

ENTROPIC COMMUNICATIONS INC

Form 10-Q

August 05, 2011

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2011

or

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

Commission file number: 001-33844

**ENTROPIC COMMUNICATIONS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-Q

**Delaware**  
(State or Other Jurisdiction)  
of Incorporation or Organization)

**33-0947630**  
(I.R.S. Employer  
Identification No.)

**6290 Sequence Drive**  
**San Diego, CA 92121**

(Address of Principal Executive Offices, Including Zip Code)

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

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

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

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

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

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

There were 86,458,660 shares of the registrant's common stock, par value \$0.001 per share, issued and outstanding as of July 29, 2011.

**Table of Contents**

**ENTROPIC COMMUNICATIONS, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2011**

**TABLE OF CONTENTS**

<b><u>PART I FINANCIAL INFORMATION</u></b>	1
Item 1. <u>Financial Statements</u>	1
<u>Unaudited Condensed Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010</u>	1
<u>Unaudited Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2011 and 2010</u>	2
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2010</u>	3
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	4
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	26
Item 4. <u>Controls and Procedures</u>	27
<b><u>PART II OTHER INFORMATION</u></b>	28
Item 1A. <u>Risk Factors</u>	28
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	53
Item 6. <u>Exhibits</u>	53
<b><u>SIGNATURES</u></b>	54

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Entropic Communications, Inc.****Unaudited Condensed Consolidated Balance Sheets***(in thousands)*

	June 30, 2011	December 31, 2010 <sup>(1)</sup>
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 33,728	\$ 98,100
Marketable securities	102,986	48,275
Accounts receivable	35,942	18,244
Inventory	33,880	39,915
Deferred tax assets, current	5,463	14,307
Prepaid expenses and other current assets	6,404	6,226
Total current assets	218,403	225,067
Property and equipment, net	11,802	11,354
Long-term marketable securities	51,331	22,386
Deferred tax assets, long-term	17,304	17,304
Other long-term assets	2,481	2,697
Total assets	\$ 301,321	\$ 278,808
<b>Liabilities and stockholders' equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 13,632	\$ 18,278
Accrued expenses and other current liabilities	3,962	3,634
Accrued payroll and benefits	4,565	6,666
Total current liabilities	22,159	28,578
Deferred rent	1,336	1,568
Other long-term liabilities	71	72
<b>Stockholders' equity:</b>		
Common Stock	86	85
Additional paid-in capital	435,214	425,767
Accumulated deficit	(157,592)	(177,203)
Accumulated other comprehensive income (loss)	47	(59)
Total stockholders' equity	277,755	248,590
Total liabilities and stockholders' equity	\$ 301,321	\$ 278,808

(1) The unaudited condensed consolidated balance sheet at December 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-Q

complete financial statements.

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

**Table of Contents****Entropic Communications, Inc.****Unaudited Condensed Consolidated Statements of Operations***(in thousands, except per share data)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net revenues	\$ 61,473	\$ 40,680	\$ 132,994	\$ 78,131
Cost of net revenues	27,646	18,831	59,585	36,532
Gross profit	33,827	21,849	73,409	41,599
Operating expenses:				
Research and development	14,148	11,746	27,297	23,284
Sales and marketing	4,303	3,991	9,123	7,769
General and administrative	3,515	3,012	7,204	5,712
Total operating expenses	21,966	18,749	43,624	36,765
Income from operations	11,861	3,100	29,785	4,834
Other income, net	213	20	402	45
Income before income taxes	12,074	3,120	30,187	4,879
Income tax provision	4,318	28	10,576	29
Net income	\$ 7,756	\$ 3,092	\$ 19,611	\$ 4,850
Net income per share basic	\$ 0.09	\$ 0.04	\$ 0.23	\$ 0.07
Net income per share diluted	\$ 0.09	\$ 0.04	\$ 0.22	\$ 0.06
Weighted average number of shares used to compute net income per share basic	86,046	71,972	85,712	71,621
Weighted average number of shares used to compute net income per share diluted	89,290	75,616	89,296	74,777

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

**Table of Contents****Entropic Communications, Inc.****Unaudited Condensed Consolidated Statements of Cash Flows***(in thousands)*

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Operating activities:</b>		
Net income	\$ 19,611	\$ 4,850
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,115	1,769
Amortization of intangible assets		811
Deferred taxes	8,844	
Stock-based compensation	6,300	4,749
Amortization of premiums on investments	1,769	
Provision (benefit) for excess and obsolete inventory	1,056	(364)
Loss on disposal of assets		7
Changes in operating assets and liabilities:		
Accounts receivable	(17,698)	(4,449)
Inventory	4,979	(6,359)
Prepaid expenses and other current assets	(169)	526
Other long-term assets	216	20
Accounts payable	(4,650)	4,257
Accrued expenses and other current liabilities	405	323
Accrued payroll and benefits	(2,125)	346
Deferred rent	(232)	(154)
Other long-term liabilities	(1)	(151)
Net cash provided by operating activities	20,420	6,181
<b>Investing activities:</b>		
Purchases of property and equipment	(2,561)	(1,901)
Purchases of marketable securities	(132,445)	
Sales/maturities of marketable securities	47,134	
Net cash used in investing activities	(87,872)	(1,901)
<b>Financing activities:</b>		
Net proceeds from the issuance of equity plan exercises	3,064	1,817
Net cash provided by financing activities	3,064	1,817
Net effect of exchange rates on cash	16	(20)
Net (decrease) increase in cash and cash equivalents	(64,372)	6,077
Cash and cash equivalents at beginning of period	98,100	35,252
Cash and cash equivalents at end of period	\$ 33,728	\$ 41,329

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

**Table of Contents**

**Entropic Communications, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**1. Organization and Summary of Significant Accounting Policies**

**Business**

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

Entropic Communications is a leading fabless semiconductor company that designs, develops and markets systems solutions to enable connected home entertainment. Our technologies change the way high-definition television-quality video, or HD video, and standard-definition television-quality video, or SD video, and other multimedia content such as movies, music, games and photos are brought into and delivered throughout the home.

**Basis of Presentation**

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP.

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

**Use of Estimates**

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

**Foreign Currency Translation**

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

**Revenue Recognition**

Our net revenues are generated principally by sales of our semiconductor products. During each of the three and six months ended June 30, 2011 and 2010, product net revenues represented more than 99% of our total net revenues.

Our sales primarily occur through the efforts of our direct sales force. The remainder of our sales occurs through third-party sales representatives and distributors. During each of the three and six months ended June 30, 2011 and 2010, more than 99% of our sales occurred through the efforts of our direct sales force.

We recognize product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and (iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment; however, we do not recognize revenue until all substantive customer acceptance requirements have been met, when applicable.





## **Table of Contents**

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

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

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

We are party to an inventory hubbing agreement with Motorola Mobility, Inc. (formerly Motorola, Inc.), or Motorola. Pursuant to this agreement, we deliver products to the designated third-party warehouse based upon Motorola's projected needs, but do not recognize product revenue unless and until Motorola removes our products from the third-party warehouse to incorporate into its own products.

We have entered into agreements to license certain hardware and software, also referred to as the nodes, to certain members of the Multimedia over Coax Alliance, or MoCA, for a period of three years and to provide upgrades when and if they become available. The agreements limit the rights to use the nodes to test compliance of the members' own products to the MoCA specification. For these arrangements, we defer all of the license revenues when the nodes are delivered and recognize the revenues on a straight-line basis over the three-year term of the agreement.

We provide rebates on our products to certain customers. At the time of the sale, we accrue 100% of the potential rebate as a reduction to net revenue and do not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. We reverse the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when we believe unclaimed rebates are no longer subject to payment and will not be paid. For the three months ended June 30, 2011 and 2010 and the six months ended June 30, 2011 and 2010, we reduced net revenue by \$0, \$14,000, \$0 and \$36,000, respectively, in connection with our rebate programs.

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

For multiple deliverable agreements entered into after December 31, 2009, consideration is allocated at the inception of the agreement to all deliverables based on their relative selling price. The relative selling price for each deliverable is dete