ENTROPIC COMMUNICATIONS INC
Form 10-Q
October 29, 2008
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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2008

or

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

Commission File Number: 001-33844

ENTROPIC COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0947630**
(State or Other Jurisdiction of Incorporation)	**(IRS Employer Identification No.)**

6290 Sequence Drive

San Diego, CA 92121

(Address of Principal Executive Offices and Zip Code)

(858) 768-3600

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes ¨ No

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

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

(Do not check if a smaller reporting company)

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

As of the close of business on October 24, 2008, 69,104,207 shares of the registrant s common stock, $0.001 par value per share, were outstanding.

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ENTROPIC COMMUNICATIONS, INC.

FORM 10-Q

For the Quarterly Period Ended September 30, 2008

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 25,244	$ 51,475
Restricted cash		58
Marketable securities	6,860	2,965
Accounts receivable, net	19,691	24,489
Inventory	22,255	15,332
Prepaid expenses, deferred income taxes and other current assets	1,552	2,238
Total current assets	75,602	96,557
Property and equipment, net	12,224	8,952
Intangible assets, net	30,883	34,145
Goodwill	88,082	86,256
Other long-term assets	281	416
Total assets	$ 207,072	$ 226,326
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 12,680	$ 18,909
Accrued payroll and benefits	4,080	4,253
Deferred revenues		303
Current portion of line of credit and loans payable		2,860
Current portion of software licenses and capital lease obligations	60	384
Total current liabilities	16,820	26,709
Stock repurchase liability	982	1,765
Lines of credit and loans payable, less current portion		5,547
Other long-term liabilities	3,203	1,907
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock	69	68
Additional paid-in capital	295,721	282,627
Accumulated deficit	(109,723)	(92,297)
Total stockholders equity	186,067	190,398
Total liabilities and stockholders equity	$ 207,072	$ 226,326

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

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ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net revenues	$ 31,678	$ 36,144	$ 116,502	$ 82,377
Cost of net revenues	17,308	21,999	64,014	54,491
Gross profit	14,370	14,145	52,488	27,886
Operating expenses:				
Research and development	13,902	11,923	42,892	22,812
Sales and marketing	3,991	3,283	12,590	6,642
General and administrative	2,798	2,706	9,862	5,104
Write off of in-process research and development			1,300	21,400
Amortization of purchased intangibles	713	1,296	2,022	1,338
Restructuring charges	209		1,278	
Total operating expenses	21,613	19,208	69,944	57,296
Loss from operations	(7,243)	(5,063)	(17,456)	(29,410)
Other income (expense), net	156	(1,583)	149	(2,070)
Loss before income taxes	(7,087)	(6,646)	(17,307)	(31,480)
Provision for income taxes	37		119	
Net loss	(7,124)	(6,646)	(17,426)	(31,480)
Accretion of redeemable convertible preferred stock		(32)		(95)
Net loss attributable to common stockholders	$ (7,124)	$ (6,678)	$ (17,426)	$ (31,575)
Net loss per share attributable to common stockholders basic and diluted	$ (0.11)	$ (0.53)	$ (0.26)	$ (3.89)
Weighted average number of shares used to compute loss per share attributable to common stockholders	67,669	12,506	67,378	8,113

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

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ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30,	
	2008	**2007**
Operating activities:		
Net loss	$ (17,426)	$ (31,480)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,375	1,130
Amortization of purchased intangible assets	6,442	2,578
Amortization of inventory step-up in acquisitions		2,062
Stock-based compensation to consultants	92	171
Stock-based compensation to employees	10,362	3,654
Interest expense attributable to amortization and early payoff of debt issuance costs	476	132
In-process research and development	1,300	21,400
Revaluation of preferred stock warrant liabilities		2,006
Impairment of assets related to restructuring charge	259	
Loss on disposal of assets	8	
Changes in operating assets and liabilities:		
Restricted cash	58	
Accounts receivable	4,800	(9,020)
Inventory	(6,909)	(3,206)
Prepaid expenses, deferred income taxes and other current assets	686	(501)
Other long-term assets	44	(1,553)
Accounts payable and accrued expenses	(6,412)	3,718
Accrued payroll and benefits	(309)	768
Deferred revenues	(303)	3
Other long-term liabilities	1,296	99
Net cash used in operating activities	(3,161)	(8,039)
Investing activities:		
Purchases of property and equipment	(5,741)	(1,417)
Purchases of marketable securities	(17,144)	
Sales/maturities of marketable securities	13,249	7,746
Net cash (used in) provided by acquisitions	(6,113)	4,205
Net cash (used in) provided by investing activities	(15,749)	10,534
Financing activities:		
Principal payments on debt and capital lease obligations	(9,180)	(1,727)
Proceeds from line of credit obligations		3,000
Proceeds from issuance common stock net of repurchases and issuance costs	1,859	1,585
Net cash (used in) provided by financing activities	(7,321)	2,858
Net (decrease) increase in cash and cash equivalents	(26,231)	5,353
Cash and cash equivalents at beginning of period	51,475	5,928
Cash and cash equivalents at end of period	$ 25,244	$ 11,281

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

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ENTROPIC COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008

1. Organization and Summary of Significant Accounting Policies

Business

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

In October 2007, the Company completed a 1-for-3.25 reverse stock split. The accompanying financial statements and notes to the financial statements give retroactive effect to the reverse stock split for all periods presented.

Basis of Presentation

The accompanying 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 Form 10-Q and Article 10 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC). They do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2007 included in the Company s Annual Report on Form 10-K (Annual Report) filed on March 3, 2008 with the SEC.

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

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates

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

Revenue Recognition

The Company s revenues are generated principally by sales of its semiconductor products. During the three and nine months ended September 30, 2008 and 2007 product revenues represented more than 99% of the Company s total net revenues. The Company also generates service revenues from development contracts.

The majority of the Company s sales occur through the efforts of its direct sales force. The remainder of the Company s sales occurs through distributors. During the three months ended September 30, 2008 and 2007 and the nine months ended September 30, 2008 and 2007, more than 99% of the Company s sales occurred through the efforts of its direct sales force.

In accordance with SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, and SAB No. 104, *Revenue Recognition*, the Company recognizes product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and

(iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment. However, the Company does not recognize revenue until all customer acceptance requirements have been met, when applicable.

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

The Company records reductions to revenues for estimated product returns and pricing adjustments, such as competitive pricing

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

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

The Company derives revenues from development contracts that involve new and unproven technologies. Revenues under these contracts are deferred until customer acceptance is obtained, and other contract-specific terms have been completed in accordance with the completed contract method of American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Provisions for losses related to development contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. The costs associated with development contracts are included in cost of service revenue. The Company defers the cost of services provided under its development contracts.

The Company acquired a development agreement in connection with its acquisition of RF Magic, Inc. (RF Magic) in June 2007 that provides the Company with royalties in exchange for an exclusive right to manufacture and sell certain products. The Company has determined that it is not able to reliably estimate the royalties earned in the period the sales occur. Thus, the Company records revenues based on cash receipts. The royalty revenues recorded during the three months ended September 30, 2008 and 2007 and the nine months ended September 30, 2008 and 2007, were $533,000, $749,000, $2,296,000 and $749,000, respectively.

Concentration of Credit Risk

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

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

Inventories

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

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Goodwill and Intangible Assets

The Company records goodwill and other intangible assets in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The purchase method of accounting for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired. The Company uses the discounted cash flow method to estimate the value of intangible assets acquired. The estimates used to value and amortize intangible assets are consistent with the plans and estimates that the Company uses to manage its business and are based on available historical information and industry estimates and averages.

SFAS 142 requires that goodwill and certain intangible assets be assessed for impairment on an annual basis, or more frequently if indicators of impairment exist, using fair value measurement techniques. SFAS 142 requires an interim goodwill impairment test if it is more likely than not that the fair value of a reporting unit is less than the carrying amount. The Company operates with one reporting unit. The goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as in a business combination. Determining the fair value of the implied goodwill is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including the size and timing of deployments by the Company s customers and related projections and timing of future cash flows, discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, stage of products in development, determination of appropriate market comparables, and determination of whether a premium or discount should be applied to comparables.

In the third quarter of 2008, the Company considered whether it would need to perform an interim assessment for impairment of

its goodwill carrying value as of September 30, 2008 as a result of current market or other company-specific conditions, including, but not limited to:

- the significant decline in the market value of the Company s invested capital, including the market value of its common stock;
- reduction of near-term forecasted revenue growth due to a slow-down in deployments of products that incorporate the Company s chipsets by service providers; and
- sustained operating losses.

In considering whether the occurrence of these market and company-specific conditions triggered the need for the Company to perform an interim assessment for impairment, the Company also considered other factors, including, but not limited to:

- the Company s belief that its net revenues for the three months ended September 30, 2008 relative to historical revenue levels are not indicative of a long-term trend of reduced revenue;
- the Company s continued expectation that in the future there will be additional operator deployments and significant increases in the sales volume of the Company s products that incorporate the Multimedia over Coax Alliance (MoCA) standard;
- the Company has not experienced significant underperformance relative to its historical operating results;
- the Company is currently the only high-volume supplier of chipsets based on MoCA standard;

there have not been significant changes in the manner or use of the acquired assets or the strategy of the Company s overall business;

there have not been significant negative industry trends for a sustained period of time;

there has not been a significant decline in the Company s market capitalization relative to its net book value for a sustained period of time; and

recent volatility in the Company s market capitalization appears to be at least partially attributable to the overall volatility in the U.S. stock market.

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Based on the foregoing considerations and the authoritative guidance provided by SFAS 142, the Company believes that, notwithstanding the occurrence of certain market and company-specific conditions during the three months ended September 30, 2008, the Company has reasonable grounds to believe that these conditions are temporary in nature and have not made it more likely than not that the fair value of the Company s reporting unit is less than its carrying amount as of September 30, 2008. Accordingly, the Company has concluded that it is not necessary to conduct an interim impairment assessment of the fair value of its goodwill and other intangible assets as of September 30, 2008, but will perform its annual impairment assessment as scheduled during the fourth quarter of 2008.

Guarantees and Indemnifications

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

Rebates

The Company accounts for rebates in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*, and, accordingly, at the time of the sale accrues 100% of the potential rebate as a reduction to revenue and does not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. The Company reverses the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when management believes unclaimed rebates are no longer subject to payment and will not be paid.

Warranty Accrual

The Company s products are subject to warranty periods of one year or more. The Company provides for the estimated future costs of replacement upon shipment of the product as cost of net revenues. The warranty accrual is based on management s best estimate of expected costs associated with product failure and historical product failures.

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Research and Development Costs

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

Income Taxes

The Company utilizes the liability method of accounting for income taxes as set forth in Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes* (SFAS 109). Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

The Company also follows Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48), which provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise s financial statements in accordance with SFAS 109. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits within operations as income tax expense.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), including the provisions of SAB No. 107 (SAB 107) and SAB No. 110 (SAB 110). Under SFAS 123R, stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee s requisite service period. The Company has not granted awards with vesting subject to market conditions. The Company adopted the provisions of SFAS 123R using the prospective transition method. Accordingly, prior periods have not been revised for comparative purposes.

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The valuation provisions of SFAS 123R apply to new awards and to awards that are outstanding on the effective date, January 1, 2006, which are subsequently modified or canceled. Prior to the adoption of SFAS 123R, the Company used the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), related interpretations, and the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, for employee stock options and recorded compensation cost for options granted at exercise prices that were less than the market value of the Company s common stock at the date of grant. Pursuant to SFAS 123R, as the Company utilized the minimum value method through December 31, 2005, the Company will continue to recognize compensation expense relating to unvested awards as of the date of adoption using APB 25, which is the same accounting principle originally applied to those awards.

The stock-based compensation for the Company s 2007 Employee Stock Purchase Plan (ESPP) was determined using the Black-Scholes option pricing model and the provisions of FASB Technical Bulletin No. 97-1, *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option*, as amended by SFAS 123R.

The Company accounts for stock-based compensation awards granted to non-employees in accordance with EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18). Under EITF 96-18, the Company determines the fair value of the stock-based compensation awards granted as either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. If the fair value of the equity instruments issued is used, it is measured using the stock price and other measurement assumptions as of the earlier of either (1) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached, or (2) the date at which the counterparty s performance is complete.

Due to the adoption of SFAS 123R, the Company recognizes excess tax benefits associated with stock-based compensation to stockholders equity only when realized. When assessing whether excess tax benefits relating to stock-based compensation have been realized, the Company follows the with and without approach excluding any indirect effects to be realized until after the utilization of all other tax benefits available to the Company.

Segment Reporting

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), establishes standards for the way public business enterprises report information about operating segments in annual consolidated financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers.

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

Recently Issued Accounting Standards

In September 2006, FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. The Company adopted this pronouncement as of January 1, 2008 for financial instruments. Although the adoption of SFAS 157 did not have an impact on its interim financial results, the Company is now required to provide additional disclosures as part of its financial statements. See Note 2 for information and related disclosures regarding the Company s fair value measurements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to choose to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option have been elected are reported in earnings at each subsequent reporting date. The Company adopted this pronouncement in the first quarter of 2008 and it did not have an impact on its interim financial results.

In June 2007, the FASB ratified 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. The Company adopted this standard in the first quarter of 2008 and it did not have an impact on its interim financial results.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations the Company engages in will be recorded and disclosed in accordance with existing GAAP until January 1, 2009. The Company expects SFAS 141R will have an impact on its consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions consummated after the effective date. The Company is still assessing the impact of this standard on its future consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under SFAS 161, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS 133 for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application of SFAS 161 is encouraged. SFAS 161 will only have an impact on the Company s consolidated financial position and results of operations if it engages in any derivative or hedging activities after November 15, 2008.

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2. Supplemental Financial Information

Fair Value of Financial Instruments

The Company holds certain financial assets, including cash equivalents and marketable securities that are required to be measured at fair value on a recurring basis. Cash equivalents include commercial paper and corporate bonds of high credit quality. Marketable securities were carried at amortized cost which approximated fair value.

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers

include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The fair value of the Company s financial assets subject to the disclosure requirements of SFAS 157 was determined using the following levels of inputs as of September 30, 2008 (in thousands):

	Fair Value Measurements as of September 30, 2008			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	$ 24,512	$ 24,512	$	$
Marketable securities	6,860	6,860		
Total	$ 31,372	$ 31,372	$	$

During the three and nine months ended September 30, 2008, no transfers were made into the Level 2 or Level 3 categories.

Inventory

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

	As of September 30, 2008	As of December 31, 2007
Capitalized development contract costs	$	$ 66
Work-in-process	13,967	8,379
Finished goods	8,288	6,887
Total	$ 22,255	$ 15,332

Property and Equipment

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

	Useful Lives (in years)	As of September 30, 2008	As of December 31, 2007
Office and laboratory equipment	5	$ 6,650	$ 4,337

Computer equipment	3-5	2,025	1,541
Furniture and fixtures	6-7	1,571	407
Leasehold improvements	Lease term	4,874	287
Licensed software	1-3	2,401	2,284
Construction in progress		83	3,423
Property and equipment, gross		17,604	12,279
Less: accumulated depreciation		(5,380)	(3,327)
Property and equipment, net		$ 12,224	$ 8,952

Depreciation and amortization expense for the three months ended September 30, 2008 and 2007 and nine months ended September 30, 2008 and 2007 was $861,000, $489,000, $2,375,000 and $1,130,000, respectively.

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Intangible Assets

Intangible assets were as follows (in thousands):

	As of September 30, 2008			As of December 31, 2007		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Developed technology	$ 28,860	$ (7,257)	$ 21,603	$ 26,060	$ (2,648)	$ 23,412
Customer relationships	10,920	(2,310)	8,610	10,800	(900)	9,900
Backlog	1,660	(1,573)	87	1,400	(1,400)	
Trade name	1,000	(417)	583	1,000	(167)	833
Total	$ 42,440	$ (11,557)	$ 30,883	$ 39,260	$ (5,115)	$ 34,145

As of September 30, 2008, the estimated future amortization expenses of purchased intangible assets charged to cost of net revenues and operating expenses for the remainder of fiscal 2008 and periods thereafter are as follows (in thousands):

Years Ending December 31,	Cost of Net Revenues	Operating Expenses	Total
2008	$ 1,590	$ 713	$ 2,303
2009	6,360	2,415	8,775
2010	5,310	2,219	7,529
2011	4,960	2,052	7,012
2012	2,480	1,884	4,364
Thereafter		900	900
Total	$ 20,700	$ 10,183	$ 30,883

Acquisition

On April 3, 2008, the Company acquired certain specified assets of Vativ Technologies, Inc. (Vativ), including Vativ s intellectual property rights, existing product lines, inventory and equipment. Vativ, a fabless semiconductor company based in San Diego, California, focused on providing innovative high-bandwidth, advanced digital signal processing solutions for digital television and 10 gigabit Ethernet markets. The Company paid approximately $5,906,000 in cash at closing, $850,000 of which was contributed, and remains subject, to an escrow fund which is available to satisfy potential indemnity claims. The results of operations of Vativ have been included in the Company s results of operations from the date of acquisition.

The acquired assets did not include Vativ s cash, cash equivalents, investments or any portion of Vativ s accounts receivable. The Company assumed certain liabilities of Vativ equal to approximately $318,000, including current accounts payable and accrued vacation liabilities for the former employees of Vativ hired by the Company. In addition, the Company committed to pay cash retention bonuses in the aggregate amount of $650,000 to employees hired from Vativ in connection with the acquisition earned over the first 90 days of employment. The retention bonuses were recorded as expense during the service period and were not included in the assumed liabilities. In July 2008, the Company paid $560,000 of these retention bonuses to the former Vativ employees and expects to pay the remaining $90,000 within the next six months.

The acquisition of Vativ has been accounted for by the purchase method of accounting in accordance with SFAS No. 141, *Business Combinations*, and as such, the assets acquired and liabilities assumed have been recorded at fair value. The excess of the purchase price over the fair value of net assets acquired was allocated to goodwill. The allocation of the purchase price for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the identifiable tangible and intangible assets acquired and liabilities assumed based on their respective fair values. The Company determined the estimated fair values of in-process research and development, identifiable intangible assets and certain tangible assets of the acquisition based on information available at the time of the acquisition. Such valuations require significant estimates and assumptions including but not limited to: determining the timing and estimated costs to complete the in-process projects, estimating future cash flows and developing appropriate discount rates. The Company believes the fair values assigned to

the assets acquired and liabilities assumed, respectively, are based on reasonable assumptions.

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The following table summarizes the components of the purchase price (in thousands):

Cash	$ 5,906
Direct acquisition costs	207
Total	$ 6,113

The acquisition was funded from the Company s cash and cash equivalents balances.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed in the acquisition (in thousands):

Current assets	$ 16
Property and equipment	109
Identifiable intangible assets	3,180
In-process research and development	1,300
Goodwill	1,826
Accounts payable and accrued liabilities	(318)
Total	$ 6,113

The goodwill recorded for the acquisition of Vativ is deductible for tax purposes over 15 years and will be assessed annually for impairment. Given that the Company has a full valuation allowance for its deferred tax assets, and given that the tax amortization for goodwill has an indefinite reversal period, the Company will be recording income tax expense for the tax impact of this amortization. The weighted average amortization period of the identifiable intangible assets acquired from Vativ is 1.2 years as of September 30, 2008.

The identifiable intangible assets acquired from Vativ and related amortizations are summarized below (in thousands, except for years):

Purchased Intangible Assets:	Purchase Price Allocation	Estimated Useful Life (in years)	Amortization for the Nine Months Ended September 30, 2008
Developed technology amortization to cost of net revenues	$ 2,800	2	$ 700
Backlog	$ 260	0.75	$ 173
Customer relationships	120	1	60
Total	$ 380		$ 233

These identifiable intangible assets are being amortized on a straight-line basis.

The developed technology represents proprietary knowledge that is technologically feasible as of the valuation date, and included all fully functioning products at the date of the valuation. The amount assigned to the developed technology was assigned based on the estimated net discounted cash flows from the related product lines on the date of acquisition.

The in-process research and development (IPR&D) acquired at the date of acquisition relates to Vativ s High Definition Multimedia Interface switch product. The amount was expensed on the acquisition date because the acquired technology had not yet reached technological feasibility and had no alternative future uses. A discounted cash flow approach was utilized in valuing the IPR&D. The value of the technology was the sum of the present value of projected debt-free net income, in excess of returns on requisite assets, over the economic life of the IPR&D.

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Pro Forma Statements of Operations

The following unaudited pro forma financial information reflects the consolidated results of operations as if the acquisition of Vativ had occurred on January 1, 2007 for the three and nine month periods ended September 30, 2007 and on January 1, 2008 for the three and nine month periods ended September 30, 2008. The unaudited pro forma financial data presented are not necessarily indicative of the Company s results of operations that might have occurred had the acquisition been completed at the beginning of the periods presented, and do not purport to represent what the Company s consolidated results of operations might be for any future period (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(unaudited)		(unaudited)	
Net revenues	$ 31,678	$ 36,282	$ 116,676	$ 82,654
Net loss attributable to common stockholders	$ (7,124)	$ (8,857)	$ (20,408)	$ (39,672)
Net loss per share basic and diluted	$ (0.11)	$ (0.71)	$ (0.30)	$ (4.89)

The unaudited pro forma financial data presented above should be read in conjunction with the unaudited pro forma condensed consolidated combined financial statements and related notes and disclosures contained in the Company s Current Report on Form 8-K/A filed with the SEC on June 17, 2008.

Accrued Warranty

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

	As of September 30, 2008
Liability as of December 31, 2007	$ 926
Expirations	(359)
Accruals for warranties issued during the year	527
Warranty rate adjustment	(437)
Settlements made during the year	(137)
Liability as of September 30, 2008	$ 520

During the three months ended June 30, 2008, the Company revised its warranty accrual based on historical experience of claims resulting in a reduction of the warranty accrual for the three months and nine months ended September 30, 2008 of $0 and $437,000, respectively.

Accrued Management Bonuses

The Company maintains a discretionary management bonus plan. The potential bonus payments made under the plan are based significantly on the achievement of operational, financial and business development objectives for the calendar year. As of September 30, 2008, the Company believed the achievement of the performance targets for the management bonuses was no longer probable. During the three months ended September 30, 2008, the Company reversed $750,000 of compensation expense and related payroll taxes previously accrued for the plan. As of September 30, 2008, no amounts for management bonuses were accrued and no management bonus expense was recorded for the nine months ended September 30, 2008.

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Restructuring Activity

In February 2008, the Company implemented a restructuring plan to exit the operating lease for its former corporate headquarters in San Diego, California. The original lease was effective through May 2010. No employees were terminated in connection with the restructuring plan. In May 2008, the Company entered into a Lease Termination Agreement with its landlord to terminate its operating lease resulting in the completion of its restructuring plan. The Company made cash payments in connection with the restructuring plan of approximately $815,000, including a non-recurring lease termination fee of $702,000.

In August 2008, the Company implemented another restructuring plan to improve its operating cost structure. The cost reduction initiative included a reduction-in-force that included terminating approximately 20 employees. The Company expects this restructuring plan to be completed by October 2008. The Company provided severance pay, medical and other related benefits to the employees terminated as a result of this restructuring plan.

The Company accounted for the restructuring plans in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. As a result of the February 2008 restructuring plan, the Company recorded a $1,069,000 restructuring charge, including $820,000 that was accrued for the exited facility, and $259,000 related to the impairment of property and equipment and other long-term assets. As a result of the August 2008 restructuring plan, the Company recorded a $209,000 restructuring charge.

The following table presents a rollforward of the Company s restructuring liability, which is included within accounts payable and accrued expenses in the unaudited condensed consolidated balance sheets (in thousands):

	Operating lease commitments	Impairment of property and equipment	Impairment of other long-term assets	Employee Separation Expenses	Total
Liability as of December 31, 2007	$	$	$	$	$
Additions	820	195	64	209	1,288
Non-cash charges		(195)	(64)		(259)
Cash payments	(815)			(115)	(930)
Restructuring charge adjustment	(5)				(5)
Liability as of September 30, 2008	$	$	$	$ 94	$ 94

Debt

In April 2008, the Company entered into a Consent and Amendment to Loan and Security Agreement with Silicon Valley Bank (SVB) to extend the term of its credit facility to April 2009 and increase the maximum amount of credit available under the facility from $7,000,000 to $10,000,000. The amount available under the credit line may be decreased by certain commitments, such as the $1,160,000 standby letter of credit that secures the Company s performance under its current headquarters facilities lease.

In May 2008, the Company entered into an Amendment to Loan and Security Agreement with SVB to further amend its credit facility to provide the Company the option, until April 2009, to increase the maximum amount of credit available under the facility from $10,000,000 to $15,000,000 upon payment of a commitment fee of up to $15,000. If the Company elects to exercise its option, the Company will be subject to a loan covenant to maintain a tangible net worth of at least $50,000,000 on a consolidated basis. No amounts were outstanding under the credit agreement as of September 30, 2008.

Deferred Rent

The Company recognized rent expense on a straight-line basis over the lease term as defined in SFAS No. 13, *Accounting for Leases*. In addition, the Company recorded landlord allowances for tenant improvements as deferred rent, in accordance with FASB Technical Bulletin No. 88-1, *Issues Related to Accounting for Leases*. The deferred rent is amortized over the lease term as a reduction of rent expense. As of September 30, 2008 and December 31, 2007, there was $2,569,000 and $1,301,000, respectively, of unamortized deferred rent recorded as a component of other long-term liabilities.

Purchase Commitments

The Company had firm purchase order commitments for the acquisition of inventory as of September 30, 2008 and December 31, 2007 of $8,651,000 and $11,910,000, respectively.

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Stock-Based Compensation

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

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

Stock-based compensation expense recognized in the Company s statement of operations for the three and nine months ended September 30, 2008 and 2007 included compensation expense for stock-based options and awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with SFAS 123R. For options and awards granted during the three and nine months ended September 30, 2008 and 2007, expenses are amortized under the straight-line method. Stock-based compensation expense recognized in the statement of operations for the three and nine months ended September 30, 2008 and 2007 has been reduced for estimated forfeitures of options that are subject to vesting. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The fair value of options granted after January 1, 2006 and awards under the ESPP are estimated on the grant date using the Black-Scholes option valuation model. This valuation model requires the Company to make assumptions and judgments about the variables used in the fair value calculation, including the expected life of the option or award, the volatility of the price of Company s common stock, the expected risk-free interest rate and the expected dividend yield. The expected life for stock options reflects the application of the simplified method set out in SAB 107, as renewed by SAB 110. The expected life of an award granted under the ESPP is based upon the length of the applicable offering periods. The risk-free interest rate is based on zero coupon U.S. Treasury instruments with maturities similar to those of the expected term of the award being valued. The simplified method defines the life as the average of the contractual term of the options and the weighted-average vesting period for all option tranches. The estimated volatility reflects the application of the interpretive guidance provided by SAB 107 and, accordingly, incorporates historical volatility of similar entities whose share prices are publicly available. The expected dividend yield is based on the Company s expectation of not paying dividends on the common stock for the foreseeable future.

The following assumptions are used to value options and awards granted under the Company s equity incentive plans for the three and nine months ended September 30, 2008 and 2007:

	Employee stock options				Employee Stock Purchase Plan			
	Three Months Ended September 30,		Nine Months Ended September 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007	2008	2007	2008	2007
Expected life (years)	6.1	6.0	6.0 - 6.1	6.0	0.52 - 1.01		0.01 - 1.01	
Risk-free interest rate	3.6%	4.5 - 5.0%	3.2 - 4.0%	4.5 - 5.0%	1.74 - 1.98%		0.8 - 1.98%	
Expected volatility	68%	73%	68%	73%	77%		77%	
Expected dividend yield								

The weighted average fair value of options granted for the three months ended September 30, 2008 and 2007 and the nine months ended September 30, 2008 and 2007 was approximately $1.47, $7.03, $2.71 and $6.05, respectively.

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The following table shows total stock-based compensation expense included in the unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2008 and 2007 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Cost of sales	$ 63	$ 85	$ 173	$ 88
Research and development	1,834	1,477	5,421	1,927
Sales and marketing	647	475	1,881	685
General and administrative	914	917	2,979	1,125
Total	$ 3,458	$ 2,954	$ 10,454	$ 3,825

For the three months ended September 30, 2008 and 2007 and the nine months ended September 30, 2008 and 2007, the Company recorded stock-based compensation expense for non-employees totaling $8,000, $113,000, $92,000 and $171,000, respectively. For the three and nine months ended September 30, 2008, the Company recorded stock-based compensation expense for the ESPP totaling $378,000 and $799,000, respectively. The Company held its first offering under the ESPP in December 2007; therefore, no stock-based compensation expense for the ESPP was recorded for the three or nine months ended September 30, 2007.

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

As of September 30, 2008 and December 31, 2007, the Company estimates there were $30,513,000 and $32,999,000, respectively, in total unrecognized compensation costs related to unvested employee stock option agreements, which are expected to be recognized over a weighted-average period of 2.9 and 2.8 years, respectively. As of September 30, 2008, the Company estimates there were $419,000 of unrecognized compensation costs related to the shares expected to be purchased through the ESPP, which are expected to be recognized over a weighted-average period of 0.5 years.

Stock Options and Awards Activity

The following is a summary of option activity for the Company s equity incentive plans (excluding options to purchase up to 162,000 shares of the Company s common stock subject to put and call agreements for certain RF Magic options) for the nine months ended September 30, 2008:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2007	6,738	$ 1.29	8.6	$ 40,458
Granted	3,492	4.32		
Exercised	(432)	0.68		
Forfeitures and cancellations	(999)	2.39		
Outstanding as of September 30, 2008	8,799	2.39	8.0	$ 7,190

During the three months ended June 30, 2008, the Company granted a total of 84,000 restricted stock units with a vesting period of 12 months and a weighted average grant date fair value of $3.92 per share. No restricted stock units were granted in the three months ended September 30, 2008.

In April 2008, approximately 165,000 shares of the Company s common stock were purchased through the ESPP which resulted in proceeds of $602,000 to the Company.

During the three and nine months ended September 30, 2008, 20,000 shares of the Company s common stock were issued in connection with the exercise of RF Magic options subject to put and call agreements.

As of September 30, 2008, the Company had 6,949,000 authorized shares available for future issuance under all of its equity incentive plans.

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3. Income Taxes

The Company calculates its interim income tax provision in accordance with Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods.* At the end of each interim period, the Company estimates the annual effective tax rate and applies that rate to its ordinary quarterly earnings. The tax expense or benefit related to significant, unusual or extraordinary items that will be separately reported or reported net of their related tax effect and are individually computed, are recognized in the interim period in which those items occur. In addition, the effect of changes in enacted tax laws, rates or tax status is recognized in the interim period in which the change occurs.

The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in foreign jurisdictions, permanent and temporary differences as a result differences between amounts measured and recognized in accordance with tax laws and financial accounting standards, and the likelihood of recovering deferred tax assets. The accounting estimates used to compute the provision for income taxes may change as new events occur, additional information is obtained or as the tax environment changes. When the Company s annual estimated income tax rate changes, the year-to-date effect of the change is recorded in the current period, which can cause fluctuations in effective tax rates in interim periods.

The effective tax rate for the three and nine months ended September 30, 2008 was (0.5)% and (0.7)%, respectively, compared to 0% for each of the three and nine months ended September 30, 2007. The effective tax rates for the three and nine months ended September 30, 2008 are expressed as negative rates because the Company recorded tax expense while in a loss position for both periods. There were no discrete items recorded in the nine months ended September 30, 2008. The tax expense related to foreign taxes during the three months ended September 30, 2008 and 2007 and the nine months ended September 30, 2008 and 2007 were $(20,000), $17,000, $61,000 and $17,000, respectively.

FIN 48 prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions.

On January 1, 2007, the Company adopted the provisions of FIN 48. Included in the unrecognized tax benefits of $7,054,000 as of December 31, 2007 were $3,075,000 of tax benefits that, if recognized, would reduce the Company s annual effective tax rate net of any related valuation allowance recorded. The remainder of the unrecognized tax benefits in the amount of $3,979,000 will reduce goodwill. No adjustments have been made during the nine months ended September 30, 2008 for any uncertain tax positions and the Company does not expect its unrecognized tax benefits to change significantly over the next 12 months. There were no accrued interest and penalties associated with uncertain tax positions as of September 30, 2008 or December 31, 2007.

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

4. Net Income Per Share

Under the provisions of SFAS No. 128, *Earnings per Share*, basic loss per share is computed by dividing net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding for the period. Diluted loss per share is computed using the weighted average number of shares of common stock and dilutive common equivalent shares outstanding during the year. Common equivalent shares from stock options and other common stock equivalents are excluded from the computation when their effect is antidilutive. The Company was in a loss position for all periods presented and, accordingly, there is no difference between basic loss per share and diluted loss per share.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Numerator:				
Net loss	$ (7,124)	$ (6,646)	$ (17,426)	$ (31,480)
Accretion of redeemable convertible preferred stock		(32)		(95)
Net loss attributable to common stockholders basic and diluted	$ (7,124)	$ (6,678)	$ (17,426)	$ (31,575)
Denominator:				
Weighted average number of common shares outstanding	68,943	14,529	68,735	9,837
Less: Restricted stock	(1,274)	(2,023)	(1,357)	(1,724)
Weighted average number of shares used in computing net loss per common share basic and diluted	67,669	12,506	67,378	8,113
Net loss per share basic and diluted				
Net loss	$ (0.11)	$ (0.53)	$ (0.26)	$ (3.88)
Accretion of redeemable convertible preferred stock				(0.01)
Net loss attributable to common stockholders basic and diluted	$ (0.11)	$ (0.53)	$ (0.26)	$ (3.89)

As of September 30, 2008 and 2007, the Company had securities outstanding which could potentially dilute basic loss per share in the future, but which were excluded from the computation of diluted net loss per share in the periods presented as their effect would have been anti-dilutive. Potentially dilutive outstanding securities consist of the following (in thousands):

	As of September 30,	
	2008	2007
Stock options outstanding	8,799	6,942
Stock reserved for issuance under put and call option agreements	162	182
Restricted stock	1,095	2,073
Preferred stock warrants		648
Common stock warrants		283
Redeemable convertible preferred stock		44,897
Total	10,056	55,025

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

Cash Flow

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

	Nine Months Ended September 30,	
	2008	2007
Cash paid for interest	$ 220	$ 332

Non-Cash Activity

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

	Nine Months Ended September 30,	
	2008	2007
Accretion of redeemable convertible preferred stock	$	$ 95
Issuance of preferred stock warrants in connection with debt financing		523
Issuance of common stock in connection with acquisition of Arabella Software, Ltd.		2,466
Issuance of redeemable convertible preferred stock and common stock in connection with acquisition of RF Magic		140,988
Issuance of common stock warrants and preferred stock warrants in connection with acquisition of RF Magic		9,566
Assets acquired in connection with acquisition of Vativ, net of liabilities assumed	4,287	
Vesting of early exercised stock options	783	966

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6. Significant Customer and Geographic Information

Customers

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

	Revenues				Accounts Receivable	
	Three Months Ended September 30,		Nine Months Ended September 30,		As of September 30,	
	2008	2007	2008	2007	2008	2007
Actiontec Electronics, Inc.	18%	22%	21%	28%	26%	16%
Jabil Circuit (Wuxi) Co., Ltd.	13	13	*	14	15	14
Motorola, Inc.	28	42	39	46	18	50
Westell, Inc.	13	*	*	*	*	*
Wistron NeWeb Corporation	*	*	*	*	11	*

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

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Geographic Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Asia	93%	95%	95%	97%
Europe	2	3	3	2
United States of America	5	1	2	1
Other North America	*	1	*	*
	100%	100%	100%	100%

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

7. Subsequent Events

In October 2008, the Company granted options to purchase 1,772,000 shares of its common stock under its 2007 Equity Incentive Plan to its non-executive employees at a weighted average exercise price of $1.44 per share.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this Quarterly Report on Form 10-Q, or Quarterly Report, and our consolidated financial statements and related notes as of and for the year ended December 31, 2007 and the related Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2007, or Annual Report, filed with the Securities and Exchange Commission, or SEC, on March 3, 2008.

Forward-Looking Statements

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

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Overview

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

In December 2004, we introduced and commenced commercial shipments of our home networking products. In the first quarter of 2006, we began commercially shipping our broadband access solutions. In May 2007, we acquired Arabella Software Ltd., or Arabella, a developer of embedded software. In June 2007, we acquired RF Magic Inc., or RF Magic, a provider of digital broadcast satellite outdoor unit and silicon television tuner solutions. In April 2008, we acquired certain specified assets of Vativ Technologies, Inc., or Vativ, including Vativ s intellectual property rights, existing product lines, inventory and equipment. Since inception, we have invested heavily in product development and have not yet achieved profitability on a quarterly or annual basis. Our revenues have grown from $3.7 million in 2005 to $41.5 million in 2006 to $122.5 million in 2007, driven primarily by demand for our home networking products. Our revenues have increased from $82.4 million during the nine months ended September 30, 2007 to $116.5 million during the nine months ended September 30, 2008, driven primarily by demand for our home networking products and, to a lesser extent, from sales resulting from the RF Magic acquisition. As of September 30, 2008, we had an accumulated deficit of $109.7 million.

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

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

In the nine months ended September 30, 2008, Motorola, Inc., or Motorola, and Actiontec Electronics, Inc., or Actiontec, accounted for 39% and 21%, respectively, of our net revenues. We expect to continue to have major concentrations of sales to a relatively small number of ODM and OEM customers.

In the nine months ended September 30, 2008, 95% of our revenues were derived from Asia, 3% were derived from Europe, and 2% was derived from the United States and other North American countries. In the nine months ended September 30, 2007, 97% of our revenues were derived from Asia, 2% was derived from Europe, and 1% was derived from the United States and other North American countries. Many of our ODM and OEM customers in Asia incorporate our chipsets into products that they sell to U.S.-based service providers.

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

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

In February 2008, we relocated our two separate facilities in San Diego, California, into a 90,000 square foot facility which serves as our corporate headquarters.

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

Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Consolidated Statements of Operations Data:				
Net revenues	100%	100%	100%	100%
Cost of net revenues	55	61	55	66
Gross profit	45	39	45	34
Operating expenses:				
Research and development	43	33	37	28
Sales and marketing	13	9	11	8
General and administrative	9	7	8	6
Write off of in-process research and development			1	26
Amortization of purchased intangible assets	2	4	2	2
Restructuring charge	1		1	
Total operating expenses	68	53	60	70
Loss from operations	(23)	(14)	(15)	(36)
Other income (expense), net	1	(4)		(2)
Provision for income taxes				
Net loss attributable to common stockholders	(22)%	(18)%	(15)%	(38)%

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

(Tables presented in thousands, except percentage amounts)

Net Revenues

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
Net revenues	$ 31,678	$ 36,144	(12)%	$ 116,502	$ 82,377	41%

The decrease in net revenues for the three months ended September 30, 2008 compared to the three months ended September 30, 2007 was driven primarily by softness in demand for our home networking products.

The increase in net revenues for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 was driven primarily by demand for our home networking products and from sales of digital broadcast satellite, or DBS, outdoor unit chips resulting from the RF Magic acquisition.

Gross Profit/Gross Margin

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
Gross profit	$ 14,370	$ 14,145	2%	$ 52,488	$ 27,886	88%
% of net revenues	45%	39%		45%	34%	

Although gross profit increased by $0.2 million for the three months ended September 30, 2008 compared to the three months ended September 30, 2007, the increase was primarily due to a $2.1 million inventory step-up charge related to the acquisition of RF Magic that lowered our gross profit for the three months ended September 30, 2007. Absent the effect of the inventory step-up charge, the gross profit for the three months ended September 30, 2008, as compared to the three months ended September 30, 2007, decreased by $1.9 million primarily as a result of lower revenue from softness of demand for our home networking products.

Gross profit increased by $24.6 million for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. This increase was primarily due to higher revenues from our home networking chipsets and the addition of revenues as a result of our acquisition of RF Magic.

The increase in gross profit as a percentage of revenue for the three months ended September 30, 2008 compared to the three months ended September 30, 2007 was primarily due to the $2.1 million of inventory step-up charge included in the cost of net revenues for three months ended September 30, 2007.

The increase in gross profit as a percentage of revenue for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 was primarily due to a decrease in the unit costs of our home networking chipsets principally as a result of more favorable manufacturing costs and from the contribution to gross margin from the sales of our DBS outdoor unit products as a result of our acquisition of RF Magic.

Additionally, as a result of our acquisitions, which we accounted for by using the purchase method of accounting as required by Statement of Financial Accounting Standards, or SFAS, No. 141, *Business Combinations,* cost of net revenues included amortization of developed technology in the amounts of $1.6 million and $4.4 million for the three and nine months ended September 30, 2008, respectively, and $1.2 million for each of the three and nine month periods ended September 30, 2007.

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Research and Development Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
Research and development	$ 13,902	$ 11,923	17%	$ 42,892	$ 22,812	88%
% of net revenues	43%	33%		37%	28%	

The increase in research and development expenses during the three months ended September 30, 2008, compared to the three months ended September 30, 2007, was primarily due to increased personnel costs of $1.9 million (of which $0.4 million was due to stock-based compensation) which included approximately $2.3 million related to a 24% increase in the number of employees engaged in research and development activities at the end of the periods and was offset by a reduction of $0.4 million in accrued management bonuses, which was primarily due to the improbable achievement of annual performance targets under the management bonus plan during the three months ended September 30, 2008. The increase in research and development personnel primarily resulted from normal hiring to support the growth of our business and the addition of employees in connection with the Vativ acquisition in April 2008. The remainder of the increase was primarily due to increases in overhead allocations of $0.2 million, mainly due to higher facility related costs, and depreciation of $0.2 million, offset by a decrease in development tools and licensing of $0.5 million, which was primarily due to the timing of these expenditures.

The increase in research and development expenses during the nine months ended September 30, 2008, compared to the nine months ended September 30, 2007, was primarily due to increased personnel costs of $15.2 million (of which $3.6 million was due to stock-based compensation) which included approximately $14.5 million primarily due to a 24% increase in the number of employees engaged in research and development activities at the end of the periods, and 0.6 million due to the Vativ bonuses. The increase in research and development personnel primarily resulted from the addition of employees in connection with the RF Magic acquisition in June 2007, and to a lesser extent, from normal hiring to support the growth of our business and the addition of employees in connection with the Vativ acquisition in April 2008. The remainder of the increase was primarily due to increases in overhead allocations of $2.8 million, mainly due to higher facility related costs, development tools and licensing expenditures of $0.8 million, and depreciation of $0.8 million, primarily due to increased activities related to customer-driven projects.

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Sales and Marketing Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
Sales and marketing	$ 3,991	$ 3,283	22%	$ 12,590	$ 6,642	90%
% of net revenues	13%	9%		11%	8%	

The increase in sales and marketing expenses for the three months ended September 30, 2008, compared to the three months ended September 30, 2007, included increased personnel costs of $0.2 million (of which $0.2 million was due to stock-based compensation) which included approximately $0.5 million primarily related to a 17% increase in the number of employees engaged in sales and marketing activities at the end of the periods and was offset by a reduction of $0.3 million in accrued management bonuses, which was primarily due to the improbable achievement of annual performance targets under the management bonus plan during the three months ended September 30, 2008. The increase in sales and marketing personnel resulted from normal hiring to support the growth of our business. The remainder of the increase, including increases in overhead allocations of $0.2 million and travel costs of $0.2 million, was primarily due to a general increase in business activities.

The increase in sales and marketing expenses for the nine months ended September 30, 2008, compared to the nine months ended September 30, 2007, included increased personnel costs of $4.0 million (of which $1.3 million was due to stock-based compensation), which included approximately $4.2 million primarily related to a 17% increase in the number of employees engaged in sales and marketing activities at the end of the periods, and $0.1 million due to the Vativ bonuses, and was offset by a reduction of $0.3 million in accrued management bonuses, which was primarily due to the improbable achievement of annual performance targets under the management bonus plan during the three months ended September 30, 2008. The increase in sales and marketing personnel primarily resulted from the addition of employees in connection with the RF Magic acquisition in June 2007, and to a lesser extent, from normal hiring to support the growth of our business and the addition of employees in connection with the Vativ acquisition in April 2008. The remainder of the increase, including increases in overhead allocations of $0.9 million and travel costs of $0.5 million, was primarily due to a general increase in business activities.

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General and Administrative Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
General and administrative	$ 2,798	$ 2,706	3%	$ 9,8624	$ 5,104	93%
% of net revenues	9%	7%		8%	6%	

The $0.1 million increase in general and administrative expenses for the three months ended September 30, 2008, compared to the three months ended September 30, 2007, included decreased personnel costs of $0.1 million, which was primarily related to the improbable achievement of annual performance targets under the management bonus plan during the three months ended September 30, 2008, and increases of $0.2 million in other costs primarily due to being a public reporting company.

The increase in general and administrative expenses for the nine months ended September 30, 2008, compared to the nine months ended September 30, 2007, was partly due to increased personnel costs of $2.6 million (of which $1.9 million was due to stock-based compensation), which included approximately $3.1 million primarily related to a 15% increase in the number of employees engaged in general and administrative activities at the end of the periods and was offset by a reduction of $0.4 million in management bonuses, which was primarily due to the improbable achievement of annual performance targets under the management bonus plan during the three months ended September 30, 2008. The increase in general and administrative personnel primarily resulted from the addition of employees in connection with the RF Magic acquisition in June 2007, and to a lesser extent, from normal hiring to support the growth of our business and the addition of employees in connection with the Vativ acquisition in April 2008. The remainder of the increases, including increases in outside services of $0.6 million, legal fees of $0.6 million and overhead allocations of $0.4 million, was primarily due to being a public reporting company and a general increase in business activities.

Write Off of In-Process Research and Development

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
Write off of in-process research and development	$	$	%	$ 1,300	$ 21,400	(94)%
% of net revenues	%	%		1%	26%	

During the nine months ended September 30, 2008, as a result of the Vativ acquisition in April 2008, we incurred a write off of in-process research and development, or IPR&D, related to Vativ s High Definition Multimedia Interface, or HDMI, switch product. During the nine months ended September 30, 2007, as a result of the RF Magic acquisition in June 2007, we incurred a write off of IPR&D related to RF Magic s channel stacking switch products.

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

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Amortization of Purchased Intangible Assets

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
Amortization of purchased intangible assets	$ 713	$ 1,296	(45)%	$ 2,022	$ 1,338	51%
% of net revenues	2%	4%		2%	2%	

During the three months ended September 30, 2008, compared to the three months ended September 30, 2007, amortization of purchased intangible assets decreased $0.6 million due to amortization of backlog purchased intangibles of $0 and $0.7 million for the three months ended September 30, 2008 and 2007, respectively, related to the acquisition of RF Magic in June 2007. This decrease of $0.7 million during the three months ended September 30, 2008 was offset by $0.1 million of amortization of purchased intangibles related to the acquisition of Vativ in April 2008.

During the nine months ended September 30, 2008, as compared to the same period in 2007, we incurred an increase in amortization of purchased intangibles as a result of the RF Magic acquisition in June 2007, and the acquisition of Vativ in April 2008.

Restructuring Charges

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	% Change	2008	2007	% Change
Restructuring charges	$ 209	$	100 %	$ 1,278	$	100 %
% of net revenues	1%	%		1%	%	

During the three months ended September 30, 2008, we recorded a $0.2 million restructuring charge related to the reduction-in-force of approximately 20 employees in August 2008.

In addition to the $0.2 million reduction-in-force restructuring charge during the nine months ended September 30, 2008, we also recorded a $1.1 million restructuring charge related to the relocation of our headquarters into a 90,000 square foot facility in San Diego, California. This restructuring charge consisted of approximately $0.8 million of lease termination costs and approximately $0.3 million for the impairment of property and equipment and other long-term assets.

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Liquidity and Capital Resources

As of September 30, 2008, we had cash and cash equivalents of $25.2 million and marketable securities of $6.9 million.

We have entered into a Loan and Security Agreement with Silicon Valley Bank, or SVB, under which we have access to a credit line that is secured against substantially all of our tangible and intangible assets, excluding intellectual property. Under the terms of our Loan and Security Agreement we may borrow up to $10.0 million under our credit line. We also have the option until April 2009 to increase our credit limit to $15.0 million upon payment of a commitment fee of up to $15,000 and our satisfaction of certain specified conditions. If we elect to increase the line, we will be subject to a loan covenant to maintain a tangible net worth of at least $50.0 million. The amount available under our credit line may be decreased by certain commitments, such as the $1.2 million standby letter of credit that secures our performance under our headquarters facilities lease. The interest on amounts drawn down under the credit line is payable on a monthly basis at an annual interest rate equal to the prime rate plus 0.5% if we maintain a liquidity ratio of at least 1.75 to 1, or the prime rate plus 2.0% if we maintain a liquidity ratio of less than 1.75 to 1. As of September 30, 2008, we had not borrowed any money from our credit line in 2008. As of September 30, 2008, $8.6 million was available to us under our $10.0 million credit line and no amount was outstanding under our credit line.

The following table shows our cash flows from operating activities, investing activities and financing activities for the nine months ended September 30, 2008 and 2007 (in thousands):

	Nine Months Ended September 30,	
	2008	2007
Net cash used in operating activities	$ (3,161)	$ (8,039)
Net cash (used in) provided by investing activities	(15,749)	10,534
Net cash (used in) provided by financing activities	(7,321)	2,858
Total (decrease) increase in cash and cash equivalents	$ (26,231)	$ 5,353

Cash Flows from Operating Activities

Net cash used in operating activities was $3.2 million for the nine months ended September 30, 2008, primarily resulting from a net loss of $17.4 million, a $6.9 million increase in inventory primarily due to our inventory build in preparation for the ramp of our channel stacking switch product into the DIRECTV deployment, as well as from softness in demand for our MoCA products mainly related to our Verizon FiOS deployment, and a $6.4 million decrease in accounts payable primarily due to lower inventory purchases, offset by stock-based compensation of $10.5 million, depreciation and amortization of $8.8 million, mostly due to the RF Magic acquisition and a decrease in accounts receivable of $4.8 million, primarily driven by lower sales. These changes were also partially offset by a $1.3 million increase in other long-term liabilities related to deferred rent for our new corporate headquarters in San Diego, California, a $1.3 million increase for the non-cash IPR&D charge resulting from our acquisition of Vativ, and a $0.7 million decrease in prepaid liabilities and other current assets resulting from prepaid liabilities amortized during 2008.

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Net cash used in operating activities was $8.0 million for the nine months ended September 30, 2007, primarily consisting of a net loss of $31.5 million, an increase of $9.0 million in accounts receivable primarily driven by higher sales and an increase of $3.2 million in inventory primarily driven by higher expected sales. This was offset by the write off of in-process research and development of $21.4 million, stock-based compensation of $3.8 million and an increase in accounts payable of $3.7 million. The remaining changes in operating cash flows primarily reflect amortization of purchased intangible assets and inventory step-up resulting from acquisitions, depreciation and amortization, and revaluation of preferred stock warrant liabilities.

Cash Flows from Investing Activities

Net cash used in investing activities was $15.7 million for the nine months ended September 30, 2008, consisting of $6.1 million of cash used in the acquisition of Vativ in April 2008, purchases of property and equipment of $5.7 million primarily consisting of tenant improvements and equipment for our newly leased facilities in San Diego, California, and net purchases of short-term investments of $3.9 million.

Net cash provided by investing activities was $10.5 million for the nine months ended September 30, 2007, from sales and maturities of short-term investments of $7.7 million to support general business growth and net cash provided by acquisitions of $4.2 million primarily from the acquisition of RF Magic in June 2007 and offset by purchases of property and equipment of $1.4 million to support product development and general growth.

Cash Flows from Financing Activities

Net cash used in financing activities was $7.3 million for the nine months ended September 30, 2008, primarily driven by the payoff of outstanding debt in the amount of $8.9 million. This amount was offset by cash provided by the net proceeds from warrant exercises and common stock purchases, primarily pursuant to our 2007 Employee Stock Purchase Plan.

Net cash provided by financing activities was $2.9 million for the nine months ended September 30, 2007, consisting of $2.0 million from net credit line obligation increases and stock option exercises of $1.6 million, and offset by principal payments of software licenses and capital lease obligations of $0.6 million.

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

We believe that our cash, cash equivalents and marketable securities of $32.1 million, together with the $8.6 million available to us under our credit line as of September 30, 2008, and taking into account our ability to increase the maximum amount of credit available to us under our credit line by an additional $5.0 million, will be sufficient to fund our projected operating requirements for at least the next 12 months. We intend to continue spending substantial amounts in connection with the growth of our business and we may need to obtain additional financing to pursue our business strategy, develop new products, respond to competition and market opportunities and acquire complementary businesses or technologies. We may not be able to obtain such financing on favorable terms or at all. If we were to raise additional capital through further sales of our equity securities, our stockholders would suffer dilution of their equity ownership. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, prohibit us from paying dividends, repurchasing our stock or making investments, and force us to maintain specified liquidity or other ratios, any of which could harm our business, operating results and financial condition.

Contractual Obligations

The following table summarizes our contractual obligations as of September 30, 2008 (in thousands):

		Years Ending December 31,					
	Remaining 2008	2009	2010	2011	2012	Thereafter	Total
Operating leases	$ 2,642	$ 6,062	$ 5,249	$ 2,931	$ 2,441	$ 4,796	$ 24,121
Capitalized software licenses	60						60
Inventory and related purchase obligations	8,651						8,651

Total	$ 11,353	$ 6,062	$ 5,249	$ 2,931	$ 2,441	$ 4,796	$ 32,832

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Indemnities

In the ordinary course of business, we have entered into agreements with customers that include indemnity provisions. Based on historical experience and information known as of September 30, 2008, we have not recorded any indemnity obligations.

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

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and the results of operations are based on our financial statements which have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the significant judgments and estimates used in the preparation of our interim condensed consolidated financial statements.

Intangible Assets and Goodwill

We record goodwill and other intangible assets in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, or SFAS 142. The purchase method of accounting for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired. We use the discounted cash flow method to estimate the value of intangible assets acquired. The estimates used to value and amortize intangible assets are consistent with the plans and estimates that we use to manage our business and are based on available historical information and industry estimates and averages. These judgments can significantly affect our net operating results.

SFAS 142 requires that goodwill and certain intangible assets be assessed for impairment on an annual basis, or more frequently if indicators of impairment exist, using fair value measurement techniques. SFAS 142 requires an interim goodwill impairment test if it is more likely than not that the fair value of a reporting unit is less than the carrying amount. We operate with one reporting unit. The goodwill impairment test compares the implied fair value of our reporting unit s goodwill with the carrying amount of that goodwill to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as in a business combination. Determining the fair value of the implied goodwill is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including the size and timing of deployments by our customers and related projections and timing of future cash flows, discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, stage of products in development, determination of appropriate market comparables, and determination of whether a premium or discount should be applied to comparables. It is reasonably possible that the plans and estimates used to value these assets may be incorrect. If actual results, or the plans and estimates used in future impairment analyses, are lower than the original estimates used to assess the recoverability of these assets, we could incur impairment charges.

In the third quarter of 2008, we considered whether we would need to perform an interim assessment for impairment of our goodwill carrying value as of September 30, 2008 as a result of current market or other company-specific conditions, including, but not limited to:

the significant decline in the market value of our invested capital, including the market value of our common stock;

reduction of near-term forecasted revenue growth due to a slow-down in deployments of products that incorporate our chipsets by service providers; and

sustained operating losses.

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In considering whether the occurrence of these market and company-specific conditions triggered the need for us to perform an interim assessment for impairment, we also considered other factors, including, but not limited to:

- our belief that our net revenues for the three months ended September 30, 2008 relative to historical revenue levels are not indicative of a long-term trend of reduced revenue;
- our continued expectation that in the future there will be additional operator deployments and significant increases in the sales volume of our products that incorporate the MoCA standard;
- we are currently the only high-volume supplier of chipsets based on the MoCA standard;
- there have not been significant changes in the manner or use of the acquired assets or the strategy of our overall business;
- there have not been significant negative industry trends for a sustained period of time;
- there has not been a significant decline in our market capitalization relative to our net book value for a sustained period of time; and
- recent volatility in our market capitalization appears to be at least partially attributable to the overall volatility in the U.S. stock market.

Based on the foregoing considerations and the authoritative guidance provided by SFAS 142, we believe that notwithstanding the occurrence of certain market and company-specific conditions during the three months ended September 30, 2008, we have reasonable grounds to believe that these conditions are temporary in nature and have not made it more likely than not that the fair value of our reporting unit is less than its carrying amount as of September 30, 2008. Accordingly, we have concluded that it is not necessary to conduct an interim impairment assessment of the fair value of our goodwill and other intangible assets as of September 30, 2008, but will perform our annual impairment assessment as scheduled during the fourth quarter of 2008.

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Revenue Recognition

Our revenues are generated principally by sales of our semiconductor products. We account for revenues in accordance with SEC Staff Accounting Bulletin, or SAB, No. 101, *Revenue Recognition in Financial Statements*, and SAB No. 104, *Revenue Recognition*. We recognize product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and (iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment. However, we do not recognize revenue until all customer acceptance requirements have been met, when applicable.

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

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

We have entered into an inventory hubbing arrangement with a key customer. Pursuant to this arrangement, we deliver products to the designated third party warehouse based upon the customer s projected needs, but do not recognize product revenue unless and until the customer removes our products from the third party warehouse to incorporate into its own products.

We derive revenues from development contracts that involve new and unproven technologies. Revenues under these contracts are deferred until customer acceptance is obtained, and other contract-specific terms have been completed in accordance with the completed contract method of American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Provisions for losses related to development contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. The costs associated with development contracts are included in cost of service revenue. We defer the cost of services provided under our development contracts.

We acquired a development agreement in connection with our acquisition of RF Magic in June 2007 that provides us with royalties in exchange for an exclusive right to manufacture and sell certain products. We have determined that we are not able to reliably estimate the royalties earned in the period the sales occur. Thus, we record revenues based on cash receipts.

Inventories

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

Guarantees and Indemnifications

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

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Rebates

We account for rebates in accordance with Emerging Issues Task Force, or EITF, Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*, and, accordingly, at the time of the sale accrue 100% of the potential rebate as a reduction to revenue and do not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. We reverse the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when we believe unclaimed rebates are no longer subject to payment and will not be paid.

Warranty Accrual

Our products are subject to warranty periods of one year or more. We provide for the estimated future costs of replacement upon shipment of the product as cost of net revenues. The warranty accrual is based on management s best estimate of expected costs associated with product failure and historical product failures.

Research and Development Costs

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

Income Taxes

We utilize the liability method of accounting for income taxes as set forth in SFAS No. 109, *Accounting for Income Taxes*, or SFAS 109. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

We also follow Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*, or FIN 48, which provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise s financial statements in accordance with SFAS 109. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. We recognize potential accrued interest and penalties related to unrecognized tax benefits within operations as income tax expense.

Stock-Based Compensation

Effective January 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R, including the provisions of SAB No. 107 and SAB No. 110. Under SFAS 123R, stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee s requisite service period. We have not granted awards with vesting subject to market conditions. We adopted the provisions of SFAS 123R using the prospective transition method. Accordingly, prior periods have not been revised for comparative purposes.

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The valuation provisions of SFAS 123R apply to new awards and to awards that are outstanding on the effective date, January 1, 2006, which are subsequently modified or canceled. Prior to the adoption of SFAS 123R, we used the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, or APB 25, related interpretations, and the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, for employee stock options and recorded compensation cost for options granted at exercise prices that were less than the market value of the Company s common stock at the date of grant. Pursuant to SFAS 123R, as we utilized the minimum value method through December 31, 2005, we will continue to recognize compensation expense relating to unvested awards as of the date of adoption using APB 25, which is the same accounting principle originally applied to those awards.

The stock-based compensation for our 2007 Employee Stock Purchase Plan was determined using the Black-Scholes option pricing model and the provisions of FASB Technical Bulletin No. 97-1, *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option*, as amended by SFAS 123R.

We account for stock-based compensation awards granted to non-employees in accordance with EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, or EITF 96-18. Under EITF 96-18, we determine the fair value of the stock-based compensation awards granted as either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. If the fair value of the equity instruments issued is used, it is measured using the stock price and other measurement assumptions as of the earlier of either (1) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached, or (2) the date at which the counterparty s performance is complete.

Due to the adoption of SFAS 123R, we recognize excess tax benefits associated with stock-based compensation to stockholders equity only when realized. When assessing whether excess tax benefits relating to stock-based compensation have been realized, we follow the with and without approach excluding any indirect effects to be realized until after the utilization of all other tax benefits available to us.

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Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, or SFAS 157, which defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. We adopted this pronouncement as of January 1, 2008 for financial instruments. Although the adoption of SFAS 157 did not have an impact on our interim financial results, we are now required to provide additional disclosures as part of our financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to choose to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. We adopted this pronouncement in the first quarter of 2008 and it did not have an impact on our interim financial results.

In June 2007, the FASB ratified Emerging Issues Task Force Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*, or 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. We adopted this standard in the first quarter of 2008 and it did not have an impact on our interim financial results.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, or SFAS 141R. SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations we engage in will be recorded and disclosed in accordance with existing GAAP until January 1, 2009. We expect SFAS 141R will have an impact on our consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions consummated after the effective date. We are still assessing the impact of this standard on our future consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under SFAS 161, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS 133 for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application of SFAS 161 is encouraged. SFAS 161 will only have an impact on our consolidated financial position and results of operations if we engage in any derivative or hedging activities after November 15, 2008.

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

Foreign Currency Risk

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

Interest Rate Risk

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

Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of September 30, 2008, the carrying value of our cash and cash equivalents approximated fair value. A change in market interest rates of 1.0% annualized would have impacted our net income from these investments by approximately $0.2 million for the nine months ended September 30, 2008.

Marketable Securities Risk

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

Our investment policy for marketable securities requires that all securities mature in two years or less, with a weighted average maturity of no longer than 12 months. As of September 30, 2008, the carrying value of $31.4 million approximated the fair value of these securities. The fair value of our marketable securities fluctuates based on changes in market conditions and interest rates and is affected by the credit condition of the U.S. financial sector. Absent the unprecedented turmoil and upheaval in the U.S. financial sector, given the short-term maturities of our marketable securities, we do not believe these instruments to be subject to significant market or interest rate risk. However, the current unstable credit environment of the U.S. financial sector may lead us to incur significant realized, unrealized or impairment losses associated with our investments.

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

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

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

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

An evaluation was also performed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of any change in our internal control over financial reporting that occurred during our fiscal quarter ended September 30, 2008 and that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. That evaluation did not identify any change in our internal control over financial reporting that occurred during our fiscal quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1A. ***Risk Factors***

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

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

Risks Related to Our Business

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

We have never been profitable on an annual basis or in any fiscal quarter. We incurred net losses attributable to common stockholders of $7.1 million and $17.4 million for the three and nine month periods ended September 30, 2008, respectively, and $32.0 million, $7.1 million and $12.2 million for the years ended December 31, 2007, 2006 and 2005, respectively. As of September 30, 2008, we had an accumulated deficit of $109.7 million. Accordingly, there can be no assurance if or when we may achieve profitability. Though our revenues increased from approximately $41.5 million for the year ended December 31, 2006 to $122.5 million for the year ended December 31, 2007, a portion of that growth was attributable to businesses we acquired during the year, and we may not achieve similar growth in future periods. You should not rely on our operating results for any prior quarterly or annual periods as an indication of our future operating performance. Moreover, we expect to make significant expenditures related to the development of our products and the expansion of our business, including research and development, sales and marketing and general and administrative expenses. As a public company, we also incur significant legal, accounting and other expenses that we did not incur as a private company. Additionally, we may encounter unforeseen difficulties, complications, product delays and other unknown factors that require additional expenditures and unforeseen difficulties or costs associated with the integration of acquired assets or businesses. As a result of these expenditures, we may have to generate and sustain substantially increased revenue to achieve profitability. If we are unable to achieve adequate revenue growth, we may not achieve or sustain profitability and our stock price could decline.

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

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

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Currently, we face competition from a number of established companies that offer products based on competing technologies, such as DOCSIS, versions of xDSL, Ethernet, HomePNA, HomePlug AV, Wi-Fi, WiMedia, which is based on UWB technology, and WiMAX. Many of our competitors and potential competitors are substantially larger and have longer operating histories, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than us. Given their capital resources, many of these larger organizations are in a better position to withstand any significant reduction in capital spending by customers or market downturns in the markets in which we compete. Many of our competitors also have broader product lines and market focus, allowing them to bundle their products and services and effectively use other products to subsidize lower prices for those products that compete with ours or to provide integrated product solutions that offer cost advantages to customers. In addition, many of our competitors have been in operation much longer than us and therefore have better name recognition and more long-standing and established relationships with service providers, ODMs and OEMs.

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

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

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

In addition, consolidation by industry participants or acquisitions of our competitors by our customers or suppliers could result in competitors with increased market share, larger customer bases, greater diversified product offerings and greater technological and marketing expertise, which would allow them to compete more

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

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

We derive a substantial portion of our revenues from a limited number of customers. For example, during the nine months ended September 30, 2008 and the year ended December 31, 2007, ten customers accounted for approximately 94% and 96%, respectively, of our revenues. During the nine months ended September 30, 2008, Motorola and Actiontec accounted for 39% and 21%, respectively, of our revenues. Our inability to generate anticipated revenues from our key existing or targeted customers, or a significant shortfall in sales to these customers would significantly reduce our revenues and adversely affect our operating results. Our operating results in the foreseeable future will continue to depend on our ability to effect sales to existing and other large customers.

In addition, we depend on a limited number of service providers that purchase products from our customers. To date, only one major service provider, Verizon, has publicly announced its intention to use the MoCA standard for home networking in its FiOS deployment. We also primarily rely on two major service providers, EchoStar and DIRECTV, to deploy products using our DBS outdoor unit solutions. During the nine months ended September 30, 2008 and the year ended December 31, 2007, products sold to our customers that were incorporated into products purchased by Verizon, EchoStar and DIRECTV accounted for substantially all of our revenues. If these service providers, or other service providers that elect to use our products, reduce or eliminate purchases of our customers products which incorporate our products, this would significantly reduce our revenues and adversely affect our operating results. Our operating results in the foreseeable future will continue to depend on a limited number of service providers demand for products which incorporate our products.

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

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

Our operating results may be harmed if our August 2008 restructuring plan does not achieve the anticipated results or causes undesirable consequences.*

In August 2008, we implemented a restructuring plan which resulted in us reducing our workforce by 20 individuals. This restructuring plan may yield unintended consequences, such as attrition beyond our intended reduction in workforce and reduced employee morale, which may cause our employees who were not affected by the reduction in workforce to seek alternate employment. Additional attrition could impede our ability to meet our operational goals, which could have a material adverse effect on our financial performance. In addition, as a result of the reduction in our workforce, we face an increased risk of employment litigation. Furthermore, employees whose positions were eliminated in connection with this restructuring plan may seek future employment with our competitors. Although all our employees are required to sign a confidentiality agreement with us at the time of hire, we cannot assure you that the confidential nature of our proprietary information will be maintained in the course of such future employment. We cannot assure you that we will not undertake additional restructuring activities, that any of our restructuring efforts will be successful, or that we will be able to realize the cost savings and other anticipated benefits from our previous or future restructuring plans. In addition, if we continue to reduce our workforce, it may adversely impact our ability to respond rapidly to any new growth opportunities.

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

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

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

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

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

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

We derive, and expect to continue to derive for the foreseeable future, a significant portion of our revenues from sales of our home networking products based on the MoCA standard. The market for such multimedia content delivery solutions based on the MoCA standard is relatively new, still evolving, and difficult to predict. In the near-term, we believe our primary competition in this market will be from companies that offer products based on non-MoCA home networking solutions, such as Ethernet, HomePNA, Home Plug AV, Wi-Fi and WiMedia. In the future, we expect other semiconductor manufacturers to compete with us in the manufacture and sale of MoCA-compliant chipsets. It is therefore uncertain whether the MoCA standard will achieve and sustain high levels of demand and market acceptance. Moreover, deployment of services or electronic devices utilizing MoCA-based solutions may be delayed or slower than we anticipate. If the market for MoCA-based solutions does not continue to develop or develops more slowly than we expect, or if we make errors in predicting adoption and deployment rates for these solutions, our revenues may be significantly adversely affected.

Our success will depend to a substantial extent on the willingness of service providers, ODMs and OEMs to adopt the MoCA standard for multimedia content delivery. As of September 30, 2008, only one major service provider, Verizon, had publicly announced its intention to use the MoCA standard for home networking. Some service providers, ODMs and OEMs have adopted and others may adopt multimedia content delivery solutions that rely on technologies other than the MoCA standard or may choose to wait for the introduction of products and technologies that serve as a replacement or substitute for, or represent an improvement over, MoCA-based solutions. It is critical to our success that additional service providers, including telecommunications carriers, digital broadcast satellite service providers and cable operators, adopt the MoCA standard for home networking.

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

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

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

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

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

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

Recently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. While the ultimate outcome of these events cannot be predicted, they, alone and in combination with the current adverse economic conditions facing the semiconductor and communications industries, may lead to a significant negative impact to our business to the extent that consumers decrease their discretionary spending for enhanced video offerings from service providers or to the extent that services providers cut back or delay deployments that include our products. Moreover, we may experience adverse conditions in our cost base due to changes in foreign currency exchange rates that reduce the purchasing power of the U.S. dollar, increases in general and administrative expenses and other factors. These conditions may harm our margins and profitability if we are unable to increase the selling prices of our products or reduce our costs sufficiently to offset

the effects of effective increases in our costs. Our attempts to offset the effects of cost increases through controlling our expenses, passing cost increases on to our customers or any other method may not succeed.

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

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

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

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

In addition to our home networking products, we also derive a significant portion of our revenues from sales of our DBS outdoor unit products into markets served by digital broadcast satellite providers and their ODM and OEM partners. The digital broadcast satellite market may not grow in the future as anticipated or a significant market slowdown may occur, which would in turn reduce the demand for applications or devices, such as set-top boxes and low-noise block converters that

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rely on our DBS outdoor unit products. Because of the intense competition in the satellite, terrestrial and cable digital television markets, the unproven technology of many products addressing these markets and the short product life cycles of many consumer applications or devices, it is difficult to predict the potential size and future growth rate of the markets for our DBS outdoor unit products. If the demand for our DBS outdoor unit products is not as great as we expect, or if we are unable to produce competitive products to meet that demand, our revenues could be adversely affected.

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

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

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

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

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

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

We have experienced significant growth in a short period of time, including growth related to our acquisitions of RF Magic and Arabella in 2007, and our acquisition of certain specified assets of Vativ in April 2008. For example, we have increased our headcount from 83 full-time employees as of December 31, 2006 to 303 full-time employees as of September 30, 2008 (including employees which we added as part of our acquisitions of RF Magic, Arabella, and Vativ and after giving effect to a reduction-in-force that was implemented in connection with our August 2008 restructuring plan). We anticipate that further expansion of our infrastructure and headcount will be required to achieve planned expansion of our product offerings, projected increases in our customer base and anticipated growth in the number of our product deployments. For example, in the first quarter of 2008, we moved into a larger facility for our operations in San Diego, California to accommodate our growth. Our rapid growth has placed, and will continue to place, a significant strain on our administrative and operational infrastructure. Our success in managing our operations and growth will be dependent upon our ability to:

- enhance our operational, financial, and management controls, human resource policies, and reporting systems and procedures;
- expand our facilities and equipment;
- successfully hire, train, motivate and productively deploy additional employees, including technical personnel; and
- expand our international resources.

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

Further, we intend to grow our business by entering new markets, developing new product offerings and pursuing new customers. If we fail to timely or efficiently expand operational and financial systems in connection with such growth or if we fail to implement or maintain effective internal controls and procedures, resulting operating inefficiencies could increase costs and expenses more than we planned and might cause us to lose the ability to take advantage of market opportunities, enhance existing products, develop new products, satisfy customer requirements, respond to competitive pressures, control our inventory or otherwise execute our business plan. Failure to implement or maintain such controls and procedures could also impact our ability to produce timely and accurate financial statements. Additionally, if we increase our operating expenses in anticipation of the growth of our business and such growth does not meet our expectations, our financial results likely would be negatively impacted.

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

We will need to overcome significant challenges in order to realize the benefits or synergies from the acquisitions we completed in 2007 and 2008. These challenges include the following:

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

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

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

The inability to successfully integrate any businesses we acquire, or any significant delay in achieving integration, could delay introduction of new products and require expenditure of additional resources to achieve integration.

In addition, we have recorded significant amounts of goodwill and other intangible assets in connection with the acquisitions we completed in 2007 and 2008. The carrying amount of these long-lived assets could be reduced through impairment charges in future periods if events or changes in circumstances, including adverse industry conditions or a downturn in demand for our products, indicate that such amount is not recoverable. Notwithstanding the development of certain market and company-specific conditions during the three months ended September 30, 2008, we did not perform an interim assessment for impairment of our goodwill carrying value as of September 30, 2008 because we have reasonable grounds to believe that such conditions are temporary in nature. We will perform our annual assessment for impairment of our goodwill carrying value in October 2008 and any impairment charge that we assess at that time or in future periods could have a material

adverse impact on our results of operations.

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

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

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

- difficulties in assimilating any acquired workforce and merging operations;
- attrition and the loss of key personnel;
- an acquired company, asset or technology not furthering our business strategy as anticipated;
- our overpayment for a company, asset or technology or changes in the economic or market conditions or assumptions underlying our decision to make an acquisition;
- difficulties entering and competing in new product or geographic markets and increased competition, including price competition;
- significant problems or liabilities, including increased intellectual property and employment related litigation exposure, associated with acquired businesses, assets or technologies;
- in connection with any such transaction, the need to use a significant portion of our available cash, issue additional equity securities that would dilute the then-current stockholders percentage ownership or incur substantial debt or contingent liabilities; and
- requirements to record substantial charges and amortization expense related to certain purchased intangible assets, deferred stock compensation and other items.

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

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

We cannot forecast the number, timing or size of future acquisitions, strategic relationships, joint ventures or investments, or the

effect that any such transactions might have on our operating or financial results. Any such transaction could disrupt our business and harm our operating results and financial condition.

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

Our products and products sold by other companies in our industry have historically experienced a decrease in average selling prices over time. We anticipate that the average selling prices of our products will continue to decrease in the future in response to competitive pricing pressures, increased sales discounts and new product introductions by our competitors. For example, while we are currently the only manufacturer of MoCA-compliant chipsets, we expect that other chipset manufacturers who are members of MoCA will produce competing chipsets and create

pricing pressure for such products. Our future operating results may be harmed due to the decrease of our average selling prices. To maintain our current gross margins or increase our gross margins in the future, we must develop and introduce on a timely basis new products and product enhancements, continually reduce our product costs and manage product transitions in a timely and cost-effective manner. Our failure to do so would likely cause our revenues and gross margins to decline, which could have a material adverse effect on our operating results and cause the value of our common stock to decline.

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

Our product development efforts require substantial research and development expense. Our research and development expense for the nine months ended September 30, 2008 was $42.9 million and was $35.2 million, $11.6 million and $9.6 million for the years ended December 31, 2007, 2006 and 2005, respectively. There can be no assurance that we will achieve an acceptable return on our research and development efforts.

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

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

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

changes in demand for our products or those offered by service providers and our customers;

the timing and amount of orders, especially from significant service providers and customers;

the seasonal nature of our sales;

the level and timing of capital spending of service providers, both in the United States and in international markets;

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

adverse market perception of MoCA-compliant products;

our unpredictable and lengthy sales cycles;

the mix of products and product configurations sold;

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

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

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

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

unexpected changes in our operating expenses;

general economic and political conditions in the countries where we operate or our products are sold or used;

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

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

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

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

productivity of our sales and marketing force;

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

future accounting pronouncements and changes in accounting policies;

costs associated with litigation; and

changes in domestic and international regulatory environments.

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

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

Our products typically have lengthy sales cycles. A service provider must first evaluate our products. This initial evaluation period can vary considerably based on the service provider and product being evaluated, and could take a significant amount of time to complete. Products incorporating new technologies generally require longer periods for evaluation. After this initial evaluation period, if a service provider decides to adopt our products, that service provider and the applicable ODM or OEM customers will need to further test and evaluate our products prior to completing the design of the equipment that will incorporate our products. Additional time is needed to begin volume production of equipment that incorporates our products. Due to these lengthy sales cycles, we may experience significant delays from the time

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we incur research and development and sales expenses until the time, if ever, that we generate sales from these products. The delays inherent in these lengthy sales cycles increase the risk that a customer will decide to cancel or change its product plans. From time to time, we have experienced changes, delays and cancellations in the purchase plans of our customers. A cancellation or change in plans by a service provider, ODM or OEM customer could prevent us from realizing anticipated sales. In addition, our anticipated sales could be lost or substantially reduced if a significant service provider, ODM or OEM customer reduces or delays orders during our sales cycle or chooses not to release equipment that contains our products. Furthermore, we may invest significant time and effort in marketing to a particular customer that does not ultimately result in a sale to that customer. As a result of these lengthy and uncertain sales cycles for our products, it is difficult for us to predict if or when our customers may purchase products in volume from us, and our operating results may vary significantly from quarter to quarter, which may negatively affect our operating results for any given quarter.

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

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

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

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

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

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

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

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

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

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

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

In the fourth quarter of 2007, we entered into an inventory hubbing arrangement with Motorola and we may enter into similar arrangements with other customers in the future. Pursuant to these arrangements, we ship our products to a designated third party warehouse, or hub, rather than shipping them directly to the customer. The products generally remain in the hub until the customer removes them for incorporation into its own products. Prior to the implementation of this hubbing arrangement with Motorola, we recognized revenues on sales of our products to Motorola upon shipment of those products to Motorola or its ODM partners. Under the hubbing arrangement, however, we maintain ownership of our products in the hub, and therefore do not recognize the related revenue, until the date Motorola removes them from the hub. As a result, our ability to accurately predict future revenues recognized from sales to Motorola or any other customers with which we implement hubbing arrangements may be impaired, and we may experience significant fluctuations in our quarterly operating results depending on when Motorola or any such other customers remove our products from the hub, which they may do with little or no lead time. In the short term, we may experience an increase in operating expenses as we build and ship inventory to the hub and may not recognize revenues from sales of this inventory, if at all, until Motorola or any such other customers remove it from the hub at a later time. Furthermore, because we continue to own but do not maintain control over our products after they are shipped to the hub, our ability to effectively manage inventory levels may be impaired as our shipments under the hubbing arrangement increase and we may be exposed to additional risk that the inventory in the hub becomes obsolete before sales are recognized.

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

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

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

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

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

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

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

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

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

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

option payments or other prepayments to a subcontractor;

nonrefundable deposits with or loans to subcontractors in exchange for capacity commitments;

contracts that commit us to purchase specified quantities of components over extended periods; and

purchase of testing equipment for specific use at the facilities of our subcontractors.

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

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

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

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

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

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

Our products are very complex and may contain defects or errors, especially when first introduced or when new versions are released. Despite testing, errors may occur. Product errors could affect the performance of our products, delay the development or release of new products or new versions of products, adversely affect

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

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

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

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering and sales and marketing personnel. There is intense competition for qualified personnel in the markets in which we compete. Moreover, the cost of living in the San Diego, California area, where our corporate headquarters are located, has been an impediment to attracting new employees in the past, and we expect that this will continue to impair our ability to attract and retain employees in the future. We may also face challenges in recruiting personnel due to our recent reduction-in-force that was implemented in connection with our August 2008 restructuring plan. The loss of any key employees, including Patrick Henry, our President and Chief Executive Officer, other members of our senior management or our senior engineering personnel, or an inability to attract additional qualified personnel, including engineers and sales and marketing personnel, could delay the development, introduction and sale of our products and our ability to execute our business strategy may suffer. We do not currently have any key person life insurance covering any executive officer or employee, nor do we have employment agreements with most of our employees.

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

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

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

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

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

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

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

develop or enhance our products;

continue to expand our product development and sales and marketing organizations;

acquire complementary technologies, products or businesses;

expand operations, in the United States or internationally;

hire, train and retain employees; or

respond to competitive pressures or unanticipated working capital requirements.

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

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Maintaining and improving our financial controls and the requirements of being a public company may strain our resources, divert management s attention and affect our ability to attract and retain qualified board members and management.*

We completed our IPO in December 2007. As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, and the Nasdaq Stock Market Rules, or Nasdaq, rules. The requirements of these rules and regulations have increased our legal and financial compliance costs, made some activities more difficult, time-consuming or costly and have also placed significant strain on our personnel, systems and resources, and are likely to continue to do so in the future. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business, operating results and financial condition.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. Ensuring that we have adequate internal financial and accounting controls and procedures in place is a costly and time-consuming effort that needs to be re-evaluated frequently. We are in the process of documenting, reviewing and, where appropriate, improving our internal controls and procedures in preparation for compliance with the SEC regulations adopted pursuant to Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal control over financial reporting and a report by our independent auditors. Both we and our independent auditors will be testing our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify material weaknesses, significant deficiencies or other areas for further attention or improvement. Implementing any appropriate changes to our internal controls may require specific compliance training for our directors, executive officers and employees, entail substantial costs to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or any consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important to help prevent fraud. As a result, our failure to satisfy the requirements of Section 404 on a timely basis could result in the loss of investor confidence in the reliability of our financial statements, which in turn could cause the market value of our common stock to decline.

In accordance with Nasdaq rules, we are required to maintain a majority independent Board of Directors. We also expect that the various rules and regulations applicable to public companies will make it more difficult and more expensive for us to maintain directors and officers liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate directors and officers insurance, our ability to recruit and retain qualified directors, especially those directors who may be deemed independent for purposes of Nasdaq rules, and executive officers will be significantly curtailed and we may be required to indemnify directors and officers out of our own cash resources, rather than rely on insurance policies, which could materially adversely affect our liquidity and results of operations.

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

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

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Our ability to utilize our net operating loss and tax credit carryforwards may be limited, which could result in our payment of income taxes earlier than if we were able to fully utilize our net operating loss and tax credit carryforwards.

As of December 31, 2007, we had federal and state net operating loss carryforwards of $62.9 million and $50.5 million, respectively, and federal and state research and development tax credit carryforwards of $7.5 million and $6.3 million, respectively. The tax benefits related to utilization of net operating loss and tax credit carryforwards may be limited due to ownership changes or as a result of other events. For example, Section 382 of the Internal Revenue Code of 1986, as amended, imposes an annual limitation on the amount of net operating loss carryforwards and tax credit carryforwards that may be used to offset federal taxable income and federal tax liabilities when a corporation has undergone a significant change in its ownership. While prior changes in our ownership, including as a result of our acquisition of RF Magic, have resulted in annual limitations on the amount of our net operating loss and tax credit carryforwards that may be utilized in the future, we do not anticipate that such annual limitations will preclude the utilization of substantially all the net operating loss and tax credit carryforwards described above in the event we become profitable. However, to the extent our use of net operating loss and tax credit carryforwards is further limited by the issuance of common stock in our initial public offering or in future offerings or transactions or by our implementation of an international tax structure or other future events, our income would be subject to cash payments of income tax earlier than it would be if we were able to fully use our net operating loss and tax credit carryforwards without such further limitation.

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

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

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

Risks Related to Our Intellectual Property

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

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

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implement MoCA specifications to other MoCA members, who could potentially include our competitors, on reasonable and non-discriminatory terms. In addition, in connection with commercial arrangements with our customers and the service providers who deploy equipment containing our products, we may be required to license our intellectual property to third parties, including competitors or potential competitors.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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Risks Related to International Operations

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

We have derived, and expect to continue to derive, a significant portion of our revenues from international markets. Revenues outside of the United States comprised 98% of our total revenues for the nine months ended September 30, 2008 and 98% for the year ended December 31, 2007. International business activities involve certain risks, including:

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

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

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

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

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Fluctuations in exchange rates between and among the currencies in which we do business may adversely affect our operating results.*

We transact business internationally, currently mainly focusing on Israel, Taiwan, Japan, Korea, China and Europe. As a result, we may experience foreign exchange gains or losses due to the volatility of other currencies compared to the U.S. dollar. Our sales have been historically denominated in U.S. dollars and an increase in the U.S. dollar relative to the currencies of the countries in which our customers operate could materially affect the demand of our non-U.S. customers for our products, thereby forcing these customers to reduce their orders, which would adversely affect our business. We incur a portion of our expenses in currencies other than the U.S. dollar, including New Israeli Shekels. Our operating results are denominated in U.S. dollars and the difference in exchange rates in one period compared to another may directly impact period to period comparisons of our operating results. Furthermore, currency exchange rates have been especially volatile in the recent past and these currency fluctuations may make it difficult for us to predict our results.

Currently, we have not implemented any strategies to mitigate risks related to the impact of fluctuations in currency exchange rates. Even if we were to implement hedging strategies, not every exposure can be hedged, and, where hedges are put in place based on expected foreign exchange exposure, they are based on forecasts which may vary or which may later prove to have been inaccurate. Failure to hedge successfully or anticipate currency risks properly could adversely affect our operating results. We cannot predict future currency exchange rate changes.

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

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

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

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

Substantially all of our products are manufactured by third party contractors located in the Pacific Rim. The risk of an earthquake in these areas is significant due to the proximity of major earthquake fault lines to the facilities of our foundry, assembly and test subcontractors. For example, in December 2006, major earthquakes occurred in Taiwan. The occurrence of additional earthquakes or other natural disasters could result in the disruption of our foundry or assembly and test capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling or testing from the affected contractor to another third party vendor. We may not be able to obtain alternate capacity on favorable terms, if at all.

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Risks Related to Ownership of Our Common Stock

An active trading market for our common stock may not be sustained.

Prior to our IPO in December 2007, there was no public market for our common stock. We cannot predict the extent to which investor interest in our company will sustain an active trading market on the Nasdaq Global Market or any other stock market or how liquid any such market might become. An active public market for our common stock may not be sustained. If an active public market is not sustained, it may be difficult for an investor to sell his, her or its shares of our common stock at a price that is attractive to such investor, or at all.

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

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

price and volume fluctuations in the overall stock market;

market conditions or trends in our industry or the economy as a whole;

changes in operating performance and stock market valuations of other technology companies generally, or those that sell semiconductor products in particular;

the timing of customer or service provider orders that may cause quarterly or other periodic fluctuations in our results that may, in turn, affect the market price of our common stock;

the seasonal nature of our sales;

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

the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;

changes in financial estimates or ratings by any securities analysts who follow our common stock, our failure to meet these estimates or failure of those analysts to initiate or maintain coverage of our common stock;

the public s response to press releases or other public announcements by us or third parties, including our filings with the SEC and announcements relating to product development, litigation and intellectual property impacting us or our business;

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

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

announcements of mergers or acquisition transactions;

our inclusion or deletion from certain stock indices;

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

announcements of changes in our senior management;

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

changes in accounting principles.

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

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

Nasdaq imposes, among other requirements, listing maintenance standards as well as minimum bid and public float requirements. The price of our common stock must trade at or above $1.00 to comply with Nasdaq s minimum bid requirement for continued listing on the Nasdaq Global Market. Recently, our common stock has traded at below $1.00 per share including at closing.

On October 16, 2008, Nasdaq announced the immediate suspension of its enforcement of the rules requiring a minimum $1.00 closing bid price and that it will not take any action to delist any security traded on the Nasdaq Global Market that fails to comply with the minimum $1.00 closing bid price requirement until January 19, 2009. Consequently, for as long as Nasdaq s rule suspension remains in effect, Nasdaq will not delist our stock if the closing bid price for our common stock falls below $1.00 per share during the rule suspension period.

If the closing bid price of our common stock continues to fail to meet Nasdaq s minimum closing bid price requirement at any time on or after January 19, 2009, or if we otherwise fail to meet all other applicable Nasdaq Global Market requirements, Nasdaq may make a determination to delist our common stock. Any such delisting could adversely affect the market liquidity of our common stock and the market price of our common stock could decrease and could also adversely affect our ability to obtain financing for the continuation of our operations and/or result in the loss of confidence by investors, customers, suppliers and employees.

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

A significant number of shares of our common stock are held by a small number of stockholders. Sales of a substantial number of shares of our common stock,

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

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

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

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

- establish a classified Board of Directors so that not all members of our Board are elected at one time;
- authorize the issuance of undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval, and which may include rights superior to the rights of the holders of common stock;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the Board of Directors is expressly authorized to make, alter, or repeal our bylaws;
- establish advance notice requirements for nominations for elections to our Board or for proposing matters that can be acted upon by stockholders at stockholder meetings; and
- provide that in addition to any vote required by law or by our amended and restated certificate of incorporation, the approval by holders of at least 66 $^{2}/_{3}$% of our then outstanding common stock is required to adopt, amend or repeal any provision of our amended and restated bylaws.

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

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

As of September 30, 2008, our executive officers, directors and holders of 5% or more of our outstanding common stock, beneficially owned, in the aggregate, approximately 21% of our outstanding common stock. These stockholders may have interests that conflict with our other stockholders and, if acting together, have the ability to substantially influence or determine the outcome of matters submitted to our stockholders

for approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these stockholders, acting together, may have the ability to control our management and affairs. Accordingly, this concentration of ownership may harm the market price of our common stock by:

delaying, deferring or preventing a change in control;

impeding a merger, consolidation, takeover or other business combination involving us; or

discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

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

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

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

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

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

Use of Proceeds

Our IPO was effected through a registration statement on Form S-1 (file no. 333-144899) that was declared effective by the SEC on December 6, 2007. During the three months ended September 30, 2008, we did not use any of the net proceeds from our IPO. As of September 30, 2008, we had invested $31.4 million of net proceeds from our IPO in money market mutual funds and short- and intermediate-term investment-grade instruments.

Issuer Purchases of Equity Securities

Pursuant to the terms of our 2001 Stock Option Plan, options may be exercised prior to vesting. Shares of common stock issued prior to vesting that remain unvested are subject to a repurchase option in our favor that lapses in accordance with the original vesting schedule for the option. The following table provides information with respect to purchases made by us of shares of our common stock during the three month period ended September 30, 2008:

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Value Paid by Company
July 1, 2008 through July 31, 2008	21,410	$ 0.4476	$ 9,583
August 1, 2008 through August 31, 2008	2,116	2.6650	5,639
September 1, 2008 through September 30, 2008			
Total	23,526		$ 15,222

(1) All shares were originally purchased from us by directors, employees and consultants pursuant to exercises of unvested stock options. During the months listed above, we routinely repurchased the shares from our directors, employees and consultants upon the termination of their employment or consulting relationship with us pursuant to our right to repurchase unvested shares at the original exercise price under the terms of our 2001 Stock Option Plan and the related stock option agreements.

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Working Capital Restrictions and Other Limitations upon the Payment of Dividends

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

Item 6. ***Exhibits*.**

Exhibit Number	Description of Document
3.1(1)	Amended and Restated Certificate of Incorporation of the registrant.
3.2(1)	Amended and Restated Bylaws of the registrant.
4.1	Reference is made to Exhibits 3.1 and 3.2.
4.2(2)	Form of Common Stock Certificate of the registrant.
4.3(3)	Third Amended and Restated Investor Rights Agreement dated June 30, 2007, as amended, by and among the registrant and certain of its stockholders.
31.1	Certification of the principal executive officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the principal financial officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of the principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

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

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

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SIGNATURES

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

ENTROPIC COMMUNICATIONS, INC.

Date: October 28, 2008

By: /s/ David Lyle
David Lyle
Chief Financial Officer
(Duly Authorized Officer and

Principal Financial Officer)

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