DOT HILL SYSTEMS CORP
Form 10-Q
August 11, 2008

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2008

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 1-13317

DOT HILL SYSTEMS CORP.
(Exact name of registrant as specified in its charter)

Delaware	**13-3460176**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2200 Faraday Avenue, Suite 100, Carlsbad, CA	**92008**
(Address of principal executive offices)	(Zip Code)

(760) 931-5500
(Registrant s telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	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 þ

The registrant had 46,058,904 shares of common stock, $0.001 par value, outstanding as of August 2, 2008.

DOT HILL SYSTEMS CORP.
FORM 10-Q
For the Quarter Ended June 30, 2008
INDEX

Part I. Financial Information	3
Item 1. Financial Statements	3
Unaudited Condensed Consolidated Balance Sheets at December 31, 2007 and June 30, 2008	3
Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss for the Three and Six Months Ended June 30, 2007 and 2008	4
Unaudited Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2007 and 2008	5
Notes to Unaudited Condensed Consolidated Financial Statements	6
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures About Market Risk	33
Item 4. Controls and Procedures	33
Part II. Other Information	34
Item 1. Legal Proceedings	34
Item 1A. Risk Factors	35
Item 4. Submission of Matters to a Vote of Security Holders	50
Item 6. Exhibits	51
Signatures	52
EXHIBIT 31.1	
EXHIBIT 31.2	
EXHIBIT 32.1	

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

DOT HILL SYSTEMS CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands)

	December 31, 2007	June 30, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 82,358	$ 62,082
Accounts receivable, net of allowance of $302 and $228	32,445	46,458
Inventories	9,013	13,584
Prepaid expenses and other	3,968	4,534
Total current assets	127,784	126,658
Property and equipment, net	9,599	8,231
Intangible assets, net	2,280	1,467
Other assets	264	225
Total assets	$ 139,927	$ 136,581
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 28,472	$ 36,004
Accrued compensation	3,115	3,237
Accrued expenses	6,227	4,684
Deferred revenue	1,409	1,196
Income taxes payable	143	488
Total current liabilities	39,366	45,609
Other long-term liabilities	4,132	3,616
Total liabilities	43,498	49,225
Commitments and Contingencies (Note 11)		
Stockholders Equity:		
Preferred stock, $0.001 par value, 10,000 shares authorized, no shares issued or outstanding		
Common stock, $0.001 par value, 100,000 shares authorized, 45,781 and 46,055 shares issued and outstanding at December 31, 2007 and June 30, 2008, respectively	46	46
Additional paid-in capital	294,193	298,701
Accumulated other comprehensive loss	(3,100)	(3,202)
Accumulated deficit	(194,710)	(208,189)
Total stockholders equity	96,429	87,356

Total liabilities and stockholders equity	$ 139,927	$ 136,581

See accompanying notes to unaudited condensed consolidated financial statements.

3

Table of Contents

DOT HILL SYSTEMS CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(In Thousands, Except Per Share Amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2008**	**2007**	**2008**
NET REVENUE	$ 56,199	$ 71,027	$ 109,640	$ 123,853
COST OF GOODS SOLD	49,275	63,805	96,042	112,465
GROSS PROFIT	6,924	7,222	13,598	11,388
OPERATING EXPENSES:				
Sales and marketing	3,871	3,647	7,779	7,919
Research and development	4,797	7,125	10,871	14,549
General and administrative	3,322	3,939	6,992	6,982
Legal settlement				(3,836)
Total operating expenses	11,990	14,711	25,642	25,614
OPERATING LOSS	(5,066)	(7,489)	(12,044)	(14,226)
OTHER INCOME:				
Interest income	1,231	358	2,539	1,066
Other income, net				79
Total other income, net	1,231	358	2,539	1,145
LOSS BEFORE INCOME TAXES	(3,835)	(7,131)	(9,505)	(13,081)
INCOME TAX (BENEFIT) EXPENSE	(93)	239	199	398
NET LOSS	$ (3,742)	$ (7,370)	$ (9,704)	$ (13,479)
NET LOSS PER SHARE:				
Basic and diluted	$ (0.08)	$ (0.16)	$ (0.21)	$ (0.29)
WEIGHTED AVERAGE SHARES USED TO CALCULATE NET LOSS PER SHARE:				
Basic and diluted	45,472	46,055	45,315	46,005
COMPREHENSIVE LOSS:				
Net loss	$ (3,742)	$ (7,370)	$ (9,704)	$ (13,479)
Foreign currency translation adjustments	163	130	(441)	(101)
Comprehensive loss	$ (3,579)	$ (7,240)	$ (10,145)	$ (13,580)

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

DOT HILL SYSTEMS CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2008
Cash Flows From Operating Activities:		
Net loss	$ (9,704)	$ (13,479)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,422	2,991
Loss on disposal of property and equipment	166	57
Reduction in bad debt reserve	(41)	(120)
Issuance of warrant to customer		2,282
Share-based compensation expense	977	1,563
Changes in operating assets and liabilities:		
Accounts receivable	2,169	(13,851)
Inventories	(826)	(4,547)
Prepaid expenses and other assets	725	(530)
Accounts payable	(3,824)	7,370
Accrued compensation and expenses	(3,005)	(1,448)
Deferred revenue	8	(228)
Income taxes payable	15	345
Other long-term liabilities	(65)	(516)
Net cash used in operating activities	(9,983)	(20,111)
Cash Flows From Investing Activities:		
Purchases of property and equipment	(1,914)	(865)
Net cash used in investing activities	(1,914)	(865)
Cash Flows From Financing Activities:		
Proceeds from sale of stock to employees	508	465
Proceeds from exercise of stock options and warrants	134	198
Net cash provided by financing activities	642	663
Effect of Exchange Rate Changes on Cash	(11)	37
Net Decrease in Cash and Cash Equivalents	(11,266)	(20,276)
Cash and Cash Equivalents, beginning of period	99,663	82,358
Cash and Cash Equivalents, end of period	$ 88,397	$ 62,082
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	$	$
Cash paid for income taxes	$ 172	$ 56

Supplemental Disclosure of Non-Cash Investing and Financing Activities:		
Construction in progress costs incurred but not paid	$ 350	$ 275

See accompanying notes to unaudited condensed consolidated financial statements.

5

DOT HILL SYSTEMS CORP. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The Company

Dot Hill Systems Corp (referred to herein as Dot Hill, we, our or us) is a provider of entry level and midrange storage systems for organizations requiring high reliability, high performance networked storage and data management solutions in an open systems architecture. Our storage solutions consist of integrated hardware, firmware and software products employing a modular system that allows end-users to add capacity as needed. Our broad range of products, from medium capacity stand-alone storage units to complete very high capacity storage area networks, provide end-users with a cost-effective means of addressing increasing storage demands without sacrificing performance. Our new product family based on our R/Evolution(TM) architecture provides high performance and large capacities for a broad variety of environments, employing Fibre Channel, Internet Small Computer Systems Interface, (or iSCSI), or Serial Attached SCSI, (or SAS), interconnects to switches and/or hosts. Our SANnet products have been distinguished by certification as Network Equipment Building System, or NEBs, Level 3 (a telecommunications standard for equipment used in central offices) and are MIL-STD-810F (a military standard created by the U.S. government) compliant based on their ruggedness and reliability.

Basis of Presentation

The interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Securities and Exchange Commission, or SEC, Form 10Q and Article 10 of SEC Regulation S-X. They do not include all of the information and footnotes required by generally accepted accounting principles, or GAAP, for complete financial statements. In the opinion of management, all adjustments and reclassifications considered necessary for a fair and comparable presentation have been included and are of a normal recurring nature. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007. Operating results for the three and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for future quarters or the year ending December 31, 2008.

Use of Estimates

The preparation of our financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of net revenue and expenses in the reporting periods. We regularly evaluate estimates and assumptions related to allowances for doubtful accounts, sales returns and allowances, warranty reserves, inventory reserves, share-based compensation expense, deferred income tax asset valuation allowances, uncertain tax positions, tax contingencies, litigation and other contingencies. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by us may differ materially and adversely from our estimates. To the extent there are material differences between the estimates and the actual results, future results of operations will be affected.

Revenue Recognition

In accordance with SEC Staff Accounting Bulletin, or SAB, No. 101, *Revenue Recognition in Financial Statements*, and SAB No. 104, *Revenue Recognition,* we recognize product revenue when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the price to our customer is fixed or determinable and (iv) collection of the resulting accounts receivable is reasonably assured. Revenue is recognized for product sales upon transfer of title to the customer. We record reductions to revenue for estimated product returns and pricing adjustments in the same period that the related revenue is recorded. These estimates are based on historical sales returns, analysis of credit memo data, and other factors known at the time. If actual future returns and allowances differ from past experience, additional allowances may be required. Revenue from product maintenance contracts is deferred and recognized ratably over the contract term, generally 12 to

36 months. We recognize revenue on upfront nonrefundable payments from our customers by deferring the payment and recognizing it ratably over the term of the agreement. In accordance with Emerging Issues Task Force, or EITF, Issue No. 01-9, *Accounting for Consideration Given by a*

Table of Contents

Vendor to a Customer (Including a Reseller of the Vendor s Products), when we provide consideration to our customers we recognize the value of that consideration as a reduction in revenue. We maintain inventory, or hubbing, arrangements with certain of our customers. Pursuant to these arrangements we deliver products to a customer or a designated third party warehouse based upon the customer s projected needs, but do not recognize product revenue unless and until the customer reports that it has removed our product from the warehouse to incorporate into its end products.

A majority of our net revenue is derived from a limited number of customers. We currently have three customers that each account for more than 10% of our total net revenue; Sun Microsystems, Hewlett Packard, and NetAPP. For the three months ended June 30, 2008 sales to these OEM customers accounted for approximately 84% of total sales as compared to approximately 75% for the three months ended June 30, 2007. Net revenue to Sun accounted for approximately 28% and 65% of total net revenue for the three months ended June 30, 2008 and 2007, respectively. Net revenue to HP accounted for 33% and less than 1% of total net revenue for the three months ended June 30, 2008 and 2007, respectively. Net revenue to NetAPP accounted for 22% and 9% of total net revenue for the three months ended June 30, 2008 and 2007, respectively. For the six months ended June 30, 2008 sales to these OEM customers accounted for approximately 79% of total sales as compared to approximately 76% for the six months ended June 30, 2007. Net revenue to Sun accounted for approximately 35% and 71% of total net revenue for the six months ended June 30, 2008 and 2007, respectively. Net revenue to HP accounted for 21% and less than 1% of total net revenue for the six months ended June 30, 2008 and 2007, respectively. Net revenue to NetAPP accounted for 23% and less than 5% of total net revenue for the six months ended June 30, 2008 and 2007, respectively. No other customer had net revenue for the three and six months ended June 30, 2008 and 2007 that represented 10% or more of our total net revenue.

Foreign Currency Transaction and Translation

A portion of our international business is presently conducted in currencies other than the United States dollar. Foreign currency transaction gains and losses arising from normal business operations are credited to or charged against earnings in the period incurred. As a result, fluctuations in the value of the currencies in which we conduct our business relative to the United States dollar will cause currency transaction gains and losses, which we have experienced in the past and continue to experience. Due to the substantial volatility of currency exchange rates, among other factors, we cannot predict the effect of exchange rate fluctuations upon future operating results. There can be no assurances that we will not experience currency losses in the future. We have not previously undertaken hedging transactions to cover currency exposure and we currently do not intend to engage in hedging activities in the near future.

During the first quarter of 2008, we closed our operations in the Netherlands and transitioned all functions previously performed in that location to our Carlsbad location. During this process, we performed a review of the functional currency for this operation in accordance with *Financial Accounting Standards Board* , or FASB, Statement No. 52, *Foreign Currency Transactions,* and based on the changes in operating conditions and economic facts and circumstances we changed the functional currency for our operation in the Netherlands from the Euro to the United States dollar effective January 1, 2008. For foreign subsidiaries whose functional currency is the local currency, assets and liabilities are translated into United States dollars at period-end exchange rates. Revenues and expenses, and gains and losses are translated at rates of exchange that approximate the rates in effect on the transaction date. Resulting translation gains and losses are recognized as a component of other comprehensive loss.

Adoption of New Accounting Pronouncements

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements,* which defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and requires enhanced disclosures about fair value measurements. FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008 the FASB issued FASB staff position, or FSP, No. 157-2, *Effective Date of FASB Statement No. 157*, which delays the effective date of FASB Statement No. 157 for non-financial assets and liabilities, other than those that are recognized or disclosed at fair value on a recurring basis, to fiscal years beginning after November 15, 2008. The Company s adoption of FASB Statement No. 157 related to financial assets and liabilities in the quarter ended March 31, 2008, had no impact on the Company s condensed consolidated financial statements. The Company is currently evaluating the impact, if any, that FASB Statement No. 157 may have on its future condensed consolidated financial statements related to non-financial assets and liabilities.

Recent Accounting Pronouncements

In December 2007 the FASB issued FASB Statement No. 141(R), *Business Combinations*. FASB Statement No. 141(R) establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. FASB Statement No. 141(R) is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations we engage in will be recorded and disclosed following existing GAAP until January 1, 2009. We are in the process of assessing the impact of the adoption of this standard on our future consolidated financial statements.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*. FSP FAS 142-3 amends FASB Statement No. 142, *Goodwill and Other Intangible Assets*, to improve the consistency between the useful life of a recognized intangible asset under FASB Statement No. 142 and the period of expected cash flows used to measure the fair value of the asset

Table of Contents

under FASB Statement No 141, *Business Combinations*, and other U.S. GAAP. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. The guidance for determining the useful life of a recognized intangible asset is to be applied prospectively, therefore, the impact of the implementation of this pronouncement cannot be determined until the transactions occur.

2. Share-Based Compensation

We account for share-based compensation in accordance with the FASB Statement No.123(R), *Share-Based Payment*, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees, directors and consultants, including stock option grants and purchases of stock made pursuant to our 2000 Amended and Restated Equity Incentive Plan, or the 2000 EIP, our 2000 Amended and Restated Non-Employee Directors Stock Option Plan, or the 2000 NEDSOP, and our 2000 Amended and Restated Employee Stock Purchase Plan, or the 2000 ESPP, based on estimated fair values.

FASB Statement No. 123(R) requires us to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the award s portion that is ultimately expected to vest is recognized as expense over the requisite service periods in the accompanying unaudited condensed consolidated financial statements for the three and six months ended June 30, 2007 and 2008.

As of June 30, 2008, total unrecognized share-based compensation cost related to unvested stock options was $6.1 million, which is expected to be recognized over a weighted average period of approximately 2.8 years. We have included the following amounts for share-based compensation cost, including the cost related to the 2000 EIP, 2000 NEDSOP and 2000 ESPP, in the accompanying unaudited condensed consolidated statements of operations (amounts in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2008**	**2007**	**2008**
Cost of goods sold	$ 67	$ 108	$ 170	$ 204
Sales and marketing	120	147	225	286
Research and development	174	261	367	458
General and administrative	391	382	215	615
Share-based compensation expense before taxes	752	898	977	1,563
Related deferred income tax benefits				
Share-based compensation expense, net of income taxes	$ 752	$ 898	$ 977	$ 1,563
Net share-based compensation expense per basic and diluted common share	$ 0.02	$ 0.02	$ 0.02	$ 0.03

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2008**	**2007**	**2008**
Share-based compensation expense is derived from:				
Stock options	$ 661	$ 797	$ 791	$ 1,365
2000 ESPP	91	101	186	198

Share-based compensation expense before taxes	$ 752	$ 898	$ 977	$ 1,563

Share-based compensation expense recognized during the three and six months ended June 30, 2008 included (1) compensation expense for awards granted prior to, but not fully vested as of, January 1, 2006 and (2) compensation expense for the share-based payment awards granted subsequent to December 31, 2005, based on the grant date fair values estimated in accordance with the

8

Table of Contents

provisions of FASB Statement No. 123(R). FASB Statement No.123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In our pro forma disclosures required under FASB Statement No.123, *Accounting for Stock-based Compensation*, for the periods prior to 2006, we accounted for forfeitures as they occurred. We have historically and continue to estimate the fair value of share-based awards using the Black-Scholes option-pricing model. Total unrecognized share-based compensation cost related to unvested stock options as of June 30, 2008 has been adjusted for changes in estimated forfeitures.

To estimate compensation expense under FASB Statement No.123(R) for the six months ended June 30, 2007 and 2008, we used the Black-Scholes option-pricing model with the following weighted-average assumptions for equity awards granted:

	2000 EIP and 2000 NEDSOP Six Months Ended June 30,		**2000 ESPP Six Months Ended June 30,**	
	2007	**2008**	**2007**	**2008**
Risk-free interest rate	4.50%	2.50%	5.16%	2.07%
Expected dividend yield	%	%	%	%
Volatility	68%	68%	68%	68%
Expected life	5.4 years	5.6 years	0.5 years	0.5 years

The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent remaining term. We have not paid dividends in the past and do not plan to pay any dividends in the future. The expected volatility is based on implied volatility of our stock for the related vesting period. The expected life of the equity award is based on historical experience.

Stock Incentive Plans

2*000 EIP*. During 2007 and 2008, we granted options to purchase common stock to our employees under the 2000 EIP. These options expire 10 years from the date of grant and typically vest over four years, with 25% of the shares subject to the option vesting one year from the date of grant and the remaining shares subject to the option vesting ratably thereafter on a monthly basis. The number of shares of common stock reserved for issuance under the 2000 EIP is increased annually on the date of our meeting of stockholders by an amount equal to the lesser of (A) two percent of our outstanding shares as of the date of our annual meeting of stockholders, (B) 1,000,000 shares or (C) an amount determined by our board of directors. If an option is surrendered or for any other reason ceases to be exercisable in whole or in part, the shares with respect to which the option was not exercised shall continue to be available under the 2000 EIP. As of June 30, 2008, options to purchase 6,168,436 shares of common stock were outstanding under the 2000 EIP and the options to purchase 1,908,475 shares of common stock remained available for grant under the 2000 EIP.

2*000 NEDSOP*. Under the 2000 NEDSOP, nonqualified stock options to purchase common stock are automatically granted to our non-employee directors upon appointment to our board of directors (initial grants) and upon each of our annual meetings of stockholders (annual grants). Options granted under the 2000 NEDSOP expire 10 years from the date of the grant. Initial grants vest over four years, with 25% of the shares subject to the option vesting one year from the date of grant and the remaining shares subject to the option vesting ratably thereafter on a monthly basis. Annual grants are fully vested on the date of grant. 1,000,000 shares of common stock are reserved for issuance under the 2000 NEDSOP. As of June 30, 2008, options to purchase 580,000 shares of common stock were outstanding under the 2000 NEDSOP and options to purchase 333,124 shares of common stock remained available for grant under the 2000 NEDSOP.

2*000 ESPP*. The 2000 ESPP qualifies under the provisions of Section 423 of the Internal Revenue Code, or IRC, and provides our eligible employees, as defined in the 2000 ESPP, with an opportunity to purchase shares of our common stock at 85% of fair market value, as defined in the 2000 ESPP. The number of shares of common stock reserved for issuance under the 2000 ESPP is increased annually on the date of our meeting of stockholders by an amount equal to the lesser of (A) 100,000 shares or (B) an amount determined by our board of directors. There were 191,594 and 168,971 shares issued for the 2000 ESPP during the six months ended June 30, 2007 and 2008, respectively.

Table of Contents

Activity and pricing information regarding all options to purchase shares of common stock are summarized as follows:

	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2007	6,672,095	$ 5.36		
Granted	1,171,500	2.43		
Exercised	(73,715)	2.69		
Forfeited	(756,027)	3.67		
Expired	(265,417)	8.26		
Outstanding at June 30, 2008	6,748,436	$ 4.96	6.51	$ 392,293
Vested and expected to vest at June 30, 2008	6,197,269	$ 5.12	6.29	$ 362,289
Exercisable at June 30, 2008	4,173,991	$ 5.96	5.05	$ 270,843

The weighted average grant-date fair values of options granted during the three months ended June 30, 2007 and 2008 were $2.40 per share and $1.74 per share, respectively.

The weighted average grant-date fair values of options granted during the six months ended June 30, 2007 and 2008 were $2.22 per share and $1.60 per share, respectively.

During the six months ended June 30, 2008, cash generated from share-based compensation arrangements amounted to $0.2 million from the exercise of options and $0.5 million from the purchase of shares through the 2000 ESPP. We issue new shares from the respective plan share reserves upon exercise of options to purchase common stock and for purchases through the 2000 ESPP.

The total fair value of options to purchase common stock that vested during the three months ended June 30, 2007 and 2008 was $1.0 million and $0.7 million, respectively. The total fair value of options to purchase common stock that vested during the six months ended June 30, 2007 and 2008 was $1.8 million and $1.5 million, respectively.

3. Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period.

Diluted net loss per share reflects the potential dilution by including common stock equivalents, such as stock options and stock warrants, in the weighted average number of common shares outstanding for a period, if dilutive.

The following table sets forth a reconciliation of the basic and diluted number of weighted average shares outstanding used in the calculation of net loss per share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2008	2007	2008
Shares used in computing basic net loss per share	45,472	46,055	44,315	46,005
Dilutive effect of warrants and common stock equivalents				
Shares used in computing diluted net loss per share	45,472	46,055	44,315	46,005

For the three months ended June 30, 2007, outstanding options to purchase 6,275,531 shares of common stock with exercise prices ranging from $1.34 to $17.14 per share and outstanding warrants to purchase 1,109,084 shares of common stock at prices ranging from $2.97 to $4.50 were not included in the calculation of diluted loss per share because their effect was antidilutive. For the six months ended June 30, 2007, outstanding options to purchase 5,984,137 shares of common stock with exercise prices ranging from $1.34 to $17.14 per share and outstanding warrants to purchase 1,400,961 shares of common stock at prices ranging from $2.97 to $4.50 were not included in the calculation of diluted loss per share because their effect was antidilutive.

For the three and six months ended June 30, 2008, outstanding options to purchase 6,748,436 shares of common stock with exercise prices ranging from $1.34 to $16.36 per share were not included in the calculation of diluted loss per share because their effect was antidilutive.

Table of Contents

4. Cash and Cash Equivalents

At June 30, 2008, we had $62.1 million in cash and cash equivalents. Pursuant to FASB Statement No. 157, *Fair Value Measurements* the fair value of our cash equivalents is determined based on Level 1 inputs, which consist of quoted prices in active markets. We place our cash investments in instruments that meet credit quality standards and maturity guidelines, as specified in our investment policy. These guidelines limit the type, maturity and exposure to any one issue. The policy requires all investments to have a minimum rating of AAA, Aaa, AA, A-1 or P-1, as reported by two rating agencies.

Substantially all of our cash and cash equivalents are maintained with two major financial institutions in the United States. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal risk.

A summary of our cash and cash equivalents by major security type is as follows (in thousands):