MoSys, Inc.
Form 10-Q
November 07, 2012
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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, DC 20549**

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# 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, 2012**

**OR**

**o 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 000-32929**

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# MOSYS, Inc.

(Exact name of registrant as specified in its charter)

| **Delaware** | **77-0291941** |
|---|---|
| (State or other jurisdiction of Incorporation or organization) | (I.R.S. Employer Identification Number) |

**3301 Olcott Street**

**Santa Clara, California, 95054**

(Address of principal executive office and zip code)

**(408) 415-4500**

(Registrant s telephone number, including area code)

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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 filing requirements for the past 90 days. YES x NO o

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

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of November 1, 2012, 39,906,910 shares of the Registrant s common stock, $0.01 par value, were outstanding.

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**MOSYS, INC.**

**FORM 10-Q**
**September 30, 2012**

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**MOSYS, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Unaudited)**

**(In thousands, except par value)**

| | September 30, 2012 | December 31, 2011 |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | $ 5,967 | $ 40,025 |
| Short-term investments | 30,208 | 9,413 |
| Accounts receivable, net | 1 | 969 |
| Prepaid expenses and other current assets | 2,092 | 1,596 |
| Total current assets | 38,268 | 52,003 |
| | | |
| Long-term investments | 9,089 | 8,537 |
| Property and equipment, net | 1,034 | 1,382 |
| Goodwill | 23,134 | 23,134 |
| Intangible assets, net | 2,904 | 4,400 |
| Other assets | 182 | 181 |
| Total assets | $ 74,611 | $ 89,637 |
| | | |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities | | |
| Accounts payable | $ 847 | $ 336 |
| Accrued expenses and other liabilities | 1,923 | 2,779 |
| Deferred revenue | 663 | 920 |
| Total current liabilities | 3,433 | 4,035 |
| | | |
| Long-term liabilities | 158 | 109 |
| | | |
| Commitments and contingencies (Note 4) | | |
| | | |
| Stockholders equity | | |
| Preferred stock, $0.01 par value; 20,000 shares authorized; none issued and outstanding | | |
| Common stock, $0.01 par value; 120,000 shares authorized; 39,810 shares and 38,423 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively | 398 | 384 |
| Additional paid-in capital | 155,836 | 150,507 |
| Accumulated other comprehensive income | 26 | 1 |
| Accumulated deficit | (85,240) | (65,399) |
| Total stockholders equity | 71,020 | 85,493 |

| | | |
|---|---|---|
| Total liabilities and stockholders equity | $ 74,611 | $ 89,637 |

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

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**MOSYS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

**(Unaudited)**
**(In thousands, except per share data)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| **Net revenue** | | | | |
| Licensing and other | $ 248 | $ 756 | $ 1,113 | $ 3,319 |
| Royalty | 1,079 | 1,351 | 3,374 | 5,619 |
| Total net revenue | 1,327 | 2,107 | 4,487 | 8,938 |
| | | | | |
| Cost of net revenue | | | | |
| Licensing and other | 53 | 356 | 289 | 1,515 |
| Total cost of net revenue | 53 | 356 | 289 | 1,515 |
| | | | | |
| Gross profit | 1,274 | 1,751 | 4,198 | 7,423 |
| | | | | |
| **Operating expenses** | | | | |
| Research and development | 7,026 | 6,648 | 21,220 | 19,369 |
| Selling, general and administrative | 1,738 | 1,952 | 6,092 | 6,583 |
| Gain on sale of assets | (1,435) | | (3,291) | |
| Total operating expenses | 7,329 | 8,600 | 24,021 | 25,952 |
| | | | | |
| **Loss from operations** | (6,055) | (6,849) | (19,823) | (18,529) |
| Other income and expense, net | 61 | 10 | 121 | 44 |
| | | | | |
| Loss before income taxes | (5,994) | (6,839) | (19,702) | (18,485) |
| Income tax provision | 79 | 24 | 139 | 59 |
| | | | | |
| **Net loss** | $ (6,073) | $ (6,863) | $ (19,841) | $ (18,544) |
| | | | | |
| Other comprehensive loss, net of tax: | | | | |
| Net unrealized gains (losses) on available-for-sale securities | 27 | (23) | 25 | (15) |
| **Comprehensive loss** | $ (6,046) | $ (6,886) | $ (19,816) | $ (18,559) |
| | | | | |
| Net loss per share | | | | |
| Basic and diluted | $ (0.15) | $ (0.18) | $ (0.51) | $ (0.49) |
| Shares used in computing net loss per share | | | | |
| Basic and diluted | 39,299 | 38,090 | 38,919 | 37,700 |

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

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**MOSYS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**(In thousands)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2012** | **2011** |
| **Cash flows from operating activities:** | | |
| Net loss | $ (19,841) | $ (18,544) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 730 | 839 |
| Stock-based compensation | 2,991 | 2,474 |
| Amortization of intangible assets | 1,496 | 1,964 |
| Gain on sale of assets | (3,291) | |
| Provision for doubtful accounts | | 106 |
| Other non-cash items | (27) | 18 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 968 | 371 |
| Prepaid expenses and other assets | 161 | 1,126 |
| Deferred revenue | (257) | (589) |
| Accounts payable | (211) | (355) |
| Accrued expenses and other liabilities | (203) | (289) |
| Net cash used in operating activities | (17,484) | (12,879) |
| | | |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | (257) | (349) |
| Net proceeds from sale of assets | 3,437 | |
| Net cash paid for purchase of MagnaLynx, Inc. | | (1,000) |
| Proceeds from sales and maturities of marketable securities | 29,175 | 30,314 |
| Purchases of marketable securities | (50,497) | (27,712) |
| Net cash (used in) provided by investing activities | (18,142) | 1,253 |
| | | |
| **Cash flows from financing activities:** | | |
| Proceeds from issuance of common stock | 3,146 | 3,207 |
| Repurchase of common stock (Note 4) | (1,444) | |
| Payments on capital lease obligations | (134) | (140) |
| Net cash provided by financing activities | 1,568 | 3,067 |
| | | |
| Net decrease in cash and cash equivalents | (34,058) | (8,559) |
| | | |
| Cash and cash equivalents at beginning of period | 40,025 | 14,340 |
| Cash and cash equivalents at end of period | $ 5,967 | $ 5,781 |

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

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**MOSYS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. The Company and Summary of Significant Accounting Policies**

***The Company***

MoSys, Inc. (the Company ) was incorporated in California in September 1991, and reincorporated in September 2000 in Delaware. The Company has been designing, developing, marketing and licensing high-performance semiconductor memory and high-speed parallel and serial interface intellectual property (IP) used by the semiconductor industry and communications, networking and storage equipment manufacturers. In February 2010, the Company announced the commencement of a new product initiative to develop a family of integrated circuit (IC) products under the Bandwidth Engine product name. Bandwidth Engine ICs combine the Company s proprietary high-density embedded memory with its high-speed 10 Gigabits per second interface (I/O) technology and are initially being marketed to networking systems companies and designers of advanced systems-on-chip designs. The Company s strategy and primary business objective is to become a fabless semiconductor company focused on development and sale of Bandwidth Engine ICs. During 2011, the Company began to dedicate more of its engineering resources and the engineering budget to IC efforts, and in 2012, most of the Company s emphasis was on IC product sales as opposed to IP licensing transactions. The Company s future success and ability to achieve and maintain profitability depends on its success in developing a market for the Bandwidth Engine ICs.

The accompanying condensed consolidated financial statements of the Company have been prepared without audit in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). The condensed consolidated balance sheet at December 31, 2011 has been derived from the audited consolidated financial statements at that date. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted in accordance with these rules and regulations. The information in this report should be read in conjunction with the Company s consolidated financial statements and notes thereto included in its most recent annual report on Form 10-K filed with the SEC.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly the Company s financial position, results of operations and cash flows for the interim periods presented. The operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012 or for any other future period.

***Basis of Presentation***

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The Company s fiscal year is the calendar year.

***Use of Estimates***

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses recognized during the reported period. Actual results could differ from those estimates.

***Cash Equivalents and Investments***

The Company has invested its excess cash in money market accounts, certificates of deposit, commercial paper, corporate debt, government agency and municipal debt securities and considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Investments with original maturities greater than three months and remaining maturities less than one year are classified as short-term investments. Investments with remaining maturities greater than one year are classified as long-term investments. Management generally determines the appropriate classification of securities at the time of purchase. All securities are classified as available-for-sale. The Company s available-for-sale short-term and long-term investments are carried at fair value, with the unrealized holding gains and losses reported in accumulated other comprehensive income. Realized gains and losses and declines in the value judged to be other than temporary are included in the other income and expense, net line item in the condensed consolidated statements of operations and comprehensive loss. The cost of securities sold is based on the specific identification method.

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***Fair Value Measurements***

The Company measures the fair value of financial instruments using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as follows:

Level 1 Inputs used to measure fair value are unadjusted quoted prices that are available in active markets for the identical assets or liabilities as of the reporting date.

Level 2 Pricing is provided by third party sources of market information obtained through the Company s investment advisors rather than models. The Company does not adjust for or apply any additional assumptions or estimates to the pricing information it receives from advisors. The Company s Level 2 securities include cash equivalents and available-for-sale securities, which consisted primarily of certificates of deposit, commercial paper, corporate debt, and government agency and municipal debt securities from issuers with high quality credit ratings. The Company s investment advisors obtain pricing data from independent sources, such as Standard & Poor s, Bloomberg and Interactive Data Corporation, and rely on comparable pricing of other securities because the Level 2 securities are not actively traded and have fewer observable transactions. The Company considers this the most reliable information available for the valuation of the securities.

Level 3 Unobservable inputs that are supported by little or no market activity and reflect the use of significant management judgment are used to measure fair value. These values are generally determined using pricing models for which the assumptions utilize management s estimates of market participant assumptions. The determination of fair value for Level 3 investments and other financial instruments involves the most management judgment and subjectivity.

***Allowance for Doubtful Accounts***

The Company establishes an allowance for doubtful accounts to ensure that its trade receivables balances are not overstated due to uncollectibility. The Company performs ongoing customer credit evaluations within the context of the industry in which it operates. A specific allowance of up to 100% of the invoice value is provided for any problematic customer balances. Delinquent account balances are written off after management has determined that the likelihood of collection is remote. The Company performs ongoing credit evaluations of its customers financial condition and generally does not require collateral from its customers. The Company grants credit only to customers deemed creditworthy in the judgment of management. The Company maintains an allowance for doubtful accounts receivable based upon the expected collectibility of all accounts receivable. There was no allowance for doubtful accounts receivable at September 30, 2012 or December 31, 2011.

***Inventory***

The Company values its inventories at the lower of cost, which approximates actual cost on a first-in, first-out basis, or market value. The Company records inventory reserves for estimated obsolescence or unmarketable inventories based upon assumptions about future demand and market conditions. Once a reserve is established, it is maintained until the product to which it relates is sold or otherwise disposed of. If actual market conditions are less favorable than those expected by management, additional adjustment to inventory valuation may be required. As of

September 30, 2012 and December 31, 2011, inventory was not significant and has been included in the prepaid expenses and other current assets line item of the condensed consolidated balance sheet.

***Revenue Recognition***

*General*

The Company generates revenue from the licensing of its IP and sales of IC products. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery or performance has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Evidence of an arrangement generally consists of signed agreements or customer purchase orders.

*Licensing*

Licensing revenue consists of fees earned from license agreements, development services and support and maintenance. For stand-alone license agreements or license deliverables in multi-deliverable arrangements that do not require significant development, modification or customization, revenues are recognized when all revenue recognition criteria have been met. Delivery of the licensed technology is typically the final revenue recognition criterion met, at which time revenue is recognized. If any of the criteria are not met, revenue recognition is deferred until such time as all criteria have been met.

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When sales arrangements contain multiple deliverables (e.g., license and services), the Company reviews each deliverable to determine the separate units of accounting that exist within the agreement. If more than one unit of accounting exists, the consideration payable to the Company under the agreement is allocated to each unit of accounting using the relative fair value method. Revenue is recognized for each unit of accounting when the revenue recognition criteria have been met for that unit of accounting. The Company allocates revenue among the deliverables using the relative selling price method. Revenue allocated to each element is recognized when the basic revenue recognition criteria is met for each element. Under GAAP, the Company is required to apply a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value (VSOE), (ii) third-party evidence of selling price (TPE) and (iii) best estimate of the selling price (ESP). In general, the Company is unable to establish VSOE or TPE for license fees and development services. Therefore revenue is allocated to these elements based on the Company s ESP, which the Company determines after considering multiple factors such as management approved pricing guidelines, geographic differences, market conditions, competitor pricing strategies, internal costs and gross margin objectives. These factors may vary over time depending upon the unique facts and circumstances related to each deliverable. If the facts and circumstances underlying the factors considered change or should future facts and circumstances lead the Company to consider additional factors, the Company s ESP for license fee and development services could change.

For license agreements involving deliverables that do require significant production, modification or customization, and where the Company has significant experience in meeting the design specifications in the contract and the direct labor hours related to services under the contract can be reasonably estimated, the Company recognizes revenue over the period in which the contract services are performed. For these arrangements, the Company recognizes revenue using the percentage of completion method. Under this method, revenue recognized in any period depends on the Company s progress toward completion of projects in progress. Significant management judgment and discretion are used to estimate total direct labor hours. These judgmental elements include determining that the Company has the experience to meet the design specifications and estimate the total direct labor hours to perform the contract services, based on experience in developing prior licensees designs. The direct labor hours for the development of the licensee s design are estimated at the beginning of the contract. As the direct labor hours are incurred, they are used as a measure of progress towards completion. During the contract performance period, the Company reviews estimates of direct labor hours to complete the contracts and will revise its estimates of revenue and gross profit under the contract if it revises the estimations of the direct labor hours to complete. The Company s policy is to reflect any revision in the contract gross profit estimate in reported income or loss in the period in which the facts giving rise to the revision become known. Under the percentage of completion method, provisions for estimated losses on uncompleted contracts are recorded in the period in which such losses are determined to be likely. If the amount of revenue recognized under the percentage of completion accounting method exceeds the amount of billings to a customer, the excess amount is recorded as an unbilled contracts receivable. Unbilled contracts receivable as of September 30, 2012 and December 31, 2011 are not considered significant and have been included in the prepaid expenses and other current assets line item of the condensed consolidated balance sheets.

The Company provides support and maintenance under many of its license agreements. Under these arrangements, the Company provides unspecified upgrades, design rule changes and technical support. No other upgrades, products or other post-contract support are provided. Support and maintenance revenue is recognized at its fair value established by VSOE, ratably over the period during which the obligation exists, typically 12 months. These arrangements are generally renewable annually by the customer.

Under limited circumstances, the Company also recognizes prepaid pre-production royalties as license revenues. These are lump sum payments made when the Company enters into licensing agreements that cover future shipments of a product that is not commercially available from the licensee. The Company characterizes such payments as license revenues because they are paid as part of the initial license fee and not with respect to products being produced by the licensee. These payments are non-cancelable and non-refundable.

*Royalty*

The Company s licensing contracts typically also provide for royalties based on licensees use of the Company s memory technology in their currently shipping commercial products. The Company recognizes royalties in the quarter in which it receives the licensee s report. Under limited circumstances, the Company may also recognize prepaid post-production royalties as revenue upon execution of the contract, which are paid in a lump sum after the licensee commences production of the royalty-bearing product and applied against future unit shipments regardless of the actual level of shipments by the licensee. The criteria for revenue recognition of prepaid royalties are that a formal agreement with the licensee is executed, no deliverables, development or support services related to prepaid royalties are required, the fees are non-refundable and not contingent upon future product shipments by the licensee, and the fees are payable by the licensee in a time period consistent with the Company s normal billing terms. If any of these criteria are not met, the Company defers revenue recognition until such time as all criteria have been met.

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*IC products*

The Company sells products both directly to customers, as well as through distributors. Revenue from sales directly to customers is generally recognized at the time of shipment. The Company records an estimated allowance, at the time of shipment, for future returns and other charges against revenue consistent with the terms of sale. IC product revenue and costs relating to sales made through distributors with rights of return and stock rotation are deferred until the distributors sell the product to end customers due to the Company s inability to estimate future returns and credits to be issued. At the time of shipment to distributors, an accounts receivable for the selling price is recorded, as there is a legally enforceable right to receive payment, and inventory is relieved, as legal title to the inventory is transferred upon shipment. Revenues are recognized upon receiving notification from the distributors that products have been sold to end customers. Distributors provide information regarding products and quantity, end customer shipments and remaining inventory on hand. The associated deferred margin is included in the deferred revenues line item in the condensed consolidated balance sheet. The Company recorded initial IC product revenue in 2012, and a significant reserve for returns has been recorded due to the product s early stage of development and testing. IC product revenue was not significant for the three and nine months ended September 30, 2012, and has been included in the licensing and other revenue line item in the condensed consolidated statements of operations and comprehensive loss.

***Cost of Revenue***

Cost of licensing and other revenue consists primarily of engineering personnel and overhead allocation costs directly related to development services specified in licensing agreements and direct and indirect costs of IC product sales. Development services typically include customization of the Company s technologies for the licensee s particular IC design and may include engineering support to assist in the commencement of production of a licensee s products.

***Goodwill***

The Company reviews goodwill for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. The Company first assesses qualitative factors to determine whether it is more-likely-than-not that the fair value of the reporting unit is less than the carrying amount as a basis for determining whether it is necessary to perform the two-step impairment test. If the qualitative assessment warrants further analysis, the Company compares the fair value of the reporting unit to its carrying value. The fair value of the reporting unit is determined using the market approach. If the fair value of the reporting unit exceeds the carrying value of net assets of the reporting unit, goodwill is not impaired, and the Company is not required to perform further testing. If the carrying value of the net assets of the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step in order to determine the implied fair value of the reporting unit s goodwill and compare it to the carrying value of the reporting unit s goodwill. If the carrying value of the reporting unit s goodwill exceeds its implied fair value, then the Company must record an impairment charge equal to the difference. The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. The Company performed the annual impairment test in September 2012, and the test did not indicate impairment of goodwill, as the fair value exceeded the carrying value of the reporting unit by approximately 44%. As the Company used the market approach to assess impairment, the price of its common stock is an important component of the fair value calculation. If the Company s stock price continues to experience significant price and volume fluctuations, this will impact the fair value of the reporting unit, which can lead to potential impairment in future periods. As of September 30, 2012, the Company had not identified any factors to indicate there was an impairment of our goodwill and determined that no additional impairment analysis was required.

***Intangible Assets***

Intangible assets acquired in business combinations, referred to as purchased intangible assets, are accounted for based on the fair value of assets purchased and are amortized over the period in which economic benefit is estimated to be received. Identifiable intangible assets relating to business combinations and the patent license were as follows (dollar amounts in thousands):

| | | September 30, 2012 | | |
|---|---|---|---|---|
| | Life (years) | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
| Developed technology | 3-5 | $ 9,240 | $ 7,032 | $ 2,208 |
| Customer relationships | 3 | 390 | 390 | |
| Subtotal purchased intangible assets | | 9,630 | 7,422 | 2,208 |
| Patent license | 7 | 780 | 84 | 696 |
| Total | | $ 10,410 | $ 7,506 | $ 2,904 |

| | | December 31, 2011 | | |
|---|---|---|---|---|
| | Life (years) | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
| Developed technology | 3-5 | $ 9,240 | $ 5,676 | $ 3,564 |
| Customer relationships | 3 | 390 | 334 | 56 |
| Contract backlog | 1 | 750 | 750 | |
| Non-compete agreements | 1.5 | 140 | 140 | |
| Subtotal purchased intangible assets | | 10,520 | 6,900 | 3,620 |
| Patent license | 7 | 780 | | 780 |
| Total | | $ 11,300 | $ 6,900 | $ 4,400 |

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The related amortization expense was $0.3 million and $0.7 million for the three months ended September 30, 2012 and 2011, respectively. The related amortization expense was $1.5 million and $2.0 million for the nine months ended September 30, 2012 and 2011, respectively. Amortization expense has been included in research and development expense in the condensed consolidated statements of operations and comprehensive loss. The estimated aggregate amortization expense to be recognized in future years is approximately $0.3 million for the remainder of 2012, $1.0 million for 2013, $1.0 million for 2014, $0.3 million for 2015 and $0.1 million annually for 2016 through 2018.

***Per Share Amounts***

Basic net loss per share is computed by dividing net loss for the period by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share gives effect to all potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of incremental shares of common stock issuable upon the exercise of stock options, vesting of stock awards and purchases under the employee stock purchase plan. As of September 30, 2012 and 2011, stock awards to purchase approximately 10,990,000 and 10,129,000 shares, respectively, were excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive.

**Note 2. Fair Value of Financial Instruments**

The estimated fair values of financial instruments outstanding were as follows (in thousands):

| | September 30, 2012 | | | |
|---|---|---|---|---|
| | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Cash and cash equivalents | $ 5,967 | $ | $ | $ 5,967 |
| Short-term investments: | | | | |
| U.S. government debt securities | $ 10,628 | $ 4 | $ | $ 10,632 |
| Corporate notes and commercial paper | 14,403 | 15 | (1) | 14,417 |
| Certificates of deposit | 5,156 | 3 | | 5,159 |
| Total short-term investments | $ 30,187 | $ 22 | $ (1) | $ 30,208 |
| Long-term investments: | | | | |
| U.S. government debt securities | $ 6,770 | $ 2 | $ | $ 6,772 |
| Corporate notes | 2,074 | 2 | | 2,076 |
| Certificates of deposit | 240 | 1 | | 241 |
| Total long-term investments | $ 9,084 | $ 5 | $ | $ 9,089 |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Cash and cash equivalents | $ 40,025 | $ | $ | $ 40,025 |
| Short-term investments: | | | | |
| U.S. government debt securities | $ 4,834 | $ 2 | $ | $ 4,836 |
| Corporate notes | 4,578 | 1 | (2) | 4,577 |
| Total short-term investments | $ 9,412 | $ 3 | $ (2) | $ 9,413 |
| Long-term investments: | | | | |
| U.S. government debt securities | $ 5,721 | $ 1 | $ (1) | $ 5,721 |

| | | | | |
|---|---|---|---|---|
| Corporate notes | 2,816 | 2 | (2) | 2,816 |
| Total long-term investments | $ 8,537 | $ 3 | $ (3) | $ 8,537 |

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As of September, 30, 2012 and December 31, 2011, all of the available-for-sale securities with unrealized losses had been in a loss position for less than 12 months. Total fair value of available-for-sale securities with unrealized losses was $7.6 million at September 30, 2012.

Cost and fair value of investments based on two maturity groups were as follows (in thousands):

| | September 30, 2012 | | | |
|---|---|---|---|---|
| | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Due within 1 year | $ 30,187 | $ 22 | $ (1) | $ 30,208 |
| Due in 1-2 years | 9,084 | 5 | | 9,089 |
| Total | $ 39,271 | $ 27 | $ (1) | $ 39,297 |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Due within 1 year | $ 9,412 | $ 3 | $ (2) | $ 9,413 |
| Due in 1-2 years | 8,537 | 3 | (3) | 8,537 |
| Total | $ 17,949 | $ 6 | $ (5) | $ 17,950 |

The following table represents the Company s fair value hierarchy for its financial assets (cash equivalents and investments) as of September 30, 2012 and December 31, 2011 (in thousands):

| | September 30, 2012 | | | |
|---|---|---|---|---|
| | Fair Value | Level 1 | Level 2 | Level 3 |
| Money market funds | $ 1,445 | $ 1,445 | $ | $ |
| Certificates of deposit | 5,400 | | 5,400 | |
| Corporate notes and commercial paper | 20,019 | | 20,019 | |
| U.S. government debt securities | 17,905 | | 17,905 | |
| Total assets | $ 44,769 | $ 1,445 | $ 43,324 | $ |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Fair Value | Level 1 | Level 2 | Level 3 |
| Money market funds | $ 2,792 | $ 2,792 | $ | $ |
| Corporate notes | 7,393 | | 7,393 | |
| U.S. government debt securities | 10,557 | | 10,557 | |
| Total assets | $ 20,742 | $ 2,792 | $ 17,950 | $ |

There were no transfers in or out of Level 1 and Level 2 securities during the three and nine months ended September 30, 2012 and 2011. There were no Level 3 financial assets as of September 30, 2012 or December 31, 2011.

**Note 3: Asset Purchase Agreement**

In March 2012, the Company entered into an asset purchase agreement for an exclusive license of a portion of its intellectual property pertaining to its high-speed serial I/O technology for approximately $4.3 million. As part of the agreement, the Company provided certain technology transfer support services, and 15 employees of the Company s India subsidiary accepted employment with the purchaser. The Company received approximately $2.2 million, net of transaction costs, in cash upon execution of the agreement. The agreement provides for an additional $1.9 million (the Holdback ) to be paid upon providing technology transfer support services and achievement of certain contractually agreed-upon development milestones. A portion of the Holdback is reserved for any costs related to indemnification claims that may arise during the 12 month period following the agreement date. In July 2012, $1.3 million of the Holdback payment was received.

The Company recognized a $1.4 million and $3.3 million gain on this asset sale, net of transaction costs, during the three and nine months ended September 30, 2012, respectively. The gain on asset sale has been recorded as a reduction of operating expenses in the condensed consolidated statements of operations and comprehensive loss. Gains related to the remaining Holdback will be recorded when the indemnity period lapses, which is expected to be within 12 months of the agreement date.

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**Note 4. Commitments and Contingencies**

***Indemnifications***

In the ordinary course of business, the Company enters into contractual arrangements under which it may agree to indemnify the counterparties from any losses incurred relating to breach of representations and warranties, failure to perform certain covenants, or claims and losses arising from certain events as outlined within the particular contract, which may include, for example, losses arising from litigation or claims relating to past performance. Such indemnification clauses may not be subject to maximum loss clauses. The Company has entered into indemnification agreements with its officers and directors. No material amounts were reflected in the Company s condensed consolidated financial statements for the three and nine months ended September 30, 2012 or 2011 related to these indemnifications.

The Company has not estimated the maximum potential amount of indemnification liability under these agreements due to the limited history of prior claims and the unique facts and circumstances applicable to each particular agreement. To date, the Company has not made any payments related to these indemnification agreements.

***Legal Matters***

The Company is not a party to any material legal proceeding that the Company believes is likely to have a material adverse effect on its consolidated financial position or results of operations. From time to time, the Company may be subject to legal proceedings and claims in the ordinary course of business. These claims, even if not meritorious, could result in the expenditure of significant financial resources and diversion of management efforts.

In September 2010, a claimant filed suit against the Company seeking a contractual payment of approximately 200,000 shares of the Company s common stock, among other claims. In November 2010, the suit went to arbitration, and, in December 2010, the Company filed a counter claim against the claimant. On April 3, 2012, the arbitrator ruled against the Company and awarded the claimant a cash award of approximately $1.4 million, which was paid in the second quarter of 2012 and has been recorded as a repurchase of common stock in the condensed consolidated statement of cash flows. The Company repurchased the disputed shares in the second quarter of 2012, and the shares were retired. In the first quarter of 2012, the value of the disputed shares, $0.8 million as of the arbitration settlement date, was recorded as a reduction to stockholders equity as a stock repurchase. The remaining amount of $0.6 million was recorded as a selling, general and administrative expense in the Company s condensed consolidated statements of operations and comprehensive loss.

**Note 5. Business Segments and Significant Customers**

The Company operates in one business segment and uses one measurement of profitability for its business. Revenue attributed to the United States and to all foreign countries is based on the geographical location of the customer.

The Company recognized revenue from customers in North America, Asia and Europe as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| United States | $ 600 | $ 638 | $ 2,217 | $ 3,072 |
| Taiwan | 473 | 785 | 1,244 | 2,422 |
| Japan | 247 | 511 | 940 | 2,721 |
| Europe | 7 | 173 | 86 | 715 |
| Other Asia | | | | 8 |
| Total | $ 1,327 | $ 2,107 | $ 4,487 | $ 8,938 |

Customers who accounted for at least 10% of total revenues were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Customer A | 36% | 37% | 27% | 27% |
| Customer B | 34% | 17% | 32% | 14% |
| Customer C | * | * | * | 14% |
| Customer D | * | 13% | * | * |

*Represents percentages less than 10%.

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One customer accounted for 100% of net accounts receivable at September 30, 2012. Four customers accounted for 96% of net accounts receivable at December 31, 2011.

**Note 6. Income Tax Provision**

The Company determines deferred tax assets and liabilities based upon the differences between the financial statement and tax bases of the Company s assets and liabilities using tax rates in effect for the year in which the Company expects the differences to affect taxable income. A valuation allowance is established for any deferred tax assets for which it is more likely than not that all or a portion of the deferred tax assets will not be realized.

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. The Company is currently under tax examination in India. The 2003 through 2011 tax years generally remain subject to examination by federal, state and foreign tax authorities. As of September 30, 2012, the Company has not recorded any liability for unrecognized tax benefits related to uncertain tax positions.

**Note 7. Stock-Based Compensation**

The Company recorded $0.9 million of stock-based compensation expense for both the three months ended September 30, 2012 and 2011. The Company recorded $3.0 million and $2.5 million of stock-based compensation expense for the nine months ended September 30, 2012 and 2011, respectively. The expense relating to stock-based awards is recognized on a straight-line basis over the requisite service period, usually the vesting period, based on the grant-date fair value. The unamortized compensation cost, net of expected forfeitures, as of September 30, 2012 was $5.7 million and is expected to be recognized as expense over a weighted average period of approximately 2.74 years.

The Company presents the tax benefits resulting from tax deductions in excess of the compensation cost recognized from the exercise of stock options as financing cash flows in the condensed consolidated statements of cash flows. For the three and nine months ended September 30, 2012 and 2011, there were no such tax benefits associated with the exercise of stock options due to the Company s loss position.

***Common Stock Options and Restricted Stock***

A summary of the option and restricted stock unit activity under the Company s Amended and Restated 2000 Stock Option and Equity Incentive Plan and 2010 Equity Incentive Plan (2010 Plan), referred to collectively as the Plans, is presented below (in thousands, except exercise price):

| | | Options Outstanding | |
|---|---|---|---|
| | Available for Grant | Number of Shares | Weighted Average |

| | | | | Exercise Prices |
|---|---|---|---|---|
| Balance at December 31, 2011 | 1,977 | 6,528 | $ | 4.48 |
| Additional shares authorized under the 2010 Plan | 500 | | | |
| Options granted | (4) | 4 | $ | 3.93 |
| Options cancelled | 111 | (111) | $ | 4.23 |
| Options exercised | | (34) | $ | 2.85 |
| Options expired | (55) | | | |
| Balance at March 31, 2012 | 2,529 | 6,387 | $ | 4.50 |
| Options granted | (430) | 430 | $ | 3.23 |
| Options cancelled | 361 | (361) | $ | 6.70 |
| Options exercised | | (20) | $ | 1.98 |
| Options expired | (235) | | | |
| Balance at June 30, 2012 | 2,225 | 6,436 | $ | 4.30 |
| Options granted | (1,338) | 1,338 | $ | 3.23 |
| Options cancelled | 356 | (356) | $ | 5.77 |
| Options exercised | | (78) | $ | 2.29 |
| Options expired | (209) | | | |
| Balance at September 30, 2012 | 1,034 | 7,340 | $ | 4.04 |

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The Company also has awarded options to new employees outside of the Plans and may continue to do so outside of the 2010 Plan, as material inducements to the acceptance of employment with the Company, as permitted under the Listing Rules of the Nasdaq Stock Market. These grants must be approved by the compensation committee of the board of directors, a majority of the independent directors or, below a specified share level, by an authorized executive officer.

A summary of the inducement grant option activity is presented below (in thousands, except exercise price):

| | Options Outstanding | |
|---|---|---|
| | Number of Shares | Weighted Average Exercise Prices |
| Balance at December 31, 2011 | 4,815 | $ 3.29 |
| Granted | 350 | $ 3.92 |
| Cancelled | (103) | $ 1.54 |
| Exercised | (111) | $ 1.54 |
| Balance at March 31, 2012 | 4,951 | $ 3.41 |
| Cancelled | (199) | $ 1.55 |
| Exercised | (438) | $ 1.55 |
| Balance at June 30, 2012 | 4,314 | $ 3.69 |
| Cancelled | (248) | $ 1.55 |
| Exercised | (597) | $ 1.55 |
| Balance at September 30, 2012 | 3,469 | 4.21 |

The following table summarizes significant ranges of outstanding and exercisable options, excluding restricted stock awards and restricted stock unit activity, as of September 30, 2012 (in thousands, except contractual life and exercise price):

| | Options Outstanding | | | | Options Exercisable | | | |
|---|---|---|---|---|---|---|---|---|
| Range of Exercise Price | Number Outstanding | Weighted Average Remaining Contractual Life (in Years) | Weighted Average Exercise Price | Aggregate Intrinsic value | Number Exercisable | Weighted Average Remaining Contractual Life (in Years) | Weighted Average Exercise Price | Aggregate Intrinsic value |
| $1.50 - $3.09 | 2,995 | 3.79 | $ 2.30 | $ 5,224 | 1,408 | 2.72 | $ 1.85 | $ 3,087 |
| $3.10 - $3.92 | 3,048 | 4.73 | $ 3.62 | 1,291 | 1,042 | 3.96 | $ 3.71 | 339 |
| $3.93 - $5.61 | 3,216 | 3.48 | $ 4.96 | | 2,756 | 3.43 | $ 5.03 | |
| $5.62 - $15.00 | 1,550 | 2.93 | $ 6.70 | | 1,043 | 2.17 | $ 7.03 | |
| | 10,809 | 3.84 | $ 4.09 | $ 6,515 | 6,249 | 3.15 | $ 4.43 | $ 3,426 |

As of September 30, 2012, the Company had 9.9 million shares subject to outstanding options fully vested and expected to vest, after estimated forfeitures, with a remaining contractual life of 3.72 years, weighted average exercise price of $4.13 and aggregate intrinsic value of $6.0 million.

The total fair value of shares subject to outstanding options vested calculated using the Black-Scholes valuation method was $1.7 million and $1.2 million for the nine months ended September 30, 2012 and 2011, respectively. The total intrinsic value of employee stock options exercised during the nine months ended September 30, 2012 and 2011 was $2.3 million and $2.2 million, respectively.

Options to purchase 6.2 million and 5.8 million shares with weighted average exercised prices of $4.43 and $4.36 per share were exercisable at September 30, 2012 and 2011, respectively.

***Valuation Assumptions and Expense Information***

The fair value of the Company s share-based payment awards for the three and nine months ended September 30, 2012 and 2011 was estimated on the grant date using a Black-Scholes valuation method and an option-pricing model with the following assumptions:

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2011 | | 2012 | | 2011 | |
| **Employee stock options:** | | | | | | | | |
| Risk-free interest rate | 0.2% | 0.6% | 0.2% | 0.7% | 0.2% | 0.8% | 0.2% | 1.7% |
| Volatility | 65.2% | 73.1% | 40.7% | 61.3% | 65.2% | 73.1% | 40.7% | 63.8% |
| Expected life (years) | 4.0 | | 4.0 | | 4.0 | | 4.0 | |
| Dividend yield | 0% | | 0% | | 0% | | 0% | |

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The risk-free interest rate was derived from the Daily Treasury Yield Curve Rates as published by the U.S. Department of the Treasury as of the grant date for terms equal to the expected terms of the options. The expected volatility was based on the combination of: 1) four-year historical volatility and 2) implied volatility of the Company s stock price. The expected term of options granted was derived from historical data based on employee exercises and post-vesting employment termination behavior. A dividend yield of zero is applied because the Company has never paid dividends and has no intention to pay dividends in the near future.

The stock-based compensation expense recorded is adjusted based on estimated forfeiture rates. An annualized forfeiture rate has been used as a best estimate of future forfeitures based on the Company s historical forfeiture experience. The stock-based compensation expense will be adjusted in later periods if the actual forfeiture rate is different from the estimate.

***Employee Stock Purchase Plan***

In June 2010, the Company s stockholders approved the 2010 Employee Stock Purchase Plan (ESPP). A total of 2,000,000 shares of common stock has been reserved for issuance under the ESPP. The ESPP, which is intended to qualify under Section 423 of the Internal Revenue Code, is administered by the board of directors or the compensation committee of the board of directors. The ESPP provides that eligible employees may purchase up to $25,000 worth of the Company s common stock annually over the course of two six-month offering periods. The purchase price to be paid by participants is 85% of the price per share of the Company s common stock either at the beginning or the end of each six-month offering period, whichever is less. On February 29, 2012, approximately 178,000 shares of common stock were issued at an aggregate purchase price of $579,000 under the ESPP. On August 30, 2012, approximately 173,000 shares of common stock were issued at an aggregate purchase price of $501,000 under the ESPP. As of September 30, 2012, there were approximately 1,335,000 shares authorized and unissued under the ESPP.

**Note 8. Related Party Transaction**

In February 2012, the Company entered into a strategic development and marketing agreement with Credo Semiconductor (Hong Kong) Ltd. (Credo), a privately-funded fabless semiconductor company, to develop, market and sell integrated circuits. Two of the Company s executive officers are investors in Credo. The agreement calls for the Company to pay approximately $1.4 million to Credo upon Credo achieving certain development and verification milestones towards the development of IC products and provides the Company with exclusive sales and marketing rights for such IC products. In the first nine months of 2012, Credo achieved a number of the milestones set forth in the agreement and, in the third quarter of 2012, delivered the IC designs to its foundry for tape-out. As a result of the milestone achievements, the Company paid Credo $1.0 million, which the Company recorded as research and development expense. As of September 30, 2012, $0.1 million is included as a current liability. The first $1.2 million of gross profits generated by the sale of these integrated circuits will be retained by the Company. Thereafter, the gross profits will be shared equally by the two companies.

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

*This Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying condensed consolidated financial statements and notes included in this report. This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which*

*include, without limitation, statements about the market for our technology, our strategy, competition, expected financial performance, all information disclosed under Item 3 of this Part I, and other aspects of our business identified in our most recent annual report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2012 and in other reports that we file from time to time with the Securities and Exchange Commission. Any statements about our business, financial results, financial condition and operations contained in this Form 10-Q that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, expects, intends, plans, projects, or similar expressions are intended to identify forward-looking statements. Our actual results could differ materially from those expressed or implied by these forward-looking statements as a result of various factors, including the risk factors described below in Risk Factors and elsewhere in this report and under Item 1A of our annual report on Form 10-K for the year ended December 31, 2011. We undertake no obligation to update publicly any forward-looking statements for any reason, except as required by law, even as new information becomes available or events occur in the future.*

***Overview***

Our strategy and primary business objective is to become a fabless semiconductor company focused on the development and sale of integrated circuits (ICs) to networking equipment systems providers and their subsystem and component vendors. Our Bandwidth Engine family of ICs combines our 1T-SRAM high-density embedded memory and high-speed 10 Gigabits per second (Gbps) serial

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interface (I/O) technology with our intelligent access technology and a highly efficient interface protocol and is initially being marketed to networking systems companies. Bandwidth Engine ICs have been designed to increase system performance by using a serial I/O to increase the accesses per second between the processor and memory components in networking systems.

Since the beginning of 2010, we have invested an increasing amount of our financial and engineering resources towards the development of our Bandwidth Engine family of ICs. We shipped initial samples of our first Bandwidth Engine ICs to prospective customers in December 2010, and, in May 2012, we announced our first design wins with original equipment manufacturers. Our future success and ability to achieve and maintain profitability depend on our success in developing a market for our Bandwidth Engine ICs.

Historically, our primary business has been defining, designing, marketing and licensing differentiated embedded memory and high-speed parallel and serial interface intellectual property (IP) for advanced systems-on-chip (SoC) designs. However, our competitiveness and the demand for licenses to our IP have declined since the beginning of 2011 when we began dedicating more of our engineering and marketing resources to our IC efforts. This trend is continuing, as we place all of our ongoing business emphasis on IC product sales rather than on IP transactions.

As a result of our reduced licensing activities, we expect our licensing and royalty revenue to continue to decrease in future periods. We do not expect to generate significant revenue from our Bandwidth Engine ICs until 2013, at the earliest, and do not believe that the growth in our IC revenues will offset the decline in our IP revenues and gross margin from historical levels until sometime thereafter. Accordingly, we expect our losses from operations to increase in the near future.

***Sources of Revenue***

*Licensing.* Licensing revenue consists of fees earned from license agreements, development services, prepaid pre-production royalties, and support and maintenance. Our licensing revenue consists primarily of fees for providing circuit design, layout and design verification and granting licenses to customers that embed our technology into their products. License fees generally range from $100,000 to several million dollars per contract, depending on the scope and complexity of the development project, and the extent of the licensee s rights. The vast majority of our contracts allow for milestone billing based on work performed. Fees billed prior to revenue recognition are recorded as deferred revenue.

*Royalty.* Royalty revenue represents amounts earned under provisions in our memory licensing contracts that require our licensees to report royalties and make payments at a stated rate based on actual units manufactured or sold by licensees for products that include our memory IP. Our license agreements require the licensee to report the manufacture or sale of products that include our technology after the end of the quarter in which the sale or manufacture occurs, and we recognize royalties in the quarter in which we receive the licensee s report.

The timing and level of royalties are difficult to predict. They depend on the licensee s ability to market, produce and sell products incorporating our technology. Many of the products of our licensees that are currently subject to licenses from us are used in consumer products, such as electronic game consoles, for which demand can be seasonal.

*IC product.* IC product revenue, which is included in licensing and other revenue, is generally recognized at the time of shipment to our customers. An estimated allowance is recorded, at the time of shipment, for future returns and other charges against revenue consistent with the terms of sale. IC product revenue and costs relating to sales made through distributors with rights of return and stock rotation are deferred until the distributors sell the product to end customers due to our inability to estimate future returns and credits to be issued. At the time of shipment to distributors, an accounts receivable for the selling price is recorded, as there is a legally enforceable right to receive payment, inventory is relieved, as legal title to the inventory is transferred upon shipment, and the associated deferred margin is recorded as deferred revenues in the condensed consolidated balance sheets. Revenues are recognized upon receiving notification from the distributors that products have been sold to end customers.

***Critical Accounting Policies and Estimates***

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis we make these estimates based on our historical experience and on assumptions that we consider reasonable under the circumstances. Actual results may differ from these estimates, and reported results could differ under different assumptions or conditions. Our significant accounting policies and estimates are disclosed in Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2011. As of September 30, 2012, there have been no material changes to our significant accounting policies and estimates.

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***Results of Operations***

*Net Revenue*.

| | September 30, 2012 | 2011 | Change 2011 to 2012 | |
|---|---|---|---|---|
| | (dollar amounts in thousands) | | | |
| Licensing and other three months ended | $ 248 | $ 756 | $ (508) | (67)% |
| Percentage of total net revenue | 19% | 36% | | |
| Licensing and other nine months ended | $ 1,113 | $ 3,319 | $ (2,206) | (66)% |
| Percentage of total net revenue | 25% | 37% | | |

Licensing and other revenue decreased for the three and nine months ended September 30, 2012, compared with the same periods of 2011, primarily due to the decline in the number and value of new license agreements. In the first nine months of 2012, all licensing revenue was generated from agreements entered into in 2011 and prior years.

| | September 30, 2012 | 2011 | Change 2011 to 2012 | |
|---|---|---|---|---|
| | (dollar amounts in thousands) | | | |
| Royalty three months ended | $ 1,079 | $ 1,351 | $ (272) | (20)% |
| Percentage of total net revenue | 81% | 64% | | |
| Royalty nine months ended | $ 3,374 | $ 5,619 | $ (2,245) | (40)% |
| Percentage of total net revenue | 75% | 63% | | |

Royalty revenue decreased for the three months ended September 30, 2012, compared with the same period of 2011, primarily due to a decrease in royalties received from a major foundry partner. Royalty revenue decreased for the nine months ended September 30, 2012, compared with the same period of 2011, primarily due to a decrease in royalties received from an IDM licensee whose product is used in the Nintendo Wii® game console and from a major foundry partner. These decreases were partially offset by royalties received from a fabless semiconductor company selling into networking applications.

*Cost of Net Revenue and Gross Profit.*

| | September 30, 2012 | 2011 | Change 2011 to 2012 | |
|---|---|---|---|---|
| | (dollar amounts in thousands) | | | |
| Cost of net revenue three months ended | $ 53 | $ 356 | $ (303) | (85)% |
| Percentage of total net revenue | 4% | 17% | | |
| Cost of net revenue nine months ended | $ 289 | $ 1,515 | $ (1,226) | (81)% |
| Percentage of total net revenue | 6% | 17% | | |

| | | September 30, 2012 | 2011 | Change 2011 to 2012 | |
|---|---|---|---|---|---|
| | | (dollar amounts in thousands) | | | |
| Gross profit | three months ended | $ 1,274 | $ 1,751 | $ (477) | (27)% |
| Percentage of total net revenue | | 96% | 83% | | |
| Gross profit | nine months ended | $ 4,198 | $ 7,423 | $ (3,225) | (43)% |
| Percentage of total net revenue | | 94% | 83% | | |

Cost of net revenue consists of personnel and related overhead allocation costs for engineers assigned to revenue-generating licensing arrangements and direct and indirect costs related to the sale of IC products.

Cost of net revenue decreased for the three and nine months ended September 30, 2012, compared with the same periods of 2011, primarily due to the lack of new licensing agreements and reduced requirements for engineering services on existing contracts. Cost of net revenue included stock-based compensation expense of $3,000 and $30,000 for the three months ended September 30, 2012 and 2011, respectively, and $49,000 and $137,000 for the nine months ended September 30, 2012 and 2011, respectively.

Gross profit decreased for the three and nine months ended September 30, 2012, compared with the same periods of 2011, primarily due to the decrease in our revenue. Gross margin percentage increased for the three and nine months ended September 30, 2012, compared with the same period of 2011, primarily due to the increase in royalty revenue, which has no related costs, as a percentage of total net revenue, along with fewer number of license agreements requiring customization.

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*Research and Development.*

| | September 30, 2012 | 2011 | Change 2011 to 2012 | |
|---|---|---|---|---|
| | (dollar amounts in thousands) | | | |
| Research and development three months ended | $ 7,026 | $ 6,648 | $ 378 | 6% |
| Percentage of total net revenue | 529% | 316% | | |
| Research and development nine months ended | $ 21,220 | $ 19,369 | $ 1,851 | 10% |
| Percentage of total net revenue | 473% | 217% | | |

Our research and development expenses include costs related to the development of our IC products and amortization of technology-based intangible assets. We expense research and development costs as they are incurred.

The $0.4 million increase for the three months ended September 30, 2012, compared with the same period a year ago, was primarily due to an increase in costs related to the development of our IC products.

Research and development expenses included stock-based compensation expense of $0.6 million for both the three months ended September 30, 2012 and 2011.

The $1.9 million increase for the nine months ended September 30, 2012, compared with the same period a year ago, was primarily related to an increase in stock-based compensation expense, more engineering time allocated to research and development instead of revenue-producing IP projects and increases in costs related to the development of new IC products, offset by decreases in personnel costs resulting from lower headcount and lower amortization of intangible assets.

Research and development expenses included stock-based compensation expense of $2.1 million and $1.4 million for the nine months ended September 30, 2012 and 2011, respectively.

*Selling, General and Administrative (SG&A).*

| | September 30, 2012 | 2011 | Change 2011 to 2012 | |
|---|---|---|---|---|
| | (dollar amounts in thousands) | | | |
| SG&A three months ended | $ 1,738 | $ 1,952 | $ (214) | (11)% |
| Percentage of total net revenue | 131% | 93% | | |
| SG&A nine months ended | $ 6,092 | $ 6,583 | $ (491) | (7)% |
| Percentage of total net revenue | 136% | 74% | | |

SG&A expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, human resources and general management.

The $0.2 million decrease for the three months ended September 30, 2012, compared with the same period a year ago, was primarily due to lower personnel costs.

The $0.5 million decrease for the nine months ended September 30, 2012, compared with the same period a year ago, was primarily due to lower personnel, legal, commissions and stock-based compensation expense.

Selling, general and administrative expenses included stock-based compensation expense of $0.3 million for both the three months ended September 30, 2012 and 2011. Selling, general and administrative expenses included stock-based compensation expense of $0.8 million and $1.0 million for the nine months ended September 30, 2012 and 2011, respectively.

We expect total selling, general and administrative expenses to increase in absolute dollars in the fourth quarter of 2012 compared with the third quarter as year-end compliance costs are incurred.

*Other Income and Expense, net.*

| | | September 30, | | Change | |
|---|---|---|---|---|---|
| | | 2012 | 2011 | 2011 to 2012 | |
| | | (dollar amounts in thousands) | | | |
| Other income and expense, net | three months ended | $ 61 | $ 10 | $ 51 | 510% |
| Percentage of total net revenue | | 5% | | | |
| Other income and expense, net | nine months ended | $ 121 | $ 44 | $ 77 | 175% |
| Percentage of total net revenue | | 3% | | | |

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Other income and expense, net primarily consisted of interest income on our investments, which was $0.1 million for each of the nine months ended September 30, 2012 and 2011. Interest income was partially offset by expenses, including foreign exchange transaction losses and other non-operating expenses, for the nine months ended September 30, 2012 and 2011.

*Income Tax Provision.*

| | | September 30, 2012 | 2011 | Change 2011 to 2012 | |
|---|---|---|---|---|---|
| | | (dollar amounts in thousands) | | | |
| Income tax provision | three months ended | $ 79 | $ 24 | $ 55 | 229% |
| Percentage of total net revenue | | 6% | 1% | | |
| Income tax provision | nine months ended | $ 139 | $ 59 | $ 80 | 136% |
| Percentage of total net revenue | | 3% | 1% | | |

The provision for the three and nine months ended September 30, 2012 and 2011 was attributable primarily to taxes on earnings of our foreign subsidiaries and branches. We believe that, based on the history of our operating losses and other factors, the weight of available evidence indicates that it is more likely than not that we will not be able to realize the benefit of our net operating losses. Accordingly, a full valuation reserve has been recorded against our net deferred tax assets.

***Liquidity and Capital Resources; Changes in Financial Condition***

*Cash Flows*

As of September 30, 2012, we had cash, cash equivalents and long and short-term investments of $45.3 million and had total working capital of $34.8 million. Our principal source of cash and investments was the sale of patents for $35 million in December 2011. Our primary capital requirements are to fund working capital, including development of Bandwidth Engine ICs, and any acquisitions that we make that require cash considerations or expenditures.

Net cash used in operating activities was $17.5 million for the first nine months of 2012, which primarily resulted from the net loss of $19.8 million, increased by the $3.3 million gain on the sale of assets and adjusted for non-cash charges consisting of stock-based compensation of $3.0 million and depreciation and amortization of $2.2 million. The changes in assets and liabilities primarily related to the timing of billing our customers, collection of receivables and payments to vendors.

Net cash used in operating activities of $12.9 million for the first nine months of 2011 was primarily attributable to our net loss of $18.5 million, partially offset by $0.3 million in changes in assets and liabilities, non-cash charges, including stock-based compensation expense of $2.5 million, depreciation and amortization expense of $2.8 million and a provision for doubtful accounts of $0.1 million. The changes in assets and liabilities primarily related to the timing of billing our customers, collection of receivables and payments to vendors.

Net cash used in investing activities of $18.1 million for the first nine months of 2012 included net amounts transferred from cash to marketable securities of $21.3 million that did not impact our liquidity and $3.4 million in net proceeds from the sale of SerDes technology in March 2012.

Net cash used in investing activities of $1.3 million for the first nine months of 2011 included net amounts transferred from cash to marketable securities of $2.6 million that did not impact our liquidity, a $1.0 million earn-out payment related to the MagnaLynx acquisition and $0.3 million for purchases of fixed assets.

Our financing activities for the first nine months of 2012 primarily consisted of proceeds from the exercise of stock options and our employee stock purchase plan, offset by a payment made to repurchase shares of common stock to comply with an arbitration judgment. Our cash from financing activities for the first nine months of 2011 of $3.1 million consisted primarily of the proceeds received from issuance of common stock related to the exercise of stock options and our employee stock purchase plan.

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Our future liquidity and capital requirements are expected to vary from quarter to quarter, depending on numerous factors, including:

- level and timing of licensing, royalty and IC product revenue;
- cost, timing and success of technology development efforts, including meeting customer design specifications;
- fabrication costs, including mask costs of our Bandwidth Engine ICs, currently under development;
- variations in yields, materials costs and other manufacturing risks;
- costs of acquiring other businesses and integrating the acquired operations; and
- profitability of our business.

We expect our cash expenditures to continue to exceed receipts for the remainder of 2012 and into 2013, as the revenue generated from IC sales will not be sufficient to offset the expected reduction in licensing and royalty revenues compared with 2011, and we continue our research and development efforts for the expansion and fabrication of our IC product line. We believe our existing cash, cash equivalents and investments, along with our existing capital and cash generated from operations, if any, to be sufficient to meet our operating cash requirements through the remainder of 2012 and for the foreseeable future. Should our cash resources prove inadequate, we may seek additional funding through public or private equity or debt financing, and have a shelf registration allowing us to sell up to approximately $30 million of our securities from time to time until November 2013. We also might decide to raise additional capital at such times and upon such terms as management considers favorable and in our interests, including, but not limited to, from the sale of our debt and/or equity securities under our existing shelf registration statement. There can be no assurance that such additional funding will be available to us on favorable terms, if at all. The failure to raise capital when needed could have a material adverse effect on our business and financial condition.

***Contractual Obligations***

The impact that our contractual obligations as of September 30, 2012 are expected to have on our liquidity and cash flow in future periods is as follows (in thousands):

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Operating Leases | $ 5,938 | $ 849 | $ 1,567 | $ 1,397 | $ 2,125 |
| Purchase Commitments | 693 | 693 | | | |
| Capital Lease | 16 | 16 | | | |
| | $ 6,647 | $ 1,558 | $ 1,567 | $ 1,397 | $ 2,125 |

As of September 30, 2012, we had purchase commitments, primarily related to computer-aided design tools, payable through March 2013 and a capital lease for testing equipment.

**ITEM 3. Qualitative and Quantitative Disclosures about Market Risk**

Our investment portfolio consists of money market accounts, certificates of deposit, corporate debt, commercial paper, government agency and municipal debt securities. The portfolio dollar-weighted average maturity of these investments is within 12 months. Our primary objective with this investment portfolio is to invest available cash while preserving principal and meeting liquidity needs. No single security should exceed 5% of the portfolio at the time of purchase. In accordance with our investment policy, we place investments with high credit quality issuers and limit the amount of credit exposure to any one issuer. These securities, which approximated $44.8 million as of September 30, 2012 and earned an average annual interest rate of approximately 0.3% during the first nine months of 2012, are subject to interest rate and credit risks. We do not have any investments denominated in foreign currencies, and, therefore, are not subject to foreign currency risk on such investments.

**ITEM 4. Controls and Procedures**

*Disclosure Controls and Procedures.* Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation 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) under the Securities Exchange Act of 1934. Based on this evaluation, our management concluded that as of September 30, 2012, our disclosure controls and procedures were effective.

*Changes in Internal Control over Financial Reporting.* During the third quarter of 2012, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

The discussion of legal matters in Note 4 of the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this report under the heading Legal Matters is incorporated by reference in response to this Part II, Item 1.

**ITEM 1A. Risk Factors**

We face many significant risks in our business, some of which are unknown to us and not presently foreseen. These risks could have a material adverse impact on our business, financial condition and results of operations in the future. We have disclosed a number of material risks under Item 1A of our annual report on Form 10-K for the year ended December 31, 2011, which we filed with the Securities and Exchange Commission on March 15, 2012.

**ITEM 6. Exhibits**

(a) Exhibits

| | |
|---|---|
| 31.1 | Rule 13a-14 certification |
| 31.2 | Rule 13a-14 certification |
| 32.1 | Section 1350 certification |
| 101 | The following financial information from MoSys, Inc. s Quarterly Report on Form 10-Q for the period ended September 30, 2012, filed with the SEC on November 7, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations and Comprehensive Loss for the three and nine months ended September 30, 2012 and 2011, (ii) the Condensed Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (iii) the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011, and (iv) Notes to Condensed Consolidated Financial Statements. |

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**Signatures**

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

Dated: November 7, 2012

MOSYS, INC.

By: /s/ Leonard Perham
Leonard Perham
President and Chief Executive Officer

By: /s/ James W. Sullivan
James W. Sullivan
Vice President of Finance and Chief Financial Officer
(Principal Financial Officer)

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**EXHIBIT INDEX**

| | |
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