CAVIUM NETWORKS, INC.
Form 10-Q
August 06, 2009

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

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from __________ to __________

Commission file number: 001-33435
CAVIUM NETWORKS, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE	77-0558625
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
805 E. Middlefield Road Mountain View, California	94043
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (650) 623-7000

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

Indicate by check mark whether the registrant 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

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

The number of shares of the Registrant s Common Stock, $.001 par value, outstanding at August 4, 2009 was: 41,477,322

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CAVIUM NETWORKS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE MONTHS ENDED JUNE 30, 2009
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PART I. FINANCIAL INFORMATION

Item 1. *Condensed Consolidated Financial Statements*

CAVIUM NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)
(unaudited)

	June 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 66,747	$ 77,027
Accounts receivable, net of allowances of $370 and $203, respectively	15,292	14,054
Inventories	16,484	17,281
Prepaid expenses and other current assets	3,149	1,298
Total current assets	101,672	109,660
Property and equipment, net	8,853	11,115
Intangible assets, net	14,433	16,958
Goodwill	13,047	12,925
Other assets	447	506
Total assets	$ 138,452	$ 151,164
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 7,473	$ 7,309
Accrued expenses and other current liabilities	2,706	7,697
Deferred revenue	1,676	1,700
Capital lease and technology license obligations, current portion	2,476	2,619
Total current liabilities	14,331	19,325
Capital lease and technology license obligations, net of current portion	892	2,116
Other non-current liabilities	1,430	1,162
Total liabilities	16,653	22,603
Commitments and contingencies (Note 11)		
Stockholders equity:		
Preferred stock, par value $0.001: 10,000,000 shares authorized, no shares issued and outstanding as of June 30, 2009 and December 31, 2008		
Common stock, par value $0.001: 200,000,000 shares authorized; 41,374,388 and 41,183,010 shares issued and outstanding as of June 30, 2009 and December 31, 2008, respectively	41	41

Additional paid-in capital		191,682		185,743
Accumulated deficit		(69,924)		(57,223)
Total stockholders equity		121,799		128,561
Total liabilities and stockholders equity	$	138,452	$	151,164

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

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CAVIUM NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Net revenue	$ 22,804	$ 21,562	$ 43,186	$ 39,904
Cost of revenue	12,139	7,808	22,953	14,395
Gross profit	10,665	13,754	20,233	25,509
Operating expenses:				
Research and development	10,274	6,461	20,265	12,281
Sales, general and administrative	6,526	5,454	12,663	10,009
Total operating expenses	16,800	11,915	32,928	22,290
(Loss) income from operations	(6,135)	1,839	(12,695)	3,219
Other income, net:				
Interest expense	(67)	(135)	(146)	(288)
Interest income and other	90	609	224	1,601
Total other income, net	23	474	78	1,313
(Loss) income before provision for income taxes	(6,112)	2,313	(12,617)	4,532
Provision for income taxes	56	240	84	487
Net (loss) income	$ (6,168)	$ 2,073	$ (12,701)	$ 4,045
Net (loss) income, per common share, basic	$ (0.15)	$ 0.05	$ (0.31)	$ 0.10
Shares used in computing basic net (loss) income per common share	41,212	40,300	41,148	40,133
Net (loss) income, per common share, diluted	$ (0.15)	$ 0.05	$ (0.31)	$ 0.09
Shares used in computing diluted net (loss) income per common share	41,212	42,981	41,148	42,702

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

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CAVIUM NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flows from operating activities		
Net (loss) income	$ (12,701)	$ 4,045
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities		
Stock-based compensation expense	5,494	2,278
Depreciation and amortization	7,110	4,643
Amortization of lease incentive	(52)	
Loss on disposal of fixed assets	47	
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	(1,238)	(1,099)
Inventories	819	(3,287)
Prepaid expenses and other current assets	(1,568)	(341)
Other assets	59	(253)
Accounts payable	252	1,191
Accrued expenses and other current and non-current liabilities	(700)	556
Deferred revenue	(24)	314
Net cash (used in) provided by operating activities	(2,502)	8,047
Cash flows used in investing activities		
Purchases of property and equipment	(1,737)	(4,550)
Proceeds from sales of property and equipment	43	
Purchases of IP licenses and intangible assets	(424)	
Acquisition of businesses	(4,712)	(817)
Net cash used in investing activities	(6,830)	(5,367)
Cash flows used in financing activities		
Proceeds from issuance of common stock upon exercise of options	430	764
Principal payment of capital lease and technology license obligations	(1,363)	(2,618)
Repurchases of shares of unvested common stock	(15)	(4)
Net cash used in financing activities	(948)	(1,858)
Net (decrease) increase in cash and cash equivalents	(10,280)	822
Cash and cash equivalents, beginning of period	77,027	98,462
Cash and cash equivalents, end of period	$ 66,747	$ 99,284

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

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CAVIUM NETWORKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Organization and Significant Accounting Policies

Organization

Cavium Networks, Inc., (the Company), was incorporated in the State of California on November 21, 2000 and was reincorporated in the State of Delaware on February 6, 2007. The Company designs, develops and markets semiconductor processors for intelligent and secure networks.

Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements include the accounts of Cavium Networks, Inc. and its wholly owned foreign subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, and with the instructions to Securities and Exchange Commission, or SEC, Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. For further information, these financial statements should be read in conjunction with the Company s Annual Report on Form 10-K (File No. 001-33435) on file with the SEC for the year ended December 31, 2008.

The unaudited condensed consolidated financial statements contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly the Company s condensed consolidated financial position at June 30, 2009, and the condensed consolidated results of its operations for the three months and six months ended June 30, 2009 and 2008, and the condensed consolidated cash flows for the six months ended June 30, 2009 and 2008. The results of operations for the three months and six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the full year.

The condensed consolidated balance sheet at December 31, 2008 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP.

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 its condensed consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis of making judgments about the carrying values of assets and liabilities. Actual results could differ from those estimates. During the six months ended June 30, 2009, there were no significant changes to the significant accounting policies and estimates discussed in the Company s Annual Report on Form 10-K.

Concentration of Risk

A majority of the Company s products are currently manufactured, assembled and tested by third-party contractors in Asia. There are no long-term agreements with any of these contractors. A significant disruption in the operations of one or more of these contractors would impact the production of the Company s products for a substantial period of time, which could have a material adverse effect on the Company s business, financial condition and results of operations.

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash, cash equivalents and accounts receivable. The Company deposits cash and cash equivalents with credit worthy financial institutions. The Company has not experienced any losses on its deposits of cash and cash equivalents. Management believes that the cash and cash equivalents are in quality money market funds, and, accordingly, minimal credit risk exists.

The Company performs ongoing credit evaluations of its customers financial condition and, generally, requires no collateral from its customers. The Company provides an allowance for doubtful accounts receivable based upon the expected collectibility of accounts

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receivable. Summarized below are individual customers whose revenues or accounts receivable balances were 10% or higher of respective total consolidated amounts.

	For the three months ended June 30,		For the six months ended June 30,	
	2009	**2008**	**2009**	**2008**
Percentage of total net revenue				
Customer A	19%	*	14%	*
Customer B	18%	33%	20%	32%
Customer C	13%	15%	10%	10%

* Represents less than 10% of the consolidated net revenue for the respective period end.

	As of June 30, 2009	As of December 31, 2008
Percentage of gross accounts receivable		
Customer A	21%	*
Customer D	11%	21%
Customer E	*	10%

* Represents less than 10% of the consolidated gross accounts receivable for the respective period end.

Revenue Recognition

The Company derives its revenue primarily from sales of semiconductor products. The Company applies the provisions of Staff Accounting Bulletin No. 104 *Revenue Recognition,* (SAB 104) for product revenue derived by the sale of semiconductor products. Under SAB 104, the Company recognizes revenue when all of the following criteria have been met: (i) persuasive evidence of a binding arrangement exists, (ii) delivery has occurred, (iii) the price is deemed fixed or determinable and free of contingencies and significant uncertainties, and (iv) collection is probable. The price is considered fixed or determinable at the execution of an agreement, based on specific products and quantities to be delivered at specified prices, which is often memorialized with a customer purchase order. Agreements with non-distributor customers do not include rights of return or acceptance provisions. The Company assesses the ability to collect from the Company s customers based on a number of factors, including credit worthiness and any past transaction history of the customer.

Shipping charges billed to customers are included in product revenue and the related shipping costs are included in cost of revenue. The Company generally recognizes revenue at the time of shipment to the Company s customers. Revenue consists primarily of sales of the Company s products to networking original equipment manufacturers, or OEMs, their contract manufacturers or its distributors. Initial sales of the Company s products for a new design are usually made directly to networking OEMs as they design and develop their product. Once their design enters production, they often outsource their manufacturing to contract manufacturers that purchase the Company s products directly from the Company or from the Company s distributors.

Revenue is recognized upon shipment for sales to distributors with limited rights of returns and price protection if the Company concludes it can reasonably estimate the credits for returns and price adjustments issuable. The Company records an estimated allowance, at the time of shipment, based on the Company s historical patterns of returns and pricing credits of sales recognized upon shipment. The credits issued to distributors or other customers were not material in the three and six months ended June 30, 2009 and 2008.

Revenue and costs relating to sales to distributors are deferred if the Company grants more than limited rights of returns and price

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credits or if it cannot reasonably estimate the level of returns and credits issuable. The Company has a distribution agreement with Avnet, Inc. to distribute the Company s products primarily in the United States. Given the terms of the distribution agreement, for sales to Avnet revenue and costs are deferred until products are sold by Avnet to its end customers. For the three months ended June 30, 2009 and 2008, 5.5% and 3.4% of the Company s net revenues and for the period six months ended June 30, 2009 and 2008, 5.8% and 3.6% of the Company s net revenues were from products sold by Avnet, respectively. Revenue recognition depends on notification from the distributor that product has been sold to Avnet s end customers. Avnet reports to the Company, on at least a monthly basis, the product resale price, quantity and end customer shipment information, as well as inventory on hand. Reported distributor inventory on hand is reconciled monthly to the Company s deferred revenue and cost balances. Deferred income on shipments to Avnet is included in deferred revenue. Accounts receivable from Avnet is recognized and inventory is relieved when title to inventories transfers, which typically takes place at the time of shipment, which is the point in time at which the Company has a legal enforceable right to collection under normal payment terms.

The Company also derives revenue in the form of license and maintenance fees through licensing its software products. Revenue from such arrangements is recorded by applying the provisions of Statement of Position, or SOP No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Modification of SOP No. 97-2, Software Revenue Recognition with Respect to Certain Transactions.* Revenue from such arrangements totaled $131,000 and $271,000 for the three months ended June 30, 2009 and 2008, respectively, and $1.7 million and $537,000 for the six months ended June 30, 2009 and 2008, respectively. If the arrangements contain support services, the value of such support services is recognized as services revenue on a straight-line basis over the term of the related support period, which is typically one year.

The Company also enters into development agreements with some of its customers. Development revenue is recognized under the proportional performance method, with the associated costs included in cost of revenue. The Company estimates the proportional performance of the development contracts based on an analysis of progress toward completion. The Company periodically evaluates the actual status of each project to ensure that the estimates to complete each contract remain accurate. If the amount billed exceeds the amount of revenue recognized, the excess amount is recorded as deferred revenue. Revenue recognized in any period is dependent on progress toward completion of projects in progress. To the extent the Company is unable to estimate the proportional performance then the revenue is recognized on a completed performance basis. Revenue from such arrangements totaled $540,000 and $590,000 for the three months ended June 30, 2009 and 2008, respectively, and $1.3 million for the six months ended June 30, 2009 and 2008, respectively.

Total deferred revenue was $1.7 million as of June 30, 2009 and as of December 31, 2008, respectively, which includes deferred income on shipment to Avnet, development revenue and deferred revenue associated with license and maintenance fees.

Warranty Accrual

The Company s products are subject to a one-year warranty period. The Company provides for the estimated future costs of replacement upon shipment of the product as cost of revenue. The warranty accrual is estimated based on historical claims compared to historical revenue. The following table presents a reconciliation of the Company s product warranty liability, which is included within accrued expenses and other current liabilities in the consolidated balance sheets:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
	(in thousands)			
Beginning balance	$ 192	$ 260	$ 154	$ 261
Accruals for warranties issued	152	107	352	124
Settlements made	(94)	(107)	(256)	(125)
Ending balance	$ 250	$ 260	$ 250	$ 260

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) approved the FASB Accounting Standards Codification (the Codification) as the single source of authoritative nongovernmental GAAP. All existing accounting standard documents, such as FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force and other related literature, excluding guidance from the Securities and Exchange Commission (SEC), will be superseded by the Codification. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become nonauthoritative. The Codification does not change GAAP, but instead introduces a new structure that will combine all authoritative standards into a comprehensive, topically organized online database. The Codification will be effective for interim or annual periods ending after September 15, 2009, and will

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apply to the Company s financial statement disclosures beginning with the quarter ending September 30, 2009 as all future references to authoritative accounting literature will be referenced in accordance with the Codification. There will be no changes to the content of the Company s financial statements or disclosures as a result of implementing the Codification.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS 165), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date, but before the financial statements are issued or available to be issued (subsequent events). SFAS 165 requires disclosure of the date through which the entity has evaluated subsequent events and the basis for that date. For public entities, this is the date the financial statements are issued. SFAS 165 does not apply to subsequent events or transactions that are within the scope of other GAAP and will not result in significant changes in the subsequent events reported by the Company. SFAS 165 is effective for interim or annual periods ending after June 15, 2009. The Company implemented SFAS 165 during the quarter ended June 30, 2009. The Company evaluated for subsequent events through August 6, 2009, the issuance date of the Company s financial statements. No recognized or non-recognized subsequent events were noted.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, or FAS 107-1, which requires disclosures about fair value of financial instruments in interim periods of publicly traded companies that were previously only required to be disclosed in annual financial statements. The provisions of FAS 107-1 are effective for the interim reporting period ending after June 15, 2009. The adoption of FAS 107-1 did not have an impact on the Company s consolidated financial statements.

2. Net Income (Loss) Per Common Share

The Company calculates net income (loss) per share in accordance with SFAS No. 128, "*Earnings per Share*, or SFAS 128. Under SFAS 128, basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period (excluding shares subject to repurchase). Diluted net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common and potentially dilutive common equivalent shares outstanding during the period. Potentially dilutive securities, composed of incremental common shares issuable upon the exercise of stock options, restricted stock units, and common stock subject to repurchase, are included in diluted net income per share for the three months and six months ended June 30, 2009 and 2008, respectively.

The following table sets forth the computation of income (loss) per share:

(in thousands, except per share data)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Net income (loss)	$ (6,168)	$ 2,073	$ (12,701)	$ 4,045
Weighted average common shares outstanding basic	41,212	40,300	41,148	40,133
Dilutive effect of employee stock plans		2,681		2,569
Weighted average common shares outstanding diluted	41,212	42,981	41,148	42,702
Basic net income (loss) per share	$ (0.15)	$ 0.05	$ (0.31)	$ 0.10
Diluted net income (loss) per share	$ (0.15)	$ 0.05	$ (0.31)	$ 0.09

The Company excluded outstanding options and restricted stock units of 8.1 million for the three months and six months ended June 30, 2009 and 228,000 and 584,000 for the three and six months ended June 30, 2008 from the computation of diluted net income (loss) per common share because including them would have had an anti-dilutive effect.

3. Fair Value

At June 30, 2009, all of the Company s investments were classified as cash equivalents and are comprised of highly liquid investments in money market instruments. In accordance with SFAS 157, the Company determined the fair value hierarchy of its financial assets (cash equivalents) in the money market fund as Level 1, which approximated $55.4 million as of June 30, 2009.

4. Balance Sheet Components

Inventories

Inventories are stated at the lower of cost (determined using the first-in, first-out method), or market value (estimated net realizable value) and are comprised of the following:

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	As of June 30, 2009	As of December 31, 2008
	(in thousands)	
Work-in-process	$ 14,607	$ 14,411
Finished goods	1,877	2,870
	$ 16,484	$ 17,281

Property and equipment, net, consist of the following:

	As of June 30, 2009	As of December 31, 2008
	(in thousands)	
Mask costs and test equipment	$ 12,021	$ 11,016
Software, computer and other equipment	15,855	15,402
Furniture, office equipment and leasehold improvements	437	121
	28,313	26,539
Less: accumulated depreciation and amortization	(19,460)	(15,424)
	$ 8,853	$ 11,115

Depreciation and amortization expense was $1.9 million and $2.2 million for the three months ended June 30, 2009 and 2008, respectively, and $4.2 million and $4.1 million for the six months ended June 30, 2009 and 2008, respectively.

The Company has capitalized mask costs of none and $1.0 million during the three months ended June 30, 2009 and 2008, respectively, and $680,000 and $2.2 million during the six months ended June 30, 2009 and 2008, respectively.

Capital leases, which are time-based subscription design tools, are included in property and equipment, and they were $8.9 million at June 30, 2009 and December 31, 2008. Amortization expense related to assets recorded under capital lease was $717,000 and $700,000 for the three months ended June 30, 2009 and 2008, respectively, and $1.5 million and $1.3 million for the six months ended June 30, 2009 and 2008, respectively.

Accrued expenses and other current liabilities consist of the following:

	As of June 30, 2009	As of December 31, 2008
	(in thousands)	
Accrued compensation and related benefits	$ 1,052	$ 1,191
Acquisition related payables	228	4,489
Restructuring related payables	218	389
Accrued warranty	250	154
Professional fees	372	835
Income tax payable	107	54
Other	479	585
	$ 2,706	$ 7,697

Other non-current liabilities consist of the following:

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	As of June 30, 2009	As of December 31, 2008
	(in thousands)	
Accrued rent	$ 675	$ 187
Acquisition related payables		220
Restructuring related payables	464	464
Income tax payable	291	291
	$ 1,430	$ 1,162

5. Business Combinations

Parallogic Corporation

On May 20, 2008, the Company acquired certain assets of Parallogic Corporation (Parallogic), a privately held company. The aggregate purchase price consisted of cash consideration of approximately $1.3 million, including direct acquisition costs of approximately $61,000. The Company paid $826,000 in cash at the time of close of the acquisition. The remaining two subsequent payments of $220,000 each are due at the completion of certain milestones or the 18 th and 36 th month anniversaries of the acquisition date, whichever comes first. In January 2009, the Company paid the first installment of $220,000 due to Parallogic s achievement of the first milestone as defined in the merger agreement. The remaining $220,000 is recorded as acquisition related payables in accrued expenses and other current liabilities. As of August 4, 2009, Parallogic has achieved the second milestone as defined in the merger agreement and this amount is expected to be paid in the third quarter of 2009.

Identifiable intangible assets of approximately $450,000 consist of intellectual property related to the developed technology as well as incremental value associated with existing customer relationships. The developed technology acquired from Parallogic is the multi-core software focused on gigabit packet processing and security applications.

The total purchase price was allocated to tangible and identifiable intangible assets based on their estimated fair value as of May 20, 2008. The excess of the purchase price over the tangible and identifiable intangible assets were recorded as goodwill. The purchase price allocation was as follows (in thousands):

Net tangible assets	$
Identifiable intangible assets:	
Customer relationships	76
Developed technology	374
Goodwill	816
Total purchase price	$ 1,266

The fair value assigned to developed technology and customer relationships was based upon future discounted cash flows related to the assets projected income streams using a discount rate of 20% and 15% respectively. Factors considered in estimating the discounted cash flows to be derived from developed technology and customer relationships include risk related to the characteristics and applications of the technology, existing and future markets and an assessment of the age of the technology within its life span. The Company is amortizing the purchased intangible assets to cost of revenue on a straight-line basis over its estimated useful life of one to five years.

The results of operations from Parallogic have been included in the Company s consolidated statements of operations only since the date of acquisition. Pro forma results of operations for the acquisition have not been presented as the effect has not been significant.

Of the total purchase price, approximately $0.8 million was allocated to goodwill, which represents the excess of the purchase price over the estimated fair value of the underlying net tangible and identifiable intangible assets acquired. The goodwill was attributed to the premium paid for the opportunity to expand and better serve the addressable market and achieve greater long-term growth opportunities. All of the $0.8 million allocated to the goodwill is expected to be deductible for tax purposes. With this acquisition the Company believes it is better positioned to deliver professional services for customers to help reduce the time-to-market for design wins and provide high-performance tuning. In accordance with SFAS No. 142, goodwill will not be amortized, but instead will be tested for impairment at least annually and more frequently if certain indicators are present.

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Star Semiconductor Corporation

On August 1, 2008, the Company acquired substantially all of the intangible assets and inventory and certain other tangible assets of Star Semiconductor Corporation (Star), a Taiwan-based design house in Hsinchu that builds highly integrated ARM-based SOC processors for the broadband, connected home and SOHO market segments. The Company paid approximately $9.6 million in cash, including acquisition related expenses of approximately $0.8 million. Included in the purchase price was $1.0 million that was placed in escrow for 60 days after the close in order to indemnify the Company for certain matters, including breaches of representations and warranties and covenants made by Star. Subsequent to 60 days after the close of the acquisition, the escrow was closed. The acquisition provided the Company with a highly experienced stand-alone SOC processor team based in Taiwan. The results of operations from Star have been included in the Company s consolidated statements of operations only since the date of acquisition.

The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. Under the purchase method of accounting, the total estimated purchase price was allocated to the tangible and identifiable intangible assets and liabilities assumed based on their relative fair values. The excess of the purchase price over the net tangible and identifiable intangible assets was recorded as goodwill. In accordance with SFAS No. 142, goodwill will not be amortized, but instead will be tested for impairment at least annually and more frequently if certain indicators are present. All of the $3.3 million allocated to goodwill is expected to be deductible for state income tax purposes but not for federal tax purposes. While the Company has accrued all acquisition costs that it is aware of, any adjustments to these costs will be adjusted to goodwill. The purchase price allocation will be finalized in 2009. The total purchase price was as follows:

	Amount (in thousands)
Total purchase price of the acquisition of Star is as follows:	
Cash consideration	$ 8,790
Acquisition related expenses [(1)]	791
Total purchase price	$ 9,581

(1) Acquisition related expenses include legal and accounting fees and other external costs directly related to the acquisition.

The purchase price allocation was as follows (in thousands):

Net tangible assets	$ 973
Identifiable intangible assets	5,295
Goodwill	3,313
Total purchase price	$ 9,581

The following table represents details of the purchased intangible assets as part of the acquisition:

Intangible Assets	**Estimated useful life (in years)**	**Amount**
Existing technology product	4.0	$ 3,849
Core technology product	4.0	467
Existing technology license	0.2	507
Customer contracts and relationships	7.0	307
Trade name	2.0	82
Order backlog	0.2	83
Total		$ 5,295

The fair value of the existing technology- product, existing technology-license and the customer contracts and relationships was determined based on an income approach using the discounted cash flow method. The discount rate of 18.0% used to value the existing technology - product and discount rate of 20.0% used to value the customer contracts and relationships was estimated using a discount rate based on implied rate of return of the transaction, adjusted for the specific risk profile of each asset. The discount rate of 4.5% used to value the existing technology-license was based on a short-term risk free interest rate. The remaining useful life was estimated based on historical product development cycles, the projected rate of technology attrition, and the patterns of project economic benefit of the assets.

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The fair value of core technology and trade name was determined using a variation of income approach known as the profit allocation method. The estimated savings in profit were determined using a 3.0% profit allocation rate and a discount rate of 18.0%. The estimated useful life was determined based on the future economic benefit expected to be received from the asset.

The fair value of order backlog was determined using a cost approach where the fair value was based on estimated sales and marketing expenses expected to be incurred to regenerate the order backlog. The estimated useful life was determined based on the future economic benefit expected to be received from the asset.

W&W Communications, Inc.

On December 23, 2008, the Company completed the acquisition of W&W Communications, Inc. (W&W). Total merger consideration was approximately $8.2 million, which consisted of cash consideration of approximately $3.9 million, 338,245 unregistered common shares of the Company valued at approximately $3.1 million (the fair value of Cavium s stock of $9.16 per share was derived using an average closing price of the Company s shares of common stock on the announcement date and for the two days prior to, and two days subsequent to the public announcement of the acquisition on November 20, 2008) and direct acquisition costs of approximately $1.2 million. Additionally, in order to effect the acquisition of W&W, the Company assumed and immediately paid-off W&W s notes payable of approximately $8.9 million. As the notes payable were immediately paid-off, the $8.9 million has been presented as a cash outflow and included in Acquisition of businesses, net of cash acquired within the cash flows used in investing activities section of the consolidated statement of cash flows for the year ended December 31, 2008. The acquisition allowed the Company to strategically acquire W&W s developed technology and its design team for the emerging consumer market for high definition encoding semiconductors. In connection with the acquisition, the Company recorded approximately $853,000 of restructuring costs related to the contractual operating lease obligations of a W&W facility in accordance with EITF Issue No. 95-3, *Recognition of Liabilities in Connection with Purchase Business Combinations* or EITF 95-3. The costs associated with the obligation were recognized as a liability assumed in the purchase business combination and included in the purchase price allocation. The results of operations from W&W have been included in the Company s consolidated statements of operations only since the date of acquisition.

The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. Under the purchase method of accounting, the total estimated purchase price was allocated to the tangible and identifiable intangible assets and liabilities assumed based on their relative fair values. The excess of the purchase price over the net tangible and identifiable intangible assets was recorded as goodwill. In accordance with SFAS No. 142, goodwill will not be amortized, but instead will be tested for impairment at least annually and more frequently if certain indicators are present. None of the $8.9 million allocated to goodwill is expected to be deductible for federal or state income tax purposes. While the Company has accrued all acquisition costs that it is aware of, any adjustments to these costs will be adjusted to goodwill. The purchase price allocation will be finalized in 2009. The total purchase price was as follows:

		Amount (in thousands)
Total purchase price of the acquisition of W&W is as follows:		
Cash consideration (1)	$	3,891
Value of common stock issued		3,098
Acquisition related expenses (2)		1,195
Total purchase price	$	8,184

(1) As of June 30, 2009, of the the total cash

consideration of $3.9 million, $0.1 million was paid in fiscal 2008 and $3.8 million was paid during the six months ended June 30, 2009.

(2) As of June 30, 2009, acquisition related expenses of $1.2 million include legal and accounting fees and other external costs directly related to the acquisition, of which $0.5 million was paid in fiscal 2008 and the remaining $0.7 million was paid during the six months ended June 30, 2009.

The purchase price allocation was as follows (in thousands):

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	As adjusted
Cash and cash equivalents	$ 283
Inventories, net	829
Other assets	230
Goodwill	8,919
In-process research and development	1,319
Other intangibles, net	10,114
Accounts payable	(1,357)
Accrued expenses	(2,440)
Accrued restructuring	(853)
Notes payable	(8,860)
Total purchase price	$ 8,184

The fair value of intangible assets of $10.1 million has been allocated to the following identifiable intangible asset categories:

Intangible Assets	**Estimated useful life (in years)**	**Amount (in thousands)**
Existing technology	1-5	$ 7,768
Core technology	5.0	1,306
Customer contracts and relationships	6.0	583
Order backlog	0.6	457
Total		$ 10,114

Of the $11.4 million of acquired intangible assets, $1.3 million was assigned to in-process research and development or IPR&D. In accordance with FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, the IPR&D was expensed immediately as it relates to the acquisition of an in-process technology project which had not reached technological feasibility at the time of acquisition, and had no future alternative use. The fair value of the IPR&D was determined based on an income approach using the discounted cash flow method. A discount rate of 24% used to value the project was based on the implied rate of return of the transaction, adjusted to reflect additional risks inherent in the acquired project. As of June 30, 2009, the Company estimates that an additional investment of approximately $1.7 million will be required to complete the project. The Company expects to complete the project by the end of 2009 and to benefit from the IPR&D project beginning in 2010.

The fair value of the existing technology and customer contracts and relationships was determined based on an income approach using the discounted cash flow method. A discount rate of 18% was used to value the existing technology and a discount rate of 20% was used to value the customer contracts and relationships and was estimated using a discount rate based on implied rate of return of the transaction, adjusted for the specific risk profile of each asset. The remaining useful life of existing technology was estimated based on historical product development cycles, the projected rate of technology attrition, and the patterns of project economic benefit of the assets. The remaining useful life of customer contracts and relationships was estimated based on customer attrition, new customer acquisition and future economic benefit of the asset.

The fair value of core technology was determined using a variation of income approach known as the profit allocation method. The estimated savings in profit were determined using a 5% profit allocation rate and a discount rate of 20%. The estimated useful life was determined based on the future economic benefit expected to be received from the asset.

The fair value of order backlog was determined using a cost approach where the fair value was based on estimated sales and marketing expenses expected that would have to be incurred to regenerate the order backlog. The estimated useful life was determined based on the future economic benefit expected to be received from the asset.

Pro forma financial information (unaudited)

The unaudited pro forma financial information in the table below summarizes the combined results of operations of the Company, Star and W&W, on a pro forma basis, as though the companies had been combined as of the beginning of the period presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisitions had taken place at the beginning of each of the periods presented. The pro forma

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financial information for all periods presented includes the purchase accounting adjustments on historical Star and W&W inventory, adjustments to depreciation on acquired property and equipment, amortization charges from acquired intangible assets and related tax effects.

The unaudited pro forma financial information for the three months and six months ended June 30, 2008 combines the historical results for the Company, Star and W&W for the three months and six months ended June 30, 2008. The following table summarizes the pro forma financial information (in thousands, except per share amounts):

	Three Months Ended June 30, 2008	Six Months Ended June 30, 2008
Net revenue	$ 23,078	$ 42,709
Net loss	$ (3,419)	$ (4,699)
Net loss per common share, basic	$ (0.08)	$ (0.12)
Net loss per common share, diluted	$ (0.08)	$ (0.12)

6. Goodwill and Intangible Assets, Net

Goodwill

The increase in goodwill of $122,000 during the six months ended June 30, 2009 was primarily the result of adjustments to acquisition related expenses for the acquisitions completed in 2008. (See Note 5)

Intangible assets, net consisted of the following:

	As of June 30, 2009	As of December 31, 2008
	(in thousands)	
Existing and core technology product	$ 17,614	$ 17,614
Technology license	9,961	9,536
Customer contracts and relationships	966	966
Trade name	82	82
Order backlog	540	540
	29,163	28,738
Less: accumulated amortization		
Existing and core technology product	(6,410)	(4,398)
Technology license	(7,575)	(6,787)
Customer contracts and relationships	(167)	(65)
Trade name	(38)	(17)
Order backlog	(540)	(513)
	$ 14,433	$ 16,958

Amortization expense was $1.5 million and $261,000 for the three months ended June 30, 2009 and 2008, respectively, and $2.9 million and $583,000 for the six months ended June 30, 2009 and 2008, respectively. The weighted-average remaining estimated lives for intangible assets are approximately 3.3 years for existing and core technology-product and 1.7 years for technology license. The weighted average remaining estimated life of intangible assets in total is approximately 2.4 years. Future amortization expense is estimated to be $2.8 million for 2009, $4.3 million for 2010, $3.2 million for 2011, $2.5 million for 2012 and $1.6 million thereafter.

7. Restructuring Accrual

In connection with the acquisition of W&W, the Company recorded restructuring liabilities of approximately $853,000 in accordance

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with EITF 95-3. Of the $682,000 balance as of June 30, 2009, $218,000 was recorded as restructuring related payables in accrued expenses and other current liabilities and the remaining $464,000 was recorded in other non-current liabilities. The liabilities are related to an operating lease commitment for one W&W facility, which the Company no longer occupies. The Company expects the obligation to be settled by the end of January 2011 with payments of approximately $218,000 in 2009, $426,000 in 2010 and $38,000 in 2011.

In connection with a workforce reduction action in the three months ended June 30, 2009, the Company incurred approximately $316,000 in expenses primarily related to severance and related costs. These charges were recorded as operating expenses and the Company fully paid the amount by the end of June, 2009.

A summary of the accrued restructuring related activities during the six months ended June 30, 2009 is as follows (in thousands):

		Severance and other Benefits	Excess Facility related costs	Total
Accrued restructuring	January 1, 2009	$	$ 853	$ 853
Additions		316		316
Cash payments		(316)	(171)	(487)
Accrued restructuring	June 30, 2009	$	$ 682	$ 682
Less: current portion			218	218
Long-term portion		$	$ 464	$ 464

8. Stockholders Equity

Common and Preferred Stock

As of June 30, 2009, the Company is authorized to issue 200,000,000 shares of $0.001 par value common stock and 10,000,000 shares of $0.001 par value preferred stock. The Company has the authority to issue preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption and liquidation preferences. As of June 30, 2009 and December 31, 2008, no shares of preferred stock were outstanding.

Equity Incentive Plans

The description of the key features of the Company s 2007 Equity Incentive Plan and 2001 Stock Incentive Plan, may be read in conjunction with the audited financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

The following table summarizes the details related to activity of early-exercise unvested shares of common stock granted under the 2001 Stock Incentive Plan:

	Number of Unvested Shares Outstanding	**Weighted-Average Exercise/ Purchase Price**
Balance as of December 31, 2008	145,564	$3.50
Issued		
Vested	(30,404)	2.12
Cancelled and forfeited		
Balance as of March 31, 2009	115,160	$3.86
Issued		
Vested	(31,965)	2.81
Repurchased	(2,502)	5.99

Balance as of June 30, 2009	80,693	$4.22

The following table summarizes the details related to stock options granted and outstanding under the 2007 Equity Incentive Plan and 2001 Stock Incentive Plan:

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	Number of Shares Outstanding	Weighted Average Exercise Price per Share
Balance at December 31, 2008	5,397,454	$ 8.78
Options granted	2,535,906	9.90
Options exercised	(26,611)	2.12
Options cancelled and forfeited	(75,879)	14.77
Balance as of March 31, 2009	7,830,870	$ 9.11
Options granted	83,000	13.13
Options exercised	(97,120)	3.80
Options cancelled and forfeited	(159,197)	14.95
Balance as of June 30, 2009	7,657,553	$ 9.10

The following table summarizes the details related to restricted stock units granted and outstanding under the 2007 Equity Incentive Plan:

	Number of Shares	Weighted-Average Grant Date Fair Value Per Share
Balance as of December 31, 2008	280,933	$17.16
Granted	278,549	8.88
Issued and released	(38,247)	15.80
Cancelled and forfeited	(9,080)	15.40
Balance as of March 31, 2009	512,155	$12.79
Granted	9,000	12.56
Issued and released	(31,902)	13.68
Cancelled and forfeited	(11,086)	14.84
Balance as of June 30, 2009	478,167	$12.68

For restricted stock units, or RSUs, stock-based compensation expense is calculated based on the market price of the Company s common stock on the date of grant, multiplied by the number of RSUs granted. The grant date fair value of RSUs, less estimated forfeitures, is recorded on a straight-line basis, over the vesting period.

As of June 30, 2009, there was $5.4 million of unrecognized compensation costs related to RSUs granted under the Company s 2007 Equity Incentive Plan. The unrecognized compensation cost is expected to be recognized over a weighted average period of 3.1 years.

Stock-Based Compensation

The Company recognizes stock-based compensation for options granted to employees in accordance with FAS 123(R). The following table presents the detail of stock-based compensation expense amounts included in the consolidated statement of operations for each of the periods presented:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in thousands)			
Cost of revenue	$ 80	$ 54	$ 167	$ 83
Research and development	1,397	659	2,613	987
Sales, general and administrative	1,428	798	2,714	1,208
	$ 2,905	$ 1,511	$ 5,494	$ 2,278

The total stock-based compensation cost capitalized as part of inventory as of June 30, 2009 and 2008 was $197,000 and $96,000, respectively.

The fair value of each employee option grant for the three months and six months ended June 30, 2009 and 2008 under SFAS 123(R) was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Risk-free interest rate	2.19%	3.32%	1.52% to 2.19%	2.33% to 3.32%
Expected life	4.53 - 4.75 years	4.53 - 4.75 years	4.53 - 4.75 years	4.53 - 4.75 years
Dividend yield	None	None	None	None
Volatility	63.4% to 63.5%	55.4%	63.4% to 63.7%	55.4% to 56.0%

The estimated weighted-average grant date fair value of options granted were $6.92 and $9.97 for the three months ended June 30, 2009 and 2008, respectively, and $8.99 and $7.86 for the six months ended June 30, 2009 and 2008, respectively.

As of June 30, 2009, there was $24.2 million of unrecognized compensation costs related to stock options granted under the Company s 2007 and 2001 Stock Incentive Plans. The unrecognized compensation cost is expected to be recognized over a weighted average period of 2.92 years.

9. Income Taxes

For the three months and six months ended June 30, 2009 and 2008, the provision for income taxes was based on the estimated annual effective tax rate in compliance with SFAS 109 and other related guidance. The Company updates its estimate of its annual effective tax rate at the end of each quarterly period. The estimate takes into account estimations of annual pre-tax income, the geographic mix of pre-tax income and interpretations of tax laws and the possible outcomes of current and future audits.

The following table presents the provision for income taxes and the effective tax rates for the three months and six months ended June 30, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in thousands)			
(Loss) income before provision for income taxes	$ (6,112)	$ 2,313	$ (12,617)	$ 4,532
Provision for income taxes	$ 56	$ 240	$ 84	$ 487
Effective tax rate	-0.9%	10.4%	-0.7%	10.7%

The provision for income taxes was $56,000 and $84,000 for the three and six months ended June 30, 2009, respectively. The income tax expense for the three and six months ended June 30, 2009 was primarily related to federal alternative minimum taxes, international taxes and state income taxes.

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The provision for income taxes was $240,000 and $487,000 for the three and six months ended June 30, 2008, respectively. The income tax expense for the three and six months ended June 30, 2008 was primarily related to the federal alternative minimum tax on profits in the United States adjusted by certain non-deductible items, international taxes and state income taxes.

The Company continues to maintain a full valuation allowance on its U.S. net deferred tax assets until sufficient positive evidence exists, including history of taxable income, to support reversal of the valuation allowance.

As of June 30, 2009 and December 31, 2008, the Company had $4.0 million of unrecognized tax benefits, which is netted against deferred tax assets and is fully offset by a valuation allowance. There were no significant changes to the unrecognized tax benefit during the six months ended June 30, 2009.

The Company s major tax jurisdictions are the United States federal government and the State of California. The Company files income tax returns in the United States federal jurisdiction, the State of California and various state and foreign tax jurisdictions in which it has a subsidiary or branch operation. The United States federal corporation income tax returns beginning with the 2000 tax year remain subject to examination by the Internal Revenue Service, or IRS. The California corporation income tax returns beginning with the 2000 tax year remain subject to examination by the California Franchise Tax Board. There are no on-going income tax audits in the major tax jurisdictions.

10. Segment Information

SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments. 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, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company is organized as, and operates in, one reportable segment: the development and sale of semiconductor processor solutions for next-generation intelligent networking equipment. The chief operating decision-maker is the Chief Executive Officer. The Company s Chief Executive Officer reviews financial information presented on a consolidated basis, accompanied by information about revenue by customer and geographic region, for purposes of evaluating financial performance and allocating resources. The Company and its Chief Executive Officer evaluate performance based primarily on revenue to the customers and in the geographic locations in which the Company operates. Revenue is attributed by geographic location based on the ship-to location of customers. The Company s assets are primarily located in the United States of America and not allocated to any specific region. Therefore, geographic information is presented only for total revenue. Substantially all of the Company s long-lived assets are located in the United States of America.

The following table is based on the geographic location of the OEMs or the distributors who purchased the Company s products. The geographic locations of the Company s distributors may be different from the geographic locations of the ultimate end users. Revenues by geography for the periods indicated were as follows:

	Three months ended June 30,		**Six months ended June 30,**	
	2009	**2008**	**2009**	**2008**
	(in thousands)			
United States	$ 7,837	$ 10,123	$ 18,196	$ 20,551
Hong Kong	6,089	599	8,844	870
Taiwan	2,650	2,523	5,119	5,633
Japan	3,257	3,529	5,021	4,840
China	987	1,632	2,356	2,954
Other countries	1,984	3,156	3,650	5,056
Total	$ 22,804	$ 21,562	$ 43,186	$ 39,904

11. Commitments and Contingencies

The Company is not currently a party to any legal proceedings that management believes would have a material adverse effect on the consolidated financial position, results of operations or cash flows of the Company.

The Company leases its facilities under non-cancelable operating leases, which contain renewal options and escalation clauses, and expire on varying dates ending in April 2013. The Company also acquires certain assets under capital leases.

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Minimum commitments under non-cancelable capital and operating lease agreements, excluding accrued restructuring liability (See Note 7) as of June 30, 2009 were as follows:

	Capital lease and technology license obligations	Operating leases (in thousands)	Total
2009	$ 1,350	794	$ 2,144
2010	2,038	1,913	3,951
2011	144	1,658	1,802
2012		1,044	1,044
2013		281	281
thereafter			
	$ 3,532	$ 5,690	$ 9,222
Less: Interest component	(164)		
Present value of minimum lease payment	3,368		
Less: current portion	(2,476)		
Long-term portion of obligations	$ 892		

Rent expense incurred under operating leases was $483,000 and $342,000 for the three months ended June 30, 2009 and 2008, respectively, and $997,000 and $652,000 for the six months ended June 30, 2009 and 2008, respectively.

The capital lease and technology license obligations include future cash payments payable primarily for license agreements with outside vendors. The significant obligations which have outstanding payments as of June 30, 2009 are summarized as follows:

The license agreement, which was entered into in October 2007, with Synopsys is for certain design tools totaling $7.0 million, with 12 installment payments. The term of the license is three years which will expire in October 2010. The present value of the installment payments has been capitalized and is amortized over three years, and included within capital lease and technology license obligations on the consolidated balance sheets. As of June 30, 2009, $4.0 million of the total $7.0 million due under the licenses agreement was paid.

A second license agreement with Synopsys, which was entered into in October 2008, is for certain design tools totaling $575,000. The term of the license is three years which will expire in October 2011. As of June 30, 2009, $144,000 of the total $575,000 due under the licenses agreement was paid.

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

The following discussion should be read in conjunction with the Consolidated Condensed Financial Statements and the related notes that appear elsewhere in this document.

The information in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act), which are subject to the safe harbor created by those sections. Forward-looking statements are based on our management s beliefs and assumptions and on information currently available to our management. In some cases, you can identify forward-looking statements by terms such as may, will, should, could, would, estimate, project, predict, potential, continue, strategy, believe, anticipate, plan, expect, intend and similar expression intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance, time frames or achievements to be materially different from any future results, performance, time frames or achievements expressed or implied by the forward-looking statements. We discuss many of these risks, uncertainties and other factors in this Quarterly Report on Form 10-Q in greater detail under the heading Risk Factors. Given these risks, uncertainties and other factors, you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this filing. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect. We hereby qualify our forward-looking statements by these cautionary statements. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

Overview

We are a provider of highly integrated semiconductor products that enable intelligent processing for networking, communications, storage, wireless, video and security applications. We market and sell our products to providers of networking equipment that sell their products into the enterprise network, data center, broadband and consumer, and access and service provider markets. Our products are used in a broad array of networking equipment, including routers, switches, content-aware switches, unified threat management, or UTM and other security appliances, application-aware gateways, voice/video/data, or triple-play, gateways, wireless local area network, or WLAN and third-generation, or 3G access and aggregation devices, storage networking equipment, servers and intelligent network interface cards. We focus our resources on the design, sales and marketing of our products, and outsource the manufacturing of our products.

From our incorporation in 2000 through 2003, we were primarily engaged in the design and development of our first processor family, NITROX, which we began shipping commercially in 2003. In 2004, we introduced and commenced commercial shipments of NITROX Soho. In 2006, we commenced our first commercial shipments of our OCTEON family of multi-core MIPS64® processors. We introduced a number of new products within all three of these product families in 2006. In 2007, we introduced our new line of OCTEON based storage services processors designed to address the specific needs in the storage market, as well as other new products in the OCTEON and NITROX families. In 2008, we expanded our OCTEON and NITROX product families with new products including wireless services processors to address the needs for wireless infrastructure equipment. In 2009, we announced the next generation OCTEON II Internet Application Processor (IAP) family multi-core MIPS64® processors, with one to 32 cores to address next generation networking applications support converged voice, video, data mobile traffic and services.We expect to begin shipments of OCTEON II processors towards the end of 2009.

We acquired W&W Communications, Inc. (W&W) in the fourth quarter of 2008. This acquisition launched us into the high growth video processor market with a broad product line called PureVu™. The PureVu™ family of video processors and modules incorporate proprietary and patent pending video technology that produce perceptual lossless video quality and deliver practically zero latency with extremely low power and cost. Through the acquisition of substantially all of the assets of Star Semiconductor Corporation (Star) in the third quarter of 2008, we also added the Star ARM-based processors to our portfolio to address connected home and office applications. For a complete discussion on our 2008 acquisitions, see Note 5 Business Combinations in Item 1, of this Quarterly Report, which is incorporated herein by reference.

Since inception, we have invested heavily in new product development and achieved our first quarter of profitability during the quarter ended September 30, 2007. Our net revenue has grown from $19.4 million in 2005 to $34.2 million in 2006, $54.2 million in 2007, $86.6 million in 2008 and $43.2 million in the six months ended June 30, 2009, driven primarily by demand in the enterprise network and data center markets, and more recently in 2008 and 2009 by increased demand in the broadband and consumer markets. We expect sales of our products for use in the enterprise network and data center markets to continue to represent a substantial portion of our revenue in the foreseeable future.

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We primarily sell our products to OEMs, either directly or through their contract manufacturers. Contract manufacturers purchase our products only when an OEM incorporates our product into the OEM s product, not as commercial off-the-shelf products. Our customers products are complex and require significant time to define, design and ramp to volume production. Accordingly, our sales cycle is long. This cycle begins with our technical marketing, sales and field application engineers engaging with our customers system designers and management, which is typically a multi-month process. If we are successful, a customer will decide to incorporate our product in its product, which we refer to as a design win. Because the sales cycles for our products are long, we incur expenses to develop and sell our products, regardless of whether we achieve the design win and well in advance of generating revenue, if any, from those expenditures. We do not have long-term purchase commitments from any of our customers, as sales of our products are generally made under individual purchase orders. However, once one of our products is incorporated into a customer s design, it is likely to remain designed in for the life cycle of the product. We believe this to be the case because a redesign would generally be time consuming and expensive. We have experienced revenue growth due to an increase in the number of our products, an expansion of our customer base, an increase in the number of average design wins within any one customer and an increase in the average revenue per design win.

Key Business Metrics

Design Wins. We closely monitor design wins by customer and end market on a periodic basis. We consider design wins to be a key ingredient in our future success, although the revenue generated by each design can vary significantly. Our long-term sales expectations are based on internal forecasts from specific customer design wins based upon the expected time to market for end customer products deploying our products and associated revenue potential.

Pricing and Margins. Pricing and margins depend on the features of the products we provide to our customers. In general, products with more complex configurations and higher performance tend to be priced higher and have higher gross margins. These configurations tend to be used in high performance applications that are focused on the enterprise network, data center, and access and service provider markets. We tend to experience price decreases over the life cycle of our products, which can vary by market and application. In general, we experience less pricing volatility with customers that sell to the enterprise and data center markets.

Sales Volume. A typical design win can generate a wide range of sales volumes for our products, depending on the end market demand for our customers products. This can depend on several factors, including the reputation, market penetration, the size of the end market that the product addresses, and the marketing and sales effectiveness of our customer. In general, our customers with greater market penetration and better branding tend to develop products that generate larger volumes over the product life cycle. In addition, some markets generate large volumes if the end market product is adopted by the mass market.

Customer Product Life Cycle. We typically commence commercial shipments from nine months to three years following the design win. Once our product is in production, revenue from a particular customer may continue for several years. We estimate our customers product life cycles based on the customer, type of product and end market. In general, products that go into the enterprise network and data center take longer to reach volume production but tend to have longer lives. Products for other markets, such as broadband and consumer, tend to ramp relatively quickly, but generally have shorter life cycles. We estimate these life cycles based on our management s experience with providers of networking equipment and the semiconductor market as a whole.

Results of Operations

Three and Six months ended June 30, 2009 and 2008

Net Revenue. Our net revenue consists primarily of sales of our semiconductor products to providers of networking equipment and their contract manufacturers and distributors. Initial sales of our products for a new design are usually made directly to providers of networking equipment as they design and develop their product. Once their design enters production, they often outsource their manufacturing to contract manufacturers that purchase our products directly from us or from our distributors. We price our products based on market and competitive conditions and periodically reduce the price of our products, as market and competitive conditions change, and as manufacturing costs are reduced. We do not experience different margins on direct sales to providers of networking equipment and indirect sales through contract manufacturers because in all cases we negotiate product pricing directly with the providers of networking equipment. To date, all of our revenue are denominated in U.S. dollars.

We also derive revenue in the form of license and maintenance fees through licensing our software products which help our customers build products around our systems-on-a-chip, or SoCs in a more time and cost efficient manner. Revenue from such arrangements totaled $131,000 and $271,000 for the three months ended June 30, 2009 and 2008, respectively, and $1.7 million and $537,000 for the six months ended June 30, 2009 and 2008, respectively.

Our customers representing greater than 10% of net revenue for each of the periods were:

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	For the three months ended June 30,		For the six months ended June 30,	
	2009	2008	2009	2008
Percentage of total net revenue				
Actiontec	19%	*	14%	*
Cisco	18%	33%	20%	32%
Sumitomo	13%	15%	10%	10%

* Represents less than 10% of the consolidated net revenue for the respective period end.

Our distributors are used primarily to support international sale logistics in Asia, including importation and credit management. Total net revenue through distributors was $8.5 million and $7.8 million for the three months ended June 30, 2009 and 2008, or 37.3% and 36.1% of net revenue, respectively, and $15.2 million and $13.3 million for the six months ended June 30, 2009 and 2008, or 35.2% and 33.3% of net revenue, respectively. While we have purchase agreements with our distributors, the distributors do not have long-term contracts with any of the equipment providers. Our distributor agreements, except as noted below for Avnet, limit the distributor s ability to return product up to a portion of purchases in the preceding quarter. Given our experience, along with our distributors limited contractual return rights, we believe we can reasonably estimate expected returns from our distributors. Accordingly, we recognize sales through distributors at the time of shipment, reduced by our estimate of expected returns.

Revenue and costs relating to sales to distributors are deferred if we grant more than limited rights of returns and price credits or if we cannot reasonably estimate the level of returns and credits issuable. Our distribution agreement with Avnet, Inc. is to distribute our products primarily in the United States. Given the terms of the distribution agreement, for sales to Avnet, revenue and costs are being deferred until products are sold by Avnet to their end customers. For the three months ended June 30, 2009 and 2008, 5.5% and 3.4%, respectively, and for the six months ended June 30, 2009 and 2008, 5.8% and 3.6%, respectively, of our net revenues were from products sold by Avnet. Revenue recognition depends on notification from Avnet that product has been sold to Avnet s end customers.

The following table is based on the geographic location of the original equipment manufacturers or the distributors who purchased our products. The geographic locations of our distributors may be different from the geographic locations of the ultimate end customers. Revenues by geography for the periods indicated were:

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
	(in thousands)			
United States	$ 7,837	$ 10,123	$ 18,196	$ 20,551
Hong Kong	6,089	599	8,844	870
Taiwan	2,650	2,523	5,119	5,633
Japan	3,257	3,529	5,021	4,840
China	987	1,632	2,356	2,954
Other countries	1,984	3,156	3,650	5,056
Total	$ 22,804	$ 21,562	$ 43,186	$ 39,904

Three Months and Six Months ended June 30, 2009 Compared to the Three Months and Six Months ended June 30, 2008: Net Revenue. Our net revenue was $22.8 million in the three months ended June 30, 2009, as compared to $21.6 million in the three months ended June 30, 2008, an increase of $1.2 million, or 5.8%. Our net revenue was $43.2 million in the six months ended June 30, 2009, as compared to $39.9 million in the six months ended June 30, 2008, an increase of $3.3 million, or 8.2%. The increase in net revenue in the three months and six months ended June 30, 2009 was mainly attributable to the increase in sales of $5.9 million and $9.4 million, respectively, in broadband and consumer markets due to increase in demand for our products from our existing and new customers combined with revenue generated from acquisitions completed in 2008. The net revenue growth in the three months and six months ended June 30, 2009 was partially offset by sales declines of $4.5 million and $7.3 million, respectively, in the enterprise network and data center markets and access and service provider markets due to weakened demand as a result of the current global economic downturn. Our net revenue from distributors in the three months and six months ended June 30, 2009 were increased by 1.2 and 1.9 percentage points, respectively, due to increased sales across most of our major distributors.

Cost of Revenue and Gross Margin. We outsource wafer fabrication, assembly and test functions of our products. A significant portion of our cost of revenue consists of payments for the purchase of wafers and for assembly and test services, amortization of acquired intangibles and amortization related to capitalized mask costs. To a lesser extent, cost of revenue includes expenses relating to our internal operations that manage our contractors, stock-based compensation, the cost of shipping and logistics, royalties, inventory valuation expenses for excess and obsolete inventories, warranty costs and changes in product cost due to changes in sort, assembly and test yields. In general, our cost of revenue associated with a particular product declines over time as a result of yield improvements, primarily associated with design and test enhancements.

We use third-party foundries and assembly and test contractors, which are primarily located in Asia, to manufacture, assemble and test our semiconductor products. We purchase processed wafers on a per wafer basis from our fabrication suppliers, which are currently TSMC, UMC and Fujitsu. We also outsource the sort, assembly, final testing and other processing of our product to third-party contractors, primarily ASE and ISE. We negotiate wafer fabrication on a purchase order basis and do not have long-term agreements with any of our third-party contractors. A significant disruption in the operations of one or more of these contractors would impact the production of our products which could have a material adverse effect on our business, financial condition and results of operations.

Our net revenue, cost of revenue, gross profit and gross margin for the three months and six months ended June 30, 2009 and 2008 were:

	For the three months ended June 30,				**For the six months ended June 30,**			
	2009	**2008**	**change**	**% change**	**2009**	**2008**	**change**	**% change**
		(in thousands)				**(in thousands)**		
Net revenue	$ 22,804	$ 21,562	$ 1,242	5.8%	$ 43,186	$ 39,904	$ 3,282	8.2%
Cost of revenue	12,139	7,808	4,331	55.5%	22,953	14,395	8,558	59.5%
Gross Profit	$ 10,665	$ 13,754	$ (3,089)	-22.5%	$ 20,233	$ 25,509	$ (5,276)	-20.7%
Gross Margin	46.8%	63.8%	-17.0%	-26.7%	46.9%	63.9%	-17.0%	-26.6%

Our gross margin has been and will continue to be affected by a variety of factors, including average sales prices of our products, the product mix, amortization of acquired intangibles, the cost of fabrication masks that are capitalized and amortized, the timing of cost reductions for fabricated wafers and assembly and test service costs, inventory valuation charges and the timing and changes in sort, assembly and test yields. Overall product margin is impacted by the mix between higher performance, higher margin products and lower performance, lower margin products. In addition, we typically experience lower yields and higher associated costs on new products, which improve as production volumes increase.

Three Months and Six Months ended June 30, 2009 Compared to the Three Months and Six Months ended June 30, 2008: Cost of Revenue and Gross Margin. Gross margin declined from 63.8% in the three months ended June 30, 2008 to 46.8% in the three months ended June 30, 2009, a decline of 17.0 percentage points. Gross margin declined from 63.9% in the six months ended June 30, 2008 to 46.9% in the six months ended June 30, 2009, a decline of 17.0 percentage points. The decline in gross margin in the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 was primarily due to product sales mix shift towards increased sales of lower performance, lower margin products particularly in the broadband and consumer markets, and to a lesser extent, from higher amortization costs of acquired intangible assets and amortization of fair value adjustments of acquired inventory resulting from the acquisitions completed in 2008.

We expect our gross margin to improve slightly in the third quarter of 2009 compared to the second quarter of 2009, due to expected increase in revenue in the enterprise and data center markets as a percentage of overall revenue combined with expected decreases in wafer, assembly and testing costs of all of our products. In addition, we expect the amortization costs of acquired intangible assets from the acquisitions completed in 2008 to remain constant from the first six months ended June 30, 2009.

Research and Development Expenses

Research and development expenses primarily include personnel costs, engineering design development software and hardware tools, allocated facilities expenses and depreciation of equipment used in research and development, and stock-based compensation under SFAS 123(R).

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Total research and development expenses for the three months and six months ended June 30, 2009 and 2008 were:

	For the three months ended June 30,				For the six months ended June 30,			
	2009	2008	change	% change	2009	2008	change	% change
	(in thousands)				(in thousands)			
Research and development expenses	$10,274	$6,461	$3,813	59.0%	$20,265	$12,281	$7,984	65.0%
Percent of total net revenue	45.1%	30.0%	15.1%	50.3%	46.9%	30.8%	16.1%	52.3%

Three Months and Six Months ended June 30, 2009 Compared to the Three Months and Six Months ended June 30, 2008: Research and development expenses increased by $3.8 million and $8.0 million, or 59.0% and 65.0% to $10.3 million and $20.3 million in the three months and six months ended June 30, 2009 from $6.5 million and $12.3 million in the three months and six months ended June 30, 2008. Of the $3.8 million and $8.0 million increase in the three months and six months ended June 30, 2009, salaries and benefits accounted for $2.2 million and $4.6 million, respectively, and stock-based compensation expense accounted for $0.6 million and $1.5 million, respectively, due to increased headcount mainly resulting from the acquisitions completed in 2008. Consulting services and other miscellaneous expenses accounted for $0.7 million and $1.6 million of the increase in the three months and six months ended June 30, 2009, respectively. In addition, workforce reduction related charges of $0.2 million contributed to the overall increase in the three months and six months ended June 30, 2009. Research and development headcount increased to 222 at the end of June 2009 from 147 at the end of June 2008.

We expect our research and development expenses in total dollars to increase slightly in the third and fourth quarters of 2009 compared to the first six months ended June 30, 2009.

Sales, General and Administrative Expenses

Sales, general and administrative expenses primarily include personnel costs, accounting and legal fees, information systems, sales commissions, trade shows, marketing programs, depreciation, allocated facilities expenses and stock-based compensation under SFAS 123(R). Total sales, general and administrative costs for the three months and six months ended June 30, 2009 and 2008 were:

	For the three months ended June 30,				For the six months ended June 30,			
	2009	2008	change	% change	2009	2008	change	% change
	(in thousands)				(in thousands)			
Sales, general and administrative	$6,526	$5,454	$1,072	19.7%	$12,663	$10,009	$2,654	26.5%
Percent of total net revenue	28.6%	25.3%	3.3%	13.0%	29.3%	25.1%	4.2%	16.7%

Three Months and Six Months ended June 30, 2009 Compared to the Three Months and Six Months ended June 30, 2008: Sales, general and administrative expenses increased $1.1 million and $2.7 million, or 19.7% and 26.5% to $6.5 million and $12.7 million in the three months and six months ended June 30, 2009 from $5.4 million and $10.0 million in the three months and six months ended June 30, 2008. Of the $1.1 million and $2.7 million increase in the three months and six months ended June 30, 2009, stock-based compensation expense accounted for $0.6 million and $1.5 million, respectively, and salaries, benefits and commissions accounted for $0.3 million and $0.7 million, respectively, due to increased headcount. Other miscellaneous expenses accounted for $0.2 million and $0.4 million of the increase in the three months and six months ended June 30, 2009. Sales, general and administrative headcount increased to 79 at the end of June 2009 from 67 at the end of June 2008.

Other Income, Net. Other income, net, primarily includes interest income on cash and cash equivalents and, to a lesser extent, includes interest expense component associated with the installment payment of capitalized licenses.

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	For the three months ended June 30, 2009	2008	change%	change	For the six months ended June 30, 2009	2008	change%	change
	(in thousands)				(in thousands)			
Interest income and other	$ 90	$ 609	$ (519)	-85.2%	$ 224	$ 1,601	$ (1,377)	-86.0%
Interest expense	(67)	(135)	68	-50.4%	(146)	(288)	142	-49.3%
Total other income, net	$ 23	$ 474	$ (451)	-95.1%	$ 78	$ 1,313	$ (1,235)	-94.1%

Three Months and Six Months ended June 30, 2009 Compared to the Three Months and Six Months ended June 30, 2008: Other income, net decreased in the three months and six months ended June 30, 2009 primarily as the result of decreased interest income resulting from lower average cash and cash equivalents balances combined with lower short-term U.S. interest rates in the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008.

Provision for Income Taxes. For the three months and six months ended June 30, 2009 and 2008; the provision for income taxes was based on our estimated annual effective tax rate in compliance with SFAS 109 and other related guidance. We update our estimate of our annual effective tax rate at the end of each quarterly period. Our estimate takes into account estimations of annual pre-tax income, the geographic mix of pre-tax income and our interpretations of tax laws and the possible outcomes of current and future audits.

The following table presents the provision for income taxes and the effective tax rates for the three months and six months ended June 30, 2009 and 2008:

	Three Months Ended June 30, 2009	2008	Six Months Ended June 30, 2009	2008
	(in thousands)			
(Loss) income before provision for income taxes	$(6,112)	$2,313	$(12,617)	$4,532
Provision for income taxes	$ 56	$ 240	$ 84	$ 487
Effective tax rate	-0.9%	10.4%	-0.7%	10.7%

The provision for income taxes was $56,000 and $84,000 for the three months and six months ended June 30, 2009, respectively, compared to $240,000 and $487,000 for the three months and six months ended June 30, 2008, respectively. The provision for income taxes for the three months and six months ended June 30, 2009 was primarily related to federal alternative minimum taxes, international taxes and state income taxes. The provision for the three months and six months ended June 30, 2008 was primarily related to the federal alternative minimum tax on profits in the United States adjusted by certain non-deductible items, international taxes and state income taxes.

We continue to maintain a full valuation allowance on our U.S. net deferred tax assets until sufficient positive evidence exists, including history of taxable income, to support reversal of the valuation allowance.

Liquidity and Capital Resources

We believe that we will have adequate liquidity over the next 12 months to operate our business and to meet our cash requirements. Our primary sources of cash subsequent to our initial public offering in 2007 have been cash generated from our operations, cash collections from customers and to a lesser extent, cash received from the exercise of employee stock options.

Cash equivalents consist primarily of an investment in a money market fund. As of June 30, 2009, we have not experienced any impairment charges due to such concentration of credit risk. We believe that our $66.7 million of cash and cash equivalents at June 30, 2009 and expected cash flows from operations, if any, will be sufficient to fund our projected operating requirements for at least 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our engineering, sales and marketing activities, the timing and extent of our expansion into new territories, the timing of introductions of new products and enhancements to existing products and the continuing market acceptance of our products. Although we currently are not a party to any agreement or letter of intent with respect to potential material investments in, or acquisitions of, complementary

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businesses, services or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

Following is a summary of our working capital and cash and cash equivalents as of June 30, 2009 and December 31, 2008:

	As of	
	June 30, 2009	December 31, 2008
	(in thousands)	
Working capital	$87,341	$ 90,335
Cash and cash equivalents	$66,747	$ 77,027

Following is a summary of our cash flows from operating activities, investing activities and financing activities for the six months ended June 30, 2009 and 2008:

	Six Months Ended June 30,	
	2009	2008
	(in thousands)	
Net cash (used in) provided by operating activities	$(2,502)	$ 8,047
Net cash used in investing activities	$(6,830)	$(5,367)
Net cash used in financing activities	$ (948)	$(1,858)

Cash Flows from Operating Activities

Net cash from operating activities decreased by $10.5 million in the six months ended June 30, 2009 compared to the six months ended June 30, 2008. The decrease in our cash flows from operations was primarily due to our net loss of $12.7 million in the six months ended June 30, 2009 compared to net income of $4.0 million in the six months ended June 30, 2008, which was offset in part by higher non-cash expenses of $5.7 million in the six months ended June 30, 2009. The non-cash expenses were mainly attributable to the higher stock-based compensation due to increased headcount as a result of our acquisitions completed in 2008 and higher amortization expenses resulting from the intangibles acquired in connection with the acquisitions completed in 2008. In addition, changes in assets and liabilities, net decreased by $0.5 million in the six months ended June 30, 2009 compared to the changes in assets and liabilities in the six months ended June 30, 2008.

Cash Flows from Investing Activities

Net cash used in investing activities increased by $1.5 million in the six months ended June 30, 2009 compared to the six months ended June 30, 2008. The increase was mainly due to cash paid for the W&W Communications, Inc. acquisition completed in December 2008, which was accrued for as of December 31, 2008. The increase was offset by lower cash used for purchases of property and equipment.

Cash Flows from Financing Activities

Net cash used in financing activities decreased by $0.9 million in the six months ended June 30, 2009 compared to the six months ended June 30, 2008. The decline was mainly due to lower principal payments of capital lease and technology license obligations.

Indemnities

In the ordinary course of business, we have entered into agreements with customers that include indemnity provisions. Based on historical experience and information known as of June 30, 2009, we believe our exposure related to the indemnities at June 30, 2009 is not material. We also enter into indemnification agreements with our officers and directors and our certificate of incorporation and bylaws include similar indemnification obligations to our officers and directors. It is not possible to determine the amount of our liability related to these indemnification agreements and obligations to our officers and directors due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement.

Off-Balance Sheet Arrangements

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During the periods presented, we did not have, nor do we currently have, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Contractual Obligations

The following table describes our commitments to settle contractual obligations in cash as of June 30, 2009:

	Less Than 1 Year	1 to 2 Years	3 to 5 Years	More Than 5 Years	Total
			(in thousands)		
Operating lease obligations	$ 794	$ 3,571	$ 1,325	$	$ 5,690
Capital lease obligations	1,350	2,182			3,532
Purchase obligations	2,034				2,034
Total	$ 4,178	$ 5,753	$ 1,325	$	$ 11,256

We adopted FIN 48 on January 1, 2007. As of June 30, 2009, we had $4.0 million of total gross unrecognized tax benefits and related interest. The timing of any payments which could result from these unrecognized tax benefits will depend upon a number of factors. Accordingly, the timing of payment cannot be estimated. We do not expect a significant tax payment related to these obligations to occur within the next 12 months.

In addition to the contractual obligations noted in the table above, we also have the following funding commitments:

In connection with our acquisition of certain assets of Parallogic Corporation (Parallogic), we are obligated to make two installment payments of $220,000 each at the completion of certain milestones or the 18th and 36th month anniversaries of the acquisition date, whichever comes first. In January 2009, we paid the first installment of $220,000 due to Parallogic s achievement of the first milestone as defined in the Asset Purchase Agreement. The remaining $220,000 was recorded as acquisition related payables in accrued expenses and other current liabilities. As of August 4, 2009, Parallogic has achieved the second milestone as defined in the Asset Purchase Agreement and we expect to pay the second installment in the third quarter of 2009.

Critical Accounting Policies and Estimates

The preparation of our financial statements and accompanying disclosures in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and the accompanying notes. The SEC has defined a company s critical accounting policies as policies that are most important to the portrayal of a company s financial condition and results of operations, and which require a company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified our most critical accounting policies and estimates to be as follows: (1) revenue recognition; (2) product warranty accrual; (3) stock-based compensation; (4) inventory valuation; (5) accounting for income tax; (6) mask costs; (7) business combinations and (8) goodwill and purchased intangible assets. Although we believe that our estimates, assumptions and judgments are reasonable, they are based upon information not presently available. Actual results may differ significantly from these estimates if the assumptions, judgments and conditions upon which they are based turn out to be inaccurate. Management believes that there have been no significant changes during the six months ended June 30, 2009 to the items that we disclosed as our critical accounting policies and estimates in Management s Discussion and Analysis of Financial Condition and Results of Operations, in our Annual Report on Form 10-K for the year ended December 31, 2008 filed on March 2, 2009.

Recent Accounting Pronouncements

Please refer to the recent accounting pronouncements listed in the footnote 1 of the financial statements.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

During the six months ended June 30, 2009, there were no material changes to our quantitative and qualitative disclosures about market risk related to our investment activities as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the SEC on March 2, 2009.

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Item 4. ***Controls and Procedures***

Disclosure Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer evaluated with the participation of our management, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of June 30, 2009. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to management as appropriately to allow for timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recently completed second quarter ending on June 30, 2009. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that there has not been any change in our internal control over financial reporting during that quarter that has materially affected, or is reasonably likely to materially affect, the effectiveness, design or operation of our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

From time to time, we may become involved in legal proceedings arising in the ordinary course of our business. We are not presently a party to any legal proceedings the outcome of which, if determined adversely against us, would individually or in the aggregate have a material adverse effect on our business, operating results, financial condition or cash flows.

Item 1A. ***Risk Factors***

The following risks and uncertainties may have a material adverse effect on our business, financial condition or results of operations. Investors should carefully consider the risks described below before making an investment decision. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently believe are immaterial may also significantly impair our business operations. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and investors may lose all or part of their investment.

We have marked with an asterisk(*) those risks described below that reflect substantive changes from the risks described under Item 1A. Risk Factors included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2009.

Risks Related to Our Business and Industry

We had a limited history of profitability, and we may not achieve or sustain profitability in the future, on a quarterly or annual basis.*

We were established in 2000. Our first quarter of profitability since then was the quarter ended September 30, 2007 and we remained profitable until the quarter ended December 31, 2008. We experienced a net loss of $12.7 million and net income of $4.0 million for the six months ended June 30, 2009 and 2008, respectively. As of June 30, 2009, our accumulated deficit was $69.9 million. We expect to make significant expenditures related to the development of our products and expansion of our business, including research and development and sales and administrative expenses. As a public company, we also incur significant legal, accounting and other expenses. Additionally, we may encounter unforeseen difficulties, complications, product delays and other unknown factors that require additional expenditures. As a result of these increased expenditures, we may have to generate and sustain substantially increased revenue to achieve profitability. Our revenue growth trends in prior periods may not be sustainable. Accordingly, we may not be able to achieve or maintain profitability and we may continue to incur losses in the future.

We face intense competition and expect competition to increase in the future, which could reduce our revenue and customer base.

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The market for our products is highly competitive and we expect competition to intensify in the future. This competition could make it more difficult for us to sell our products, and result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and failure to increase, or the loss of, market share or expected market share, any of which would likely seriously harm our business, operating results and financial condition. For instance, semiconductor products have a history of declining prices as the cost of production is reduced. However, if market prices decrease faster than product costs, gross and operating margins can be adversely affected. Currently, we face competition from a number of established companies, including Broadcom Corporation, Freescale Semiconductor, Inc., Intel Corporation, Marvell Technology Group Ltd., PMC-Sierra, Inc. and others. We also face competition from a number of private or smaller companies, including RMI Corporation and to a lesser extent, Hifn, Inc. and others. In addition, in the video capture, process and display market segments we consider our competition to be companies that provide video encode and decode solutions, including TI DSPs and SOCs for H.264 encoding and Amimon for wireless replacement of HDMI cables and wireless video displays.

A few of our current competitors operate their own fabrication facilities and have, and some of our potential competitors could have, longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than we have. Potential customers may prefer to purchase from their existing suppliers rather than a new supplier regardless of product performance or features.

We expect increased competition from other established and emerging companies both domestically and internationally. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties. If so, new competitors or alliances that include our competitors may emerge that could acquire significant market share. We expect these trends to continue as companies attempt to strengthen or maintain their market positions in an evolving industry. In the future, further development by our competitors could cause our products to become obsolete. We expect continued competition from incumbents as well as from new entrants into the markets we serve. Our ability to compete depends on a number of factors, including:

- our success in identifying new and emerging markets, applications and technologies;
- our products performance and cost effectiveness relative to that of our competitors products;
- our ability to deliver products in large volume on a timely basis at a competitive price;
- our success in utilizing new and proprietary technologies to offer products and features previously not available in the marketplace;
- our ability to recruit design and application engineers and sales and marketing personnel; and
- our ability to protect our intellectual property.

In addition, we cannot assure you that existing customers or potential customers will not develop their own products, purchase competitive products or acquire companies that use alternative methods to enable networking, communication or security applications to facilitate network-aware processing in their systems. Any of these competitive threats, alone or in combination with others, could seriously harm our business, operating results and financial condition.

Our customers may cancel their orders, change production quantities or delay production, and if we fail to forecast demand for our products accurately, we may incur product shortages, delays in product shipments or excess or insufficient product inventory.

We generally do not obtain firm, long-term purchase commitments from our customers. Because production lead times often exceed the amount of time required to fulfill orders, we often must build in advance of orders, relying on an imperfect demand forecast to project volumes and product mix. Our demand forecast accuracy can be adversely affected by a number of factors, including inaccurate forecasting by our customers, changes in market conditions, adverse changes in our product order mix and demand for our customers products. Even after an order is received, our customers may cancel these orders or request a decrease in production quantities. Any such cancellation or decrease subjects us to a number of risks, most notably that our projected sales will not materialize on schedule or at all, leading to unanticipated revenue shortfalls and excess or obsolete inventory which we may be unable to sell to other customers. Alternatively, if we are unable to project customer requirements accurately, we may not build enough products, which could lead to delays in product shipments and lost sales opportunities in the near term, as well as force our customers to identify alternative sources, which could affect our ongoing relationships with these customers. We have in the past had customers dramatically increase their requested production quantities with little or no advance notice. If we do not timely fulfill customer demands, our customers may cancel their orders and we may be subject to customer claims for cost of replacement. Either underestimating or overestimating demand would lead to insufficient, excess or obsolete inventory, which could harm our operating results, cash flow and financial condition, as well as our relationships with our customers.

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Adverse changes in general economic or political conditions in any of the major countries in which we do business could adversely affect our operating results.

As our business has grown to both customers located in the United States as well as customers located outside of the United States, we have become increasingly subject to the risks arising from adverse changes in both the domestic and global economic and political conditions. For example, the direction and relative strength of the U.S. and International economies remains uncertain due to softness in the housing markets, difficulties in the financial services sector and credit markets and continuing geopolitical uncertainties. If economic growth in the United States and other countries economies continues to slow, the demand for our customer s products could decline, which would then decrease demand for our products. Furthermore, if economic conditions in the countries into which our customers sell their products continue to deteriorate, some of our customers may decide to postpone or delay certain development programs, which would then delay their need to purchase our products. This could result in a reduction in sales of our products or in a reduction in the growth of our product sales. Any of these events would likely harm investors view of our business, our results of operations and financial condition.

We receive a substantial portion of our revenues from a limited number of customers, and the loss of, or a significant reduction in, orders from one or a few of our major customers would adversely affect our operations and financial condition.*

We receive a substantial portion of our revenues from a limited number of customers. We received an aggregate of approximately 53.0% and 65.0% of our net revenues from our top five customers for the six months ended June 30, 2009 and 2008, respectively. We anticipate that we will continue to be dependent on a limited number of customers for a significant portion of our revenues in the immediate future and in some cases the portion of our revenues attributable to certain customers may increase in the future. However, we may not be able to maintain or increase sales to certain of our top customers for a variety of reasons, including the following:

- our agreements with our customers do not require them to purchase a minimum quantity of our products;

- some of our customers can stop incorporating our products into their own products with limited notice to us and suffer little or no penalty; and

- many of our customers have pre-existing or concurrent relationships with our current or potential competitors that may affect the customers decisions to purchase our products.

In the past, we have relied in significant part on our strategic relationships with customers that are technology leaders in our target markets. We intend to continue expanding such relationships and forming new strategic relationships but we cannot assure you that we will be able to do so. These relationships often require us to develop new products that may involve significant technological challenges. Our customers frequently place considerable pressure on us to meet their tight development schedules. Accordingly, we may have to devote a substantial amount of our resources to our strategic relationships, which could detract from or delay our completion of other important development projects. Delays in development could impair our relationships with our other strategic customers and negatively impact sales of the products under development. Moreover, it is possible that our customers may develop their own product or adopt a competitor s solution for products that they currently buy from us. If that happens, our sales would decline and our business, financial condition and results of operations could be materially and adversely affected.

In addition, our relationships with some customers may also deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer certain customers favorable prices on our products. In that event, our average selling prices and gross margins would decline. The loss of a key customer, a reduction in sales to any key customer or our inability to attract new significant customers could seriously impact our revenue and materially and adversely affect our results of operations.

We expect our operating results to fluctuate.

We expect our revenues and expense levels to vary in the future, making it difficult to predict our future operating results. In particular, we experience variability in demand for our products as our customers manage their product introduction dates and their inventories. Given the current global economic uncertainty, the demand for our products may be more varied and difficult to ascertain in a timely and efficient manner.

Additional factors that could cause our results to fluctuate include, among other things:

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our ability to retain, recruit and hire key executives, technical personnel and other employees in the positions and numbers, and with the experience and capabilities that we need;

fluctuations in demand, sales cycles, product mix and prices for our products;

the timing of our product introductions, and the variability in lead time between the time when a customer begins to design in one of our products and the time when the customer s end system goes into production and they begin purchasing our products;

the forecasting, scheduling, rescheduling or cancellation of orders by our customers;

our ability to successfully define, design and release new products in a timely manner that meet our customers needs;

changes in manufacturing costs, including wafer, test and assembly costs, mask costs, manufacturing yields and product quality and reliability;

the timing and availability of adequate manufacturing capacity from our manufacturing suppliers;

the timing of announcements by our competitors or us;

future accounting pronouncements and changes in accounting policies;

volatility in our stock price, which may lead to higher stock compensation expenses;

general economic and political conditions in the countries where we operate or our products are sold or used; costs associated with litigation, especially related to intellectual property; and

productivity and growth of our sales and marketing force.

Unfavorable changes in any of the above factors, most of which are beyond our control, could significantly harm our business and results of operations.

We may not sustain our growth rate, and we may not be able to manage any future growth effectively.

We have experienced significant growth in a short period of time. Our revenues increased from approximately $7.4 million in 2004 to approximately $19.4 million in 2005, $34.2 million in 2006, $54.2 million in 2007 and $86.6 million in 2008. We may not achieve similar growth rates in future periods. You should not rely on our operating results for any prior quarterly or annual periods as an indication of our future operating performance. If we are unable to maintain adequate revenue growth, our financial results could suffer and our stock price could decline.

To manage our growth successfully and to continue handling the responsibilities of being a public company, we believe we must effectively, among other things:

recruit, hire, train and manage additional qualified engineers for our research and development activities, especially in the positions of design engineering, product and test engineering, and applications engineering;

add additional sales personnel and expand sales offices;

expand our administrative, financial and operational systems, procedures and controls; and

enhance our information technology support for enterprise resource planning and design engineering by adapting and expanding our systems and tool capabilities, and properly training new hires as to their use.

If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities or develop new products and we may fail to satisfy customer requirements, maintain product quality, execute our business plan or respond to competitive pressures.

The average selling prices of products in our markets have historically decreased over time and will likely do so in the future, which could harm our revenues and gross profits.

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Average selling prices of semiconductor products in the markets we serve have historically decreased over time. Our gross profits and financial results will suffer if we are unable to offset any reductions in our average selling prices by reducing our costs, developing new or enhanced products on a timely basis with higher selling prices or gross profits, or increasing our sales volumes. Additionally, because we do not operate our own manufacturing, assembly or testing facilities, we may not be able to reduce our costs as rapidly as companies that operate their own facilities, and our costs may even increase, which could also reduce our margins. We have reduced the prices of our products in anticipation of future competitive pricing pressures, new product introductions by us or our competitors and other factors. We expect that we will have to do so again in the future.

We may be unsuccessful in developing and selling new products or in penetrating new markets.

We operate in a dynamic environment characterized by rapidly changing technologies and industry standards and technological obsolescence. Our competitiveness and future success depend on our ability to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost effective basis. A fundamental shift in technologies in any of our product markets could harm our competitive position within these markets. Our failure to anticipate these shifts, to develop new technologies or to react to changes in existing technologies could materially delay our development of new products, which could result in product obsolescence, decreased revenues and a loss of design wins to our competitors. The success of a new product depends on accurate forecasts of long-term market demand and future technological developments, as well as on a variety of specific implementation factors, including:

- timely and efficient completion of process design and transfer to manufacturing, assembly and test processes;
- the quality, performance and reliability of the product; and
- effective marketing, sales and service.

If we fail to introduce new products that meet the demand of our customers or penetrate new markets that we target our resources on, our revenues will likely decrease over time and our financial condition could suffer. Additionally, if we concentrate resources on a new market that does not prove profitable or sustainable, our financial condition could decline.

Fluctuations in the mix of products sold may adversely affect our financial results.*

Because of the wide price differences among our processors, the mix and types of performance capabilities of processors sold affect the average selling price of our products and have a substantial impact on our revenue. Generally, sales of higher performance products have higher gross margins than sales of lower performance products. We currently offer both higher and lower performance products in our NITROX, OCTEON, ECONA ARM and PureVu Video product families. During 2008 and in the six months ended June 30, 2009, we experienced a sales mix shift towards increased sales of lower performance, lower margin products. If this shift continues, our overall gross margins will be negatively affected. Fluctuations in the mix and types of our products may also affect the extent to which we are able to recover our fixed costs and investments that are associated with a particular product, and as a result can negatively impact our financial results.

The semiconductor and communications industries have historically experienced significant fluctuations with prolonged downturns, which could impact our operating results, financial condition and cash flows.*

The semiconductor industry has historically exhibited cyclical behavior, which at various times has included significant downturns in customer demand. We began to see such a downturn in the fourth quarter of 2008 and expect this downturn to continue through 2009. Because a significant portion of our expenses is fixed in the near term or is incurred in advance of anticipated sales, we may not be able to decrease our expenses rapidly enough to offset any unanticipated shortfall in revenues. If this situation were to occur, it could adversely affect our operating results, cash flow and financial condition. Furthermore, the semiconductor industry has periodically experienced periods of increased demand and production constraints. If this happens in the future, we may not be able to produce sufficient quantities of our products to meet the increased demand. We may also have difficulty in obtaining sufficient wafer, assembly and test resources from our subcontract manufacturers. Any factor adversely affecting the semiconductor industry in general, or the particular segments of the industry that our products target, may adversely affect our ability to generate revenue and could negatively impact our operating results.

The communications industry has, in the past, experienced pronounced downturns, and these cycles may continue in the future. To respond to a downturn, many networking equipment providers may slow their research and development activities, cancel or delay new product development, reduce their inventories and take a cautious approach to acquiring our products, which would have a significant negative impact on our business. If this situation were to occur, it could adversely affect our operating results, cash flow

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and financial condition. In the future, any of these trends may also cause our operating results to fluctuate significantly from year to year, which may increase the volatility of the price of our stock.

Our products must meet exact specifications, and defects and failures may occur, which may cause customers to return or stop buying our products.

Our customers generally establish demanding specifications for quality, performance and reliability that our products must meet. However, our products are highly complex and may contain defects and failures when they are first introduced or as new versions are released. If defects and failures occur in our products during the design phase or after, we could experience lost revenues, increased costs, including warranty expense and costs associated with customer support, delays in or cancellations or rescheduling of orders or shipments, product returns or discounts, diversion of management resources or damage to our reputation and brand equity, and in some cases consequential damages, any of which would harm our operating results. In addition, delays in our ability to fill product orders as a result of quality control issues may negatively impact our relationship with our customers. We cannot assure you that we will have sufficient resources, including any available insurance, to satisfy any asserted claims.

We may have difficulty selling our products if our customers do not design our products into their systems, and the nature of the design process requires us to incur expenses prior to recognizing revenues associated with those expenses which may adversely affect our financial results.

One of our primary focuses is on winning competitive bid selection processes, known as design wins, to develop products for use in our customers products. We devote significant time and resources in working with our customers system designers to understand their future needs and to provide products that we believe will meet those needs and these bid selection processes can be lengthy. If a customer s system designer initially chooses a competitor s product, it becomes significantly more difficult for us to sell our products for use in that system because changing suppliers can involve significant cost, time, effort and risk for our customers. Thus, our failure to win a competitive bid can result in our foregoing revenues from a given customer s product line for the life of that product. In addition, design opportunities may be infrequent or may be delayed. Our ability to compete in the future will depend, in large part, on our ability to design products to ensure compliance with our customers and potential customers specifications. We expect to invest significant time and resources and to incur significant expenses to design our products to ensure compliance with relevant specifications.

We often incur significant expenditures in the development of a new product without any assurance that our customers system designers will select our product for use in their applications. We often are required to anticipate which product designs will generate demand in advance of our customers expressly indicating a need for that particular design. Even if our customers system designers select our products, a substantial period of time will elapse before we generate revenues related to the significant expenses we have incurred.

The reasons for this delay generally include the following elements of our product sales and development cycle timeline and related influences:

- our customers usually require a comprehensive technical evaluation of our products before they incorporate them into their designs;

- it can take from nine months to three years from the time our products are selected to commence commercial shipments; and our customers may experience changed market conditions or product development issues. The resources devoted to product development and sales and marketing may not generate material revenue for us, and from time to time, we may need to write off excess and obsolete inventory if we have produced product in anticipation of expected demand. We may spend resources on the development of products that our customers may not adopt. If we incur significant expenses and investments in inventory in the future that we are not able to recover, and we are not able to compensate for those expenses, our operating results could be adversely affected. In addition, if we sell our products at reduced prices in anticipation of cost reductions but still hold higher cost products in inventory, our operating results would be harmed.

Additionally, even if system designers use our products in their systems, we cannot assure you that these systems will be commercially successful or that we will receive significant revenue from the sales of processors for those systems. As a result, we may be unable to accurately forecast the volume and timing of our orders and revenues associated with any new product introductions.

If customers do not believe our products solve a critical need, our revenues will decline.

Our products are used in networking and security equipment including routers, switches, UTM appliances, intelligent switches,

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application-aware gateways, triple-play gateways, WLAN and 3G access and aggregation devices, storage networking equipment, servers, intelligent network interface cards, IP surveillance systems, wireless HDMI cable replacement systems, video conferencing systems and connected home and office equipment.

In order to meet our growth and strategic objectives, providers of networking equipment must continue to incorporate our products into their systems and the demands for their systems must grow as well. Our future depends in large part on factors outside our control, and the sale of next-generation networks may not meet our revenue growth and strategic objectives.

In the event we terminate one of our distributor arrangements, it could lead to a loss of revenues and possible product returns.

A portion of our sales is made through third-party distribution agreements. Termination of a distributor relationship, either by us or by the distributor, could result in a temporary or permanent loss of revenues, until a replacement distributor can be established to service the affected end-user customers. We may not be successful in finding suitable alternative distributors on satisfactory terms or at all and this could adversely affect our ability to sell in certain locations or to certain end-user customers. Additionally, if we terminate our relationship with a distributor, we may be obligated to repurchase unsold products. We record a reserve for estimated returns and price credits. If actual returns and credits exceed our estimates, our operating results could be harmed. Our arrangements with our distributors typically also include price protection provisions if we reduce our list prices.

We rely on our ecosystem partners to enhance our product offerings and our inability to continue to develop or maintain such relationships in the future would harm our ability to remain competitive.

We have developed relationships with third parties, which we refer to as ecosystem partners, which provide operating systems, tool support, reference designs and other services designed for specific uses with our SoCs. We believe that these relationships enhance our customers ability to get their products to market quickly. If we are unable to continue to develop or maintain these relationships, we might not be able to enhance our customers ability to commercialize their products in a timely fashion and our ability to remain competitive would be harmed.

The loss of any of our key personnel could seriously harm our business, and our failure to attract or retain specialized technical, management or sales and marketing talent could impair our ability to grow our business.

We believe our future success will depend in large part upon our ability to attract, retain and motivate highly skilled managerial, engineering, sales and marketing personnel. The loss of any key employees or the inability to attract, retain or motivate qualified personnel, including engineers and sales and marketing personnel, could delay the development and introduction of and harm our ability to sell our products. We believe that our future success is highly dependent on the contributions of Syed Ali, our co-founder, President and Chief Executive Officer, and others. None of our employees have fixed-term employment contracts; they are all at-will employees. The loss of the services of Mr. Ali, other executive officers or certain other key personnel could materially and adversely affect our business, financial condition and results of operations. For instance, if any of these individuals were to leave our company unexpectedly, we could face substantial difficulty in hiring qualified successors and could experience a loss in productivity during the search for and while any such successor is integrated into our business and operations.

There is currently a shortage of qualified technical personnel with significant experience in the design, development, manufacturing, marketing and sales of integrated circuits. In particular, there is a shortage of engineers who are familiar with the intricacies of the design and manufacture of networking processors, and competition for these engineers is intense. Our key technical personnel represent a significant asset and serve as the source of our technological and product innovations. We may not be successful in attracting, retaining and motivating sufficient numbers of technical personnel to support our anticipated growth.

To date, we have relied primarily on our direct marketing and sales force to drive new customer design wins and to sell our products. Because we are looking to expand our customer base and grow our sales to existing customers, we will need to hire additional qualified sales personnel in the near term and beyond if we are to achieve revenue growth. The competition for qualified marketing and sales personnel in our industry, and particularly in Silicon Valley, is very intense. If we are unable to hire, train, deploy and manage qualified sales personnel in a timely manner, our ability to grow our business will be impaired. In addition, if we are unable to retain our existing sales personnel, our ability to maintain or grow our current level of revenues will be adversely affected. Further, if we are unable to integrate and retain personnel acquired through our various acquisitions, we may not be able to fully capitalize on such acquisitions.

Stock options and restricted stock units generally comprise a significant portion of our compensation packages for all employees. The FASB requirement to expense the fair value of stock options awarded to employees beginning in the first quarter of our fiscal 2006 has increased our operating expenses and may cause us to reevaluate our compensation structure for our employees. Our inability to attract, retain and motivate additional key employees could have an adverse effect on our business, financial condition and results of operations.

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In addition, we rely on stock-based awards as one means for recruiting, motivating and retaining highly skilled talent. If the value of such stock awards does not appreciate as measured by the performance of the price of our common stock or if our share-based compensation otherwise ceases to be viewed as a valuable benefit, our ability to attract, retain, and motivate employees could be weakened, which could harm our results of operations. The decline in the trading price of our common stock has resulted in the exercise price of a portion of our outstanding options to exceed the current trading price of our common stock, thus lessening the effectiveness of these stock-based awards. Consequently, we may not continue to successfully attract and retain key personnel which would harm our business.

We have a limited operating history, and we may have difficulty accurately predicting our future revenues for the purpose of appropriately budgeting and adjusting our expenses.*

We were established in 2000. Our first quarter of profitability since then was the quarter ended September 30, 2007 and we remained profitable until the quarter ended December 31, 2008. We experienced net loss of $12.7 million and net income of $4.0 million for the six months ended June 30, 2009 and 2008, respectively. Since we had only five quarters of operating profitability, we do not have an extended history from which to predict and manage profitability. Our limited operating experience, a dynamic and rapidly evolving market in which we sell our products, our dependence on a limited number of customers, as well as numerous other factors beyond our control, including general market conditions, impede our ability to forecast quarterly and annual revenues accurately. As a result, we could experience budgeting and cash flow management problems, unexpected fluctuations in our results of operations and other difficulties, any of which could make it difficult for us to gain and maintain profitability and could increase the volatility of the market price of our common stock.

Some of our operations and a significant portion of our customers and contract manufacturers are located outside of the United States, which subjects us to additional risks, including increased complexity and costs of managing international operations and geopolitical instability.

We have international sales offices and research and development facilities and we conduct, and expect to continue to conduct, a significant amount of our business with companies that are located outside the United States, particularly in Asia and Europe. Even customers of ours that are based in the U.S. often use contract manufacturers based in Asia to manufacture their systems, and it is the contract manufacturers that purchase products directly from us. As a result of our international focus, we face numerous challenges, including:

- increased complexity and costs of managing international operations;
- longer and more difficult collection of receivables;
- difficulties in enforcing contracts generally;
- geopolitical and economic instability and military conflicts;
- limited protection of our intellectual property and other assets;
- compliance with local laws and regulations and unanticipated changes in local laws and regulations, including tax laws and regulations;
- trade and foreign exchange restrictions and higher tariffs;
- travel restrictions;
- timing and availability of import and export licenses and other governmental approvals, permits and licenses, including export classification requirements;
- foreign currency exchange fluctuations relating to our international operating activities;
- transportation delays and limited local infrastructure and disruptions, such as large scale outages or interruptions of service from utilities or telecommunications providers;

difficulties in staffing international operations;

heightened risk of terrorism;

local business and cultural factors that differ from our normal standards and practices;

differing employment practices and labor issues;

regional health issues (e.g., SARS) and natural disasters; and

work stoppages.

We outsource our wafer fabrication, assembly, testing, warehousing and shipping operations to third parties, and rely on these parties to produce and deliver our products according to requested demands in specification, quantity, cost and time.

We rely on third parties for substantially all of our manufacturing operations, including wafer fabrication, assembly, testing, warehousing and shipping. We depend on these parties to supply us with material of a requested quantity in a timely manner that meets our standards for yield, cost and manufacturing quality. We do not have any long-term supply agreements with our manufacturing suppliers. Any problems with our manufacturing supply chain could adversely impact our ability to ship our products to our customers on time and in the quantity required, which in turn could cause an unanticipated decline in our sales and possibly damage our customer relationships.

The fabrication of integrated circuits is a complex and technically demanding process. Our foundries could, from time to time, experience manufacturing defects and reduced manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundries could result in lower than anticipated manufacturing yields or unacceptable performance. 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 our foundries, or defects, integration issues or other performance problems in our products could cause us significant customer relations and business reputation problems, harm our financial results and result in financial or other damages to our customers. Our customers could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

Our products are manufactured at a limited number of locations. If we experience manufacturing problems at a particular location, we would be required to transfer manufacturing to a backup location or supplier. Converting or transferring manufacturing from a primary location or supplier to a backup fabrication facility could be expensive and could take one to two quarters. During such a transition, we would be required to meet customer demand from our then-existing inventory, as well as any partially finished goods that can be modified to the required product specifications. We do not seek to maintain sufficient inventory to address a lengthy transition period because we believe it is uneconomical to keep more than minimal inventory on hand. As a result, we may not be able to meet customer needs during such a transition, which could delay shipments, cause a production delay or stoppage for our customers, result in a decline in our sales and damage our customer relationships. In addition, we have no long-term supply contracts with the foundries that we work with. Availability of foundry capacity has in the recent past been reduced due to strong demand. The ability of each foundry to provide us with semiconductor devices is limited by its available capacity and existing obligations. Foundry capacity may not be available when we need it or at reasonable prices which could cause us to be unable to meet customer needs, delay shipments, because a production delay or stoppage for our customers, result in a decline in our sales and harm our financial results.

In addition, a significant portion of our sales are to customers that practice just-in-time order management from their suppliers, which gives us a very limited amount of time in which to process and complete these orders. As a result, delays in our production or shipping by the parties to whom we outsource these functions could reduce our sales, damage our customer relationships and damage our reputation in the marketplace, any of which could harm our business, results of operations and financial condition.

Any increase in the manufacturing cost of our products could reduce our gross margins and operating profit.

The semiconductor business exhibits ongoing competitive pricing pressure from customers and competitors. Accordingly, any increase in the cost of our products, whether by adverse purchase price variances or adverse manufacturing cost variances, will reduce our gross margins and operating profit. We do not have any long-term supply agreements with our manufacturing suppliers and we typically negotiate pricing on a purchase order by purchase order basis. Consequently, we may not be able to obtain price reductions or anticipate or prevent future price increases from our suppliers.

Some of our competitors may be better financed than we are, may have long-term agreements with our main foundries and may induce our foundries to reallocate capacity to those customers. This reallocation could impair our ability to secure the supply of components that we need. Although we use several independent foundries to manufacture substantially all of our semiconductor products, most of our components are not manufactured at more than one foundry at any given time, and our products typically are designed to be manufactured in a specific process at only one of these foundries. Accordingly, if one of our foundries is unable to provide us with components as needed, we could experience significant delays in securing sufficient supplies of those components. We cannot assure you that any of our existing or new foundries will be able to produce integrated circuits with acceptable manufacturing yields, or that our foundries will be able to deliver enough semiconductor devices to us on a timely basis, or at reasonable prices. These and other related factors could impair our ability to meet our customers needs and have a material and adverse effect on our operating results.

In order to secure sufficient foundry capacity when demand is high and mitigate the risks described in the foregoing paragraph, we may enter into various arrangements with suppliers that could be costly and harm our operating results, such as nonrefundable deposits with or loans to foundries in exchange for capacity commitments and contracts that commit us to purchase specified quantities of integrated circuits over extended periods. We may not be able to make any such arrangement in a timely fashion or at all, and any arrangements may be costly, reduce our financial flexibility, and not be on terms favorable to us. Moreover, if we are able to secure foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. The Sarbanes-Oxley Act of 2002 requires management and our auditors to evaluate and assess the effectiveness of our internal control over financial reporting. These Sarbanes-Oxley Act requirements may be modified, supplemented or amended from time to time. Implementing these changes may take a significant amount of time and may require specific compliance training of our personnel. In the future, we may discover areas of our internal controls that need improvement. If our auditors or we discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market s confidence in our financial statements and harm our stock price. We may not be able to effectively and timely implement necessary control changes and employee training to ensure continued compliance with the Sarbanes-Oxley Act and other regulatory and reporting requirements. Our rapid growth in recent periods and our possible future expansion through acquisitions, present challenges to maintain the internal control and disclosure control standards applicable to public companies. If we fail to maintain effective internal controls, we could be subject to regulatory scrutiny and sanctions and investors could lose confidence in the accuracy and completeness of our financial reports.

We rely on third-party technologies for the development of our products and our inability to use such technologies in the future would harm our ability to remain competitive.

We rely on third parties for technologies that are integrated into our products, such as wafer fabrication and assembly and test technologies used by our contract manufacturers, as well as licensed MIPS and ARM architecture technologies. If we are unable to continue to use or license these technologies on reasonable terms, or if these technologies fail to operate properly, we may not be able to secure alternatives in a timely manner and our ability to remain competitive would be harmed. In addition, if we are unable to successfully license technology from third parties to develop future products, we may not be able to develop such products in a timely manner or at all.

Our failure to protect our intellectual property rights adequately could impair our ability to compete effectively or to defend ourselves from litigation, which could harm our business, financial condition and results of operations *.

We rely primarily on patent, copyright, trademark and trade secret laws, as well as confidentiality and nondisclosure agreements and other methods, to protect our proprietary technologies and know-how. We have been issued 16 patents in the United States and three patents in foreign countries and have an additional 28 patent applications pending in the United States and 27 patent applications pending in foreign countries. Even if the pending patent applications are granted, the rights granted to us may not be meaningful or provide us with any commercial advantage. For example, these patents could be opposed, contested, circumvented or designed around by our competitors or be declared invalid or unenforceable in judicial or administrative proceedings. The failure of our patents to adequately protect our technology might make it easier for our competitors to offer similar products or technologies. Our foreign patent protection is generally not as comprehensive as our U.S. patent protection and may not protect our intellectual property in some countries where our products are sold or may be sold in the future. Many U.S.-based companies have encountered substantial intellectual property infringement in foreign countries, including countries where we sell products. Even if foreign patents are granted, effective enforcement in foreign countries may not be available.

Monitoring unauthorized use of our intellectual property is difficult and costly. Although we are not aware of any unauthorized use of our intellectual property in the past, it is possible that unauthorized use of our intellectual property may have occurred or may occur without our knowledge. We cannot assure you that the steps we have taken will prevent unauthorized use of our intellectual property.

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Our failure to effectively protect our intellectual property could reduce the value of our technology in licensing arrangements or in cross-licensing negotiations, and could harm our business, results of operations and financial condition. We may in the future need to initiate infringement claims or litigation. Litigation, whether we are a plaintiff or a defendant, can be expensive, time consuming and may divert the efforts of our technical staff and managerial personnel, which could harm our business, whether or not such litigation results in a determination favorable to us.

Some of the software used with our products, as well as that of some of our customers, may be derived from so called open source software that is generally made available to the public by its authors and/or other third parties. Such open source software is often made available to us under licenses, such as the GNU General Public License, which impose certain obligations on us in the event we were to make available derivative works of the open source software. These obligations may require us to make source code for the derivative works available to the public, and/or license such derivative works under a particular type of license, rather than the forms of license customarily used to protect our intellectual property. In addition, there is little or no legal precedent for interpreting the terms of certain of these open source licenses, including the determination of which works are subject to the terms of such licenses. While we believe we have complied with our obligations under the various applicable licenses for open source software, in the event the copyright holder of any open source software were to successfully establish in court that we had not complied with the terms of a license for a particular work, we could be required to release the source code of that work to the public and/or stop distribution of that work.

Assertions by third parties of infringement by us of their intellectual property rights could result in significant costs and cause our operating results to suffer.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights and positions, which has resulted in protracted and expensive litigation for many companies. We expect that in the future we may receive, communications from various industry participants alleging our infringement of their patents, trade secrets or other intellectual property rights. Any lawsuits resulting from such allegations could subject us to significant liability for damages and invalidate our proprietary rights. Any potential intellectual property litigation also could force us to do one or more of the following:

- stop selling products or using technology that contain the allegedly infringing intellectual property;

- lose the opportunity to license our technology to others or to collect royalty payments based upon successful protection and assertion of our intellectual property against others; incur significant legal expenses;

- pay substantial damages to the party whose intellectual property rights we may be found to be infringing;

- redesign those products that contain the allegedly infringing intellectual property; or

- attempt to obtain a license to the relevant intellectual property from third parties, which may not be available on reasonable terms or at all.

Any significant impairment of our intellectual property rights from any litigation we face could harm our business and our ability to compete.

Our customers could also become the target of litigation relating to the patent and other intellectual property rights of others. This could trigger technical support and indemnification obligations in some of our licenses or customer agreements. These obligations could result in substantial expenses, including the payment by us of costs and damages relating to claims of intellectual property infringement. In addition to the time and expense required for us to provide support or indemnification to our customers, any such litigation could disrupt the businesses of our customers, which in turn could hurt our relationships with our customers and cause the sale of our products to decrease. We cannot assure you that claims for indemnification will not be made or that if made, such claims would not have a material adverse effect on our business, operating results or financial conditions.

Our third-party contractors are concentrated primarily in Taiwan and Japan, an area subject to earthquake and other risks. Any disruption to the operations of these contractors could cause significant

delays in the production or shipment of our products.

Substantially all of our products are manufactured by third-party contractors located in Taiwan and to a lesser extent manufactured by a third party contractor located in Japan. The risk of an earthquake in Taiwan, Japan and elsewhere in the Pacific Rim region is significant due to the proximity of major earthquake fault lines to the facilities of our foundries and assembly and test

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subcontractors. For example, several major earthquakes have occurred in Taiwan and Japan since our incorporation in 2000. Although our third-party contractors did not suffer any significant damage as a result of these most recent earthquakes, the occurrence of additional earthquakes or other natural disasters could result in the disruption of our foundry or assembly and test capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling or testing from the affected contractor to another third-party vendor. We may not be able to obtain alternate capacity on favorable terms, if at all.

We may experience difficulties in transitioning to new wafer fabrication process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

In order to remain competitive, we expect to continue to transition our semiconductor products to increasingly smaller line width geometries. This transition requires us to modify our designs to work with the manufacturing processes of our foundries. We periodically evaluate the benefits, on a product-by-product basis, of migrating to new process technologies to reduce cost and improve performance. We may face difficulties, delays and expenses as we continue to transition our products to new processes. We are dependent on our relationships with our foundry contractors to transition to new processes successfully. We cannot assure you that the foundries that we use will be able to effectively manage the transition or that we will be able to maintain our existing foundry relationships or develop new ones. If any of our foundry contractors or we experience significant delays in this transition or fail to efficiently implement this transition, we could experience reduced manufacturing yields, delays in product deliveries and increased expenses, all of which could harm our relationships with our customers and our results of operations. As new processes become more prevalent, we expect to continue to integrate greater levels of functionality, as well as customer and third-party intellectual property, into our products. However, we may not be able to achieve higher levels of design integration or deliver new integrated products on a timely basis.

Our acquisition strategy may result in unanticipated accounting charges or otherwise adversely affect our results of operations, and result in difficulties in assimilating and integrating the operations, personnel, technologies and products of acquired companies or businesses, or be dilutive to existing shareholders.*

In May 2008, we acquired certain assets of Parallogic, in August 2008 we acquired substantially all of the assets of Star, in December 2008, we acquired W&W and we may in the future acquire companies or assets of companies that we believe to be complementary to our business, including for the purpose of expanding our new product design capacity, introducing new design, market or application skills or enhancing and expanding our existing product lines. In connection with any such future acquisitions, we may need to use a significant portion of our available cash, issue additional equity securities that would dilute current stockholders percentage ownership and incur substantial debt or contingent liabilities. Such actions could adversely impact our operating results and the market price of our common stock. In addition, difficulties may occur in assimilating and integrating the operations, personnel, technologies, and products of acquired companies or businesses. In addition, key personnel of an acquired company may decide not to work for us. Moreover, to the extent we acquire a company with existing products; those products may have lower gross margins than our customary products, which could adversely affect our gross margin and operating results. If an acquired company also has inventory that we assume, we will be required to write up the carrying value of that inventory to fair value.

When that inventory is sold, the gross margins for those products are reduced and our gross margins for that period are negatively affected. Furthermore, the purchase price of any acquired businesses may exceed the current fair values of the net tangible assets of such acquired businesses. As a result, we would be required to record material amounts of goodwill, and acquired in-process research and development charges and other intangible assets, which could result in significant impairment and acquired in-process research and development charges and amortization expense in future periods. These charges, in addition to the results of operations of such acquired businesses and potential restructuring costs associated with an acquisition, could have a material adverse effect on our business, financial condition and results of operations. We cannot forecast the number, timing or size of future acquisitions, or the effect that any such acquisitions might have on our operating or financial results.

Our investment portfolio may become impaired by further deterioration of the capital markets.*

Our cash equivalents at June 30, 2009 consisted primarily of money market instruments, which are invested primarily in United States treasury securities, bonds of government agencies, and corporate bonds. We follow an established investment policy and set of guidelines to monitor, manage and limit our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

As a result of current adverse financial market conditions, investments in some financial instruments, such as structured investment vehicles, sub-prime mortgage-backed securities and collateralized debt obligations, may pose risks arising from liquidity and credit concerns. As of June 30, 2009, we had no direct holdings in these categories of investments and our indirect exposure to these financial instruments through our holdings in money market instruments was immaterial. As of June 30, 2009, we had no impairment charge associated with our cash equivalents relating to such adverse financial market conditions. Although we believe our

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current investment portfolio has very little risk of impairment, we cannot predict future market conditions or market liquidity and can provide no assurance that our investment portfolio will remain unimpaired.

We may need to raise additional capital, which might not be available or which, if available, may be on terms that are not favorable to use.

We believe our existing cash balances and cash expected to be generated from our operations will be sufficient to meet our working capital, capital expenditures and other needs for at least the next 12 months. In the future, we may need to raise additional funds, and we cannot be certain that we will be able to obtain additional financing on favorable terms, if at all. If we issue equity securities to raise additional funds, the ownership percentage of our stockholders would be reduced, and the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. If we borrow money, we may incur significant interest charges, which could harm our profitability. Holders of debt would also have rights, preferences or privileges senior to those of existing holders of our common stock. If we cannot raise needed funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, which could harm our business, operating results and financial condition.

Our future effective tax rates could be affected by the allocation of our income among different geographic regions, which could affect our future operating results, financial condition and cash flows.

We are in the process of expanding our international operations and staff to better support our expansion into international markets. This expansion includes the implementation of an international structure that includes, among other things, a research and development cost-sharing arrangement, certain licenses and other contractual arrangements between us and our wholly-owned domestic and foreign subsidiaries. As a result of these changes, we anticipate that our consolidated pre-tax income will 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 is expected 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 or if the relative mix of United States and international income changes for any reason. Accordingly, there can be no assurance that our income tax rate will be less than the United States federal statutory rate.

Risks Related to our Common Stock

The market price of our common stock may be volatile, which could cause the value of your investment to decline. *

The trading prices of the securities of technology companies have been highly volatile. Further, our common stock has a limited trading history. Since our initial public offering in May 2007 through June 30, 2009, our stock price has fluctuated from a low of $7.61 to a high of $35.60. We cannot predict the extent to which the trading market will continue to develop or how liquid the market may become. The trading price of our common stock is therefore likely to be highly volatile and could be subject to wide fluctuations in price in response to various factors, some of which are beyond our control. These factors include:

- quarterly variations in our results of operations or those of our competitors;
- general economic conditions and slow or negative growth of related markets;
- announcements by us or our competitors of design wins, acquisitions, new products, significant contracts, commercial relationships or capital commitments;
- our ability to develop and market new and enhanced products on a timely basis;
- commencement of, or our involvement in, litigation;
- disruption to our operations;
- the emergence of new sales channels in which we are unable to compete effectively;
- any major change in our board of directors or management;

changes in financial estimates including our ability to meet our future revenue and operating profit or loss projections;

changes in governmental regulations; and

changes in earnings estimates or recommendations by securities analysts.

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Furthermore, the stock market in general, and the market for semiconductor and other technology companies in particular, have experienced price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our actual operating performance. These trading price fluctuations may also make it more difficult for us to use our common stock as a means to make acquisitions or to use options to purchase our common stock to attract and retain employees. In addition, in the past, following periods of volatility in the overall market and the market price of a company s securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management s attention and resources.

A limited number of stockholders may have the ability to influence the outcome of director elections and other matters requiring stockholder approval.*

Our directors, executive officers and principal stockholders and their affiliates beneficially owned approximately 46% of our outstanding common stock as of June 30, 2009. These stockholders, if they acted together, could exert substantial influence over matters requiring approval by our stockholders, including electing directors, adopting new compensation plans and approving mergers, acquisitions or other business combination transactions. This concentration of ownership may discourage, delay or prevent a change of control of our company, which could deprive our stockholders of an opportunity to receive a premium for their stock as part of a sale of our company and might reduce our stock price. These actions may be taken even if they are opposed by our other stockholders.

Delaware law and our amended and restated certificate of incorporation and bylaws contain provisions that could delay or discourage takeover attempts that stockholders may consider favorable.

Provisions in our amended and restated certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. These provisions include the following:

- the division of our board of directors into three classes;
- the right of the board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or due to the resignation or departure of an existing board member;
- the prohibition of cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;
- the requirement for the advance notice of nominations for election to the board of directors or for proposing matters that can be acted upon at a stockholders meeting;
- the ability of our board of directors to alter our bylaws without obtaining stockholder approval;
- the ability of the board of directors to issue, without stockholder approval, up to 10,000,000 shares of preferred stock with terms set by the board of directors, which rights could be senior to those of our common stock;
- the elimination of the rights of stockholders to call a special meeting of stockholders and to take action by written consent in lieu of a meeting;
- the required approval of at least 662/3% of the shares entitled to vote at an election of directors to adopt, amend or repeal our bylaws or repeal the provisions of our amended and restated certificate of incorporation regarding the election and removal of directors and the inability of stockholders to take action by written consent in lieu of a meeting; and
- the required approval of at least a majority of the shares entitled to vote at an election of directors to remove directors without cause.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, particularly those owning 15% or more of our outstanding voting stock, from merging or combining with us. These provisions in our amended and restated certificate of incorporation and bylaws and under Delaware law could discourage potential takeover attempts, could reduce the price that investors are willing to pay for shares of our common stock in the future and could potentially result in the market price being lower than they would without these provisions.

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Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

Unregistered Sale of Equity Securities

None.

Use of Proceeds from Sale of Registered Securities

Our initial public offering of common stock was effected through a Registration Statement on Form S-1 (File No. 333-140660), that was declared effective by the SEC on May 1, 2007. As of June 30, 2009, $62.8 million of the approximately $94.7 million in net proceeds received by us in the offering, after deducting approximately $7.3 million in underwriting discounts, commissions, and $2.8 million in other offering costs, were invested in various interest-bearing instruments, and $32.1 million of the net proceeds had been used for acquisitions, general corporate purposes, including the repayment of the outstanding balances under the term loan with Silicon Valley Bank, general and administrative and manufacturing expenses.

Issuer Purchases of Equity Securities

The following table provides information regarding repurchases of our common stock during the three months ending June 30, 2009:

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs
April 1, 2009 - April 30, 2009	2,502	$5.99	Not applicable	Not applicable
May 1, 2009 - May 31, 2009			Not applicable	Not applicable
June 1, 2009 - June 30, 2009			Not applicable	Not applicable
	2,502	$5.99		

(1) Represents shares of our common stock repurchased by us from employees upon termination of service pursuant to the terms and conditions of our 2001 Stock Incentive Plan, which permits us to elect to purchase such shares at the original issuance price.

Item 3. ***Defaults Upon Senior Securities***

None.

Item 4. ***Submission of Matters to a Vote of Security Holders***

On May 8, 2009, our 2009 annual meeting of stockholders was held at our corporate offices located in Mountain View, California. During this meeting, our stockholders voted on the following two proposals:

(a) Proposal to elect a director to hold office until the 2012 annual meeting of stockholders:

	Votes	
Nominee	**Shares For**	**Shares Withheld**
Kris Chellam	32,022,868	591,662

Our Class I directors, Anthony J. Pantuso and C.N. Reddy, will each continue to serve on our Board of Directors until our 2011 annual meeting of stockholders and until his successor is elected and has qualified, or until his earlier death, resignation or removal.

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Our Class III directors, Syed B. Ali and Anthony S. Thornley will each continue to serve on our Board of Directors until our 2010 annual meeting of stockholders and until his successor is elected and has qualified, or until his earlier death, resignation or removal.

(b) Proposal to ratify the selection by the audit committee of our board of directors of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2009:

Votes For	Votes Against	Abstain
32,414,174	198,061	1,755

Item 5. *Other Information*

None

Item 6. *Exhibits*

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of the Registrant (1)
3.2	Amended and Restated Bylaws (2)
4.1	Reference is made to Exhibits 3.1 and 3.2
4.2	Specimen of Common Stock Certificate (3)
31.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Syed B. Ali, President and Chief Executive Officer
31.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Arthur D. Chadwick, Chief Financial Officer
32.1*	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Syed B. Ali, President and Chief Executive Officer and Arthur D. Chadwick, Chief Financial Officer

(1) Filed as Exhibit 3.1 to the Registrant s Annual Report on Form 10-K (No. 001-33435), filed with the SEC on March 2, 2009, and incorporated herein by reference.

(2) Filed as Exhibit 3.5 to the Registrant s registration statement on Form S-1 (No. 333-140660), filed with the SEC

on February 13, 2007, as amended, and incorporated herein by reference.

(3) Filed as Exhibit 4.2 to the Registrant s registration statement on Form S-1 (No. 333-140660), filed with the SEC on February 13, 2007, as amended, and incorporated herein by reference.

* This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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SIGNATURES

Pursuant to the requirements 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.

	CAVIUM NETWORKS, INC.
Date: August 6, 2009	By: /s/ ARTHUR D. CHADWICK Arthur D. Chadwick Chief Financial Officer and Vice President of Finance and Administration

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