ENTROPIC COMMUNICATIONS INC
Form 10-Q
October 28, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010

or

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

Commission file number: 001-33844

ENTROPIC COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

6290 Sequence Drive

San Diego, CA 92121

(Address of Principal Executive Offices, Including Zip Code)

Registrant s telephone number, including area code: (858) 768-3600

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

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

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

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

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

There were 84,036,948 shares of the registrant s common stock, par value $0.001 per share, issued and outstanding as of October 25, 2010.

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ENTROPIC COMMUNICATIONS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

Entropic Communications, Inc.

Unaudited Condensed Consolidated Balance Sheets

(in thousands)

	September 30, 2010	December 31, 2009 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 53,628	$ 35,252
Accounts receivable	29,108	15,468
Inventory	24,331	16,353
Prepaid expenses and other current assets	2,428	3,302
Total current assets	109,495	70,375
Property and equipment, net	11,362	11,581
Intangible assets, net	406	1,623
Other long-term assets	430	235
Total assets	$ 121,693	$ 83,814
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 13,391	$ 5,726
Accrued payroll and benefits	7,480	3,396
Accrued expenses and other current liabilities	2,136	2,217
Deferred revenues	120	174
Total current liabilities	23,127	11,513
Stock repurchase liability	146	345
Other long-term liabilities	2,586	3,043
Stockholders equity:		
Common stock	73	71
Additional paid-in capital	321,570	310,796
Accumulated deficit	(225,786)	(241,907)
Accumulated other comprehensive loss	(23)	(47)
Total stockholders equity	95,834	68,913
Total liabilities and stockholders equity	$ 121,693	$ 83,814

(1)

The unaudited condensed consolidated balance sheet at December 31, 2009 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The accompanying notes are an integral part of these unaudited 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, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net revenues	$ 61,310	$ 30,958	$ 139,441	$ 81,227
Cost of net revenues	28,774	15,332	65,306	40,437
Gross profit	32,536	15,626	74,135	40,790
Operating expenses:				
Research and development	12,410	10,824	35,694	34,249
Sales and marketing	5,054	3,345	12,823	10,377
General and administrative	3,798	2,642	9,510	8,043
Amortization of intangibles				16
Restructuring charges		70		2,173
Impairment of goodwill and intangible assets				208
Total operating expenses	21,262	16,881	58,027	55,066
Income (loss) from operations	11,274	(1,255)	16,108	(14,276)
Other income, net	33	26	78	115
Income (loss) before income taxes	11,307	(1,229)	16,186	(14,161)
Income tax provision	36	9	65	100
Net income (loss)	$ 11,271	$ (1,238)	$ 16,121	$ (14,261)
Net income (loss) per share basic	$ 0.15	$ (0.02)	$ 0.22	$ (0.21)
Net income (loss) per share diluted	$ 0.15	$ (0.02)	$ 0.21	$ (0.21)
Weighted average number of shares used to compute net income (loss) per share basic	72,777	70,146	72,003	69,473
Weighted average number of shares used to compute net income (loss) per share diluted	77,605	70,146	75,791	69,473

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

Entropic Communications, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30, 2010	2009
Operating activities:		
Net income (loss)	$ 16,121	$ (14,261)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,718	2,547
Amortization of intangible assets	1,217	1,233
Impairment of goodwill and intangible assets		208
Stock-based compensation to consultants	245	18
Stock-based compensation to employees	7,287	7,208
Impairment of assets related to restructuring charge		94
Loss on disposal of assets	7	
Changes in operating assets and liabilities:		
Accounts receivable	(13,641)	(1,733)
Inventory	(7,977)	4,627
Prepaid expenses and other current assets	873	160
Other long-term assets	(197)	25
Accounts payable	7,666	716
Accrued payroll and benefits	4,070	(209)
Accrued expenses and other current liabilities	(80)	(55)
Deferred revenues	(54)	(302)
Other long-term liabilities	(457)	(180)
Net cash provided by operating activities	17,798	96
Investing activities:		
Purchases of property and equipment	(2,508)	(1,352)
Sales/maturities of marketable securities		4,339
Net cash (used in) provided by investing activities	(2,508)	2,987
Financing activities:		
Net proceeds from the exercise of stock options	3,045	1,175
Net cash provided by financing activities	3,045	1,175
Net effect of exchange rates on cash	41	
Net increase in cash and cash equivalents	18,376	4,258
Cash and cash equivalents at beginning of period	35,252	30,071
Cash and cash equivalents at end of period	$ 53,628	$ 34,329

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

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ENTROPIC COMMUNICATIONS, INC.

Notes to Unaudited Condensed Consolidated Financial Statements

September 30, 2010

1. Organization and Summary of Significant Accounting Policies

Business

Entropic Communications, Inc. was organized under the laws of the state of Delaware on January 31, 2001.

We are a 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 standard-definition television-quality video, or SD video, and other multimedia content such as movies, music, games and photos are brought into and delivered throughout the home.

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, or 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, or 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 our audited consolidated financial statements and notes for the year ended December 31, 2009 which are included in our Annual Report on Form 10-K filed on February 4, 2010 with the SEC, or the Annual Report.

The interim unaudited 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 our consolidated financial position, results of operations and cash flows as of and for the interim periods presented. Interim results are not necessarily indicative of the results to be expected for future quarters or the full year.

The accompanying unaudited condensed consolidated financial statements include our accounts and those of our 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 unaudited condensed consolidated financial statements and these accompanying notes. Among the significant estimates affecting the unaudited condensed consolidated financial statements are those related to business combinations, revenue recognition, allowance for doubtful accounts, inventory reserves, long-lived assets (including intangible assets), warranty reserves, accrued bonuses, income taxes, valuation of equity securities and stock-based compensation. On an ongoing basis, management reviews its estimates based upon currently available information. Actual results could differ materially from those estimates.

Foreign Currency Translation

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

Revenue Recognition

Our net revenues are generated principally by sales of our semiconductor products. During the three and nine months ended September 30, 2010 and 2009, product net revenues represented more than 99% of our total net revenues.

Our sales primarily occur through the efforts of our direct sales force. The remainder of our sales occurs through sales representatives and distributors. During the three and nine months ended September 30, 2010 and 2009, more than 99% of our sales occurred through the efforts of our direct sales force.

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

Revenues derived from billing customers for shipping and handling costs are classified as a component of net revenues. Costs of shipping and handling charged by suppliers are classified as a component of cost of net revenues.

We record reductions to net 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 would be recorded in 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 are party to an inventory hubbing agreement with a key customer. Pursuant to this agreement, 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 receive 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 and, as a result, we record net revenues based on cash receipts. The royalty revenues recorded during the three months ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009 were $0.2 million, $0.4 million, $1.0 million and $1.6 million, respectively, and are included in net revenues on the accompanying unaudited condensed consolidated statements of operations.

We have entered into agreements to license our hardware and software, also referred to as the nodes, to certain members of the Multimedia over Coax Alliance, or MoCA, for a period of three years and to provide upgrades when and if they become available. The agreements limit the rights to use the nodes to test compliance of the members own products to the MoCA specification. For any agreements entered into on or prior to December 31, 2009, we deferred all of the license revenues when the nodes are delivered and recognized the revenues on a straight-line basis over the term of the agreement. For agreements entered into after December 31, 2009, of which there have been none, we will consider the accounting for any new node agreements under the new multiple deliverable guidance described below, as applicable.

We provide rebates on our products to certain customers. At the time of the sale, we accrue 100% of the potential rebate as a reduction to net 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. For the three months ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009, we reduced net revenue by $49,000, $0.1 million, $0.1 million and $0.3 million, respectively, in connection with our rebate programs.

We occasionally enter into agreements where revenue is derived from multiple deliverables including any mix of products and/or services. These products and/or services are generally delivered from approximately three months to two years after the execution date. Revenue recognition for agreements with multiple deliverables is based on the individual units of accounting determined to exist in the agreement. A delivered item is considered a separate unit of accounting when the delivered item has value to the customer on a stand-alone basis. Items are considered to have stand-alone value when they are sold separately by any vendor or when the customer could resell the item on a stand-alone basis.

For multiple deliverable agreements entered into after December 31, 2009, consideration is allocated at the inception of the agreement to all deliverables based on their relative selling price. The relative selling price for each deliverable is determined using vendor specific objective evidence, or VSOE, of selling price or third-party evidence of selling price if VSOE does not exist. If neither VSOE nor third-party evidence of selling price exists, we use our best estimate of the selling price for the deliverable. To date, multiple deliverable contacts have not been material to net revenues in any related period and our adoption of the new accounting guidance for determining multiple element arrangements effective January 1, 2010 did not have an impact on our operating results.

For multiple deliverable agreements entered into on or prior to December 31, 2009, consideration was generally allocated to each unit of accounting based upon its relative fair value when objective and reliable evidence of fair value existed for all units of accounting in the agreement. The fair value of an item was generally the price charged for the product, if the item was regularly sold on a stand-alone basis.

In order to establish VSOE of selling price, we must regularly sell the product and/or service on a standalone basis with a substantial majority priced within a relatively narrow range. VSOE of selling price is usually the midpoint of that range. If there is not a sufficient number of standalone sales and VSOE of selling price cannot be determined, then we consider whether third-party evidence can be used to establish the selling price. If neither VSOE nor third-party evidence of selling price exists, effective January 1, 2010 we determine our best estimate of selling price using average selling prices over a rolling 12-month period as well as market conditions. If the product or service has no history of sales, we rely upon sales prices set by our pricing committee, adjusted for applicable discounts.

We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the revenue recognition but do not change the total revenue recognized on any agreement.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable, leases payable and lines of credit. Our policy is to place our cash and cash equivalents with high quality financial institutions in order to limit our credit exposure. We extend credit to our customers based on an evaluation of the customer s financial condition and a cash deposit is generally not required. We estimate potential losses on trade receivables on an ongoing basis.

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 and, in general, represent excess inventory value on hand compared to our 12-month demand projections. Once established, these adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

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Intangible Assets

We record intangible assets based on the fair value of the assets acquired. In determining the fair value of the assets acquired, we utilize extensive 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.

We assess intangible assets for impairment using fair value measurement techniques on an annual basis or more frequently if indicators of impairment exist. In March 2009, we implemented a restructuring plan (see Note 2). As part of the restructuring plan, we closed our Kfar Saba, Israel office and terminated all of the employees at that location. As a result of this location closure, we reassessed the intangible assets associated with our Kfar Saba, Israel office and recorded an impairment charge for the remaining $0.2 million of core technology intangible assets associated with our 2007 acquisition of Arabella Software, Ltd., or Arabella.

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 financial statements.

Warranty Accrual

We generally provide a warranty on our products for a period of one year; however, it may be longer for certain customers. Accordingly, we establish provisions for estimated product warranty costs at the time revenue is recognized based upon our historical activity and, additionally, for any known product warranty issues. Warranty provisions are recorded as a cost of net revenues. The determination of such provisions requires us to make estimates of product return rates and expected costs to replace or rework the products under warranty. When the actual product failure rates, cost of replacements and rework costs differ from our estimates, revisions to the estimated warranty accrual are made. Actual claims are charged against the warranty reserve.

Research and Development Costs

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

Software Development Costs

Software development costs are capitalized beginning when technological feasibility has been established and ending when a product is available for sale to customers. To date, the period between achieving technological feasibility and when the software is made available for sale to customers has been relatively short and software development costs qualifying for capitalization have not been significant. As such, all software development costs have been expensed as incurred in research and development expense.

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Income Taxes

We estimate income taxes based on the various jurisdictions where we conduct business. Significant judgment is required in determining our worldwide income tax provision. We estimate the current tax liability and assess temporary differences that result from differing treatments of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are reflected in our balance sheets. We then assess the likelihood that deferred tax assets will be realized. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized. When a valuation allowance is established or increased, we record a corresponding tax expense in our statements of operations. We review the need for a valuation allowance each interim period to reflect uncertainties about whether we will be able to utilize deferred tax assets before they expire. The valuation allowance analysis is based on estimates of taxable income for the jurisdictions in which we operate and the periods over which our deferred tax assets will be realizable.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not of being sustained upon audit, the second step is to measure the tax benefit as the largest amount that has more than a 50% chance of being realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. We evaluate uncertain tax positions on a quarterly basis. The evaluations are based upon a number of factors, including changes in facts or circumstances, changes in tax law, correspondence with tax authorities during the course of audits and effective settlement of audit issues.

Stock-Based Compensation

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

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

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

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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Segment Reporting

We are organized as, and operate 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 HD video and other multimedia content for entertainment purposes into and throughout the home. Our chief operating decision maker is our chief executive officer, or CEO. Our 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. Our assets are primarily located in the United States and not allocated to any specific region. Therefore, geographic information is presented only for total revenue.

Recently Issued Accounting Standards

On March 31, 2010, the Financial Accounting Standards Board, or FASB, ratified the milestone method of revenue recognition. Under this new standard, an entity can recognize contingent consideration earned from the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. A milestone is defined as an event (i) that can only be achieved based in whole or in part on either the entity s performance or on the occurrence of a specific outcome resulting from the entity s performance (ii) for which there is substantive uncertainty at the date the arrangement is entered into that the event will be achieved and (iii) that would result in additional payments being due to the entity. The milestone method of revenue recognition is effective for fiscal years beginning on or after June 15, 2010 and may be applied prospectively after the adoption date or retrospectively for all periods presented. We are currently in the process of evaluating whether to adopt this new standard early. The impact of adoption on our consolidated financial statements will ultimately depend on the terms of any future business transactions.

There have been no other recent accounting pronouncements or changes in accounting pronouncements during the nine months ended September 30, 2010, as compared to the recent accounting pronouncements described in the Annual Report that are of material significance, or have potential material significance, to us.

2. Supplemental Financial Information

Fair Value Measurements

We hold certain financial assets and liabilities, including cash equivalents, marketable securities and deferred compensation liability that are required to be measured at fair value on a recurring basis. Cash equivalents generally include U.S. Treasury money market funds. Marketable securities, to the extent that we hold any, are carried at amortized cost which approximates fair value.

We use 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.

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The following table summarizes our assets and liabilities that require fair value measurements on a recurring basis.

	Fair Value Measurements as of September 30, 2010			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	$ 1,144	$ 1,144	$	$
Liabilities:				
Deferred compensation	$ 480	$	$	$ 480

	Fair Value Measurements as of December 31, 2009			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	$ 8,143	$ 8,143	$	$
Liabilities:				
Deferred compensation	$ 561	$	$	$ 561

Our deferred compensation liability represents bonus compensation to be paid out in the event that our stock price does not reach a guaranteed level in connection with certain stock options granted. The fair value of this liability is remeasured quarterly using the Black Scholes option pricing model which considers the potential payout, the remaining time until payout, volatility of the underlying shares, and the risk-free interest rate to calculate the liability that may be due under the arrangement.

The change in liability for the nine months ended September 30, 2010 is included in earnings in compensation expense as follows:

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)
Liability as of December 31, 2009	$ 561
Decrease in compensation expense	(81)
Liability as of September 30, 2010	$ 480

Inventory

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

	As of September 30, 2010	As of December 31, 2009
Work in process	$ 10,318	$ 4,177
Finished goods	14,013	12,176
Total inventory	$ 24,331	$ 16,353

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Property and Equipment

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

	Useful Lives (in years)	As of September 30, 2010	As of December 31, 2009
Office and laboratory equipment	5	$ 10,727	$ 9,325
Computer equipment	3 - 5	3,012	2,496
Furniture and fixtures	3 - 7	1,772	1,570
Leasehold improvements	Lease term	5,218	5,122
Licensed software	1 - 3	1,291	1,195
Construction in progress		361	217
		22,381	19,925
Accumulated depreciation		(11,019)	(8,344)
Property and equipment, net		$ 11,362	$ 11,581

Depreciation and amortization expense for the three months ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009 was $0.9 million, $0.8 million, $2.7 million and $2.5 million, respectively.

Intangible Assets

Intangible assets consisted of the following (in thousands):

	As of September 30, 2010			
	Gross	Accumulated Amortization	Impairment	Net
Developed technology	$ 24,800	$ (10,279)	$ (14,115)	$ 406

As of September 30, 2010, the estimated future amortization expense of intangible assets expected to be charged to cost of net revenues for the remainder of the year ending December 31, 2010 is $0.4 million.

Accrued Warranty

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

	As of September 30, 2010
Liability as of December 31, 2009	$ 147
Accruals	51
Expirations	(115)
Settlements	(6)

Liability as of September 30, 2010	$	77

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Accrued Management Bonuses

In April 2010, the compensation committee of our board of directors adopted and approved a management bonus plan, or MBP, to reward officers and specified individuals for their performance, generally on an annual basis. A portion of the bonuses payable under the MBP is dependent on the extent to which specified performance goals for a specified performance period are achieved. We refer to these bonuses as performance-based bonuses. The MBP also allows for the payment of discretionary bonuses for which no specific award criteria need to be established. The amount of 2010 performance-based bonuses payable under the MBP is based on the extent to which specified financial goals are met. As of September 30, 2010, we believe the achievement of certain of these financial goals is probable and, accordingly, have estimated and accrued $3.0 million in management bonuses under the MBP. Any actual bonus amounts awarded will be at the discretion of our compensation committee and in accordance with the terms of the MBP.

In 2009, we maintained a management bonus plan to reward the performance of officers and specified individuals for their 2009 performance. The actual bonus payments paid under the 2009 management bonus plan were determined based on the achievement of operational, financial and business development objectives for 2009. For the nine months ended September 30, 2009, we accrued $0.8 million in management bonuses under the 2009 management bonus plan.

Other Long-Term Liabilities

The components of other long-term liabilities are as follows (in thousands):

	As of September 30, 2010	As of December 31, 2009
Deferred rent	$ 2,045	$ 2,280
Other	541	763
Total other long-term liabilities	$ 2,586	$ 3,043

Impairment of Intangible Assets

During the nine months ended September 30, 2009, we recorded an impairment charge on intangible assets of $0.2 million. We determined that the intangible assets associated with our 2007 acquisition of Arabella were fully impaired as the core technology acquired would no longer be used in our ongoing business operations.

Restructuring Activity

We incurred restructuring charges totaling $0.1 million and $2.2 million during the three months and nine months ended September 30, 2009, respectively, resulting from a restructuring plan we implemented in March 2009 that resulted in a worldwide reduction-in-force of 55 employees and the closure of our Nice, France and Kfar Saba, Israel offices. All of the terminated employees received severance payments upon their effective termination. In addition, the affected French and Israeli employees continued to receive salaries until their termination became effective upon the expiration of applicable contractual or statutory notice periods.

The continued payment of salaries to the terminated Nice and Kfar Saba employees during their respective notice periods represented a one-time termination benefit since we were required by contract or law to make these payments whether or not these employees continued to work for us through their actual termination dates.

Debt

As of September 30, 2010, we had access to a $5.0 million revolving credit line under the terms of our Loan and Security Agreement, as amended, with Silicon Valley Bank, or SVB. We amended the provisions of our credit line in April 2010 upon the payment of a $12,500 amendment fee and extended the term of the credit line through April 8, 2011. The maximum credit available under the credit line was reduced from $10.0 million to $5.0 million. As amended, interest on the credit line is payable 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. If any portion of the credit line remains unused at any time, we are required to pay a fee equal to 0.125% per annum of the average unused portion of the credit line so long as we maintain a liquidity ratio of at least 1.75 to 1, or 0.5% per annum of the average unused portion of the credit line when our liquidity ratio falls below 1.75 to 1. The credit line, as amended, also limits the aggregate amount of assets and collateral that we are allowed to transfer to, and the amount of investments that we are allowed to make in, certain of our subsidiaries to $600,000 per month. The amount available under the credit line cannot exceed 80% of the value of our eligible accounts receivable and may be decreased by certain commitments, such as the $1.2 million and $35,000 standby letters of credit that secure our performance under our San Diego, California, and San Jose, California, facility leases, respectively.

As of September 30, 2010, $3.8 million was available under the credit line. The availability was reduced by the two standby letters of credit for our facility leases.

Deferred Rent

We recognize rent expense on a straight-line basis over the lease term and record landlord allowances for tenant improvements as deferred rent. The deferred rent is amortized over the lease term as a reduction of rent expense. As of September 30, 2010 and December 31, 2009, there was $2.0 million and $2.3 million, respectively, of unamortized deferred rent recorded as a component of other long-term liabilities.

Purchase Commitments

We had firm purchase order commitments for the acquisition of inventory as of September 30, 2010 and December 31, 2009 of $42.5 million and $20.2 million, respectively.

Stock-Based Compensation

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

We also grant stock awards under our ESPP. Under the terms of the ESPP, eligible employees may purchase shares of our common stock at 85% of the fair market value of our common stock on the offering date or the purchase date, whichever is less. Purchase dates occur twice each year, with a look-back period of up to 12 months to determine the lowest common stock valuation date, either the offering date or the purchase date.

Stock-based compensation expense recognized in our unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2010 and 2009 included compensation expense for stock-based options and awards granted subsequent to December 31, 2005, based on the grant date fair value. For options and awards granted, expenses are amortized under the straight-line method. Stock-based compensation expense recognized in the unaudited condensed consolidated statements of operations has been reduced for estimated forfeitures of options that are subject to vesting. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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We allocated stock-based compensation expense as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Cost of net revenues	$ 104	$ 41	$ 256	$ 102
Research and development	1,362	1,006	3,652	3,524
Sales and marketing	419	354	1,113	1,048
General and administrative	898	797	2,511	2,552
Total stock-based compensation expense	$ 2,783	$ 2,198	$ 7,532	$ 7,226

2007 Equity Incentive Plans

We reviewed and updated our forfeiture rate, expected term and volatility assumptions during the three months ended September 30, 2010. 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 expected life is based on the average life of certain guideline companies, adjusted for differences in vesting schedule and contractual terms. Prior to the quarter ended June 30, 2010, the expected life was based on the average of the contractual term of the options and the weighted-average vesting period for all option tranches. The change in the expected life assumption does not have a material impact in the current period. The estimated volatility incorporates historical volatility of similar entities whose share prices are publicly available. The expected dividend yield was based on our expectation of not paying dividends on common stock for the foreseeable future.

We granted options and other stock awards to consultants in connection with their service agreements. For the three months ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009, we recorded compensation expense related to these awards of $0.1 million, $9,000, $0.2 million and $18,000, respectively. The fair value of the awards was estimated using a Black-Scholes option-pricing model.

The fair value of stock options granted to employees, directors and consultants was estimated at the grant date using the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Expected life (years) for employee and director options	5.0	6.1	5.0 - 6.1	6.1
Contractual term (years) for consultant options	10.0	10.0	10.0	10.0
Risk-free interest rate	1.78%	3.15%	1.78% - 3.07%	2.40 - 3.18%
Expected volatility	85%	104%	80% - 85%	76% - 104%
Expected dividend yield				

As of September 30, 2010, we estimated there were $15.6 million in total unrecognized compensation costs related to employee stock option agreements, which are expected to be recognized over a weighted-average period of 1.4 years.

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2007 Employee Stock Purchase Plan

For the three months ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009, the fair value of stock-based awards granted under the ESPP was estimated using the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Expected life (years)	0.5 - 1.0	0.5 - 1.0	0.5 - 1.0	0.5 - 1.0
Risk-free interest rate	0.25% to 0.43%	0.16% - 0.92%	0.17% to 0.49%	0.16% - 0.92%
Expected volatility	63% to 139%	151% - 180%	63% to 151%	151% - 180%
Expected dividend yield				

For the three months ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009, we recorded stock-based compensation expense for the ESPP totaling $0.2 million, $0.1 million, $0.6 million and $0.3 million, respectively. As of September 30, 2010, we estimate there were $0.1 million of unrecognized compensation costs related to the shares expected to be purchased through the ESPP, which are expected to be recognized over a remaining weighted-average period of 0.4 years.

3. Income Taxes

Our effective tax rates for the three and nine months ended September 30, 2010 were 0.39% and 0.40%, respectively, compared to (0.70)% for the three and nine months ended September 30, 2009. The effective tax rate for the three and nine months ended September 30, 2009 is expressed as a negative rate because we recorded tax expense while in a loss position for the period. The tax expense related to foreign taxes during the three months ended September 30, 2010 and 2009 and nine months ended September 30, 2010 and 2009, was $17,000, $9,000, $30,000 and $98,000, respectively.

On January 1, 2007, we adopted guidance that prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, the guidance provides clarity on de-recognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The unrecognized tax benefit was $9.5 million as of December 31, 2009.

No adjustments have been made during the three and nine months ended September 30, 2010 for any uncertain tax positions and we do not expect our 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, 2010 or December 31, 2009.

We file federal and state income tax returns in the United States and various other income tax returns in foreign jurisdictions.

4. Net Income (Loss) Per Share of Common Stock

We compute basic income (loss) per share of common stock by dividing net income (loss) by the weighted average number of shares of common stock outstanding for the period. Diluted income (loss) per share is computed using the weighted average number of shares of common stock and dilutive common equivalent shares outstanding during the period. Common equivalent shares from stock options and other common stock equivalents are excluded from the computation when their effect is antidilutive.

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

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Numerator:				
Net income (loss) basic and diluted	$ 11,271	$ (1,238)	$ 16,121	$ (14,261)
Denominator:				
Weighted average number of shares of common stock outstanding	72,892	70,577	72,195	70,019
Less: Restricted stock	(115)	(431)	(192)	(546)
Weighted average number of shares used in computing net income (loss) per common share basic	72,777	70,146	72,003	69,473
Effect of dilutive securities:				
Restricted stock	115		192	
ESPP shares	42		79	
Stock award common share equivalents	4,671		3,517	
Weighted average number of shares used in computing net income (loss) per common share diluted	77,605	70,146	75,791	69,473
Net income (loss) per share basic	$ 0.15	$ (0.02)	$ 0.22	$ (0.21)
Net income (loss) per share diluted	$ 0.15	$ (0.02)	$ 0.21	$ (0.21)

Potentially dilutive securities that were not included in the diluted net income (loss) per share calculations because they would be antidilutive, for any reason, are as follows (in thousands):

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Stock options outstanding	1,840	9,163	2,949	9,415
Stock reserved for issuance under put and call option agreements		35		110
Restricted stock		429		595
Total	1,840	9,627	2,949	10,120

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, 2010	Nine Months Ended September 30, 2009
Cash paid for taxes	$ 11	$

There was no cash paid for interest in the nine months ended September 30, 2010 and 2009.

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Non-Cash Activity

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

	Nine Months Ended September 30, 2010	2009
Decrease in repurchase liability for early exercise of stock options	$ 199	$ 353
Currency translation adjustment	(24)	85

6. Significant Customer and Geographic Information

Customers

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

	Three Months Ended September 30, 2010	2009	Nine Months Ended September 30, 2010	2009
Actiontec Electronics, Inc.	*	18%	*	19%
Cisco Systems, Inc.	10%	*	*	*
Motorola, Inc.	19%	37%	18%	28%
Wistron NeWeb Corporation	22%	*	17%	*

* Customer accounted for less than 10% of our total net revenues for the period indicated.

As of September 30, 2010 and December 31, 2009, customers that individually represented 10% or more of our accounts receivable balances were as follows:

	September 30, 2010	December 31, 2009
Actiontec Electronics, Inc.	*	11%
Motorola, Inc.	24%	12%
Wistron NeWeb Corporation	26%	11%
Zinwell Corporation	*	10%

* Customer accounted for less than 10% of accounts receivable at the date indicated.

Geographic Information

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

	Nine Months Ended September 30,

	2010	2009
Asia	90%	93%
Europe	2	2
North America	8	5
	100%	100%

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7. Subsequent Events

On October 5, 2010, we completed a public offering in which 10,750,000 shares of our common stock were sold on our behalf at price to the public of $9.70 per share, and which resulted in gross offering proceeds of $104.3 million and net offering proceeds of $99.1 million after deducting underwriting discounts and commissions and estimated offering expenses payable by us. Barclays Capital and J.P. Morgan acted as the joint book-running managers for the offering and Craig-Hallum Capital Group, Signal Hill, Pacific Crest Securities and Merriman Capital acted as co-managers. The underwriters have until October 29, 2010 to exercise their 30-day option to purchase up to an additional 1,612,500 shares of our common stock at an offering price of $9.70 per share to cover over-allotments, if any.

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, 2009 and the related Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report.

Forward-Looking Statements

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

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

Overview

We are a fabless semiconductor company that designs, develops and markets systems solutions to enable connected home entertainment. Our technologies significantly change the way HD video, SD video, and other multimedia content such as movies, music, games and photos are brought into and delivered throughout the home.

We are a pioneer of key technologies that enable connected home networking of digital entertainment over existing coaxial cable. We are a founding member of MoCA, a global home networking consortium that sets standards for the distribution of video and other multimedia entertainment over coaxial cable. Our products include:

- Home networking chipsets based on the MoCA standard;
- Integrated circuits that simplify and enhance digital broadcast satellite, or DBS, services;
- High-speed broadband access chipsets; and
- Silicon tuner integrated circuits.

Our products allow telecommunications carriers, cable operators and DBS service providers, which we collectively refer to as service providers, to enhance and expand their service offerings and reduce

deployment costs in an increasingly competitive environment. Our MoCA home networking solutions are now being deployed into consumer homes to support multi-room digital video recorder service by Comcast, Cox Communications, DIRECTV, Time Warner Cable and Verizon, as well as by a number of smaller service providers.

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, 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 tuner solutions. In 2008, we acquired certain specified assets of Vativ Technologies, Inc., or Vativ, a provider of high-bandwidth, advanced digital processing solutions for digital television and 10 gigabit Ethernet markets. Since inception, we have invested heavily in product development and have not yet achieved profitability on an annual basis, although we had net income of $16.1 million for the nine months ended September 30, 2010 and $11.3 million for the three months ended September 30, 2010. Our net revenues grew from $122.5 million in 2007 to $146.0 million in 2008 driven primarily by increased demand for our home networking products. Our net revenues decreased to $116.3 million in 2009 driven primarily by softness in demand for our home networking products and, to a lesser extent, by lower demand for our DBS products. As of September 30, 2010, we had an accumulated deficit of $225.8 million.

We generate the majority of our revenues from sales of our products to original design manufacturers, or ODMs, and original equipment manufacturers, or OEMs, that provide customer premises equipment to service providers. 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 net revenues. Sales to these customers are in turn driven by service providers that purchase our customers products which incorporate our products. A substantial percentage of our net revenues are dependent upon four major service providers: DIRECTV, Verizon, DISH Network and Comcast. In addition, we are dependent on sales outside of the United States for almost all of our net revenues and expect that to continue in the future.

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 in future years 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 development tools and supply costs, which include outside services, masks costs and licenses. We also anticipate that our sales and marketing expenses will increase as we expand our domestic and international sales and marketing organization and activities and build brand awareness. Due to the lengthy sales cycles that we face, we may experience significant delays from the time we incur research and development and sales and marketing expenses until the time, if ever, that we generate sales from the related products.

Since our inception, we have funded our operations using a combination of preferred stock issuances, cash collections from customers, bank credit facilities, cash received from the exercise of stock options and proceeds from public offerings of our common stock. We intend to continue spending substantial amounts in connection with the growth of our business to pursue our business strategy, develop new products, respond to competition and market opportunities, and possibly acquire complementary businesses or technologies. For example, on October 5, 2010, we completed a public offering of 10,750,000 shares of our common stock, which resulted in net proceeds of approximately $99.1 million.

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Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Consolidated Statements of Operations Data:				
Total net revenues	100%	100%	100%	100%
Total cost of net revenues	47	50	47	50
Gross profit	53	50	53	50
Operating expenses:				
Research and development	20	35	26	42
Sales and marketing	8	11	9	13
General and administrative	6	8	7	10
Restructuring charges				3
Total operating expenses	34	54	42	68
Income (loss) from operations	19	(4)	11	(18)
Income taxes				
Net income (loss) attributable to common stockholders	19%	(4)%	11%	(18)%

Comparison of Three and Nine Months Ended September 30, 2010 and 2009

(Tables presented in thousands, except percentage amounts)

Net Revenues

	Three Months Ended September 30,		%	Nine Months Ended September 30,		%
	2010	2009	Change	2010	2009	Change
Net revenues	$ 61,310	$ 30,958	98%	$ 139,441	$ 81,227	72%

Net revenues increased during the three and nine months ended September 30, 2010 compared to the same periods in 2009 driven primarily by higher demand for our home networking products, including new deployments by additional service providers and by higher demand for our DBS outdoor unit products.

Gross Profit/Gross Margin

	Three Months Ended September 30,		%	Nine Months Ended September 30,		%
	2010	2009	Change	2010	2009	Change
Gross profit	$ 32,536	$ 15,626	108%	$ 74,135	$ 40,790	82%
% of net revenues	53%	50%		53%	50%	

Gross profit increased during the three and nine months ended September 30, 2010 compared to the same periods in 2009 driven primarily by higher net revenues from sales of our home networking products and our DBS outdoor unit products.

Gross margin increased during the three and nine months ended September 30, 2010 compared to the same periods in 2009 driven primarily by higher sales of our DBS outdoor unit products. During each of the three and nine month periods ended September 30, 2010 and 2009, cost of net revenues also included amortization of developed technology in the amounts of $0.4 million and $1.2 million, respectively, or approximately 1% of net revenues for each period.

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Research and Development Expenses

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	% Change	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	% Change
Research and development	$ 12,410	$ 10,824	15%	$ 35,694	$ 34,249	4%
% of net revenues	20%	35%		26%	42%	

The $1.6 million increase in research and development expenses during the three months ended September 30, 2010, compared to the three months ended September 30, 2009, was partially due to increased personnel costs of $1.3 million (of which $0.3 million was due to stock-based compensation). The increase in personnel costs was principally caused by a 14% increase in employees engaged in research and development activities during the three months ended September 30, 2010 compared to the same period in 2009. Other factors contributing to the increase in research and development expense include a $0.4 million increase in overhead allocations and depreciation, offset by a $0.1 million decrease in development tools and supply costs, which include outside services, masks costs and licenses that fluctuate in timing and amount from period to period, all of which resulted from a general increase in research and development activities.

The $1.4 million increase in research and development expenses during the nine months ended September 30, 2010, compared to the nine months ended September 30, 2009, was partially due to increased personnel costs of $0.5 million (which included an offsetting decrease of $0.1 million in stock-based compensation). Other factors contributing to the increase in research and development expense include a $0.1 million increase in overhead allocations and depreciation, a $0.8 million increase in development tools and supply costs, which include outside services, masks costs and licenses that fluctuate in timing and amount from period to period, all of which resulted from a general increase in research and development activities.

Sales and Marketing Expenses

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	% Change	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	% Change
Sales and marketing	$ 5,054	$ 3,345	51%	$ 12,823	$ 10,377	24%
% of net revenues	8%	11%		9%	13%	

The increase of $1.7 million in sales and marketing expenses for the three months ended September 30, 2010, compared to the three months ended September 30, 2009, was primarily due to increased personnel costs of $1.4 million (of which $0.1 million was due to stock-based compensation), attributable to a 13% increase in the number of employees engaged in sales and marketing activities to support our growth. General customer support related activities contributed to the remaining increase of $0.3 million.

The increase of $2.4 million in sales and marketing expenses for the nine months ended September 30, 2010, compared to the nine months ended September 30, 2009, was primarily due to increased personnel costs of $2.0 million, attributable to a 13% increase in the number of employees engaged in sales and marketing activities to support our growth. General customer support related activities contributed to the remaining increase of $0.4 million.

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General and Administrative Expenses

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	% Change	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	% Change
General and administrative	$ 3,798	$ 2,642	44%	$ 9,510	$ 8,043	18%
% of net revenues	6%	8%		7%	10%	

The $1.2 million increase in general and administrative expenses for the three months ended September 30, 2010, compared to the three months ended September 30, 2009, was primarily due to increased personnel costs of $1.1 million (of which $0.1 million was due to stock-based compensation), attributable to a 7% increase in the number of employees engaged in general and administrative activities to support our growth. General support related activities contributed to the remaining increase of $0.1 million.

The $1.5 million increase in general and administrative expenses for the nine months ended September 30, 2010, compared to the nine months ended September 30, 2009, was primarily due to increased personnel costs of $1.3 million, attributable to a 7% increase in the number of employees engaged in general and administrative activities to support our growth. Third party support services contributed to the remaining increase of $0.2 million.

Amortization of Intangibles

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	% Change	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	% Change
Amortization of intangible assets	$	$	%	$	$ 16	(100)%
% of net revenues	%	%		%	%	

During the nine months ended September 30, 2009, we determined that the intangible assets associated with our 2007 acquisition of Arabella were fully impaired as the core technology acquired would no longer be used in our ongoing business operation and, as such, no further amortization was recognized related to this intangible.

Impairment of Intangible Assets

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	% Change	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	% Change
Impairment of intangible assets	$	$				