SIGMA DESIGNS INC
Form 10-Q
June 07, 2012
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 28, 2012

or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 001-32207

Sigma Designs, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| California<br>(State or other jurisdiction of incorporation or organization) | 94-2848099<br>(I.R.S. Employer Identification No.) |

1778 McCarthy Boulevard,
Milpitas, California 95035
(Address of principal executive offices including Zip Code)
(408) 262-9003
(Registrant’s telephone number, including area code)

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

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer R | Non-accelerated filer o<br>(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 R

As of May 30, 2012, the Company had 32,904,078 shares of Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SIGMA DESIGNS, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

| | April 28, 2012 | January 28, 2012 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 79,050 | $ 44,283 |
| Short-term marketable securities | 7,329 | 42,134 |
| Restricted cash | 1,769 | 1,769 |
| Accounts receivable, net | 23,575 | 21,180 |
| Inventories | 18,611 | 22,037 |
| Deferred tax assets | 4,831 | 4,832 |
| Prepaid expenses and other current assets | 7,353 | 7,234 |
| Total current assets | 142,518 | 143,469 |
| | | |
| Long-term marketable securities | 52,825 | 62,022 |
| Software, equipment and leasehold improvements, net | 18,153 | 19,609 |
| Intangible assets, net | 43,577 | 45,656 |
| Deferred tax assets, net of current portion | 16,598 | 16,595 |
| Notes receivable, net of current portion | 2,750 | 3,000 |
| Long-term investments | 6,444 | 6,443 |
| Other non-current assets | 496 | 430 |
| Total assets | $ 283,361 | $ 297,224 |
| | | |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | $ 7,764 | $ 8,438 |
| Accrued liabilities | 21,512 | 24,081 |
| Total current liabilities | 29,276 | 32,519 |
| | | |
| Other long-term liabilities | 15,031 | 15,168 |
| Long-term deferred tax liabilities | 1,062 | 1,062 |
| Total liabilities | 45,369 | 48,749 |
| | | |
| Commitments and contingencies (Note 11) | | |
| | | |
| Shareholders' equity: | | |
| Preferred stock | — | — |
| Common stock and additional paid-in capital | 463,127 | 460,246 |
| Treasury stock | (85,941) | (85,941) |
| Accumulated other comprehensive income | 941 | 603 |
| Accumulated deficit | (140,135) | (126,433) |

| | | | | |
|---|---|---|---|---|
| Total shareholders' equity | | 237,992 | | 248,475 |
| Total liabilities and shareholders' equity | $ | 283,361 | $ | 297,224 |

See the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

SIGMA DESIGNS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Net revenue | $ 40,258 | $ 60,632 |
| Cost of revenue | 19,163 | 30,840 |
| Gross profit | 21,095 | 29,792 |
| | | |
| Operating expenses: | | |
| Research and development | 21,789 | 21,596 |
| Sales and marketing | 6,888 | 8,501 |
| General and administrative | 6,379 | 5,435 |
| Total operating expenses | 35,056 | 35,532 |
| Loss from operations | (13,961) | (5,740) |
| | | |
| Interest and other income, net | 491 | 819 |
| Loss before income taxes | (13,470) | (4,921) |
| Provision for income taxes | 232 | 749 |
| Net loss | $ (13,702) | $ (5,670) |
| | | |
| Net loss per share: | | |
| Basic | $ (0.42) | $ (0.18) |
| Diluted | $ (0.42) | $ (0.18) |
| | | |
| Shares used in computing net loss per share: | | |
| Basic | 32,661 | 31,731 |
| Diluted | 32,661 | 31,731 |

SIGMA DESIGNS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Net loss | $ (13,702) | $ (5,670) |
| | | |
| Other comprehensive income: | | |
| Accumulated translation adjustment | 71 | 638 |
| Unrealized gain on marketable securities | 267 | 168 |
| Other comprehensive income | 338 | 806 |
| | | |
| Comprehensive loss | $ (13,364) | $ (4,864) |

See the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

SIGMA DESIGNS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Cash flows from operating activities: | | |
| Net loss | $ (13,702) | $ (5,670) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 5,117 | 7,437 |
| Stock-based compensation | 2,826 | 3,191 |
| Provision for excess and obsolete inventory | 303 | 167 |
| Provision for (release of) sales discounts and doubtful accounts | 149 | (44) |
| Loss on disposal of equipment | 34 | 47 |
| Accretion of contributed leasehold improvements | (69) | (60) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (2,544) | (5,936) |
| Inventories | 3,123 | (644) |
| Prepaid expenses and other current assets | (113) | (727) |
| Other non-current assets | 182 | 15 |
| Accounts payable | (1,605) | (1,343) |
| Accrued liabilities | 392 | (3,826) |
| Other long-term liabilities | (1,019) | 839 |
| Net cash used in operating activities | (6,926) | (6,554) |
| | | |
| Cash flows from investing activities: | | |
| Restricted cash | — | (5) |
| Purchases of marketable securities | (10,393) | (20,104) |
| Sales and maturities of marketable securities | 54,662 | 17,571 |
| Purchases of software, purchased IP, equipment and leasehold improvements | (2,667) | (5,233) |
| Net cash provided by (used in) investing activities | 41,602 | (7,771) |
| | | |
| Cash flows from financing activities: | | |
| Net proceeds from exercise of employee stock options | 55 | 1,164 |
| Net cash provided by financing activities | 55 | 1,164 |
| | | |
| Effect of foreign exchange rate changes on cash and cash equivalents | 36 | 248 |
| Increase (decrease) in cash and cash equivalents | 34,767 | (12,913) |
| | | |
| Cash and cash equivalents at beginning of period | 44,283 | 72,732 |
| Cash and cash equivalents at end of period | $ 79,050 | $ 59,819 |
| | | |
| Supplemental disclosure of cash flow information: | | |
| | | |
| Cash paid for income taxes | $ 468 | $ 197 |

See the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

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SIGMA DESIGNS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and summary of significant accounting policies

Organization and nature of operations: Sigma Designs, Inc. (referred to collectively in these consolidated financial statements as “Sigma,” “we,” “our” and “us”) is a leader in connected media platforms. We specialize in chipset solutions tha serve as the foundation for some of the world’s leading internet protocol television, or IPTV, set-top-boxes, connected media players, residential gateways and home control systems. We sell our products to manufacturers, designers and, to a lesser extent, to distributors who, in turn, sell to manufacturers.

Basis of presentation: The consolidated financial statements include Sigma Designs, Inc. and its wholly-owned subsidiaries. All intercompany balances and transactions are eliminated upon consolidation.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, or US GAAP, for interim financial information and the rules and regulations of the Securities and Exchange Commission, or SEC. They do not include all disclosures required by US GAAP for complete financial statements. However, we believe that the disclosures are adequate and fairly present the information. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended January 28, 2012 included in our Annual Report on Form 10-K.

The condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in our opinion, are necessary to present fairly our consolidated financial position at April 28, 2012 and January 28, 2012, the consolidated results of our operations for the three months ended April 28, 2012 and April 30, 2011, and the consolidated cash flows for the three months ended April 28, 2012 and April 30, 2011. The results of operations for the three months ended April 28, 2012 are not necessarily indicative of the results to be expected for future quarters or the year.

Accounting period: Each of our fiscal quarters presented herein includes 13 weeks and ends on the last Saturday of the period. The first quarter of fiscal 2012 ended on April 28, 2012. The first quarter of fiscal 2011 ended on April 30, 2011.

Reclassifications: Certain prior fiscal year balances have been reclassified to conform to the current fiscal year presentation. In the first quarter of fiscal 2013, we concluded that it was appropriate to reclassify our purchased intellectual property, or IP, that is incorporated into our products, from software, equipment and leasehold improvements to intangible assets. The reclassification has no effect on previously reported Consolidated Condensed Statements of Operations for any period and does not materially affect previously reported cash flows from operations or from financing activities in the Consolidated Condensed Statements of Cash Flows. For comparability purposes, the corresponding gross assets and accumulated amortization of $22.2 million and $5.9 million, respectively, have been reclassified as of January 28, 2012. Such reclassifications had no effect on previously reported results of operations or retained earnings.

Software, equipment and leasehold improvements: Software, equipment and leasehold improvements are stated at cost. Depreciation and amortization for software, equipment and leasehold improvements is computed using the straight-line method based on the useful lives of the assets (one to five years) or the remaining lease term if shorter. Any allowance for leasehold improvements received from the landlord for improvements to our facilities is amortized using the straight-line method over the lesser of the remaining lease term or the useful life of the leasehold improvements. Repairs and maintenance costs are expensed as incurred.

Long-lived assets: The amounts and useful lives assigned to finite lived intangible assets acquired, other than goodwill, impact the amount and timing of future amortization. Long-lived assets include intellectual property that we purchase for incorporation into our product designs. We begin amortizing such intellectual property at the time that we begin shipment of the associated products into which it is incorporated. We amortize the intellectual property over the estimated useful life of the associated products, which is generally two to three years. We assess the carrying value of long-lived assets, including purchased intangible assets, whenever events or changes in circumstances, such as a change in technology, indicate that the carrying value of these assets may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than its carrying amount.

Use of estimates: The preparation of the consolidated financial statements in conformity with US GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates, and such differences may be material to the consolidated financial statements.

Revenue recognition: We derive our revenue primarily from product sales. Our products, which we refer to as chipsets, consist of highly integrated semiconductors and embedded software that enables real-time processing of digital video and audio content, which we refer to as real-time software. We do not deliver software as a separate product in connection with product sales. We recognize revenue for product sales when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is reasonably assured.

Inventories: Inventories are stated at the lower of standard cost, which approximates actual cost on a first-in, first-out basis, or market value. We evaluate our ending inventories for excess quantities and obsolescence on a quarterly basis. This evaluation includes analysis of historical and estimated future unit sales by product as well as product purchase commitments that are not cancelable. We develop our demand forecasts based, in part, on discussions with our customers about their forecasted supply needs. However, our customers usually only provide us with firm purchase commitments for the current period and not our entire forecasted period. Additionally, our sales and marketing personnel provide estimates of future sales to prospective customers based on actual and expected design wins. A provision is recorded for inventories in excess of estimated future demand. In addition, we write off inventories that are obsolete. Obsolescence is determined from several factors, including competitiveness of product offerings, market conditions and product life cycles. Provisions for excess and obsolete inventory are charged to cost of revenue. At the time of the loss recognition, a new, lower-cost basis for that inventory is established and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. If this lower-cost inventory is subsequently sold, we will realize higher gross margins for those products.

Inventory write-downs inherently involve assumptions and judgments as to amount of future sales and selling prices. As a result of our inventory valuation reviews, we charged approximately $0.3 million and $0.2 million to cost of revenue for the three months ended April 28, 2012 and April 30, 2011, respectively. Although we believe that the assumptions we use in estimating inventory write-downs are reasonable, significant future changes in these assumptions could produce a significantly different result. There can be no assurances that future events and changing market conditions will not result in significant inventory write-downs.

Income taxes: Income taxes are accounted for under an asset and liability approach. Deferred income taxes reflect the net tax effects of any temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts reported for income tax purposes, and any operating losses and tax credit carry forwards. Deferred tax liabilities are recognized for future taxable amounts and deferred tax assets are recognized for future deductions, net of any valuation allowance, to reduce deferred tax assets to amounts that are considered more likely than not to be realized.

The impact of an uncertain income tax position on an income tax return must be recognized as the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained.

Recent accounting pronouncements: There have been no significant changes in accounting pronouncements as compared to the recent accounting pronouncements described in our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended January 28, 2012.

2. Cash, cash equivalents and marketable securities

Cash, cash equivalents and marketable securities consist of the following (in thousands):

| | April 28, 2012 | | | January 28, 2012 | | |
|---|---|---|---|---|---|---|
| | Book Value | Net Unrealized | Fair Value | Book Value | Net Unrealized | Fair Value |

| | | Gain (Loss) | | | Gain (Loss) | |
|---|---|---|---|---|---|---|
| Corporate bonds | $ 51,537 | $ 438 | $ 51,975 | $ 91,829 | $ 192 | $ 92,021 |
| Money market funds | 46,616 | — | 46,616 | 20,876 | — | 20,876 |
| Corporate commercial paper | — | — | — | 1,946 | — | 1,946 |
| US agency discount notes | 6,505 | (2) | 6,503 | 8,506 | (4) | 8,502 |
| Municipal bonds and notes | 1,654 | 22 | 1,676 | 1,668 | 19 | 1,687 |
| Total cash equivalents and marketable securities | $ 106,312 | $ 458 | $ 106,770 | $ 124,825 | $ 207 | $ 125,032 |
| | | | | | | |
| Cash on hand held in the United States | | | 5,414 | | | 1,030 |
| Cash on hand held overseas | | | 27,020 | | | 22,377 |
| Total cash on hand | | | 32,434 | | | 23,407 |
| Total cash, cash equivalents and marketable securities | | | $ 139,204 | | | $ 148,439 |
| | | | | | | |
| Reported as: | | | | | | |
| Cash and cash equivalents | | | $ 79,050 | | | $ 44,283 |
| Short-term marketable securities | | | 7,329 | | | 42,134 |
| Long-term marketable securities | | | 52,825 | | | 62,022 |
| | | | $ 139,204 | | | $ 148,439 |

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The amortized cost and estimated fair value of cash equivalents and marketable securities, by contractual maturity, are as follows (in thousands):

| | April 28, 2012 | | January 28, 2012 | |
|---|---|---|---|---|
| | Book Value | Fair Value | Book Value | Fair Value |
| Due in 1 year or less | $ 53,912 | $ 53,945 | $ 62,970 | $ 63,010 |
| Due in greater than 1 year | 52,400 | 52,825 | 61,855 | 62,022 |
| Total | $ 106,312 | 106,770 | $ 124,825 | $ 125,032 |

3. Fair values of assets and liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The accounting standards establish a consistent framework for measuring fair value and disclosure requirements about fair value measurements and among other things, requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Fair value hierarchy

The accounting standards discuss valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). The standards utilize a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 - Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our estimate of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Determination of Fair Value

Our cash equivalents and marketable securities are classified within Level 1 because they are valued using quoted market prices, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. The types of marketable securities valued based on quoted market prices in active markets include most U.S. government and agency securities, sovereign government obligations, money market securities and certain corporate obligations with high credit ratings and an ongoing trading market.

Our foreign currency derivative instruments are classified as Level 2 because they are valued using quoted prices and other observable data of similar instruments in active markets.

The table below presents the balances of our assets and liabilities measured at fair value on a recurring basis as of April 28, 2012 and January 28, 2012 (in thousands):

| | As of April 28, 2012 | | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Corporate bonds | $ 51,975 | 51,975 | $ — | $ — |
| Money market funds | 46,616 | 46,616 | — | — |
| US agency discount notes | 6,503 | 6,503 | — | — |
| Municipal bonds and notes | 1,676 | 1,676 | — | — |
| Total cash equivalents and marketable securities | 106,770 | 106,770 | — | — |
| Restricted cash | 1,769 | 1,769 | — | — |
| Derivative instruments | (9) | — | (9) | — |
| Total assets measured at fair value | $ 108,530 | 108,539 | $ (9) | $ — |

| | As of January 28, 2012 | | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Corporate bonds | $ 92,021 | $ 92,021 | $ — | $ — |
| Money market funds | 20,876 | 20,876 | — | — |
| US agency discount notes | 8,502 | 8,502 | — | — |
| Corporate commercial paper | 1,946 | 1,946 | — | — |
| Municipal bonds and notes | 1,687 | 1,687 | — | — |
| Total cash equivalents and marketable securities | 125,032 | 125,032 | — | — |
| Restricted cash | 1,769 | 1,769 | — | — |
| Derivative instruments | (121) | — | (121) | — |
| Total assets measured at fair value | $ 126,680 | $ 126,801 | $ (121) | $ — |

Assets measured and recorded at fair value on a non-recurring basis

Our non-marketable convertible promissory note and preferred stock investments in privately-held venture capital funded technology companies are recorded at fair value only if an impairment charge is recognized. In fiscal 2009 and 2010, we purchased shares of preferred stock in a privately-held venture capital funded technology company at a total investment cost of $2.0 million and we purchased a convertible note receivable from the same company with a face value equal to the cost of $3.0 million, convertible into the issuer's preferred stock under certain circumstances, bearing interest at a rate of 9% per annum which became callable on November 30, 2009. During our second quarter of fiscal 2011, the issuer of the $3.0 million convertible promissory note and the $2.0 million of preferred stock determined that additional funding would be required to continue operations. This convertible note receivable was classified within Level 3. This issuer held discussions with various parties, and a third party made a preliminary offer to purchase substantially all of the issuer's assets at a price that would not allow us to collect any amount on our investments. Based on the available information, we determined that the value of our investments in this issuer had suffered an other-than-temporary decline in value. Accordingly, at July 31, 2010, we recorded an impairment charge of $5.2 million to fully write down the carrying value of the convertible promissory note, accrued interest and preferred stock investment due to our expected inability to recover any value from it. Subsequently, this issuer was liquidated in bankruptcy and we received no amounts.

As of April 28, 2012, we held equity investments in six, and promissory notes receivable in two, privately held venture capital funded technology companies with face values equal to cost of $6.4 million and $3.5 million, respectively. Each of these investments constituted less than a 20% ownership position. Furthermore, we do not believe that we have the ability to exert significant influence over any of these companies.

4. Derivative financial instruments

Foreign exchange contracts are recognized either as assets or liabilities on the balance sheet at fair value at the end of each reporting period. Changes in fair value of the derivatives are recorded as operating expenses or other income (expense), or as accumulated other comprehensive income, or OCI.

We currently use and expect to continue to use foreign currency derivatives such as forward and option contracts as hedges against certain anticipated transactions denominated in Israeli shekels, or NIS. For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of OCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on derivatives representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

We do not assess these derivate contracts that are used in managing NIS denominated transactions for hedge effectiveness and thus such contracts do not qualify for hedge accounting. As of April 28, 2012, we had foreign exchange contracts to sell up to approximately $8.2 million for a total amount of approximately NIS 30.2 million, that mature on or before March 27, 2013. As of January 28, 2012, we had foreign exchange contracts to sell up to approximately $10.2 million for a total amount of approximately NIS 37.0 million, that mature on or before December 27, 2012. For the three months ended April 28, 2012 and April 30, 2011, we recognized gains of approximately $0.1 million and $0.5 million, respectively, as a result of foreign exchange contracts.

The following table presents the fair value of our outstanding derivative instruments as of April 28, 2012 and January 28, 2012 (in thousands):

| Derivative Assets | Balance Sheet Location | April 28, 2012 | January 28, 2012 |
|---|---|---|---|
| Foreign exchange contracts not designated as cash flow hedges | Current liabilities | $ (9 ) | $ (121 ) |
| Total fair value of derivative instruments | | $ (9 ) | $ (121 ) |

The effects of derivative instruments on income and accumulated other comprehensive income for the three months ended April 28, 2012 and April 30, 2011 are summarized below (in thousands):

| Derivative Instruments | Gains recognized in accumulated other comprehensive income on derivatives (Effective Portion) Amount | Gains reclassified from accumulated other comprehensive income into earnings Amount | Location | Gains (Losses) recognized in earnings on derivatives (Including Ineffective Portion) Amount | Location |
|---|---|---|---|---|---|
| Three months ended April 28, 2012 foreign exchange contracts | $ — | $ — | Operating expenses and cost of revenue | $ 82 | Interest and other income, net |
| Three months ended April 30, 2011 foreign exchange contracts | $ 11 | $ 74 | Operating expenses and cost of revenue | $ 450 | Interest and other income, net |

5. Restricted cash

As of April 28, 2012 and January 28, 2012, we had $1.8 million of restricted cash related to deposits pledged to a financial institution in connection with our foreign exchange forward hedging transactions and an office operating lease.

6. Investments in and Notes receivable from privately held companies

Issuer A

During fiscal 2009, we purchased shares of preferred stock in a privately held venture capital funded technology company ("Issuer A") at a total investment cost of $2.0 million. In the third quarter of fiscal 2010, we purchased a convertible note from Issuer A with a face value equal to the cost of $3.0 million, which is convertible into the issuer's preferred stock under certain circumstances, bears interest at a rate of 9% per annum and became callable after November 30, 2009.

Three of our four directors held equity interests in Issuer A in which we had invested an aggregate of $5.0 million and one of these directors was also a director of Issuer A. In the aggregate, these equity and debt interests did not rise to the level of a material or a controlling interest in Issuer A. Our board of directors appointed our director who had no interest in Issuer A to evaluate each investment in Issuer A and to recommend appropriate action to the board of directors. All investment transactions with Issuer A were approved and recommended by this independent director and made as the result of an arms-length negotiation process between Issuer A and us, with our negotiations led by our non-interested director. We viewed this investment as a strategic investment in a technology platform into which we could potentially sell our chipset solutions. In connection with this investment, we entered into a commercial agreement with Issuer A as well.

During the second quarter of fiscal 2011, Issuer A determined that additional funding would be required to continue operations. Issuer A held discussions with various parties, and a third party made a preliminary offer to purchase substantially all of its assets at a price that would not allow us to collect any amount on our investments in Issuer A. Based on the available information, we determined that the value of our investment in Issuer A had suffered an other-than-temporary decline in value. Accordingly, at July 31, 2010, we recorded an impairment charge of $5.2 million to fully write down the carrying value of the preferred stock equity investment and fully reserve the convertible note receivable, including accrued interest, due to our expected inability to collect any amounts in connection with these investments. Subsequently, this issuer was liquidated in bankruptcy and we received no amounts. Accordingly, as of April 28, 2012 and January 28, 2012, the convertible note in Issuer A was valued at zero.

Issuer B, C, D, E, F and G

During fiscal 2009, we purchased shares of preferred stock in a privately held venture capital funded technology company ("Issuer B") at a total investment cost of $1.0 million. In the fourth quarter of fiscal 2010, we purchased additional shares of preferred stock in Issuer B at a cost of $1.0 million.

In the third quarter of fiscal 2011, we purchased shares of preferred stock in another privately held technology company ("Issuer C") at a total investment cost of $1.0 million.

In the fourth quarter of fiscal 2011, we purchased shares of preferred stock in another privately held technology company ("Issuer D") at a total investment cost of $1.0 million.

In the fourth quarter of fiscal 2011, we also purchased a convertible note from another privately held technology company ("Issuer E") with a face value equal to the cost of $0.3 million. This amount of $0.3 million will convert to a quantity of equity upon any closing of financing prior to December 31, 2012.

In the second quarter of fiscal 2012, we purchased shares of preferred stock in another privately held technology company ("Issuer F") at a total investment cost of $2.0 million.

In the third quarter of fiscal 2012, we made an equity investment of $0.2 million in a privately held joint venture ("Issuer G").

As of April 28, 2012 and January 28, 2012, our equity investments in privately held companies were valued at $6.4 million, representing their cost, net of reserve for impairment.

Notes receivable from privately held companies

In November 2010, we loaned $1.0 million to Issuer B and received a secured promissory note. This promissory note is secured by the assets of Issuer B, bearing interest at a rate of 5% per annum, and is scheduled to be fully repaid by June 2013. In January 2012, we loaned $2.5 million to a privately held venture capital funded technology company ("Issuer H"), pursuant to a strategic agreement dated January 25, 2012. We made this loan in exchange for a secured promissory note, bearing interest at a rate of 3% per annum. The note plus the accrued interest is due 36 months from the agreement date. The note is secured by the assets of Issuer H. Additionally, pursuant to this agreement we have the right, subject to certain conditions, for one year from the agreement date, to acquire all the outstanding securities of Issuer H for $11.2 million. As of April 28, 2012, these conditions had not been met and we had not determined whether we intend to exercise this right. This right will expire in January 2013. We have a variable interest in Issuer H and it is a variable interest entity, however, we have concluded that we are not the primary beneficiary of Issuer H because we do not have the power to direct the activities that most significantly impact Issuer H's financial performance. As of April 28, 2012, our maximum exposure to loss as a result of our involvement with Issuer H was limited to our $2.5 million note receivable. None of our directors held any interest in these issuers from whom we purchased notes.

As of April 28, 2012 and January 28, 2012, our notes receivable from privately held companies were valued at $3.5 million, representing their cost. We made each of the above-described investments because we viewed the issuer as either having strategic technology or a business that would complement our technological capabilities or help create an opportunity for us to sell our chipset solutions. In each case, we entered into a commercial or strategic agreement in connection with our investment. None of our directors held any interest in each of the issuers described above.

The following table sets forth the value of investments in and notes receivable from privately held companies as of April 28, 2012 and January 28, 2012:

| Equity investments | April 28, 2012 | January 28, 2012 |
|---|---|---|
| Issuer A | $ -- | $ -- |
| Issuer B | 2,000 | 2,000 |
| Issuer C | 1,000 | 1,000 |
| Issuer D | 1,000 | 1,000 |
| Issuer E | 300 | 300 |
| Issuer F | 2,000 | 2,000 |
| Issuer G | 144 | 143 |
| Total equity investments | $ 6,444 | $ 6,443 |

| Notes receivable | April 28, 2012 | January 28, 2012 |
|---|---|---|
| Issuer B | $ 1,000 | $ 1,000 |
| Issuer H | 2,500 | 2,500 |
| Total notes receivable | $ 3,500 | $ 3,500 |
| | | |
| Total Investments and Notes | $ 9,944 | $ 9,943 |

7. Inventories

Inventories consist of the following (in thousands):

| | April 28, 2012 | January 28, 2012 |
|---|---|---|
| Wafers and other purchased materials | $ 10,696 | $ 11,006 |
| Work-in-process | 890 | 191 |
| Finished goods | 7,025 | 10,840 |
| Total | $ 18,611 | $ 22,037 |

8. Acquisitions

On March 21, 2011, we executed a definitive agreement to acquire certain assets, including intangible assets and products, from a business division of a large computer manufacturer for $5.0 million in cash, which we paid on May 3, 2011. None of our directors had an interest in this large computer manufacturer.

The assets we acquired include a low-power High Definition, or HD, video encoder processor aimed at capturing HD video for visual telephony between set-top boxes, connected media players, Voice over Internet Protocol, or VoIP, devices, video phones, video conferencing TV's and video surveillance devices.

In connection with this acquisition, we obtained a valuation of the assets acquired in order to allocate the purchase price. The total purchase price was allocated to the net tangible and identified intangible assets based upon fair values as of March 21, 2011. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill. The purchase price in the transaction was allocated as follows (in thousands, except years):

| | Amount |
|---|---|
| Purchase consideration: | |
| Cash | $ 5,000 |
| | |
| Net tangible assets | $ 752 |

| | | | Estimated Useful Life |
|---|---|---|---|
| Identifiable intangible assets: | | | |
| Developed technology: | | | |
| Technology | | 1,250 | 5 years |
| Technology leveraged | | 1,680 | 8 years |
| Customer relationships | | 750 | 5 years |
| In-process research and development | | 370 | — |
| Goodwill | | 198 | — |
| Total consideration | $ | 5,000 | |

9. Intangible assets

In the first quarter of fiscal 2013, we concluded that it was appropriate to reclassify our purchased intellectual property, or IP, that is incorporated into our products, from software, equipment and leasehold improvements to intangible assets. The reclassification has no effect on previously reported Consolidated Condensed Statements of Operations for any period and does not materially affect previously reported cash flows from operations or from financing activities in the Consolidated Condensed Statements of Cash Flows. For comparability purposes, corresponding gross assets and accumulated amortization of $22.2 million and $5.9 million, respectively, have been reclassified as of January 28, 2012.

As of January 28, 2012, we included under software, the third party purchased IP that we acquire for incorporation into our product designs. During the first fiscal quarter of fiscal 2013, we reclassified $16.3 million, net of purchased IP from software, equipment and leasehold improvements to intangible assets. We begin amortizing such intellectual property at the time that we begin shipment of the associated products into which it is incorporated. We amortize the intellectual property over the estimated useful life of the associated products, which is generally two to three years.

The table below presents the balances of our intangible assets as of April 28, 2012 and January 28, 2012:

| | April 28, 2012 | January 28, 2012 |
|---|---|---|
| Acquired intangible assets | $ 75,978 | $ 75,978 |
| Purchased IP | 22,519 | 22,204 |
| Total | $ 98,497 | $ 98,182 |
| Accumulated amortization | (54,920) | (52,526) |
| Intangible assets, net | $ 43,577 | $ 45,656 |

We assess the carrying value of long-lived assets whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. As of October 29, 2011, we performed a review of the carrying value of our acquired intangible assets due to continued reductions in our profitability and sales forecasts, and negative cash flows from operations. In performing this review, we developed a forecast of the total undiscounted cash flow expected to be generated by each acquired intangible asset group and compared the result to the carrying value. The results of this review indicated that two of these intangible asset groups, consisting primarily of certain developed technology and customer relationship intangibles related to our CopperGate acquisition, were not fully recoverable. Therefore, we performed the second step of the analysis by developing a discounted cash flow analysis for each of the individual identifiable assets in these two groups to determine the amount of impairment. Our analysis resulted in an intangible asset impairment charge of $55.1 million during the third quarter of fiscal 2012. In addition, as a result of our review of indefinite-lived intangible assets, we recorded an impairment charge for our in-process research and development intangible assets of $11.1 million during the third quarter of fiscal 2012.

Acquired intangible assets, subject to amortization, were as follows as of April 28, 2012 and January 28, 2012 (in thousands, except for years):

| | Gross Value | Impairment | April 28, 2012 Accumulated Amortization and Effect of Currency | Net Value | Weighted average remaining amortization |
|---|---|---|---|---|---|

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Translation | | | | period (years) |
| Developed technology | $ | 75,827 | $ | (24,614) | $ | (29,984) | $ | 21,229 | 4.5 |
| Customer relationships | | 51,174 | | (30,486) | | (15,282) | | 5,406 | 4.6 |
| Purchased IP - amortizing | | 8,496 | | — | | (6,405) | | 2,091 | 1.7 |
| Trademarks | | 2,677 | | — | | (1,849) | | 828 | 6.4 |
| Non-compete agreements | | 1,400 | | — | | (1,400) | | — | — |
| | | 139,574 | | (55,100) | | (54,920) | | 29,554 | 4.3 |
| Purchased IP – not yet deployed | | 14,023 | | — | | — | | 14,023 | — |
| In-process research and development | | 11,070 | | (11,070) | | — | | — | — |
| | $ | 164,667 | $ | (66,170) | $ | (54,920) | $ | 43,577 | |

| | January 28, 2012 | | | | |
|---|---|---|---|---|---|
| | Gross Value | Impairment | Accumulated Amortization and Effect of Currency Translation | Net Value | Weighted average remaining amortization period (years) |
| Developed technology | $ 75,827 | $ (24,614) | $ (28,455) | $ 22,758 | 4.7 |
| Customer relationships | 51,174 | (30,486) | (14,966) | 5,722 | 4.8 |
| Purchased IP - amortizing | 8,395 | — | (5,900) | 2,495 | 1.9 |
| Trademarks | 2,677 | — | (1,805) | 872 | 6.6 |
| Non-compete agreements | 1,400 | — | (1,400) | — | — |
| | 139,473 | (55,100) | (52,526) | 31,847 | 4.8 |
| Purchased IP – not yet deployed | 13,809 | — | — | 13,809 | — |
| In-process research and development | 11,070 | (11,070) | — | — | — |
| | $ 164,352 | $ (66,170) | $ (52,526) | $ 45,656 | |

Amortization expense related to acquired intangible assets was $1.9 million and $4.7 million for the three months ended April 28, 2012 and April 30, 2011, respectively. Amortization expense related to purchased IP was $0.5 million and $0.6 million for the three months ended April 28, 2012 and April 30, 2011, respectively. As of April 28, 2012, we had $14.0 million of purchased IP, which we have not yet begun to amortize. As of April 28, 2012, we expect the amortization expense in future periods to be as follows (in thousands):

| Fiscal year | Purchased IP - Amortizing | Developed Technology | Customer Relationships | Trademarks | Total |
|---|---|---|---|---|---|
| Remainder of 2013 | $ 1,033 | $ 4,586 | $ 949 | $ 133 | $ 6,701 |
| 2014 | 762 | 5,378 | 1,265 | 119 | 7,524 |
| 2015 | 260 | 3,892 | 1,265 | 118 | 5,535 |
| 2016 | 36 | 3,860 | 1,109 | 118 | 5,123 |
| 2017 | — | 3,019 | 818 | 118 | 3,955 |
| Thereafter | — | 494 | — | 222 | 716 |
| | $2,091 | $ 21,229 | $ 5,406 | $ 828 | $ 29,554 |

10. Product warranty

In general, we sell products with a one-year limited warranty that our products will be free from defects in materials and workmanship. Warranty cost is estimated at the time revenue is recognized based on historical activity, and additionally, for any specific known product warranty issues. Accrued warranty cost includes hardware repair and/or replacement and software support costs and is included in accrued liabilities on the consolidated balance sheets.

Details of the change in accrued warranty as of April 28, 2012 and April 30, 2011 are as follows (in thousands):

| Three Months Ended | Balance | Additions | Deductions | Balance |
|---|---|---|---|---|

| | Beginning of Period | | | End of Period |
|---|---|---|---|---|
| April 28, 2012 | $ 1,326 | $ 124 | $ (325) | $ 1,125 |
| April 30, 2011 | 1,300 | 206 | (206) | 1,300 |

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11. Commitments and contingencies

Commitments

Leases

Our primary facility in Milpitas, California is leased under a non-cancelable operating lease which expires in September 2012. We also lease facilities in Canada, China, Denmark, France, Hong Kong, Israel, Japan, Singapore, Taiwan and Vietnam, and vehicles in Israel under non-cancelable operating leases. Future minimum annual payments under operating leases are as follows (in thousands):

| Fiscal years | Operating Leases |
|---|---|
| Remainder of 2013 | $ 3,000 |
| 2014 | 2,177 |
| 2015 | 1,193 |
| 2016 | 840 |
| 2017 | 757 |
| Thereafter | 629 |
| Total minimum lease payments | $ 8,596 |

Purchase commitments

We place non-cancelable orders to purchase semiconductor products from our suppliers on an eight to twelve week lead-time basis. As of April 28, 2012, the total amount of outstanding non-cancelable purchase orders was approximately $15.9 million.

Indemnifications

In certain limited circumstances, we have agreed and may agree in the future to indemnify certain customers against patent infringement claims from third parties related to our intellectual property. In these limited circumstances, the terms and conditions of sale generally limit the scope of the available remedies to a variety of industry-standard methods including, but not limited to, a right to control the defense or settlement of any claim, procure the right for continued usage, and a right to replace or modify the infringing products to make them non-infringing. To date, we have not incurred or accrued any significant costs related to any claims under such indemnification provisions.

Royalties

We pay royalties for the right to sell certain products under various license agreements. During the three months ended April 28, 2012 and April 30, 2011, we recorded royalty expense of $0.4 million and $0.6 million, respectively, which was recorded to cost of revenue.

Our wholly owned subsidiary, Sigma Designs Israel SDI Ltd. (formerly, Coppergate Communication Ltd.), participated in programs sponsored by the Office of the Chief Scientist of Israel's Ministry of Industry, Trade and Labor, or the OCS, for the support of research and development activities that we conducted in Israel. Through April 28, 2012, we had obtained grants from the OCS aggregating to $4.8 million for certain of our research and development projects in Israel. We completed the most recent of these projects in 2007. We are obligated to pay royalties to the OCS, amounting to 3% to 4.5% of the sales of certain products up to an amount equal to 100% and

150% of the grants received. As of April 28, 2012, our remaining obligation under these programs was $0.6 million.

Contingencies

Litigation

On August 6, 2011, Powerline Innovations, LLC, or Powerline, filed suit against us, certain of our subsidiaries and many other named defendants, including Qualcomm Incorporated, Qualcomm Atheros, Inc., Broadcom Corporation and ST Microelectronics N.V. in the United States District Court for the Easter District of Texas asserting infringement of U.S. Patent No. 5,471,190. The Powerline complaint seeks unspecified monetary damages and injunctive relief. At this time, we are unable to predict the outcome of this matter and, accordingly, cannot estimate the potential financial impact this action could have on our business, operating results, cash flows or financial position.

From time to time, we are involved in claims and legal proceedings that arise in the ordinary course of business. We expect that the number and significance of these matters will increase as our business expands. In particular, we could face an increasing number of patent and other intellectual property claims as the number of products and competitors in our industry grows. Any claims or proceedings against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, result in the diversion of significant operational resources or cause us to enter into royalty or licensing agreements which, if required, may not be available on terms favorable to us or at all. If an unfavorable outcome were to occur against us, there exists the possibility of a material adverse impact on our financial position and results of operations for the period in which the unfavorable outcome occurs and, potentially, in future periods.

Third-party licensed technology

We license technologies from various third parties and incorporate that technology into our products. From time to time, we are audited by licensors of these technologies for compliance with the terms of these licenses. Currently, we are under two such audits and have recently been notified of a third. We have accrued estimated fees and penalties of $0.6 million in connection with these audits. If we cannot resolve these audits in a cooperative manner with our license partners, we could be subject to revocation of the applicable license or other penalties, including additional cash penalties.

12. Net loss per share

Basic net loss and diluted net loss per share for the periods presented is computed by dividing net loss by the weighted average number of common shares outstanding.

The following table sets forth the basic and diluted net loss per share computed for the three months ended April 28, 2012 and April 30, 2011 (in thousands, except per share amounts):

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Numerator: | | |
| Net loss, as reported | $ (13,702) | $ (5,670) |
| Denominator: | | |
| Weighted average common shares outstanding - basic | 32,661 | 31,731 |
| Effect of dilutive securities: | | |
| Stock options | — | — |
| Shares used in computation – diluted | 32,661 | 31,731 |
| Net loss per share: | | |
| Basic | $ (0.42) | $ (0.18) |
| Diluted | $ (0.42) | $ (0.18) |

The following table sets forth the excluded anti-diluted and excluded potentially dilutive securities for the three months ended April 28, 2012 and April 30, 2011 (in thousands):

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Stock options excluded because the effect of including would be anti-dilutive | 153 | 611 |
| Stock options excluded because exercise price is in excess of average stock price | 5,547 | 3,437 |
| | | |
| Restricted stock awards and units excluded because the effect of including would be anti-dilutive | 21 | — |
| Restricted stock awards and units excluded because potential buyback shares exceed weighted average restricted stock units and awards outstanding | 733 | — |

13. Equity incentive plans and employee benefits

Stock incentive plans

We have adopted equity incentive plans that provide for the grant of stock option awards to employees, directors and consultants which are designed to encourage and reward their long-term contributions to us and provide an incentive for them to remain with us. These plans also align our employees' interest with the creation of long-term shareholder value. As of April 28, 2012, we have four stock option plans: the 2003 Director Stock Option Plan (the "2003 Director Plan"), the 2001 Stock Plan (the "2001 Plan"), the Amended and Restated 2009 Stock Incentive Plan (the "2009 Incentive Plan") and the CopperGate Share Option Plan (the "CopperGate Plan"). The 2009 Incentive Plan was approved by our shareholders in July 2009 along with the approval of a one-time stock option exchange program and on July 8, 2011, by shareholder approval, was amended and restated to increase the number of shares of common stock authorized for issuance by 2,000,000. The CopperGate Plan was assumed by us in connection with the acquisition of CopperGate in November 2009.



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Our 2009 Incentive Plan provides for the grant of stock options, restricted stock, restricted stock units, other stock-related and performance awards that may be settled in cash, stock or other property. In July 2009, 2,900,000 shares of common stock were reserved for issuance and in July 2011 an additional 2,000,000 shares were reserved for issuance under the 2009 Incentive Plan. In addition, up to 1,000,000 shares of common stock subject to stock awards outstanding under the 2001 Plan but terminated prior to exercise and would otherwise be returned to the share reserves under our 2001 Plan may become available for issuance under the 2009 Incentive Plan.

As of April 28, 2012, 2,179,568 shares were available for future grants under our stock incentive plans. Additionally, up to 648,106 shares of common stock subject to stock awards outstanding under the 2001 Plan may become available for issuance under the 2009 Incentive Plan. As of September 23, 2009, the 2001 Plan and the 2003 Director Plan were closed for future grants, however, these plans will continue to govern all outstanding options that we originally granted from each plan.

Stock Options

The total stock option activities and balances of our stock option plans are summarized as follows:

| | Number of Shares Outstanding | Weighted Average Exercise Price Per Share | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Balance, January 28, 2012 | 5,846,027 | $ 12.47 | 6.16 | $ 885,840 |
| Granted | - | - | | |
| Cancelled | (152,654) | 11.33 | | |
| Exercised | (25,801) | 2.18 | | |
| Balance, April 28, 2012 | 5,667,572 | $ 12.54 | 6.03 | $ 710,739 |
| | | | | |
| Ending Vested and Expected to Vest | 5,576,692 | $ 12.58 | 5.99 | $ 692,795 |
| Ending Exercisable | 3,784,702 | $ 13.15 | 5.25 | $ 582,881 |

The aggregate intrinsic value as of April 28, 2012, in the table above represents the total pretax intrinsic value, based on our closing stock price of $5.63 on that date which would have been received by the option holders had all options holders exercised their options as of that date. The aggregate exercise date intrinsic value of options that were exercised under our stock option plans was $0.1 million and $0.6 million for the three months ended April 28, 2012 and April 30, 2011, respectively, determined as of the option exercise. The total fair value of options which vested during the three months ended April 28, 2012 and April 30, 2011 was $1.5 million and $3.2 million, respectively.

As of April 28, 2012, the unrecorded stock-based compensation balance related to stock options outstanding excluding estimated forfeitures was $17.0 million and will be recognized over an estimated weighted average amortization period of 2.8 years. The amortization period is based on the expected remaining vesting term of the options.

Restricted Stock Awards

We value restricted stock awards, or RSAs, using the quoted market price of the underlying stock on the date of grant. RSAs are granted under our 2009 Incentive Plan and reduce shares available to grant under the plan by 1.3 shares for every 1 share of restricted stock granted and consist of time-based restricted shares, which shares are subject to forfeiture until vested if length of service requirements are not met. The majority of RSAs vest over five years according to the terms specified in the individual grants. As of April 28, 2012, the unrecorded stock-based compensation balance related to RSAs outstanding excluding estimated forfeitures was $1.7 million and will be recognized over an estimated weighted average amortization period of 3.2 years. The following table sets forth the shares of restricted stock awards outstanding as of April 28, 2012:

| | Restricted Stock Awards | Weighted Average Grant Date Fair Value per Unit | Aggregate Value |
|---|---|---|---|
| Balance as of January 28, 2012 | 231,179 | $ 8.82 | - |
| Granted | - | - | |
| Balance as of April 28, 2012 | 231,179 | $ 8.82 | $ 2,038,473 |

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Restricted Stock Units

We value restricted stock units, or RSUs, using the quoted market price of the underlying stock on the date of grant. RSUs are granted under our 2009 Incentive Plan and reduce shares available to grant under the plan by 1.3 shares for every 1 restricted stock unit granted and consist of time-based restricted stock units. The RSUs granted under this plan vest over a period of four years according to the terms specified in the individual grants. As of April 28, 2012, the unrecorded stock-based compensation balance related to RSUs outstanding excluding estimated forfeitures was $3.3 million and will be recognized over an estimated weighted average amortization period of 3.6 years. The following table sets forth the shares of RSUs outstanding as of April 28, 2012:

| | Restricted Stock Units | Weighted Average Grant Date Fair Value per Unit | Aggregate Value |
|---|---|---|---|
| Balance as of January 28, 2012 | 547,500 | $ 5.92 | |
| Granted | 23,075 | $ 6.03 | |
| Cancelled | (7,600 ) | $ 6.44 | |
| Balance as of April 28, 2012 | 562,975 | $ 5.62 | $ 3,169,549 |

Employee stock purchase plan

As of April 28, 2012, we had reserved a total of 2,500,000 shares of common stock for issuance under the 2010 Purchase Plan, of which 682,451 shares had been issued.

Valuation of stock-based compensation

The fair value of RSA and RSU awards is based on the quoted market price of the underlying stock at the date of grant. The fair value of stock option and employee stock purchase plan right awards is estimated at the grant date using the Black-Scholes option valuation model. The determination of fair value of stock option and employee stock purchase plan right awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards and actual employee stock option exercise behavior.

The fair value of each option and employee stock purchase plan right was estimated on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

| | Three Months Ended | | | |
|---|---|---|---|---|
| | April 28, 2012 | | April 30, 2011 | |
| | Stock Option Plan | Employee Stock Purchase Plan | Stock Option Plan | Employee Stock Purchase Plan |
| Expected volatility | - | 46.03 % | 51.31 % | 37.52 % |
| Risk-free interest rate | - | 0.08 % | 2.29 % | 0.21 % |
| Expected term (in years) | - | 0.50 | 5.92 | 0.50 |
| Dividend yield | - | None | None | None |
| Weighted average fair value at grant date | - | $1.85 | $6.89 | $2.94 |

The computation of the expected volatility assumptions used in the Black-Scholes calculations for new stock option and employee stock purchase plan right awards is based on the historical volatility of our stock price, measured over a period equal to the expected term of the grants or purchase rights. The risk-free interest rate is based on the yield available on U.S. Treasury Strips with an equivalent remaining term. The expected term of stock options represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based payment awards and vesting schedules. The expected term of employee stock purchase rights is the period of time remaining in the current offering period. The dividend yield assumption is based on our history of not paying dividends and assumption that we will not pay dividends in the future.

The following table sets forth the total stock-based compensation expense that is included in each functional line item in the condensed consolidated statements of operations (in thousands):

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Cost of revenue | $ 117 | $ 100 |
| Research and development expenses | 1,463 | 1,532 |
| Sales and marketing expenses | 472 | 594 |
| General and administrative expenses | 774 | 965 |
| Total stock-based compensation | $ 2,826 | $ 3,191 |

401(k) tax deferred savings plan

We maintain a 401(k) tax deferred savings plan for the benefit of qualified employees who are U.S. based. Under the 401(k) tax deferred savings plan, U.S. based employees may elect to reduce their current annual taxable compensation up to the statutorily prescribed limit, which is $17,000 in calendar year 2012. Employees age 50 or over may elect to contribute an additional $5,500. We have a matching contribution program whereby we match employee contributions made by each employee at a rate of $0.25 per $1.00 contributed. The matching contributions to the 401(k) tax deferred savings plan totaled $0.3 million and $0.3 million for the three months ended April 28, 2012 and April 30, 2011, respectively.

Group registered retirement savings plan

We maintain a Group Registered Retirement Savings Plan, or GRRSP, for the benefit of qualified employees who are based in Canada. Under the GRRSP, Canadian based employees may elect to reduce their annual taxable compensation up to the statutorily prescribed limit which is $22,970 Canadian in calendar year 2012. We have a matching contribution program under the GRRSP whereby we match employee contributions made by each employee up to 2.5% of their annual salary. The matching contributions to the GRRSP totaled $28,000 and $32,000 for the three months ended April 28, 2012 and April 30, 2011, respectively.

Retirement pension plan

We maintain a Retirement Pension Plan for the benefit of qualified employees who are based in Denmark. Under the Retirement Pension Plan, Denmark-based employees may elect to reduce their annual taxable compensation up to their annual salary. We have a matching contribution program whereby we will contribute 3.0% of our employee’s annual salary and may elect to terminate future contributions at our option at any time. The matching contribution to the Retirement Pension Plan totaled $47,000 and $42,000 for the three months ended April 28, 2012 and April 30, 2011, respectively.

Severance plan

We maintain a severance plan for 17 Israeli employees pursuant to Israel's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment. Upon termination of employment, employees are entitled to one-month salary for each year of employment or a portion thereof. As of April 28, 2012, we have an accrued severance liability of $1.2 million partially offset by $1.2 million of severance employee funds.

14. Segment and geographical information

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. We are organized as, and operate in, one reportable segment. Our operating segment consists of our geographically based entities in the United States, Hong Kong, Israel and Singapore. Our chief operating decision-maker reviews consolidated financial information, accompanied by information about revenue by product group, target market and geographic region. We do not assess the performance of our geographic regions on other measures of income or expense or net income.

The following table sets forth net revenue for each geographic region based on the ship-to location of customers (in thousands):

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Asia | $ 36,604 | $ 57,614 |
| North America | 1,866 | 2,115 |
| Other regions | 1,199 | 61 |
| Europe | 589 | 842 |
| Net revenue | $ 40,258 | $ 60,632 |

The following table sets forth net revenue to each significant country based on the ship-to location of customers (in thousands):

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| China, including Hong Kong | $ 30,077 | 51,123 |
| Rest of the world | 10,181 | 9,509 |
| | $ 40,258 | 60,632 |

The following table sets forth the major customers that accounted for 10% or more of our net revenue:

| | Three Months Ended | |
|---|---|---|
| Customer | April 28, 2012 | April 30, 2011 |
| Flextronics | 16% | * |
| Motorola | 16% | 20% |
| Gemtek | 14% | 30% |

* This customer provided less than 10% of our net revenue in this period.

Three international direct customers accounted for 23%, 17%, and 16% of total accounts receivable as of April 28, 2012. Four international direct customers accounted for 17%, 17%, 15% and 13% of total accounts receivable as of January 28, 2012.

15. Subsequent event

On May 4, 2012, we completed our acquisition of certain assets from Trident Microsystems, Inc. and certain of its subsidiaries (collectively referred to as "Trident") used in or related to Trident's digital television and PC television businesses (the "DTV Business") for a purchase price of $21.0 million plus additional cash consideration of $21.2 million as a result of adjustments based on the closing asset balance of the DTV Business, plus the assumption of certain employee related liabilities pursuant to an Asset Purchase Agreement dated March 23, 2012 (the "Purchase Agreement").

Pursuant to the Purchase Agreement, we acquired all of Trident's DTV Business products, certain licensed intellectual property rights, specified tangible assets and other assets specified in the Agreement. We also acquired the right to use facilities of Trident under short-term facilities use agreements for facilities located in Shanghai and Beijing, China; The Netherlands; Taiwan and California. We hired approximately 320 employees whose services are used in the DTV Business. Trident and we have also entered into a transition services agreement pursuant to which Trident will provide certain services to us following the closing. We will also receive transition support services from the purchaser of Trident's set-top box business.

Since the acquisition date occurred subsequent to April 28, 2012, the DTV Business assets acquired and liabilities assumed are not included in the unaudited condensed consolidated balance sheets as of April 28, 2012. Due to the limited time since the acquisition date, it is not practicable to prepare the supplemental pro forma revenue and earnings information. In addition, the initial purchase accounting for this business combination was incomplete as of the date of filing of this Quarterly Report. Through April 28, 2012, we incurred an aggregate of approximately $0.5 million in expenses in connection with the DTV Business acquisition, and we expect to incur additional expenses relating to the integration of the DTV Business operation.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

You should read the following discussion in conjunction with our unaudited condensed consolidated financial statements and related notes in this Form 10-Q and our Form 10-K previously filed with the Securities and Exchange Commission. Except for historical information, the following discussion contains forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In some cases, you can identify forward-looking statements by terms such as "may," "might," "will," "objective," "intend," "should," "could," "can," "would," "expect," "believe," "estimate," "predict," "potential," "plan," or the negative of these terms, and similar expressions intended to identify forward-looking statements. These forward-looking statements, include, but are not limited to, statements about our capital resources and needs, including the adequacy of our current cash reserves, revenue, our expectations that our operating expenses will increase in absolute dollars as our revenue grows and our expectations that our gross margin will vary from period to period. These forward-looking statements involve risks and uncertainties. Our actual results may differ significantly from those projected in the forward-looking statements. Factors that might cause future results to differ materially from those discussed in the forward-looking statements include, but are not limited to, those discussed under Part II, Item 1A "Risk Factors" in this Form 10-Q as well as other information found in the documents we file from time to time with the Securities and Exchange Commission. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this Form 10-Q. Unless required by U.S. federal securities laws, we do not intend to update any of these forward-looking statements to reflect circumstances or events that occur after the statement is made.

### Overview

Our goal is to be a leader in connected media platforms for use in home entertainment and control. We focus on integrated chipset solutions that serve as the foundation for some of the world's leading internet protocol television, or IPTV, set-top boxes, connected media players, residential gateways and home control systems. We have four chipset product lines: media processor products, home networking products, video image processor and encoder products, and home control and energy management automation products. We sell our products into five primary markets: IPTV media processor, home networking, home control and energy management, connected media player, and the prosumer and industrial audio/video markets. We also sell a small amount of our chipsets into other markets, such as the digital signage, high definition television, or HDTV, projection TV and PC-based add-in markets, which we refer to as our other market. We believe our software suite is a key differentiator within each of our target markets. Our software suite provides a foundation for our customers to develop their products that incorporate our chipsets.

### Our chipset products and target markets

#### Products

Our products are delineated into four primary lines of chipset products. Our chipsets are targeted toward manufacturers and large volume original equipment manufacturers, or OEMs, and original design manufacturers, or ODMs, building products for the IPTV, home networking, home control and energy management, connected media player and prosumer and industrial audio/video consumer electronic markets. For both the three months ended April 28, 2012 and April 30, 2011, we derived nearly all of our net revenue from sales of our chipset products. We derive a minor portion of our revenue from other products and services, including software development kits, engineering support services for hardware and software, engineering development for customization of chipsets and other accessories. The revenue derived from other products and services is not a significant portion of our total net revenue.

Media Processors

Our media processor product line consists of platforms that include highly integrated chipsets and reference system designs. These products are based around media processing and typically combine video and audio decoding, graphics processing, display processing, security management, memory control, peripheral interfaces, and one or more application processors, or CPUs. Our embedded software suite provides an operating environment and coordinates the real-time processing of digital video and audio content, is readily customizable by our customers and is interoperable with multiple standard operating systems. Our reference system designs provide a hardware implementation of the circuit board, access to our embedded software suite, and sometimes provide a prototypical end-use product example for customer evaluation and use.

We believe our media processor chipsets deliver industry-leading performance in video and audio decoding along with display processing, which allows our customers to offer consumers a high-quality viewing experience. We surround this media processing functionality with a security management solution, one or more on-chip CPUs, a high-speed memory interface and complementary system peripherals. As a result, we believe our media processor solutions enable our customers to efficiently bring their consumer multimedia devices to market. We believe IPTV set-top box and connected media player designers and other device manufacturers select our media processor solutions because of their high performance and ease of integration.

Home Networking

Our home networking product line consists of wired home networking controllers that are designed to provide connectivity solutions between various home entertainment products and incoming video streams. We believe these connectivity solutions provide consumers additional connection choices with greater flexibility and allow system integrators and service providers an opportunity to reduce their time and cost of home networking installations. Our home networking solutions are based on the HomePNA, or HPNA, HomePlug AV, or HPAV, and G.hn standards. HPNA and HPAV are two of the current leading technology standards used for transferring internet protocol, or IP, content across coaxial cables, phone lines and power lines. G.hn is the next generation ITU standard ratified in 2010 to create a unified global standard across coaxial cables, phone lines and power lines. Products based on these technologies enable service providers such as telecommunication carriers, cable operators and satellite providers to deliver IPTV solutions and other media-rich applications such as HDTV, Voice over Internet Protocol, or VoIP, and fast internet throughout the home.

Video Image Processors and Encoders

Our video image processor and encoder products consist of our VXP brand video image processor chipsets and our video encoder chipsets. Our VXP chipsets are standalone high performance semiconductors that provide studio-quality video output or input for professional, prosumer and consumer applications and address applications including audio/video receivers, broadcast studios, digital cinema, digital signage, front-projection home theatre televisions, HDTV, medical imaging and video conferencing systems. Our video encoder chipsets are designed to capture video for visual telephony between set-top boxes, connected media players, VoIP devices, video conferencing TVs and video surveillance devices.

Home Control and Energy Management Automation

Our home control and energy management automation product line consists of our wireless Z-Wave chipsets. These chipsets enable consumers to enjoy advanced home control and energy management automation functionality, such as home security, environmental and energy control and monitoring, within both new and existing homes. These devices consist of wireless transceiver devices along with a mesh networking protocol. Our Z-Wave chipsets utilize a low-bitrate, low-power, low-cost RF communication technology that provides an interoperable connected home security, monitoring and automation solution.

Target Markets

IPTV Media Processor Market

The IPTV media processor market consists primarily of telecommunication carriers that deploy IPTV set-top boxes for delivering video services over a DSL network. We serve this market primarily with our media processor products. We are a leading provider of high definition digital media processors for set-top boxes in the IPTV media processor market in terms of units shipped. Our media processor products are used by leading IPTV set-top box providers, such as Cisco Systems, Motorola, Netgem and Samsung. IPTV set-top boxes incorporating our media processors are deployed by telecommunications carriers globally including carriers in Asia, Europe and North America, such as AT&T, Deutsche Telekom, NTT and SFR. We work with these carriers and set-top box providers as well as with systems software providers, such as Microsoft and various Android and Linux providers, to design solutions that address carriers' specific requirements regarding features and performance. In connection with our efforts to expand our IPTV media processor market, we have development projects underway to address the hybrid set-top box opportunities that result from combining IPTV with cable and terrestrial broadcast reception.

Home Networking Market

The home networking market consists of communication devices that use a standard protocol to connect equipment inside the home and stream IP-based video and audio, VoIP or data through wired connectivity. Our home networking products are currently used in IPTV set-top boxes as well as residential gateways, optical network terminals, multiple-dwelling unit, or MDU, masters and network adapters by leading OEMs, such as Actiontec, Cisco Systems, Pace and Motorola. Set-top boxes containing our home networking products are deployed globally, primarily in North America, by telecommunications carriers, such as AT&T, Bell Aliant, Bell Canada, Century Link and Telus. To date, we have not generated significant revenue from our products based on HPAV or G.hn technologies.

Home Control and Energy Management Market

The home control and energy management market consists of communication devices that use a standard protocol to connect equipment inside the home through wireless connectivity.  Our wireless Z-Wave home control and energy management automation products are used in a wide variety of consumer products such as thermostats, light switches and door locks.  These consumer products are designed by leading industry participants such as Danfoss, Ingersoll-Rand (Schlage and Trane), Leviton and Cooper Wiring.

Connected Media Player Market

The connected media player market consists primarily of digital media adapters, or DMAs, portable media devices and wireless streaming PC to TV devices that perform playback of digital media.  We target this market with our media processor products.  Our media processors are used by consumer electronics providers, such as IO-Mega, Netgear and Western Digital in applications such as DMAs and other connected media player devices.

Prosumer and Industrial Audio/Video Market

The prosumer and industrial audio/video market consists of studio quality audio/video receivers and monitors, video conferencing, digital projectors and medical video monitors.  We target this market with our video image processor and video encoder product lines.  Our VXP video image processor products are one of the leading solutions for studio-quality video image processing and are used by leading industry participants, such as Harris, Panasonic, Polycom and Sony.  Our video encoder products are used in security and video conferencing systems.

Other Markets

We also sell products into other markets, such as the digital signage, high definition television, or HDTV, projection TV and PC-based add-in markets, which we refer to as our other market.  We derive minor revenue from sales of our products into these other markets.

Characteristics of Our Business

We do not enter into long-term commitment contracts with our customers and generate substantially all of our net revenue based on customer purchase orders.  We forecast demand for our products based not only on our assessment of the requirements of our direct customers, but also on the anticipated requirements of the telecommunications carriers that our direct customers serve.  We work with both our direct customers and these carriers to address the market demands and the necessary specifications for our technologies.  However, our failure to accurately forecast demand can lead to product shortages that can impede production by our customers and harm our relationship with these customers or lead to excess inventory, which could negatively impact our gross margins in a particular period.  During the year ending January 28, 2012, we recorded provisions for excess inventory of $9.0 million primarily due to a large end customer’s transition to a next generation product sold by one of our competitors.

Our business is substantially dependent upon being designed into set-top boxes of large telecommunications carriers.  If we are not designed into a particular generation of set-top boxes for our large target end customers, our operating results can be materially and adversely affected.  We must spend a considerable amount of resources to compete for these design wins and the failure to obtain a design win for a particular generation of set-top boxes, and in particular for our large target end customers, means we likely would not recover a substantial portion of our expenses in competing for these design wins.  However, if we do obtain these design wins, it is often the case that our end customer and direct customer will continue to incorporate our chipset solutions for that generation of set-top boxes.  The set-top box industry is cyclical due to product transitions from generation to generation.  Each generation typically incorporates emerging technologies, and so we must expend a considerable amount of research and development resources in order to compete in each of these cycles. Our failure to obtain a design win in a particular generation does not mean we necessarily will be unable to obtain a design win in the next generation. For example, our sales in the IPTV media processor market decreased in the past four fiscal quarters as a result of our inability to obtain certain design wins for our last generation of chipset solutions. However, we are in the process of competing for the next generation of set-top boxes, and we believe our chipset solutions contain features and prices that compete favorably with competitive offerings.

Many of our target markets are characterized by intense price competition. The semiconductor industry is highly competitive and, as a result, we expect our average selling prices to decline over time. On occasion, we have reduced our prices for individual customer volume orders as part of our strategy to obtain a competitive position in our target markets. The willingness of customers to design our chipsets into their products depends to a significant extent upon our ability to sell our products at competitive prices. If we are unable to reduce our costs sufficiently to offset any declines in product selling prices or are unable to introduce more advanced products with higher gross margins in a timely manner, we could see declines in our market share or gross margins. We expect our gross margins will vary from period to period due to changes in our average selling prices and average costs, volume order discounts, mix of product sales, amount of development revenue and provisions for inventory excess and obsolescence.

## Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations are based on our unaudited condensed consolidated financial statements which have been prepared in accordance with United States generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts and disclosures of the assets and liabilities at the date of the unaudited condensed consolidated financial statements and also revenue and expenses during the period reported. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. Management bases its estimates and judgments on historical experience, market trends and other factors that are believed to be reasonable under the circumstances. These estimates form the basis for judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from what we anticipate and different assumptions or estimates about the future could change our reported results. Management believes the critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended January 28, 2012 reflect the more significant judgments and estimates used in preparation of our annual and interim financial statements except for the updated policies below.

Reclassifications: Certain prior fiscal year balances have been reclassified to conform to the current fiscal year presentation. In the first quarter of fiscal 2013, we concluded that it was appropriate to reclassify, prospectively, our purchased intellectual property, or IP, that is incorporated into our products, from software, equipment and leasehold improvements to intangible assets. The reclassification has no effect on previously reported Consolidated Condensed Statements of Operations for any period and does not materially affect previously reported cash flows from operations or from financing activities in the Consolidated Condensed Statements of Cash Flows. For comparability purposes, the corresponding gross assets and accumulated amortization of $22.0 million and $5.9 million, respectively, have been reclassified as of January 28, 2012. Such reclassifications had no effect on previously reported results of operations or retained earnings.

Software, equipment and leasehold improvements: Software, equipment and leasehold improvements are stated at cost. Depreciation and amortization for software, equipment and leasehold improvements is computed using the straight-line method based on the useful lives of the assets (one to five years) or the remaining lease term if shorter. Any allowance for leasehold improvements received from the landlord for improvements to our facilities is amortized using the straight-line method over the lesser of the remaining lease term or the useful life of the leasehold improvements. Repairs and maintenance costs are expensed as incurred.

Long-lived assets: The amounts and useful lives assigned to finite lived intangible assets acquired, other than goodwill, impact the amount and timing of future amortization. Long-lived assets include intellectual property that we purchase for incorporation into our product designs. We begin amortizing such intellectual property at the time that we begin shipment of the associated products into which it is incorporated. We amortize the intellectual property over the estimated useful life of the associated products, which is generally two to three years. We assess the carrying value of long-lived assets, including purchased intangible assets, whenever events or changes in circumstances, such as a change in technology, indicate that the carrying value of these assets may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than its carrying amount.

## Results of Operations

The following table is derived from our unaudited condensed consolidated financial statements and sets forth our historical operating results as a percentage of net revenue for each of the periods indicated (in thousands, except percentages):

| | Three Months Ended | | | |
|---|---|---|---|---|
| | April 28, 2012 | % of Net Revenue | April 30, 2011 | % of Net Revenue |
| Net revenue | $ 40,258 | 100% | $ 60,632 | 100% |
| Cost of revenue | 19,163 | 48% | 30,840 | 51% |
| Gross profit | 21,095 | 52% | 29,792 | 49% |
| Operating expenses: | | | | |
| Research and development | 21,789 | 54% | 21,596 | 35% |
| Sales and marketing | 6,888 | 17% | 8,501 | 14% |
| General and administrative | 6,379 | 16% | 5,435 | 9% |
| Total operating expenses | 35,056 | 87% | 35,532 | 58% |
| Loss from operations | (13,961) | (35%) | (5,740) | (9%) |
| Interest and other income, net | 491 | 1% | 819 | 1% |
| Loss before income taxes | (13,470) | (34%) | (4,921) | (8%) |
| Provision for income taxes | 232 | * | 749 | 1% |
| Net loss | $ (13,702) | (34%) | $ (5,670) | (9%) |

* The percentage of net revenue is less than one percent.

Net revenue

Our net revenue for the three months ended April 28, 2012 decreased $20.4 million, or 34%, compared to the corresponding period in the prior fiscal year. The decrease was due primarily to a 29% decrease in average selling price, or ASP, primarily as a result of a shift in product mix, and a 7% decrease in units shipped. The units shipped for our home networking and home control and energy management products, which have lower ASPs than our media processor products, increased and the units shipped for our media processor products decreased. We expect our total net revenue to increase in future periods as we recognize the benefit of acquired products from our acquisition of assets used in the digital TV business from Trident Microsystems.

Net revenue by target market

We sell our products into five primary target markets, which are the IPTV media processor market, home networking market, home control and energy management market, connected media player market, and the prosumer and industrial audio/video market. We also sell a small amount of our chipsets into other markets, such as the digital signage, high definition television, or HDTV, projection TV and PC-based add-in markets, which we refer to as our other market.

The following table sets forth our net revenue by target market and the percentage of net revenue represented by our product sales to each target market (in thousands, except percentages):

| | Three Months Ended | | | |
|---|---|---|---|---|
| | April 28, 2012 | % of Net Revenue | April 30, 2011 | % of Net Revenue |
| Home networking | $ 20,838 | 52% | $ 24,820 | 41% |
| IPTV media processor | 10,390 | 26% | 22,308 | 37% |
| Home control and energy management | 3,184 | 8% | 2,590 | 4% |
| Connected media player | 3,152 | 8% | 7,855 | 13% |
| Prosumer and industrial audio/video | 2,571 | 6% | 2,883 | 5% |
| Other | 123 | * | 176 | * |
| Net revenue | $ 40,258 | 100% | $ 60,632 | 100% |

* This market provided less than 1% of our net revenue in this period.

Home networking market: For the three months ended April 28, 2012, net revenue from sales of our products into the home networking market decreased $4.0 million, or 16%, compared to the corresponding period in the prior fiscal year. This decrease was primarily the result of a decrease in ASP in the home networking market which was partially offset by an increase in units shipped. Our revenue from the home networking market as a percentage of our total net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year increased by 11 percentage points primarily as a result of the increase in demand in the home networking market as well as the decline in demand in the connected media player and IPTV media processor markets. We expect our revenue from the home networking market to fluctuate in future periods based on changes in inventory levels at contract manufacturers who manufacture equipment incorporating our products for deployment by telecommunication providers.

IPTV media processor market: For the three months ended April 28, 2012, net revenue from sales of our products into the IPTV media processor market decreased $11.9 million, or 53%, compared to the corresponding period in the prior fiscal year. This decline was attributable to a decline in both ASP and units shipped as a result of reduced demand for our chipsets in the IPTV media processor market as a result of competitive factors in connection with product transitions at telecommunications service providers to the next generation IPTV media processor solutions. Our revenue from the IPTV media processor market as a percentage of our total net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year decreased by 11 percentage points primarily as a result of the decrease in demand for our chipsets in the IPTV media processor market. We expect our revenue from the IPTV media processor market to fluctuate in future periods as this revenue is dependent on IPTV service deployments by telecommunication service providers, adoption of our newer and future generations of our technology, changes in inventory levels at the contract manufacturers that supply them and competitive market pressures. Additionally, due to decreases in the ASPs of our newer generation products relative to our older generation products, we must increase unit shipments of our products substantially in order to increase our revenue. We do not expect an increase in our revenue from the IPTV media processor market until at least the second half of fiscal 2013. We believe a large telecommunication service provider, whom we target as a significant end customer, is in the process of shifting to another generation of products in the near term and we are competing for this business.

Home control and energy management market: For the three months ended April 28, 2012, net revenue from sales of our products into the home control and energy management market increased $0.6 million, or 23%, compared to the corresponding period in the prior fiscal year. This increase was primarily the result of higher demand in the home control and energy management market and an increase in ASP. Our revenue from the home control and energy management market as a percentage of our total net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year increased by 4 percentage points primarily as a result of the increase in demand in the home control and energy management market as well as the decline in demand in the connected media player and IPTV media processor markets. We expect our revenue from the home control and energy management market to increase in fiscal 2013.

Connected media player market: For the three months ended April 28, 2012, net revenue from sales of our products into the connected media player market decreased $4.7 million, or 60%, compared to the corresponding period in the prior fiscal year. The decrease in revenue was the result of a decrease of 60% in units shipped, which was primarily due to competitive factors. Our revenue from the connected media player market as a percentage of our total net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year decreased by 5 percentage points primarily as a result of the overall decrease in units shipped into the connected media player market. We expect our revenue from the connected media player market to fluctuate in future periods primarily due to the timing and nature of new product introductions by consumer electronics companies that incorporate our products and their transition to our newer generation products. Additionally, due to decreases in the ASPs of our newer generation products relative to our older generation products, we must increase unit shipments of our products substantially in order to increase our revenue.

Prosumer and industrial audio/video market: For the three months ended April 28, 2012, net revenue from sales of our products into the prosumer and industrial audio/video market decreased $0.3 million, or 11%, compared to the corresponding period in the prior fiscal year. The decrease was attributable to a decrease in ASP, which was primarily due to a shift in product mix to lower ASP next-generation products. Our revenue from sales into the prosumer and industrial audio/video market as a percentage of total net revenue increased by 1 percentage point for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year. We expect our revenue from the prosumer and industrial audio/video market to fluctuate based on our ability to obtain design wins in our customers' newer generation products, broad economic trends affecting business spending on video conferencing and high end audio/video products and also discretionary consumer spending.

Other markets: Our other markets consist of HDTV, PC add-in boards, development contracts, services and other ancillary markets. The revenue derived from our other markets was not a significant portion of our total net revenue.

Net revenue by product group

Our primary product group consists of our chipsets. Our chipsets are targeted toward manufacturers and large volume designer and manufacturer customers building products for the IPTV, home networking, home control and energy management, connected media player, and prosumer and industrial audio/video consumer electronic markets. Sales of our chipsets accounted for approximately 99% and 99% of our net revenue for the three months ended April 28, 2012 and April 30, 2011, respectively.

We derive a minor portion of our revenue from other products and services, including software development kits, engineering support services for hardware and software, engineering development for customization of chipsets and other accessories. The revenue derived from other products and services was not a significant portion of our total net revenue.

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Net revenue by geographic region

The following table sets forth net revenue for each geographic region based on the ship-to location of customers (in thousands, except percentages):

| | Three Months Ended | | | |
|---|---|---|---|---|
| | April 28, 2012 | % of Net Revenue | April 30, 2011 | % of Net Revenue |
| Asia | $ 36,604 | 91% | $ 57,614 | 95% |
| North America | 1,866 | 5% | 2,115 | 4% |
| Other regions | 1,199 | 3% | 61 | * |
| Europe | 589 | 1% | 842 | 1% |
| Net revenue | $ 40,258 | 100% | $ 60,632 | 100% |

* The percentage of net revenue is less than one percent.

Asia: Our net revenue in absolute dollars from Asia decreased $21.0 million, or 36%, for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year. The decrease in net revenue from Asia in absolute dollars was primarily attributable to lower demand in the IPTV media processor market. Our net revenue from Asia as a percentage of our total net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year decreased by 4 percentage points.

As a percentage of total net revenue by country in the Asia region, China, including Hong Kong, represented 75% and 84% for the three months ended April 28, 2012 and April 30, 2011, respectively.

North America: Our net revenue in absolute dollars from North America decreased $0.2 million, or 12%, for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year. Our net revenue from North America increased 1 percentage point as a percentage of our total net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year. The decrease in our net revenue from North America in absolute dollars was primarily attributable to lower demand for our SoC solutions for the prosumer and industrial audio/video and connected media player markets.

For the three months ended April 28, 2012 and April 30, 2011, our net revenue generated outside North America was 95% and 96% of our total net revenue, respectively.

Other regions: Our net revenue in absolute dollars from other regions increased $1.1 million for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year. Our net revenue from other regions increased by 3 percentage points as a percentage of our net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year. The increase in our net revenue from other regions in both absolute dollars and as a percentage of our total net revenue was primarily attributable to higher demand for our SoC solutions for the home networking market.

Europe: Our net revenue in absolute dollars from Europe decreased $0.3 million, or 30%, for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year. Our net revenue from Europe as a percentage of our total net revenue for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year was unchanged. The decrease in our net revenue from Europe in absolute dollars was primarily attributable to lower demand for our SoC solutions for the IPTV media processor market.

Major Customers

The following table sets forth the major customers that accounted for 10% or more of our net revenue:

| | Three Months Ended | |
|---|---|---|
| Customer | April 28, 2012 | April 30, 2011 |
| Flextronics | 16% | * |
| Motorola | 16% | 20% |
| Gemtek | 14% | 30% |

* This customer provided less than 10% of our net revenue in this period.

Gross Profit and Gross Margin

The following table sets forth our gross profit and gross margin (in thousands, except percentages):

| | Three Months Ended | | |
|---|---|---|---|
| | April 28, 2012 | % change | April 30, 2011 |
| Gross profit | $ 21,095 | (29%) | $ 29,792 |
| Gross margin | 52.4% | | 49.1% |

The $8.7 million decrease in gross profit for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year was primarily due to a decline in revenue in the IPTV and connected media player markets. These declines resulted in an increase in revenue as a percentage of total revenue in the home networking market which has lower average cost per chipsets, or ACU, and overall yields a high margin. Our ASP declined by 29%, units shipped decreased by 7%, and our ACU declined by 53%. The decrease in ASP was primarily due to the increase, as a percentage of total net revenue, of sales of our home networking and home control and energy management automation products and our new generation media processor products compared to sales of our older generation media processor products, which had higher ASPs. The decrease in units shipped was primarily due to competitive factors and the timing of new product introductions at telecommunications service providers and other consumer electronics companies. The decrease in ACU was primarily due to the same reasons noted for our ASP decline and also due to a $1.1 million benefit from the sale of previously written down products. The decreases were partially offset by an increased percentage of fixed costs per unit due to the 7% decrease in units shipped. Fixed costs include such items as depreciation and amortization and compensation costs for operations.

The 3.3 percentage point increase in gross margin for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year was primarily due to the $1.1 million, or 2.8 percentage points benefit from the sale of inventory which was previously written down and the shift in product mix to higher margin HPNA products.

Research and development expense

Research and development expense consists primarily of compensation and benefits for our employees engaged in research, design and development activities, stock-based compensation expense, engineering design tools, mask and prototyping costs, testing and subcontracting costs, and costs for facilities and equipment.

The following table sets forth details of research and development expense for the three months ended April 28, 2012 and April 30, 2011 (in thousands, except percentages):

| | Three Months Ended April 28, 2012 | % of Net Revenue | Three Months Ended April 30, 2011 | % of Net Revenue | Increase (Decrease) | % Change |
|---|---|---|---|---|---|---|
| Compensation and benefits | $ 13,513 | 33% | $ 12,105 | 20% | 1,408 | 12% |
| Development and design costs | 3,276 | 8% | 3,975 | 7% | (699) | (18%) |
| Depreciation and amortization | 1,948 | 5% | 2,315 | 4% | (367) | (16%) |
| Stock-based compensation | 1,463 | 4% | 1,532 | 2% | (69) | (5%) |
| Other | 1,589 | 4% | 1,669 | 2% | (80) | (5%) |
| Total research and development expenses | $ 21,789 | 54% | $ 21,596 | 35% | 193 | 1% |

For the three months ended April 28, 2012, compensation and benefits increased primarily due to an increase in headcount to support new product development as well as salary increases. The decrease in development and design costs was mainly due to a reduction in masks and shuttle purchases. Other expenses decreased mainly due to a decrease in IT infrastructure expenses. We expect our research and development expense to increase in absolute dollars as a result of our acquisition of assets used in the digital TV business from Trident Microsystems, but to remain relatively constant as a percentage of revenue as we grow our revenue as a result of this acquisition.

Sales and marketing expense

Sales and marketing expense consists primarily of compensation and benefits costs, including commissions to our direct sales force, stock-based compensation expense, trade shows, travel and entertainment expenses and external commissions.

The following table sets forth details of sales and marketing expense for the three months ended April 28, 2012 and April 30, 2011 (in thousands, except percentages):

| | Three Months Ended | | Three Months Ended | | | |
|---|---|---|---|---|---|---|
| | April 28, 2012 | % of Net Revenue | April 30, 2011 | % of Net Revenue | Increase (Decrease) | % Change |
| Compensation and benefits | $ 4,370 | 11% | $ 3,796 | 6% | 574 | 15% |
| Depreciation and amortization | 429 | 1% | 2,094 | 4% | (1,665) | (80%) |
| Trade shows, travel and entertainment | 696 | 2% | 919 | 2% | (223) | (24%) |
| Stock-based compensation | 472 | 1% | 594 | 1% | (122) | (21%) |
| External commissions | 161 | * | 368 | * | (207) | (56%) |
| Other | 760 | 2% | 730 | 1% | 30 | 4% |
| Total sales and marketing expenses | $ 6,888 | 17% | $ 8,501 | 14% | (1,613) | (19%) |

* The percentage of net revenue is less than one percent.

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For the three months ended April 28, 2012, compensation and benefits increased primarily due to salary increases and an increase in headcount.  Depreciation and amortization decreased due to lower amortization of acquired intangible assets as a result of related acquired intangible assets impairment charges recorded in our third quarter of fiscal 2012.  Trade shows, travel and entertainment expenses decreased primarily as a result of our efforts to reduce travel expenses.  Stock-based compensation decreased primarily due to the timing of options and awards grants and option cancellations.  External commissions decreased due to lower net revenues of products sold through external sales representatives.  Other expenses remained unchanged.  We expect our sales and marketing expense to increase in absolute dollars as a result of our acquisition of assets used in the digital TV business from Trident Microsystems, but to remain relatively constant as a percentage of revenue as we grow our revenue as a result of this acquisition.

General and administrative expense

General and administrative expense consists primarily of compensation and benefits costs, stock-based compensation expense, legal, accounting and other professional fees and facilities expenses.

The following table sets forth details of general and administrative expense for the three months ended April 28, 2012 and April 30, 2011 (in thousands, except percentages):

| | Three Months Ended April 28, 2012 | % of Net Revenue | Three Months Ended April 30, 2011 | % of Net Revenue | Increase (Decrease) | % Change |
|---|---|---|---|---|---|---|
| Compensation and benefits | $ 2,068 | 5% | $ 2,144 | 4% | (76) | (4%) |
| Legal and accounting fees | 1,753 | 4% | 1,027 | 2% | 726 | 71% |
| Stock-based compensation | 774 | 2% | 965 | 2% | (191) | (20%) |
| Facilities and infrastructure | 714 | 2% | 492 | * | 222 | 45% |
| Other | 1,070 | 3% | 807 | 1% | 263 | 33% |
| Total general and administrative expenses | $ 6,379 | 16% | $ 5,435 | 9% | 944 | 17% |

* The percentage of net revenue is less than one percent.

For the three months ended April 28, 2012, compensation and benefits decreased primarily due to a reduction in headcount.  The increase in legal and accounting fees is primarily due to legal fees incurred in connection with our acquisition of assets used in the digital TV business from Trident Microsystems.  The decrease in stock-based compensation expenses is primarily due to the timing of options and awards grants and option cancellations.  The increase in facilities and infrastructure is primarily due to higher IT infrastructure expenses.  Other expenses increased primarily due to a bad debt reserve recorded in April 2012.  We expect our general and administrative expense to increase in absolute dollars as a result of our acquisition of assets used in the digital TV business from Trident Microsystems, but to remain relatively constant as a percentage of revenue as we grow our revenues as a result of this acquisition.

Goodwill and indefinite-lived intangible assets impairment

As of October 29, 2011, we concluded that an interim review of the carrying value of our goodwill and indefinite-lived intangible assets should be performed due to continued reductions in our profitability, sales forecasts and market capitalization.  As a result, we recognized a goodwill impairment charge of $45.1 million and an impairment charge for our indefinite-lived in-process research and development intangible assets of $11.1 million during the third quarter of fiscal 2012.

Impairment, reclassification and amortization of intangible assets

In the first quarter of fiscal 2013, we concluded that it was appropriate to reclassify our purchased intellectual property, or IP, that is incorporated into our products, from software, equipment and leasehold improvements to intangible assets. The reclassification has no effect on previously reported Consolidated Condensed Statements of Operations for any period and does not materially affect previously reported cash flows from operations or from financing activities in the Consolidated Condensed Statements of Cash Flows. For comparability purposes, the corresponding gross assets and accumulated amortization of $22.2 million and $5.9 million, respectively, have been reclassified as of January 28, 2012.

As of January 28, 2012, we included under software, the third party purchased IP that we acquire for incorporation into our product designs. During the first fiscal quarter of fiscal 2013, we reclassified $16.3 million, net of purchased IP from software, equipment and leasehold improvements to intangible assets. We begin amortizing such intellectual property at the time that we begin shipment of the associated products into which it is incorporated. We amortize the intellectual property over the estimated useful life of the associated products, which is generally two to three years.

The table below presents the balances of our intangible assets as of April 28, 2012 and January 28, 2012:

| | April 28, 2012 | January 28, 2012 |
|---|---|---|
| Acquired intangible assets | $ 75,978 | $ 75,978 |
| Purchased IP | 22,519 | 22,204 |
| Total | $ 98,497 | $ 98,182 |
| Accumulated amortization | (54,920) | (52,526) |
| Intangible assets, net | $ 43,577 | $ 45,656 |

During the third quarter of fiscal 2012, we performed a review of the carrying value of our acquired intangible assets due to continued reductions in our profitability and sales forecasts, and negative cash flows from operations. As a result, we recognized an intangible asset impairment charge of $55.1 million.

We classify our expense from the amortization of acquired developed technology of $1.5 million and $2.7 million for the three months ended April 28, 2012 and April 30, 2011, respectively, as cost of revenue. We classify our expense from the amortization of purchased IP of $0.5 million for the three months ended April 28, 2012, as cost of revenue. Amortization for purchased IP was $0.4 million for the three months ended April 30, 2011. We classify our amortization expense for acquired customer relationships and trademarks of $0.4 million and $2.0 million for the three months ended April 28, 2012 and April 30, 2011, respectively, as sales and marketing expense. As of April 28, 2012, the unamortized balance from our intangible assets was $43.6 million, which we intend to amortize to future periods based on the remaining estimated useful life of each acquired intangible asset. If we purchase additional intangible assets in the future, our cost of revenue or other operating expenses may increase from the amortization of those assets.

Acquired intangible assets subject to amortization were as follows as of April 28, 2012 (in thousands, except for years):

| | April 28, 2012 | | | | |
|---|---|---|---|---|---|
| | Gross Value | Impairment | Accumulated Amortization and Effect of Currency Translation | Net Value | Weighted average remaining amortization period (years) |
| Developed technology | $ 75,827 | $ (24,614) | $ (29,984) | $ 21,229 | 4.5 |
| Customer relationships | 51,174 | (30,486) | (15,282) | 5,406 | 4.6 |
| Capitalized IP - amortizing | 8,496 | — | (6,405) | 2,091 | 1.7 |
| Trademarks | 2,677 | — | (1,849) | 828 | 6.4 |
| Non-compete agreements | 1,400 | — | (1,400) | — | — |
| | 139,574 | (55,100) | (54,920) | 29,554 | 4.3 |

| | | | | | |
|---|---|---|---|---|---|
| Capitalized IP – not yet amortizing | 14,023 | — | — | 14,023 | — |
| In-process research and development | 11,070 | (11,070) | — | — | — |
| | $ 164,667 | $ (66,170) | $ (54,920) | $ 43,577 | |

Stock-based compensation expense

The following table sets forth the total stock-based compensation expense that is included in each functional line item in the condensed consolidated statements of operations (in thousands):

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Cost of revenue | $ 117 | $ 100 |
| Research and development | 1,463 | 1,532 |
| Sales and marketing | 472 | 594 |
| General and administrative | 774 | 965 |
| Total stock-based compensation | $ 2,826 | $ 3,191 |

The expensing of employee stock options, restricted stock awards and restricted stock units grants will continue to have an adverse impact on our results of operations.

Interest and other income, net

The following table sets forth net interest and other income and the related percentage change (in thousands, except percentages):

| | Three Months Ended | | |
|---|---|---|---|
| | April 28, 2012 | % change | April 30, 2011 |
| Interest and other income, net | $ 491 | (40%) | $ 819 |

Our other income and expense primarily consists of interest income from marketable securities, income from refundable research and development credits, gains or losses on foreign exchange transactions, gains or losses on sales of marketable securities and gains or losses on currency hedging activities. The decrease of $0.3 million, or 40%, for the three months ended April 28, 2012 compared to the corresponding period in the prior fiscal year was due primarily to foreign exchange losses as a result of the U.S. dollar weakening compared to the Euro, Danish krone, and Canadian dollar and a decrease in investment income in connection with market value fluctuations. The decreases were partially offset by gains from hedging activities.

Provision for income taxes

We recorded a provision for income taxes of $0.2 million and $0.7 million for the three months ended April 28, 2012 and April 30, 2011, respectively. Included in our provision for income taxes are foreign exchange gains or losses on unsettled income tax liabilities.

Liquidity and Capital Resources

The following table sets forth the balances of cash and cash equivalents and short-term marketable securities (in thousands):

| | April 28, 2012 | January 28, 2012 |
|---|---|---|
| Cash and cash equivalents | $ 79,050 | 44,283 |
| Short-term marketable securities | 7,329 | 42,134 |
| | $ 86,379 | 86,417 |

As of April 28, 2012, our principal sources of liquidity consisted of cash and cash equivalents and short-term marketable securities of $86.4 million. The balance was unchanged from $86.4 million at January 28, 2012 as the result of $6.9 million of cash used in our operating activities and $2.7 million in purchases of software, equipment and leasehold improvements. These outflows of cash, cash equivalents and short-term marketable securities were partially offset by $9.6 million of transfers from long-term marketable securities. During the first quarter of fiscal 2013, we liquidated a significant portion of our short-term marketable securities to generate sufficient cash in anticipation of our asset acquisition from Trident Microsystems, which was completed on May 4, 2012. We used a total of $42.2 million in cash for this acquisition in the second quarter of fiscal 2013.

As of April 28, 2012, we held $52.8 million of long-term marketable securities. Although these marketable securities have maturities of greater than one year, we classify them as available-for-sale and may access these funds prior to their contractual maturities.

The following table sets forth the primary net cash inflows and outflows (in thousands):

| | Three Months Ended | |
|---|---|---|
| | April 28, 2012 | April 30, 2011 |
| Net cash provided by (used in): | | |
| Operating activities | $ (6,926) | $ (6,554) |
| Investing activities | 41,602 | (7,771) |
| Financing activities | 55 | 1,164 |
| Effect of foreign exchange rate changes on cash and cash equivalents | 36 | 248 |
| Net increase (decrease) in cash and cash equivalents | $ 34,767 | $ (12,913) |

Cash flows from operating activities

Net cash used in operating activities of $6.9 million for the three months ended April 28, 2012 was primarily due to net loss of $13.7 million, a $2.5 million increase in accounts receivable, a $1.2 million decrease in accrued liabilities and accounts payable, and a $1.0 million decrease in other long-term liabilities. These amounts were partially offset by non-cash expenses of $8.4 million and a $3.1 million decrease in inventory. Non-cash expenses included in net income for the three months ended April 28, 2012 consisted primarily of $5.1 million in depreciation and amortization and $2.8 million in stock-based compensation expense.

The increase in accounts receivable was primarily the result of increased revenue compared to our prior fiscal quarter as well as the timing of product shipments during the quarter, which resulted in a decrease in our days of sales outstanding to 53 for the fiscal quarter ended April 28, 2012 compared to 54 for the previous fiscal quarter. The decrease in inventories was the result of lower media processor wafer purchases during the quarter, which resulted in an increase in our annualized rate of inventory turns to 3.8 times per year compared to 3.4 for the prior quarter. The decrease in accounts payable and accrued liabilities was primarily due to decreased purchases of inventory and the timing of payments for inventories and software.

Net cash used in operating activities of $6.6 million for the three months ended April 30, 2011 was primarily due to net loss of $5.7 million, a $5.9 million increase in accounts receivable, a $3.8 million decrease in accrued liabilities, a $1.3 million decrease in accounts payable, a $0.6 million increase in inventories and a $0.7 million increase in prepaid expenses and other current assets. These amounts were partially offset by non-cash expenses of $10.7 million and a $0.8 million increase in other long-term liabilities. Non-cash expenses included in net income for the three months ended April 30, 2011 consisted primarily of $7.4 million in depreciation and amortization and $3.2 million in stock-based compensation expense.

The increase in accounts receivable was primarily the result of timing of product shipments during the quarter, which resulted in an increase in our days of sales outstanding to 56 for the fiscal quarter ended April 30, 2011 compared to 48 for the previous fiscal quarter. The increase in inventories was the result of increases in the level of our die bank and other purchased materials during the quarter which resulted in a decrease in our annualized rate of inventory turns to 3.2 for the fiscal quarter ended April 30, 2011 compared to 4.1 for the prior quarter. The decrease in accounts payable and accrued liabilities was primarily due to the timing of payments for inventories and software.

Cash flows from our operating activities will continue to fluctuate based upon our ability to grow net revenues while managing the timing of payments to us from customers and from us to vendors, the timing of inventory purchases and subsequent manufacture and sale of our products.

Cash flows from investing activities

Net cash provided by investing activities was $41.6 million for the three months ended April 28, 2012, which was primarily due to net sales of marketable securities of $44.3 million, partially offset by purchases of software, equipment and leasehold improvements of $2.7 million.

Net cash used in investing activities was $7.8 million for the three months ended April 30, 2011, which was primarily due to purchases of software, equipment and leasehold improvements of $5.2 million and net purchases of marketable securities of $2.5 million.

Cash flows from financing activities

Net cash provided by financing activities was $55,000 for the three months ended April 28, 2012, which was due to proceeds from exercises of employee stock options.

Net cash provided by financing activities was $1.2 million for the three months ended April 30, 2011, which was due to proceeds from exercises of employee stock options.

While we generated cash from operations for fiscal 2011, 2010 and 2009, we consumed cash in operations in fiscal 2012 and in the first quarter of fiscal 2013 and it is possible that our operations will consume additional cash in future periods. Based on our current anticipated cash needs, we believe that our current balances of cash, cash equivalents and short-term marketable securities will be sufficient to meet our anticipated working capital requirements, obligations, capital expenditures, strategic investments and other cash needs for at least the next twelve months. However, it is possible that we may need to raise additional funds to finance our activities during or beyond the next 12 months and our future capital requirements may vary significantly from those currently planned. Our cash, cash equivalent and marketable security balances will continue to fluctuate based upon our ability to grow revenue, the timing of payments to us from customers and to vendors from us and the timing of inventory purchases and subsequent manufacture and sale of our products. From time to time, we may also increase our long-term investments which will cause our marketable securities balances to decrease.

Our marketable securities include primarily corporate bonds, money market funds, US agency discount notes and municipal notes and bonds. We monitor all our marketable securities for impairment and if these securities are reported to have had a decline in fair value, we may need to use significant judgment to identify events or circumstances that would likely have a significant adverse effect on the future value of each investment including: (i) the nature of the investment; (ii) the cause and duration of any impairment; (iii) the financial condition and near term prospects of the issuer; (iv) for securities with a reported decline in fair value, our ability to hold the security for a period of time sufficient to allow for any anticipated recovery of fair value; (v) the extent to which fair value may differ from cost; and (vi) a comparison of the income generated by the securities compared to alternative investments. We would recognize an impairment charge if a decline in the fair value of our marketable securities is judged to be other-than-temporary.

Contractual obligations and commitments

We generally do not have guaranteed price or quantity commitments from any of our suppliers. Additionally, we generally acquire products for sale to our customers based on purchase orders received as well as forecasts from such customers. Purchase orders with delivery dates greater than twelve weeks are typically cancelable without penalty to our customers. We currently place non-cancelable orders to purchase semiconductor wafers, other materials and finished goods from our suppliers on an eight to twelve week lead-time basis.

The following table sets forth the amounts of payments due under specified contractual obligations as of April 28, 2012 (in thousands):

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Remainder Fiscal 2013 | Fiscal 2014 - 2015 | Fiscal 2016 - 2017 | Fiscal 2018 and thereafter | Total |
| Operating leases | $ 3,000 | $ 3,370 | $ 1,597 | $ 629 | $ 8,596 |
| Non-cancelable purchase orders | 15,895 | - | - | - | 15,895 |
| | $ 18,895 | $ 3,370 | $ 1,597 | $ 629 | $ 24,491 |

Recent accounting pronouncements

See Note 1, “Recent Accounting Pronouncements,” of the Notes to Unaudited Condensed Consolidated Financial Statements of this Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following discussion about our market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We face exposure to market risk from adverse movements in interest rates and foreign currency exchange rates, which could impact our operations and financial condition. To mitigate some of the foreign currency exchange rate risk, we utilize derivative financial instruments to hedge certain foreign currency exposures. We do not use derivative financial instruments for speculative or trading purposes.

Interest rate sensitivity: As of April 28, 2012 and January 28, 2012, we held approximately $139.2 million and $148.4 million, respectively, of cash, cash equivalents and short-term and long-term marketable securities. If short-term interest rates were to decrease 10%, the decreased interest income associated with these cash, cash equivalents and marketable securities would not have a significant impact on our net income and cash flows.

Foreign currency exchange rate sensitivity: We transact our revenues in U.S. dollars. The U.S. dollar is our functional and reporting currency except for our subsidiaries in Canada, China, Denmark, France, Japan, Taiwan and Vietnam where the Canadian dollar, Danish krone, Euro, Japanese Yen, Taiwanese dollar and Vietnamese dong are the primary financial currencies, respectively. Additionally, a significant portion of our Israel subsidiary's expenses are payroll related and are denominated in Israeli shekels. This foreign currency exposure gives rise to market risk associated with exchange rate movements of the U.S. dollar against the Israeli shekel. To the extent the U.S. dollar weakens against the Israeli shekel, our Israeli subsidiary will experience a negative impact on its results of operations.

As of April 28, 2012, with the exception of our Israel operation, we had not entered into foreign exchange forward contracts to hedge certain balance sheet exposures or inter-company balances against future movements in foreign exchange rates. For our Israel operation, we do hedge portions of our forecasted expenses that are denominated in the Israeli shekel with foreign exchange forward contracts. As of April 28, 2012, we had foreign exchange contracts with notional values of approximately $8.2 million that mature on or before March 27, 2013. These hedges of cash flow exposures will only mitigate a portion of our foreign exchange exposure. If foreign exchange rates were to weaken against the U.S. dollar immediately and uniformly by 10% from the exchange rates at April 28, 2012, the notional value of our derivative instruments would decline and we would record a foreign exchange loss of approximately $0.6 million, a portion of which should be offset by our foreign exchange hedging activities.

We maintain certain cash balances denominated in the Canadian dollar, Chinese renminbi, Danish krone, Euro, Hong Kong dollar, Israeli shekel, Singapore dollar, Taiwanese dollar and Vietnamese Dong. If foreign exchange rates were to weaken against the U.S. dollar immediately and uniformly by 10% from the exchange rate at April 28, 2012, the fair value of these foreign currency amounts would decline by $0.7 million.

## ITEM 4. CONTROLS AND PROCEDURES

We are committed to maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our periodic reports filed under the Securities and Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and we necessarily are required to apply our judgment in evaluating the cost-benefit relationship of possible controls and procedures and implementing controls and procedures.

As of April 28, 2012, the end of the period covered by this Quarterly Report on Form 10-Q, we have, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of the design and effectiveness of our disclosure controls and procedures, as such terms are defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act. Based on this evaluation, we have concluded that our disclosure controls and procedures were effective as of April 28, 2012.

During the first quarter ended April 28, 2012, there were no changes in our internal control over financial reporting (as defined in Rule 13(a) – 15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls. This results in refinements to processes throughout our organization.

# PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

On August 6, 2011, Powerline Innovations, LLC, or Powerline, filed suit against us, certain of our subsidiaries and many other named defendants, including Qualcomm Incorporated, Qualcomm Atheros, Inc., Broadcom Corporation and ST Microelectronics N.V. in the United States District Court for the Easter District of Texas asserting infringement of U.S. Patent No. 5,471,190. The Powerline complaint seeks unspecified monetary damages and injunctive relief. At this time, we are unable to determine the outcome of this matter and, accordingly, cannot estimate the potential financial impact this action could have on our business, operating results, cash flows or financial position.

From time to time, we are involved in claims and legal proceedings that arise in the ordinary course of business. We expect that the number and significance of these matters will increase as our business expands. In particular, we could face an increasing number of patent and other intellectual property claims as the number of products and competitors in our industry grows. Any claims or proceedings against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of our time, result in the diversion of significant operational resources, or require us to enter into royalty or licensing agreements which, if required, may not be available on terms favorable to us or at all. Were an unfavorable outcome to occur against us, there exists the possibility of a material adverse impact on our financial position and results of operations for the period in which the unfavorable outcome occurs, and potentially in future periods.

ITEM 1A. RISK FACTORS

If any of the following risks actually occurs, our business, financial condition and results of operations could be harmed. In that case, the trading price of our common stock could decline and you might lose all or part of your investment in our common stock. The risks and uncertainties described below are not the only ones we face. You should also refer to other information set forth in this Form 10-Q, including our unaudited condensed consolidated financial statements and the related notes. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations.

Risks Related to Our Business and Our Industry

If we do not successfully anticipate market needs and develop products and product enhancements in a timely manner that meet those needs, or if those products do not gain market acceptance, we may not be able to compete effectively and our ability to generate revenue will suffer.

We may not be able to accurately anticipate future market needs or be able to develop new products or product enhancements to meet such needs or to meet them in a timely manner. Our ability to develop and deliver new products successfully will depend on various factors, including our ability to:

- accurately predict market requirements and evolving industry standards;
- accurately design new chipset products;
- timely complete and introduce new product designs;
- timely qualify and obtain industry interoperability certification of our products and the equipment into which our products will be incorporated;
- ensure that our subcontractors have sufficient foundry, assembly and test capacity and packaging materials and achieve acceptable manufacturing yields;
- shift our products to smaller geometry process technologies to achieve lower cost and higher levels of design integration; and
- gain market acceptance of our products and our customers' products.

If we fail to anticipate market requirements or to develop new products or product enhancements to meet those needs in a cost-effective and timely manner, it could substantially decrease market acceptance and sales of our present and future products and we may be unable to attract new customers or retain our existing customers, which would significantly harm our business and financial results.

Even if we are able to anticipate, develop and commercially introduce new products and enhancements, our new products or enhancements may not achieve widespread market acceptance. Any failure of our products to achieve market acceptance could adversely affect our business and financial results.

If demand for our chipsets declines or does not grow, we will be unable to increase or sustain our net revenue.

We expect our chipsets to account for a substantial majority of our net revenue for the foreseeable future. For fiscal 2012, sales of our chipsets represented nearly all of our net revenue. Even if the consumer electronic markets that we target continue to expand, manufacturers of consumer products in these markets may not choose to utilize our chipsets in their products. The markets for our products are characterized by frequent introduction of new technologies, short product life cycles and significant price competition. If we or our customers are unable to manage product transitions in a timely and cost effective manner, our net revenue would suffer. In addition, frequent technological changes and introduction of next generation products may result in inventory obsolescence which would increase our cost of revenue and adversely affect our operating performance. If demand for our chipsets declines or fails to grow or we are unable to develop new products to meet our customers' demand, our net revenue could be harmed.

Our industry is highly competitive and we may not be able to compete effectively, which would harm our market share and cause our revenue to decline.

The markets in which we operate are extremely competitive and are characterized by rapid technological change, continuously evolving customer requirements and declining average selling prices. We may not be able to compete successfully against current or potential competitors. Most of our products compete with large semiconductor providers that have substantial experience and expertise in video, audio and multimedia technology and in selling to consumer equipment providers. Many of these companies have substantially greater engineering, marketing and financial resources than we have. As a result, our competitors may be able to respond better to new or emerging technologies or standards and to changes in customer requirements. Further, some of our competitors are in a better financial and marketing position from which to influence industry acceptance of a particular industry standard or competing technology than we are. Our competitors may also be able to devote greater resources to the development, promotion and sale of products, and may be able to deliver competitive products at a lower price. We also may face competition from newly established competitors, suppliers of products based on new or emerging technologies and customers who choose to develop their own chipsets. Additionally, some of our competitors operate their own fabrication facilities or may have stronger manufacturing partner relationships than we have. We expect our current customers, particularly in the IPTV media processor and connected media player markets, to seek additional suppliers of chipsets for inclusion in their products, which will increase competition and could reduce our market share. If we do not compete successfully, our market share and net revenue could decline.

If we fail to achieve initial design wins for our products, we may be unable to recoup our investments in our products and revenue could decline.

We expend considerable resources in order to achieve design wins for our products, especially our new products and product enhancements, without any assurance that a customer will select our product. Once a customer designs a semiconductor into a product, it is likely to continue to use the same semiconductor or enhanced versions of that semiconductor from the same supplier across a number of similar and successor products for a lengthy period of time due to the significant costs and risks associated with qualifying a new supplier and potentially redesigning the product to incorporate a different semiconductor. As a result, if we fail to achieve an initial design win in a customer's qualification process, we may lose the opportunity for significant sales to that customer for a number of its products and for a lengthy period of time, or we would only be able to sell our products to these customers as a second source, which usually means we would only be able to sell a limited amount of product to them. Also, even if we achieve new design wins with customers, these manufacturers may not purchase our products in sufficient volumes to recoup our development costs, and they can choose at any time to stop using our products, for example, if their own products are not commercially successful. This may cause us to be unable to recoup our investments in the development of our products and cause our revenue to decline.

We depend on a limited number of customers and any reduction, delay or cancellation of an order from these customers or the loss of any of these customers could cause our revenue to decline.

Our dependence on a limited number of customers means that the loss of a major customer or any reduction in orders by a major customer could materially reduce our net revenue and adversely affect our results of operations. We expect that sales to relatively few customers will continue to account for a significant percentage of our net revenue for the foreseeable future. We have no firm, long-term volume commitments from any of our major customers and we generally accept purchase commitments from our customers based upon their purchase orders. Customer purchase orders may be cancelled and order volume levels can be changed, cancelled or delayed with limited or no penalties. We have experienced fluctuations in order levels from period to period and expect that we will continue to experience such fluctuations and may experience cancellations in the future. We may not be able to replace the cancelled, delayed or reduced purchase orders with new orders. Any difficulty in the collection of receivables from key customers could also harm our business.

For the three months ended April 28, 2012, Flextronics, Motorola and Gemtek accounted for 16%, 16% and 14%, respectively, of our net revenue. For the three months ended April 30, 2011, Gemtek and Motorola accounted for 30% and 20%, respectively, of our net revenue.

Our business also depends on demand for our chipsets from companies, such as large telecommunication carriers, who are not our direct customers but deploy IPTV set-boxes that incorporate our chipsets. Large carriers often use multiple set-top box providers, who in turn sometimes use multiple contract manufacturers to purchase our chipsets and manufacture set-top boxes. Even though we do not sell our products directly to these companies that ultimately deploy set-top boxes to consumers, these companies have a significant impact on the demand for our chipsets. For example, a significant number of our chipsets are incorporated into set-top boxes deployed by AT&T. This significant concentration on AT&T set-top boxes was increased by our acquisition of CopperGate. A significant percentage of the chipsets sold by CopperGate are also used in set-top boxes as well as gateways deployed by AT&T. In the past, companies that deploy set-top boxes incorporating our chipsets have had significant fluctuations in demand, which has resulted in a decline in our business from our direct customers, such as original equipment manufacturers and contract manufacturers. We may experience increased competition as companies that deploy set-top boxes incorporating our chipsets seek additional or alternate sources of supply of chipsets for inclusion in their products. Any decrease in the demand from the companies that deploy IPTV set-top boxes incorporating our chipsets, and in particular AT&T, could have a material and adverse effect on our net revenue and results of operation.

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We base orders for inventory on our forecasts of our customers' demand and if our forecasts are inaccurate, our financial condition and liquidity will suffer.

We place orders with our suppliers based on our forecasts of our customers' demand. Our forecasts are based on multiple assumptions, each of which may introduce errors into our estimates. When the demand for our customers' products increases significantly, we may not be able to meet demand on a timely basis and we may need to expend a significant amount of time working with our customers to allocate a limited supply and maintain positive customer relations. If we underestimate customer demand, we may forego revenue opportunities, lose market share and damage our customer relationships. Conversely, if we overestimate customer demand, we may allocate resources to manufacturing products that we may not be able to sell when we expect to or at all. For example, during fiscal 2012, we recorded a provision for excess inventory of $9.0 million which was primarily the result of our end customer’s transition to a next generation product sold by one of our competitors. When we have excess or obsolete inventory, the value of our inventory declines, which increases our cost of revenue and reduces our liquidity.

We have engaged, and may in the future engage in acquisitions of other businesses and technologies which could divert our attention and prove difficult to integrate with our existing business and technology.

We continue to consider investments in and acquisitions of other businesses, technologies or products as part of our efforts to improve our market position, broaden our technological capabilities and expand our product offerings. For example, in March 2011, we completed the acquisition of certain assets from a large computer manufacturer and in November 2009, we completed the acquisition of CopperGate Communications Ltd., an Israeli company. As a result, we added substantial operations, including 141 employees. In May 2012, we completed the acquisition of certain assets used in the digital TV business of Trident Microsystems, where we hired approximately 230 new employees. We also completed the acquisition of Zensys Holdings Corporation in December 2008, the acquisition of certain assets of the VXP Group from Gennum Corporation in February 2008 and the acquisition of Blue7 Communications in February 2006. In the future, we may not be able to acquire or successfully identify companies, products or technologies that would enhance our business. Once we identify a strategic opportunity, the process to consummate a transaction could divert our attention from the operation of our business causing our financial results to decline.

Acquisitions may require large one-time charges and can result in increased debt or contingent liabilities, adverse tax consequences, additional stock-based compensation expense, and the recording and subsequent amortization of amounts related to certain purchased intangible assets, any of which items could negatively impact our results of operations. We may also record goodwill in connection with an acquisition and incur goodwill impairment charges in the future. For example, in fiscal 2012, we recorded a goodwill impairment charge of $45.1 million, which represented a full write-off of all goodwill associated with our acquisitions to date, which had a materially adverse impact to our results of operations. In addition, in order to complete acquisitions, we may issue equity securities and incur debt, which would result in dilution to our existing shareholders and could negatively impact profitability.

We may experience difficulties in integrating acquired businesses. Integrating acquired businesses involves a number of risks, including:

potential disruption of our ongoing business and the diversion of management resources from other business concerns;

unexpected costs or incurring unknown liabilities;

difficulties relating to integrating the operations and personnel of the acquired businesses;

adverse effects on the existing customer relationships of acquired companies; and

adverse effects associated with entering into markets and acquiring technologies in areas in which we have little experience.

If we are unable to successfully integrate the businesses we acquire, our operating results could be harmed.

The timing of our customer orders and product shipments can adversely affect our operating results and stock price.

Our net revenue and operating results depend upon the volume and timing of customer orders received during a given period and the percentage of each order that we are able to ship and recognize as net revenue during each period. Customers may change their cycle of product orders from us, which would affect the timing of our product shipments. Any failure or delay in the closing of orders expected to occur within a quarterly period, particularly from significant customers, would adversely affect our operating results. Further, to the extent we receive orders late in any given quarter, we may not be able to ship products to fill those orders during the same period in which we received the corresponding order which could have an adverse impact on our operating results for that period.

We are facing and may face additional intellectual property claims that could be costly to defend and result in our loss of significant rights.

The semiconductor industry is characterized by frequent litigation regarding patent and intellectual property rights. We believe that it may be necessary, from time to time, to initiate litigation against one or more third parties to preserve our intellectual property rights. From time to time, we have received, and may receive in the future, notices that claim we have infringed upon, misappropriated or misused other parties' proprietary rights. Any of the foregoing events or claims could result in litigation. We have been named in a lawsuit alleging certain of our products infringe the patents held by another party. Any litigation, including the litigation to which we are currently a party, could result in significant expense to us and divert the efforts of our technical and management personnel. In the event of an adverse result in any such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of certain products or expend significant resources to develop non-infringing technology or to obtain licenses to the technology that is the subject of the litigation, and we may not be successful in such development or in obtaining such licenses on acceptable terms, if at all. In addition, patent disputes in the electronics industry have often been settled through cross-licensing arrangements. Although we have a portfolio of applicable issued patents, we may not be able to settle an alleged patent infringement claim through a cross-licensing arrangement.

To remain competitive, we need to continue to transition our chipsets to increasingly smaller sizes while maintaining or increasing functionality, and our failure to do so may harm our business.

We periodically evaluate the benefits, on a product-by-product basis, of migrating to more advanced technology to reduce the size of our chipsets. The smaller chipset size reduces our production and packaging costs, which enables us to be competitive in our pricing. We also continually strive to increase the functionality of our chipsets, which is essential to competing effectively in our target markets. The transition to smaller geometries while maintaining or increasing functionality requires us to work with our contractors to modify the manufacturing processes for our products and to redesign some products. This effort requires considerable development investment and a risk of reduced yields as a new process is brought to acceptable levels of operating and quality efficiency. In the past, we have experienced difficulties in shifting to smaller geometry process technologies or new manufacturing processes, which resulted in reduced manufacturing yields, delays in product deliveries and increased expenses. We may face similar difficulties, delays and expenses as we continue to transition our products to smaller geometry processes, all of which could harm our relationships with our customers, and our failure to do so would impact our ability to provide competitive prices to our customers, which would have a negative impact on our sales.

The average selling prices of semiconductor products have historically decreased rapidly and will likely do so in the future, which could harm our revenue and gross margins.

The semiconductor industry, in general, and the consumer electronics markets that we target, specifically, are characterized by intense price competition, frequent introductions of new products and short product life cycles, which can result in rapid price erosion in the average selling prices for semiconductor products. A decline in the average selling prices of our products could harm our revenue and gross margins. The willingness of customers to design our chipsets into their products depends to a significant extent upon our ability to sell our products at competitive prices. In the past, we have reduced our prices to meet customer requirements or to maintain a competitive advantage. Reductions in our average selling prices to one customer could impact our average selling prices to all customers. If we are unable to reduce our costs sufficiently to offset declines in product selling prices or are unable to introduce more advanced products with higher margins in a timely manner, we could experience declines in our net revenue and gross margins.

We rely upon patents, trademarks, copyrights and trade secrets to protect our proprietary rights and if these rights are not sufficiently protected, it could harm our ability to compete and to generate revenue.

Our ability to compete may be affected by our ability to protect our proprietary information. As of April 28, 2012, we held 113 patents that have been issued and these patents will expire within the next one to fifteen years. These patents cover the technology underlying our products. We have also filed 87 patent applications that are under review. We cannot assure you that any additional patents for which we have applied will be issued or that any issued patents will provide meaningful protection of our product innovations. Like other semiconductor companies, we rely primarily on trade secrets and technological know-how in the conduct of our business. We use measures such as confidentiality agreements to protect our intellectual property. However, these methods of protecting our intellectual property may not be sufficient.

The complexity of our products could result in unforeseen delays or expenses and in undetected defects, which could damage our reputation with current or prospective customers, adversely affect the market acceptance of new products and result in warranty claims.

Highly complex products, such as those that we offer, frequently contain defects, particularly when they are first introduced or as new versions are released. Our chipsets contain highly sophisticated silicon technology and complex software. In the past we have experienced, and may in the future experience, defects in our products, both with our chipsets and the related software products we offer. If any of our products contain defects or have reliability, quality or compatibility problems, our reputation may be damaged and our customers may be reluctant to buy our products, which could harm our ability to retain existing customers and attract new customers. In addition, these defects could interrupt or delay sales or shipment of our products to our customers. Manufacturing defects may not be detected by the testing process performed by our subcontractors. If defects are discovered after we have shipped our products, it could result in unanticipated costs, order cancellations or deferrals and product returns or recalls, harm to our reputation and a decline in our net revenue, income from operations and gross margins.

In addition, our agreements with some customers contain warranty provisions which provide the customer with a right to damages if a defect is traced to our products or if we cannot correct errors in our product reported during the warranty period. However, any contractual limitations to our liability may be unenforceable in a particular jurisdiction. We do not have insurance coverage for any warranty or product liability claims and a successful claim could require us to pay substantial damages. A successful warranty or product liability claim against us, or a requirement that we participate in a product recall, could have adverse effects on our business results.

If our third-party manufacturers do not achieve satisfactory yields or quality, our relationships with our customers and our reputation will be harmed, which in turn would harm our operating results and financial performance.

The fabrication of semiconductors is a complex and technically demanding process. Minor deviations in the manufacturing process can cause substantial decreases in yields and, in some cases, cause production to be stopped or suspended. Although we work closely with our third-party manufacturers to minimize the likelihood of reduced manufacturing yields, their facilities have from time to time experienced lower than anticipated manufacturing yields that have resulted in our inability to meet our customer demand. It is not uncommon for yields in semiconductor fabrication facilities to decrease in times of high demand, in addition to reduced yields that may result from normal wafer lot loss due to workmanship or operational problems at these facilities. When these events occur, especially simultaneously, as happens from time to time, we may be unable to supply our customers' demand. Many of these problems are difficult to detect at an early stage of the manufacturing process and may be time consuming and expensive to correct. Poor yields from the wafer foundries or defects, integration issues or other performance problems in our products could cause us significant customer relations and business reputation problems or force us to sell our products at lower gross margins and therefore harm our financial results.

If the growth of demand in the consumer electronics market does not continue, our ability to increase our revenue could suffer.

Our business is highly dependent on developing sectors of the consumer electronics market, including IPTV media processor, home networking, home control and energy management, connected media player and prosumer and industrial audio/video. The consumer electronics market is highly competitive and is characterized by, among other things, frequent introductions of new products and short product life cycles. The consumer electronics market may also be negatively impacted by a slowdown in overall consumer spending. The worldwide economy, generally, and consumer spending, specifically, has significantly declined, which has negatively impacted our target markets. If our target markets do not grow as rapidly or to the extent we anticipate, our business could suffer. We expect the majority of our revenue for the foreseeable future to come from the sale of our chipsets for use in emerging consumer applications. Our ability to sustain and increase revenue is in large part dependent on the continued growth of these rapidly evolving market sectors, whose future is largely uncertain. Many factors could impede or interfere with the expansion of these consumer market sectors, including consumer demand in these sectors, general economic conditions, other competing consumer electronic products, delays in the deployment of telecommunications video services and insufficient interest in new technology innovations. In addition, if market acceptance of the consumer products that utilize our products does not occur as expected, our business could be harmed.

Due to the cyclical nature of the semiconductor industry, our operating results may fluctuate significantly, which could adversely affect the market price of our common stock.

The semiconductor industry is highly cyclical and subject to rapid change and evolving industry standards and, from time to time, has experienced significant downturns. These downturns are characterized by decreases in product demand, excess customer inventories and accelerated erosion of prices. These factors have caused, and could cause, substantial fluctuations in our net revenue and in our operating results. Any downturns in the semiconductor industry may be severe and prolonged, and any failure of this industry to fully recover from downturns could harm our business. The semiconductor industry also periodically experiences increased demand and production capacity constraints, which may affect our ability to ship products. Accordingly, our operating results have varied and may vary significantly as a result of the general conditions in the semiconductor industry, which could cause our stock price to decline.

Our ability to raise capital in the future may be limited and our failure to raise capital when needed could prevent us from executing our growth strategy.

We believe that our existing cash and cash equivalents, and short-term and long-term marketable securities will be sufficient to meet our anticipated cash needs for at least the next 12 months. The timing and amount of our working capital and capital expenditure requirements may vary significantly depending on numerous factors, including:

μαρκετ αχχεπτανχε οφ ουρ προδυχτσ;

τηε νεεδ το αδαπτ το χηανγινγ τεχηνολογιεσ ανδ τεχηνιχαλ ρεθυιρεμεντσ;

τηε εξιστενχε οφ οππορτυνιτιεσ φορ εξπανσιον; ανδ

αχχεσσ το ανδ αϖαιλαβιλιτψ οφ συφφιχιεντ μαναγεμεντ, τεχηνιχαλ, μαρκετινγ ανδ φινανχιαλ περσοννελ.

If our capital resources are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity securities or debt securities or obtain debt financing. During fiscal 2009, we used an aggregate of $85.9 million to purchase 4.2 million shares of our common stock. In November 2009, we used approximately $116.0 million in cash (which includes approximately $28.0 million of acquired CopperGate cash) for the acquisition of CopperGate. The amount of cash we used for these repurchases and the acquisition of CopperGate could limit our ability to execute our business plans and require us to raise additional capital in the future in order to fund any further repurchases or for other purposes. The sale of additional equity securities or convertible debt securities would result in additional dilution to our shareholders. Additional debt would result in increased expenses and could result in covenants that would restrict our operations. We have not made arrangements to obtain additional financing and there is no assurance that financing, if required, will be available in amounts or on terms acceptable to us, if at all.

Changes in our effective tax rate or tax liability may have an adverse effect on our results of operations.

As a global company, we are subject to taxation in Hong Kong, Israel, Singapore, the United States and various other countries and states. Significant judgment is required to determine and estimate worldwide tax liabilities. Any significant change in our future effective tax rates could adversely impact our consolidated financial position, results of operations and cash flows. Our future effective tax rates may be adversely affected by a number of factors including:

changes in tax laws in the countries in which we operate or the interpretation of such tax laws;

changes in the valuation of our deferred tax assets and liabilities, including the effect of foreign exchange rate fluctuations relative to the US Dollar;

increases in expenses not deductible for tax purposes, including write-offs of acquired in-process research and development and impairment of goodwill in connection with acquisitions;

changes in stock-based compensation expense;

changes in generally accepted accounting principles; and

our ability to use our tax attributes such as research and development tax credits and net operating losses of acquired companies to the fullest extent.

In an effort to increase commercial activities in Singapore, an agency of the government of Singapore negotiated with us a reduction in its customary income tax rates in return for our commitment to fulfill a defined set of milestones that were comprised of business activities in Singapore including the establishment of an operations center. During fiscal 2009, we established a foreign operating subsidiary in Singapore. However, due to changes in our business conditions, product development cycles and other factors, we have only been able to fulfill a portion of these milestones. As a result, we have initiated renewed negotiations with the Singapore tax agency in an effort to modify the business milestones to be more achievable and continue to benefit from a reduced rate of taxation. Even though the agency continues to negotiate with us, there is a risk that we will not be able to achieve the modified milestones which could result in a significantly higher tax rate on the income we recognize in Singapore. The increased tax rate could be applied to current profits or retroactively to income generated over previous years in Singapore, which could have a material adverse impact on our consolidated financial results.

We anticipate that a portion of our consolidated pre-tax income will continue to be subject to foreign tax at relatively lower tax rates when compared to the United States' federal statutory tax rate and, as a consequence, our effective income tax rate has been and is expected to continue to be lower than the United States' federal statutory rate. Our future effective income tax rates could be adversely affected if tax authorities challenge our international tax structure, if the relative mix of United States and international income or losses changes for any reason, or if we lose the benefit of our reduced tax rate in Singapore. Accordingly, there can be no assurance that our income tax rate will be less than the United States' federal statutory rate.

We have a history of fluctuating operating results, including a net loss in fiscal 2012 and we may not be able to return to profitability in the future, which may cause the market price of our common stock to decline.

We have a history of fluctuating operating results. We reported net income of $70.2 million in fiscal 2008, net income of $26.4 million in fiscal 2009, net income of $2.5 million in fiscal 2010, net income of $9.1 million in fiscal 2011 and a net loss of $168.0 million in fiscal 2012. To return to profitability, we will need to successfully develop new products and product enhancements and sustain higher revenue while controlling our cost and expense levels. In recent years, we made significant investments in our product development efforts and have expended substantial funds to enhance our sales and marketing efforts and otherwise operate our business. However, we may not realize the benefits of these investments. We may incur operating losses in future quarterly periods or fiscal years, which in turn could cause the price of our common stock to decline.

Our sales cycle can be lengthy, which could result in uncertainty and delays in generating net revenue.

Because our products are based on constantly evolving technologies, we have experienced a lengthy sales cycle for some of our chipsets, particularly those designed for set-top box applications in the IPTV media processor market. After we have qualified a product with a customer, the customer will usually test and evaluate our product with its service provider prior to the customer completing the design of its own equipment that will incorporate our product. Our customers and the telecommunications carriers our customers serve may need from three to more than nine months to test, evaluate and adopt our product and an additional three to more than nine months to begin volume production of equipment that incorporates our product. Our complete sales cycle typically ranges from nine to eighteen months, but could be longer. As a result, we may experience a significant delay between the time we increase expenditures for research and development, sales and marketing efforts and inventory and the time we generate net revenue, if any, from these expenditures. In addition, because we do not have long-term commitments from our customers, we must repeat our sales process on a continual basis even for current customers looking to purchase a new product. As a result, our business could be harmed if a customer reduces or delays its orders, chooses not to release products incorporating our chipsets or elects not to purchase a new product or product enhancements from us.

The complexity of our international operations may increase our operating expenses and disrupt our business.

We transact business and have operations worldwide. For example, we derive a substantial portion of our net revenue from our customers outside of North America and we plan to continue expanding our business in international markets in the future. For fiscal 2012, we derived 95% of our revenue from customers outside of North America. We also have significant international operations, including research and development facilities in Canada and Vietnam, sales and research and development facilities in China, Denmark, France, Israel, Japan, Singapore and Taiwan and a sales and distribution facility in Hong Kong.

As a result of our international business, we are affected by economic, regulatory and political conditions in foreign countries, including the imposition of government controls, changes or limitations in trade protection laws, unfavorable changes in tax treaties or laws, varying statutory equity requirements, difficulties in collecting receivables and enforcing contracts, natural disasters, labor unrest, earnings expatriation restrictions, misappropriation of intellectual property, changes in import/export regulations, tariffs and freight rates, economic instability, public health crises, acts of terrorism and continued unrest in many regions and other factors, which could have a material impact on our international revenue and operations. In particular, in some countries we may experience reduced intellectual property protection. Our results of operations could also be adversely affected by exchange rate fluctuations, which could increase the sales price in local currencies of our products in international markets. Overseas sales and purchases to date have been denominated in U.S. dollars. Although we engage in some hedging of our foreign currency exposures, we do not hedge all such exposures and our hedging arrangements may not always be effective. See “Foreign currency exchange rate sensitivity” under Part I Item 3“Quantitative and Qualitative Disclosures about Market Risk” in this Form 10-Q. Moreover, local laws and customs in many countries differ significantly from those in the United States. We also face challenges in staffing and managing our global operations. If we are unable to manage the complexity of our global operations successfully, our financial performance and operating results could suffer.

The volatile global economy could negatively affect our business, results of operations and financial condition.

Current uncertainty in global economic conditions poses a risk to the overall economy as consumers and businesses may defer purchases in response to tighter credit and negative financial news, which could negatively affect demand for our products and other related matters. Consequently, demand for our products could be different from our expectations due to factors including:

- changes in business and economic conditions, including conditions in the credit market that could negatively affect consumer confidence;
- customer acceptance of our products and those of our competitors;
- changes in customer order patterns including order cancellations; and
- reductions in the level of inventory our customers are willing to hold.

There could also be a number of secondary effects from the current uncertainty in global economic conditions, such as insolvency of suppliers resulting in product delays, an inability of our customers to obtain credit to finance purchases of our products or a desire of our customers to delay payment to us for the purchase of our products. The effects, including those mentioned above, of the current global economic environment could negatively impact our business, results of operations and financial condition.

We rely on a limited number of independent third-party manufacturers for the fabrication, assembly and testing of our chipsets and the failure of any of these third-party manufacturers to deliver products or otherwise perform as requested could damage our relationships with our customers, decrease our sales and limit our growth.

We are a fabless semiconductor company and thus we do not own or operate a fabrication or manufacturing facility. We depend on independent manufacturers, each of whom is a third-party manufacturer for numerous companies, to manufacture, assemble and test our products. We currently rely on Taiwan Semiconductor Manufacturing Corporation, or TSMC, and, to a lesser extent, United Microelectronics Corporation, or UMC, to produce substantially all of our chipsets. We rely on Advanced Semiconductor Engineering, Inc., or ASE, to assemble, package and test substantially all of our products. These third-party manufacturers may allocate capacity to the production of other companies' products while reducing product deliveries or the provision of services to us on short notice or they may increase the prices of the products and services they provide to us with little or no notice. In particular, other clients that are larger and better financed than we are or that have long-term agreements with ASE, TSMC or UMC may cause any or all of them to reallocate capacity to those clients, decreasing the capacity available to us.

If we fail to effectively manage our relationships with the third-party manufacturers, if we are unable to secure sufficient capacity at our third-party manufacturers' facilities or if any of them should experience delays, disruptions or technical or quality control problems in our manufacturing operations or if we had to change or add additional third-party manufacturers or contract manufacturing sites, our ability to ship products to our customers could be delayed, our relationships with our customers would suffer and our market share and operating results would suffer. If our third-party manufacturers' pricing for the products and services they provide increases and we are unable to pass along such increases to our customers, our operating results would be adversely affected. Also, the addition of manufacturing locations or additional third-party subcontractors would increase the complexity of our supply chain management. Moreover, all of our product manufacturing, assembly and packaging is performed in Asian countries and is therefore subject to risks associated with doing business in these countries such as quarantines or closures of manufacturing facilities due to the outbreak of viruses such as swine flu, SARS, avian flu or any similar outbreaks. Each of these factors could harm our business and financial results.

We may not be able to effectively manage our growth or develop our financial and managerial control and reporting systems, and we may need to incur significant expenditures to address the additional operational and control requirements of our growth, either of which could harm our business and operating results.

To continue to grow, we must continue to expand and improve our operational, engineering, accounting and financial systems, procedures, controls and other internal management systems. This may require substantial managerial and financial resources and our efforts in this regard may not be successful. Our current systems, procedures and controls may not be adequate to support our future operations. For example, we implemented a new enterprise resource management system in fiscal 2009. We integrated the operations of CopperGate into our enterprise resource management system in fiscal 2011. Any integration efforts could be costly and time consuming. If we fail to adequately manage our growth or to improve and develop our operational, financial and management information systems or fail to effectively motivate or manage our current and future employees, the quality of our products and the management of our operations could suffer, which could adversely affect our operating results.

In the event we seek or are required to use a new manufacturer to fabricate or to assemble and test all or a portion of our chipset products, we may not be able to bring new manufacturers on-line rapidly enough, which could damage our relationships with our customers, decrease our sales and limit our growth.

We use a single wafer foundry to manufacture a substantial majority of our products and a single source to assemble and test substantially all of our products, which exposes us to a substantial risk of delay, increased costs and customer dissatisfaction in the event our third-party manufacturers are unable to provide us with our chipset requirements. Particularly during times when semiconductor capacity is limited, we may seek to, and in the event that our current foundry were to stop producing wafers for us altogether, we would be required to, qualify one or more additional wafer foundries to meet our requirements, which would be time consuming and costly. In order to bring any new foundries on-line, our customers and we would need to qualify their facilities, which process could take as long as several months. Once qualified, each new foundry would then require an additional number of months to actually begin producing chipsets to meet our needs, by which time our perceived need for additional capacity may have passed, or the opportunities we previously identified may have been lost to our competitors. Similarly, qualifying a new provider of assembly, packaging and testing services would be a lengthy and costly process and, in both cases, they could prove to be less reliable than our existing manufacturers, which could result in increased costs and expenses as well as delays in deliveries of our products to our customers.

Our ability to develop, market and sell products could be harmed if we are unable to retain or hire key personnel.

Our future success depends upon our ability to recruit and retain the services of key executive, engineering, finance and accounting, sales, marketing and support personnel. The supply of highly qualified individuals, in particular engineers in very specialized technical areas, or sales people specializing in the semiconductor industry, is limited and competition for such individuals is intense. None of our officers or key employees is bound by an employment agreement for any specific term. The loss of the services of any of our key employees, the inability to attract or retain key personnel in the future or delays in hiring required personnel, particularly engineers and sales people, and the complexity and time involved in hiring and training new employees, could delay the development and introduction of new products, and negatively impact our ability to market, sell or support our products.

Litigation due to stock price volatility or other factors could cause us to incur substantial costs and divert our attention and resources.

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. Companies such as ours in the semiconductor industry and other technology industries are particularly vulnerable to this kind of litigation due to the high volatility of their stock prices. While we are not aware of any such contemplated class action litigation against us, we may in the future be the target of securities litigation. Any future lawsuits to which we may become a party will likely be expensive and time consuming to investigate, defend and resolve. Such costs, which include investigation and defense, the diversion of our attention and resources and any losses resulting from these claims, could significantly increase our expenses and adversely affect our profitability and cash flow.

Our operations and financial results may be adversely affected as a result of the proxy solicitation process for our annual meeting of shareholders in 2012.

Potomac Capital Partners III, L.P. and certain of its affiliates, or Potomac, have filed a preliminary proxy statement soliciting proxies for the election of three new directors to our board of directors. The election of directors is scheduled to take place at our 2012 annual meeting of shareholders. We may incur expenses that are significantly higher than the expenses we typically incur in connection with our annual meeting of shareholders in responding to Potomac's proposed slate of new directors. In addition, in its preliminary proxy materials, Potomac has indicated it intends to seek reimbursement from us of all expenses it incurs in connection with its solicitation. These additional costs could adversely affect our operations and financial results.

Our business may become subject to seasonality, which may cause our revenue to fluctuate.

Our business may become subject to seasonality as a result of our target markets. We sell a number of our semiconductor products to our customers who manufacture products for the consumer electronics market. Our customers who manufacture products for the consumer electronics market typically experience seasonality in the sales of their products which in turn may affect the timing and volume of orders for our chipsets. Although we have not experienced significant seasonality to date in sales of our products, we may, in the future, experience lower sales in our first and/or fourth fiscal quarters and higher sales in our second and/or third fiscal quarters as a result of the seasonality of demand associated with the consumer electronics markets if sales of our products into these markets increases as a percentage of our net revenues. As a result, our operating results may vary significantly from quarter to quarter.

If credit market conditions deteriorate further, it could have a material adverse impact on our investment portfolio.

U.S. sub-prime mortgage defaults have had a significant impact across various sectors of the financial markets, causing global credit and liquidity related difficulties. Beginning mid 2007, global short-term funding markets have experienced credit issues, leading to liquidity issues and failed auctions in the auction rate securities market. If the global credit market continues to be weak or deteriorates further, the liquidity of our investment portfolio may be impacted and we could determine that some of our investments are impaired. This could materially adversely impact our results of operations and financial condition.

Regional instability in Israel may adversely affect business conditions and may disrupt our operations and negatively affect our revenues and profitability.

As a result of our acquisition of CopperGate in November 2009, we have engineering facilities, administrative and sales support operations and, as of April 28, 2012, we had 143 employees located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, as well as incidents of civil unrest. In addition, in the past, Israel and companies doing business with Israel have been the subject of economic boycott. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, Israel has been and is subject to civil unrest and terrorist activity, with varying levels of severity since September 2000. Over the past several months, there has been an increase in civil unrest and political instability in the Middle East. Any future armed conflicts, civil unrest or political instability in the region may negatively affect business conditions and adversely affect our results of operations.

In addition, our business insurance does not cover losses that may occur as a result of events associated with the security situation in the Middle East. Although the Israeli government currently covers the reinstatement value of direct damages that are caused by terrorist attacks or acts of war, we cannot assure you that this government coverage will be maintained. Any losses or damages incurred by us could have a material adverse effect on our business and financial results.

The income tax benefits in Israel to which we are currently entitled from our approved enterprise program may be reduced or eliminated by the Israeli government in the future and also require us to satisfy specified conditions. If they are reduced or if we fail to satisfy these conditions, we may be required to pay increased taxes and would likely be denied these benefits in the future.

The Investment Center of the Ministry of Industry, Trade and Labor has granted “approved and/or beneficiary enterprise” status to certain product development programs at our facility in Tel Aviv. Sigma Designs Israel’s taxable income from the approved and beneficiary enterprise programs is exempt from tax for a period of two years commencing calendar year 2008 and 2009, respectively, and will be subject to a reduced tax rate for an additional eight years thereafter, depending on the percentage of Sigma Designs Israel’s share capital held by non-Israelis. The Israeli government may reduce, or eliminate in the future, tax benefits available to approved enterprise programs. Our approved and beneficiary programs and the resulting tax benefits may not continue in the future at their current levels or at any level. The termination or reduction of these tax benefits would likely increase our tax liability. Additionally, the benefits available to an approved and beneficiary enterprise program are dependent upon the fulfillment of conditions stipulated under applicable law and in the certificate of approval. If we fail to comply with these conditions, in whole or in part, we may be required to pay additional taxes for the period in which we benefited from the tax exemption or reduced tax rates and would likely be denied these benefits in the future. In either case, the amount by which our taxes would increase will depend on the difference between the then applicable tax rate for non-approved enterprises and the rate of tax, if any, that we would otherwise pay as an approved enterprise, and the amount of any taxable income that we may earn in the future. The current maximum enterprise tax rate in Israel is 25%.

Failure to maintain effective internal controls over financial reporting may cause us to delay filing our periodic reports with the SEC, affect our NASDAQ listing and adversely affect our stock price.

The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on internal control over financial reporting in their annual reports on Form 10-K. Our management is responsible for maintaining internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with GAAP. Our management assessed the effectiveness of our internal control over financial reporting as of January 28, 2012 and concluded that our internal control over financial reporting was effective. Although we review our internal control over financial reporting in order to ensure compliance with the Section 404 requirements, our failure to maintain adequate internal controls over financial reporting could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively impact our stock price.

Our headquarters, certain of our other facilities, and some of our suppliers and third-party manufacturers are located in active earthquake zones. Earthquakes, tsunamis, floods or other types of natural disasters affecting our suppliers, our manufacturers or us could cause resource shortages and production delays, which would disrupt and harm our business, results of operations and financial condition.

We are headquartered in the San Francisco Bay Area, have research and development and sales offices in Japan and outsource most of our manufacturing to Taiwan. Each of these areas is an active earthquake zone, and certain of our suppliers and third-party manufacturers conduct operations in the same regions or in other locations that are susceptible to natural disasters. The occurrence of a natural disaster, such as an earthquake, tsunami or flood, or localized extended outages of critical utilities or transportation systems, or any critical resource shortages, affecting us, our suppliers or our third-party manufacturers could cause a significant interruption in our production, business, damage or destroy our facilities or those of our suppliers and cause us to incur significant costs or result in limitations on the availability of our raw materials, any of which could harm our business, financial condition and results of operations.

Risks Related to Our Common Stock

Our operating results are subject to significant fluctuations due to many factors and any of these factors could adversely affect our stock price.

Our operating results have fluctuated in the past and may continue to fluctuate in the future due to a number of factors, including:

- the loss of one or more significant customers;
- changes in our pricing models and product sales mix;
- unexpected reductions in unit sales and average selling prices, particularly if they occur precipitously;
- new product introductions by us and our competitors;
- the level of acceptance of our products by our customers and acceptance of our customers' products by their end user customers;
- an interrupted or inadequate supply of semiconductor chips or other materials included in our products;
- availability of third-party manufacturing capacity for production of certain products;
- shifts in demand for the technology embodied in our products and those of our competitors;
- the timing of, and potential unexpected delays in, our customer orders and product shipments;
- the impairment and associated write-down of strategic investments that we may make from time-to-time;
- write-downs of accounts receivable;
- inventory obsolescence;
- a significant increase in our effective tax rate in any particular period as a result of the exhaustion, disallowance or accelerated recognition of our net operating loss carry-forwards or otherwise;
- technical problems in the development, production ramp up and manufacturing of products, which could cause shipping delays;
- the impact of potential economic instability in the United States and Asia-Pacific region, including the continued effects of the recent worldwide economic slowdown;
- expenses related to implementing and maintaining a new enterprise resource management system and other information technologies; and
- expenses related to our compliance efforts with Section 404 of the Sarbanes-Oxley Act of 2002.

In addition, the market prices of securities of semiconductor and other technology companies have been volatile. This volatility has significantly affected the market prices of securities of many technology companies for reasons frequently unrelated to the operating performance of the specific companies.

Accordingly, you may not be able to resell your shares of common stock at or above the price you paid.

Our stock price has demonstrated volatility and continued volatility in the stock market or our operating performance may cause further fluctuations or decline in our stock price.

The market for our common stock has been subject to significant volatility which is expected to continue. For example, during the three months ended April 28, 2012, the high and low closing sale price per share of our common stock on the NASDAQ Global Market ranged from a high of $6.11 on February 6, 2012 to a low of $4.68 on April 10, 2012. This volatility may or may not be related or proportionate to our operating performance. Our operating performance as well as general economic and market conditions, could cause the market price of our common stock to decline.

If securities or industry analysts do not publish research or reports about our business, or if they issue an adverse opinion regarding our stock, our stock price and trading volume could decline.

The trading market for our common stock is influenced by the research and reports that industry or securities analysts publish about our business or us. If one or more of the analysts who cover us issue an adverse opinion regarding our stock, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets which in turn could cause our stock price or trading volume to decline.

Provisions in our organizational documents, our shareholders rights agreement and California law could delay or prevent a change in control of Sigma that our shareholders may consider favorable.

Our articles of incorporation and bylaws contain provisions that could limit the price that investors might be willing to pay in the future for shares of our common stock. Our Board of Directors can authorize the issuance of preferred stock that can be created and issued by our Board of Directors without prior shareholder approval, commonly referred to as "blank check" preferred stock, with rights senior to those of our common stock. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that we may issue in the future. The issuance of preferred stock could have the effect of delaying, deterring or preventing a change in control and could adversely affect the voting power of your shares. In addition, our Board of Directors has adopted a shareholder rights plan that provides each share of our common stock with an associated right to purchase from us one one-thousandth share of Series D participating preferred stock at a purchase price of $58.00 in cash, subject to adjustment in the manner set forth in the rights agreement. The rights are intended to deter certain types of changes in control, such as a hostile takeover attempt, because these rights would cause substantial dilution to a person or group that attempts to acquire a significant interest in Sigma on terms not approved by our Board of Directors. In addition, provisions of California law could make it more difficult for a third party to acquire a majority of our outstanding voting stock by discouraging a hostile bid or delaying or deterring a merger, acquisition or tender offer in which our shareholders could receive a premium for their shares or a proxy contest for control of Sigma or other changes in our management.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

None.

## ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

The following exhibits are filed herewith:

2.1 Asset Purchase Agreement dated March 23, 2012 by and between Sigma Designs, Inc. and Trident Microsystems, Inc. and certain of its subsidiaries (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 28, 2012).

2.2 Amendment to Asset Purchase Agreement dated May 4, 2012 by and between the Company and Trident Microsystems, Inc. and certain of its subsidiaries (incorporated by reference to Exhibit 2.2 filed with the Company's Current Report on Form 8-K on May 4, 2012).

3.1 Certificate of Amendment of Certificate of Determination of Rights, Preferences and Privileges of Series D Participating Preferred Stock of Sigma Designs, Inc. (incorporated by reference to Exhibit 3.1 filed with the Company's Current Report on Form 8-K on April 9, 2012).

4.1 Preferred Stock Rights Agreement, dated as of June 7, 2004, between the Company and Computershare Shareowner Services LLC (formerly known as Mellon Investor Services LLC), including the Certificate of Determination, the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively (incorporated by reference to Exhibit 4.1 filed with the Company's Current Report on Form 8-K on April 9, 2012).

4.2 Amendment No. 1 to Rights Agreement, dated as of April 9, 2012, between the Company and Computershare Shareowner Services LLC (formerly known as Mellon Investor Services LLC), including the Certificate of Amendment of Certificate of Determination, attached thereto as Exhibit A-1. (incorporated by reference to Exhibit 4.2 filed with the Company's Current Report on Form 8-K on April 9, 2012).

31.1 Certification of the President and Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer and Secretary pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

32.1 Certificate of President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (1)

32.2 Certificate of Chief Financial Officer and Secretary pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (1)

101 Pursuant to Rule 405 of Regulation S-T, the following financial information from the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended October 29, 2011, is formatted in XBRL interactive data files: (i) Unaudited Condensed Consolidated Statements of Operations; (ii) Unaudited Condensed Consolidated Balance Sheets; (iii) Unaudited Condensed Consolidated Statements of Cash Flows; and (iv) Notes to Unaudited Condensed Consolidated Financial Statements.

(1) The certificates contained in Exhibits 32.1 and 32.2 are not deemed "filed" for purposes of Section 18 of the Securities and Exchange Act of 1934 and are not to be incorporated by reference into any filing of the registrant under

the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof irrespective of any general incorporation by reference language contained in any such filing, except to the extent that the registration specifically incorporates it by reference.

SIGNATURES

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

SIGMA DESIGNS, INC.

Date: June 7, 2012

By: /s/ Thinh Q. Tran
Thinh Q. Tran

Chairman of the Board,
President and Chief Executive
Officer (Principal Executive
Officer)

By: /s/ Thomas E. Gay III
Thomas E. Gay III

Chief Financial Officer and
Secretary
(Principal Financial and
Accounting Officer)

EXHIBIT INDEX

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