ENTROPIC COMMUNICATIONS INC
Form 10-Q
August 05, 2008
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2008

or

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

Commission File Number: 001-33844

ENTROPIC COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0947630**
(State or Other Jurisdiction of Incorporation)	**(IRS Employer Identification No.)**

6290 Sequence Drive

San Diego, CA 92121

(Address of Principal Executive Offices and Zip Code)

(858) 768-3600

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes ¨ No

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x Smaller reporting company ¨

(Do not check if a smaller reporting company)

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

As of the close of business on July 31, 2008, 68,919,930 shares of the registrant s common stock, $0.001 par value per share, were outstanding.

Table of Contents

ENTROPIC COMMUNICATIONS, INC.

FORM 10-Q

For the Quarterly Period Ended June 30, 2008

TABLE OF CONTENTS

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. *Financial Statements*

ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,027	$ 51,475
Restricted cash		58
Marketable securities	12,009	2,965
Accounts receivable, net	35,588	24,489
Inventory	21,079	15,332
Prepaid expenses, deferred income taxes and other current assets	1,925	2,238
Total current assets	87,628	96,557
Property and equipment, net	12,612	8,952
Intangible assets, net	33,185	34,145
Goodwill	88,082	86,256
Other long-term assets	283	416
Total assets	$ 221,790	$ 226,326
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 22,141	$ 18,909
Accrued payroll and benefits	5,490	4,253
Deferred revenues	187	303
Current portion of line of credit and loans payable		2,860
Current portion of software licenses and capital lease obligations	119	384
Total current liabilities	27,937	26,709
Stock repurchase liability	1,208	1,765
Lines of credit and loans payable, less current portion		5,547
Other long-term liabilities	3,165	1,907
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock	69	68
Additional paid-in capital	292,010	282,627
Accumulated deficit	(102,599)	(92,297)
Total stockholders equity	189,480	190,398
Total liabilities, preferred stock and stockholders equity	$ 221,790	$ 226,326

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

Table of Contents

ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net revenues	$ 42,836	$ 26,207	$ 84,824	$ 46,233
Cost of net revenues	23,869	17,961	46,706	32,492
Gross profit	18,967	8,246	38,118	13,741
Operating expenses:				
Research and development	15,678	6,699	28,990	10,889
Sales and marketing	4,455	1,859	8,599	3,359
General and administrative	3,541	1,631	7,064	2,398
Write off of in-process research and development	1,300	21,400	1,300	21,400
Amortization of purchased intangibles	713	42	1,309	42
Restructuring charge	(10)		1,069	
Total operating expenses	25,677	31,631	48,331	38,088
Loss from operations	(6,710)	(23,385)	(10,213)	(24,347)
Other income (expense), net	191	(337)	(7)	(487)
Loss before income taxes	(6,519)	(23,722)	(10,220)	(24,834)
(Benefit) provision for income taxes	(72)		82	
Net loss	(6,447)	(23,722)	(10,302)	(24,834)
Accretion of redeemable convertible preferred stock		(31)		(63)
Net loss attributable to common stockholders	$ (6,447)	$ (23,753)	$ (10,302)	$ (24,897)
Net loss per share attributable to common stockholders basic and diluted	$ (0.10)	$ (3.82)	$ (0.15)	$ (4.33)
Weighted average number of shares used to compute loss per share attributable to common stockholders	67,215	6,223	67,023	5,756

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

Table of Contents

ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Operating activities:		
Net loss	$ (10,302)	$ (24,834)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,514	641
Amortization of purchased intangible assets	4,139	42
Stock-based compensation to consultants	84	58
Stock-based compensation to employees	6,912	813
Interest expense attributable to amortization and early payoff of debt issuance costs	476	57
In-process research and development	1,300	21,400
Revaluation of preferred stock warrant liabilities		612
Impairment of assets related to restructuring charge	259	
Loss on disposal of assets	8	
Changes in operating assets and liabilities:		
Restricted cash	58	
Accounts receivable	(11,097)	(1,073)
Inventory	(5,733)	(7,207)
Prepaid expenses, deferred income taxes and other current assets	313	(387)
Other long-term assets	43	(677)
Accounts payable and accrued expenses	3,050	6,655
Accrued payroll and benefits	1,102	222
Deferred revenues	(116)	3
Other long-term liabilities	1,258	
Net cash used in operating activities	(6,732)	(3,675)
Investing activities:		
Purchases of property and equipment	(5,269)	(551)
Purchases of marketable securities	(17,144)	
Sales/maturities of marketable securities	8,100	7,116
Net cash (used in) provided by acquisitions	(6,113)	4,561
Net cash (used in) provided by investing activities	(20,426)	11,126
Financing activities:		
Principal payments on debt and capital lease obligations	(9,121)	(1,348)
Proceeds from line of credit obligations		2,000
Proceeds from issuance common stock net of repurchases and issuance costs	1,831	1,074
Net cash (used in) provided by financing activities	(7,290)	1,726
Net (decrease) increase in cash and cash equivalents	(34,448)	9,177
Cash and cash equivalents at beginning of period	51,475	5,928
Cash and cash equivalents at end of period	$ 17,027	$ 15,105

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

5

ENTROPIC COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008

1. Organization and Summary of Significant Accounting Policies

Business

Entropic Communications, Inc. (the Company) was organized under the laws of the state of Delaware on January 31, 2001. The Company is a fabless semiconductor company that designs, develops and markets systems solutions to enable connected home entertainment.

In October 2007, the Company completed a 1-for-3.25 reverse stock split. The accompanying financial statements and notes to the financial statements give retroactive effect to the reverse stock split for all periods presented.

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC). They do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2007 included in the Company s Annual Report on Form 10-K (Annual Report) filed on March 3, 2008 with the SEC.

The interim condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly the Company s consolidated financial position, results of operations and cash flows as of and for the periods indicated. The interim results are not necessarily indicative of the results to be expected for future quarters or the full year.

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

Use of Estimates

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

Revenue Recognition

The Company s revenues are generated principally by sales of its semiconductor products. During the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, product revenues represented approximately 99% of its total net revenues. The Company also generates service revenues from development contracts.

The majority of the Company s sales occur through the efforts of its direct sales force. The remainder of the Company s sales occurs through distributors. During the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, more than 99% of the Company s sales occurred through the efforts of its direct sales force.

In accordance with SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, and SAB No. 104, *Revenue Recognition*, the Company recognizes product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and

(iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment. However, the Company does not recognize revenue until all customer acceptance requirements have been met, when applicable.

A portion of the Company s sales are made through distributors, agents, or customers acting as agents under agreements allowing for pricing credits and/or rights of return. Product revenues on sales made through these distributors are not recognized until the distributors ship the product to their customers. The Company records reductions to revenues for estimated product returns and pricing adjustments, such as competitive pricing programs, in the same period that the related revenue is recorded. To date, product returns and pricing adjustments have not been significant.

Table of Contents

The Company also has entered into an inventory hubbing arrangement with a key customer. Pursuant to this arrangement, the Company delivers products to the designated third party warehouse based upon the customer s projected needs, but does not recognize product revenue unless and until the customer removes the Company s products from the third party warehouse to incorporate into its own products.

The Company derives revenues from development contracts that involve new and unproven technologies. Revenues under these contracts are deferred until customer acceptance is obtained, and other contract-specific terms have been completed in accordance with the completed contract method of American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Provisions for losses related to development contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. The costs associated with development contracts are included in cost of service revenue. The Company defers the cost of services provided under its development contracts.

The Company acquired a development agreement in connection with its acquisition of RF Magic, Inc. (RF Magic) in June 2007 that provides the Company with royalties in exchange for an exclusive right to manufacture and sell certain products. The Company has determined that it is not able to reliably estimate the royalties earned in the period the sales occur. Thus, the Company records revenues based on cash receipts. The royalty revenues recorded during the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, were $797,000, $0, $1,763,000 and $0, respectively.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash and cash equivalents, marketable securities, accounts receivable, leases payable, lines of credit and loans payable. The Company s policy is to place its cash and cash equivalents with high quality financial institutions in order to limit its credit exposure. Credit is extended based on an evaluation of the customer s financial condition and a cash deposit is generally not required. The Company estimates potential losses on trade receivables on an ongoing basis.

The Company invests cash in deposits and money market funds with major financial institutions, U.S. government obligations and debt securities of corporations with strong credit ratings in a variety of industries. It is the Company s policy to invest in instruments that have a final maturity of no longer than two years, with a portfolio weighted average maturity of no longer than 12 months.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Lower of cost or market adjustments reduce the carrying value of the related inventory and take into consideration reductions in sales prices, excess inventory levels and obsolete inventory. These adjustments are done on a part-by-part basis. Once established, these adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

Guarantees and Indemnifications

In the ordinary course of business, the Company has entered into agreements with customers that include indemnity provisions. To date, there have been no known events or circumstances that have resulted in any significant costs related to these indemnification provisions, and as a result, no liabilities have been recorded in the accompanying interim unaudited financial statements.

Rebates

The Company accounts for rebates in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*, and, accordingly, at the time of the sale accrues 100% of the potential rebate as a reduction to revenue and does not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. The Company reverses the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when management believes unclaimed rebates are no longer subject to payment and will not be paid.

Warranty Accrual

The Company s products are subject to warranty periods of one year or more. The Company provides for the estimated future costs of replacement upon shipment of the product as cost of net revenues. The Company has not incurred significant warranty claims to date. The warranty accrual is based on management s best estimate of expected costs associated with product failure and historical product failures.