided the criteria are probable of being satisfied.

The purchase did not qualify as a business combination under SFAS No. 141, *Business Combinations* (SFAS 141), as the acquiree was deemed to be a development-stage operation as of the acquisition date. Accordingly, the purchase was recorded as an asset acquisition and the total consideration was allocated to the assets acquired and liabilities assumed, excluding goodwill, based on their estimated fair values. Assembled workforce associated with an asset acquisition qualifies as an identified intangible asset and, therefore, the Company preliminarily allocated $1.5 million of the purchase price to assembled workforce, which represents the value of the acquired work-force-in place.

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The following table reflects the preliminary allocation of the total purchase price of $1.3 million as of the date of acquisition (in thousands, except estimated useful economic life):

	Estimated Useful Economic Life (Years)	Purchase Price Allocation
Property and equipment, net		$ 63
Assembled workforce	5	1,547
Net current liabilities		(16)
Deferred tax liability		(247)
Total purchase price		$ 1,347

The final purchase price allocation will depend primarily upon the finalization of the opening balance sheet, including the acquired intangible assets and certain accrued liabilities.

Acquisition of the RTLinux Business

On February 12, 2007, the Company acquired the intellectual property, including patents, copyrights, trademarks and associated product rights for the RTLinux business from Finite State Machine Labs, Inc. RTLinux is a commercially-available, patented, hard real-time Linux technology, which will broaden the Company s product offerings for its Linux-based device software platforms. Pursuant to the purchase agreement, the Company also acquired rights to future runtime revenue streams for assumed RTLinux contracts. The Company paid approximately $10.1 million, comprised of $9.8 million in cash consideration, plus acquisition related costs. The purchase was accounted for as a taxable transaction and, in accordance with SFAS 141, the total consideration was allocated to the intangible assets acquired and liabilities assumed, based on their estimated fair values.

The following table reflects the allocation of the total purchase price of $10.1 million as of the date of acquisition (in thousands, except estimated useful economic life):

	Estimated Useful Economic Life (Years)	Purchase Price Allocation
Core and developed technology	4	$ 4,900
Customer contracts and related relationships	3	300
Non-compete agreements	2	300
Trademarks	5	100
Goodwill		4,672
Deferred revenues		(123)
Total purchase price		$ 10,149

In performing the purchase price allocation of acquired intangible assets, Wind River considered its intention for the future use of the assets, analyses of historical financial performance, and estimates of the future performance of RTLinux, among other factors. Wind River used the income valuation approach in determining the fair values of the acquired intangible assets using a discount rate of 26%. The goodwill of $4.7 million represents Wind River s assigned value for the long-term potential of the integration of RTLinux into Wind River s overall Linux product strategy and is expected to be fully deductible for tax purposes.

The condensed consolidated financial statements include the operating results of the RTLinux business from the date of acquisition. Pro forma results of operations have not been presented because the effect of this acquisition was not material to the consolidated statement of operations, balance sheets, or cash flows of Wind River.

Acquisition of Interpeak AB

On March 20, 2006, Wind River acquired Interpeak AB, a privately held Swedish company, for approximately $18.6 million, comprised of $17.8 million in cash consideration, plus acquisition related costs. For additional information, see Note 3, Goodwill and Purchased Intangibles, of the notes to consolidated financial statements in the Company s Annual Report on Form 10-K for the fiscal year ended January 31, 2007.

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Goodwill and Intangibles

The following table summarizes the Company s goodwill and other intangible assets (in thousands):

	January 31, 2007	October 31, 2007		
	Net	Gross Carrying Amount	Accumulated Amortization	Net
Goodwill	$ 108,354	$ 114,390	$	$ 114,390
Developed and core technology and patents	2,725	37,897	(32,016)	5,881
Assembled workforce		1,547	(51)	1,496
Customer relationships, contracts and agreements	996	17,356	(16,025)	1,331
Total	$ 112,075	$ 171,190	$ (48,092)	$ 123,098

Goodwill and other intangibles, net, increased primarily as a result of the Company s acquisition of Comsys and the RTLinux business and, to a lesser extent, due to translation adjustments of goodwill and other intangibles denominated in foreign currencies. Developed and core technology and patents are being amortized over a weighted average period of 3.8 years. Assembled workforce is being amortized over a period of 5.0 years, while customer relationships, contracts and agreements are being amortized over a weighted average period of 4.0 years.

The Company assesses goodwill for impairment in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), which requires that goodwill be tested for impairment at the reporting unit level at least annually or more frequently upon the occurrence of certain events, as defined by SFAS 142. The Company operates as one reporting unit and reviews goodwill for impairment at least annually during the second quarter of each fiscal year. The Company completed its annual goodwill impairment review during the second quarter of fiscal year 2008 and the results of the review did not indicate an impairment. There were no events or circumstances from the date of the annual impairment assessment through October 31, 2007 that indicated a further assessment was necessary.

Note 3: Derivative Financial Instruments

Wind River enters into foreign currency forward exchange contracts to manage foreign currency exposures related to certain non-functional currency related inter-company and other balances. Transaction gains and losses on the contracts and the assets and liabilities are recognized each period in other income (expense), net. As of October 31, 2007, Wind River had outstanding contracts with the following terms (currency amounts and USD equivalents in thousands):

	Buy	Buy	Buy	Buy	Sell	Sell
Currency	EURO( )	JPY(¥)	CAD(CAD$)	SEK(kr)	GBP(£)	ILS ( )
Amount	20,130	480,000	10,200	10,100	1,320	1,500
Rate	0.69306	114.2175	0.9525	6.3789	0.4855	3.9868
USD equivalent	$ 29,045	$ 4,203	$ 10,709	$ 1,583	$ 2,719	$ 376
Maturity date	11/30/2007	11/30/2007	11/30/2007	11/30/2007	11/30/2007	11/30/2007

Wind River does not enter into derivative financial instruments for trading or speculative purposes. As of October 31, 2007, the difference between the fair value and carrying value of the above contracts was not significant.

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Note 4: Deferred Revenues

Deferred revenues consist of the following (in thousands):

	October 31, 2007	January 31, 2007
Current deferred revenues:		
Subscription	$ 67,769	$ 73,501
Maintenance and other	34,936	38,660
Total current deferred revenues	102,705	112,161
Long-term deferred revenues:		
Subscription	12,169	13,426
Maintenance and other	992	1,442
Total long-term deferred revenues	13,161	14,868
Total deferred revenues	$ 115,866	$ 127,029

Deferred subscription revenues represent customer billings and payments made in advance for software licensed over a subscription period. Subscription periods vary from annual to multi-year and are classified as such. Long-term deferred revenues represent the portion of multi-year contracts that are due to be recognized as revenue in a time period greater than one year from the balance sheet date. Maintenance and other deferred revenues primarily include deferred maintenance, service and product revenues. Deferred maintenance revenues represent customer billings and payments made in advance for annual support contracts. Maintenance is typically billed on a per annum basis in advance and revenue is recognized ratably over the maintenance period. Deferred service revenues include pre-payments for software consulting and training services. Deferred product revenues primarily include software license transactions that are not separable from consulting services. Revenue for these contracts is recognized as the services are performed.

Note 5: Restructuring

In order to better align its operations with its current business structure, Wind River partially vacated a leased facility located in the United Kingdom during the three months ended October 31, 2007. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the Company recognized a total charge of $642,000, comprised of $266,000 related to future lease payments, net of estimated sublease income, and $376,000 related to other exit costs.

During the three and nine months ended October 31, 2006, Wind River recorded net restructuring reversals of $40,000 and $198,000, respectively, associated with adjustments to original estimates for certain vacated facilities and employee termination and related costs in EMEA.

As of January 31, 2007 and October 31, 2007, the restructuring accrual, included within accrued and other current liabilities and in other long-term liabilities on the condensed consolidated balance sheets, totaled approximately $372,000 and $592,000, respectively. The increase during the nine-months ended October 31, 2007 is primarily attributable to the restructuring charges incurred during the current quarter for the partially vacated facility and, to a lesser extent, due to currency translation adjustments related to restructuring liabilities denominated in foreign currencies. The remaining restructuring liability as of October 31, 2007 is related to the lease obligation for the United Kingdom facility and will be settled over the remaining lease term, which expires in fiscal year 2012.

Note 6: Income Taxes

The Company had a provision for income taxes of $927,000 and $477,000 for the three months ended October 31, 2007 and 2006, respectively, and $2.4 million and $511,000 for the nine months ended October 31, 2007 and 2006, respectively. The provision is based on estimates of the Company s expected liability for domestic and foreign income taxes and foreign withholding taxes incurred during the year, and is calculated by applying the estimated annual effective tax rate to the income (loss) before provision for income taxes, adjusted for any discrete items.

Deferred income taxes are recorded in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109) and are determined based on the differences between financial reporting and the tax basis of assets and liabilities using the tax rates of laws in effect when the differences are expected to reverse. SFAS 109 provides for recognition of deferred tax assets if the realization of such assets is more likely than not to occur. With the exception of primarily the U.S. jurisdiction, the Company has determined that it is more likely than not that its deferred taxes will be realized. Accordingly, the Company has net deferred tax assets of $9.7 million primarily related to certain international jurisdictions and a full valuation allowance against the remainder of its deferred tax assets as of October 31, 2007.

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As discussed in Note 1, The Company and Summary of Significant Accounting Policies, the Company adopted the provisions of FIN 48 on February 1, 2007, which did not result in a material adjustment to accumulated deficit. As of February 1, 2007, the Company had $14.0 million of unrecognized tax benefits, including interest. If recognized, the portion of unrecognized tax benefits that would decrease the Company s provision for income taxes and increase net income is $4.9 million.

During the second quarter of the fiscal year 2008, as a result of meeting certain recognition criteria, the Company recorded a benefit of $825,000 for a portion of previously unrecognized tax benefits. The Company currently anticipates that within the next several quarters, a portion of its unrecognized tax benefits will be reversed upon the expiration of statutes of limitation in certain jurisdictions, which will allow the Company to meet the recognition and measurement requirements with respect to those tax benefits.

As of October 31, 2007, the Company s unrecognized tax benefits including interest totaled $13.4 million of which $1.0 million is included as a component of other long-term liabilities and $3.4 million is included as a reduction of other long-term assets on the condensed consolidated balance sheet. If recognized, the portion of unrecognized tax benefits that would decrease the Company s provision for income taxes and decrease net losses is $4.4 million. The remaining $9.0 million balance of unrecognized tax benefits relates to deferred tax assets in jurisdictions where a full valuation allowance is recorded, which has no impact to the condensed consolidated financial statements.

The Company recognizes interest and penalties accrued on unrecognized tax benefits as well as interest received from favorable settlements within provision for income taxes on the condensed consolidated statement of operations. As of October 31, 2007, the Company had $121,000 of interest accrued as a component of other long-term liabilities, associated with unrecognized tax benefits.

The Company is subject to taxation in the U.S. and various state and foreign jurisdictions. The material jurisdictions that are subject to examination by tax authorities for tax years after fiscal year 2003 primarily include the U.S., the State of California, Canada, Germany, France and Japan. In addition, tax attribute carryforwards in years prior to fiscal year 2003 may also be subject to examination until they are fully utilized. In September 2007, the Company received notification that the fiscal year 2005 U.S. federal income tax return was selected for examination. The Company believes all exposures have been sufficiently provided for in connection with the period under audit and any other open tax year. The State of New York tax audit was concluded in the second quarter of fiscal year 2008 and no material adjustments were made in connection with the audit. The Company is not under examination in any other income tax jurisdiction at the present time.

Note 7: Comprehensive Income

The following are the components of comprehensive income (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2007	**2006**	**2007**	**2006**
Net income (loss)	$ (98)	$ (672)	$ (336)	$ 336
Other comprehensive income:				
Foreign currency translation adjustments	3,254	74	5,544	1,876
Unrealized gain on investments	347	750	745	878
Realized (gain) loss included in net income (loss)	(20)	32	51	230
Other comprehensive income	3,581	856	6,340	2,984
Total comprehensive income	$ 3,483	$ 184	$ 6,004	$ 3,320

Note 8: Net Income (Loss) Per Share Computation

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. For purposes of computing basic net income (loss) per share, the weighted average number of outstanding shares of common stock excludes unvested restricted stock awards. Diluted net income (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common shares outstanding during the period and all dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of convertible subordinated notes (using the if-converted method) and unvested restricted stock awards, outstanding options and shares issuable under the Company s employee stock purchase plan (using the treasury stock method).

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The following table provides a reconciliation of the numerators and denominators of the basic and diluted per share computations (in thousands, except per share amounts):

	Three Months Ended October 31, 2007	Three Months Ended October 31, 2006	Nine Months Ended October 31, 2007	Nine Months Ended October 31, 2006
Numerator:				
Net income (loss)	$ (98)	$ (672)	$ (336)	$ 336
Denominator:				
Weighted average common shares outstanding- basic	87,081	85,138	86,174	85,483
Effect of dilutive potential common shares				1,312
Weighted average common shares outstanding- diluted	87,081	85,138	86,174	86,795
Net income (loss) per share				
Basic	$ (0.00)	$ (0.01)	$ (0.00)	$ 0.00
Diluted	$ (0.00)	$ (0.01)	$ (0.00)	$ 0.00

The effect of the assumed conversion of the 3.75% convertible subordinated notes for 1.7 million shares of common stock is anti-dilutive for the three and nine months ended October 31, 2006 and is therefore excluded from the above computation. The above computation also excludes all anti-dilutive outstanding options, restricted stock awards and shares issuable under the Company s employee stock purchase plan, which amounted to approximately 11.8 million shares for the nine months ended October 31, 2006. Since Wind River had a net loss for the three and nine months ended October 31, 2007 and for the three months ended October 31, 2006, there is no difference between basic and diluted net loss per share. If the Company had recorded net income for the three and nine months ended October 31, 2007, it would have included in the computation dilutive potential common shares totaling approximately 1.1 million shares for each period, exclusive of anti-dilutive potential common shares, which amounted to approximately 9.5 million and 9.8 million shares, respectively. If the Company had recorded net income for the three months ended October 31, 2006, it would have included in the computation dilutive potential common shares totaling approximately 1.2 million shares exclusive of anti-dilutive potential common shares, which amounted to approximately 12.5 million shares.

Note 9: Common Stock

Common Stock

In June 2002, the Board of Directors authorized a stock repurchase program (the 2002 Repurchase Plan) to enable Wind River to acquire up to $30.0 million of outstanding common stock. From the inception of the plan in fiscal year 2003 through fiscal year 2007, the Company repurchased 2.8 million shares at an aggregate purchase price of $23.9 million with the repurchased shares being recorded as treasury stock on a last-in, first-out basis. During the nine months ended October 31, 2007, the Company repurchased 652,000 shares of common stock for a total cost of $6.5 million and an average price of $10.03 per share. As a result of these repurchases, the Company completed the 2002 Repurchase Plan in the first quarter of fiscal year 2008.

In June 2007, the Board of Directors authorized a new stock repurchase program to enable Wind River to acquire up to $50.0 million of its outstanding common stock in the open market or through negotiated transactions. Wind River may repurchase shares from time to time at management s discretion in accordance with applicable securities laws. No repurchases have been made under the new program.

The Board of Directors and the Company s stockholders have authorized the allocation of up to 300,000 shares of common stock from treasury stock each year for replenishment of the Company s 1993 Employee Stock Purchase Plan (ESPP). For the nine months ended October 31, 2007 and in each prior year commencing in fiscal year 2004, the allocation program has provided 300,000 shares for issuance to employees under the ESPP.

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Restricted Stock

In connection with the acquisition of Interpeak on March 20, 2006, Wind River issued 192,367 restricted shares of Wind River common stock to certain founders of Interpeak. On March 20, 2007, the contractual restrictions imposed on the shares lapsed in accordance with their terms. However, the shares remain subject to certain restrictions under applicable securities laws. The total fair value of the restricted stock issued was $2.4 million and was recorded as stock-based compensation expense over the restriction period as services were provided.

Note 10: Stock-Based Compensation Plans

The Company has adopted certain equity incentive and stock purchase plans as described in Note 11, Stock-Based Compensation Plans, of the notes to consolidated financial statements in the Company s Annual Report on Form 10-K for the fiscal year ended January 31, 2007.

Stock-Based Compensation Expense

The Company recorded stock-based compensation expense as follows for the three and nine months ended October 31, 2007 and 2006 (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2007	2006	2007	2006
Cost of revenues	$ 593	$ 572	$ 1,869	$ 1,765
Selling and marketing	1,511	1,406	4,493	4,233
Product development and engineering (1)	1,011	1,463	3,238	3,954
General and administrative	2,139	2,301	6,518	6,828
Total stock-based compensation expense	$ 5,254	$ 5,742	$ 16,118	$ 16,780

(1) Includes stock-based compensation expense of $309,000 for the nine months ended October 31, 2007 and $605,000 and $1.5 million for the three and nine months ended October 31, 2006, respectively, related to restricted stock issued in connection with the Interpeak acquisition.

Valuation Assumptions

Wind River uses the Black-Scholes option pricing model to determine the fair value of stock options and stock purchase rights. The fair value of each option grant or stock purchase right is estimated on the date of grant and is affected by the Company s stock price and a number of highly complex and subjective variables including, but not limited to, the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise and cancellation behaviors.

The Company used the following weighted average valuation assumptions to estimate the fair value of options granted during the three and nine months ended October 31, 2007 and 2006:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2007	2006	2007	2006
Risk-free interest rate	4.11% - 4.12%	4.61% - 4.83%	4.11% - 5.08%	4.61% - 5.21%
Expected life (in years)	3.8 - 3.9	3.6 - 4.0	3.8 - 5.3	3.6 - 7.0
Expected volatility	43.7% - 43.9%	48.7% - 54.7%	36.3% - 47.7%	48.7% - 56.9%
Dividend yield	0%	0%	0%	0%

The weighted average fair value of stock option awards granted during the three and nine months ended October 31, 2007 was $4.17 and $3.76, respectively, and the weighted average fair value of stock option awards granted during the three and nine months ended October 31, 2006 was $4.36 and $5.22, respectively.

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The Company used the following weighted average valuation assumptions to estimate the fair value of stock purchase rights granted during the nine months ended October 31, 2007 and 2006:

	Nine Months Ended October 31, 2007	Nine Months Ended October 31, 2006
Risk-free interest rate	5.02%	5.27%
Expected life (in years)	0.3	0.5
Expected volatility	27.7%	38.7%
Dividend yield	0%	0%

The weighted average fair value of common stock purchase rights granted under the ESPP during the nine months ended October 31, 2007 and 2006 was $2.28 and $2.37, respectively. No common stock purchase rights were granted under the ESPP during the three months ended October 31, 2007 or 2006.

Stock Option Activity

The following table summarizes option activity under the Company s equity incentive plans for the nine months ended October 31, 2007 (in thousands, except exercise prices and contractual terms):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at February 1, 2007	16,292	$ 10.94		
Granted	2,988	10.25		
Exercised	(2,135)	7.04		
Cancelled	(1,688)	13.53		