

ENTROPIC COMMUNICATIONS INC

Form 10-K

February 03, 2012

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
December 31, 2011 For the fiscal year ended December 31, 2011

or

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

Commission file number: 001-33844

**Entropic Communications, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

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

**33-0947630**  
(I.R.S. Employer

Identification No.)

**6290 Sequence Drive**

**San Diego, CA 92121**

(Address of Principal Executive Offices, Including Zip Code)

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

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
<b>Common Stock, par value \$0.001 per share</b>	<b>The NASDAQ Stock Market</b>
<b>Securities registered pursuant to Section 12(g) of the Act: None</b>	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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  (Do not check if a smaller reporting company)

Smaller reporting company

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

As of June 30, 2011, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$727.2 million based on the closing price of the registrant's common stock on The NASDAQ Global Market of \$8.89 per share on June 30, 2011.

There were 87,213,770 shares of the registrant's common stock issued and outstanding as of January 31, 2012.

**DOCUMENTS INCORPORATED BY REFERENCE**

Part III of this Annual Report on Form 10-K incorporates by reference certain information from the registrant's definitive proxy statement for the registrant's 2012 Annual Meeting of Stockholders to be filed within 120 days after the end of the registrant's fiscal year ended

December 31, 2011.

**Table of Contents**

**ENTROPIC COMMUNICATIONS, INC.**  
**ANNUAL REPORT ON FORM 10-K**  
**FOR THE FISCAL YEAR ENDED December 31, 2011**

**TABLE OF CONTENTS**

		<b>Page</b>
<b><u>PART I</u></b>		
Item 1.	<u>Business</u>	2
	<u>Executive Officers of the Company</u>	20
Item 1A.	<u>Risk Factors</u>	23
Item 1B.	<u>Unresolved Staff Comments</u>	52
Item 2.	<u>Properties</u>	52
Item 3.	<u>Legal Proceedings</u>	52
Item 4.	<u>(Removed and Reserved)</u>	52
<b><u>PART II</u></b>		
Item 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	53
Item 6.	<u>Selected Financial Data</u>	55
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	58
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	74
Item 8.	<u>Financial Statements and Supplementary Data</u>	75
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	75
Item 9A.	<u>Controls and Procedures</u>	75
Item 9B.	<u>Other Information</u>	78
<b><u>PART III</u></b>		
Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	79
Item 11.	<u>Executive Compensation</u>	79
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	79
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	79
Item 14.	<u>Principal Accountant Fees and Services</u>	80
<b><u>PART IV</u></b>		
Item 15.	<u>Exhibits, Financial Statement Schedules</u>	81
	<u>Signatures</u>	

Entropic, Entropic Communications, c.LINK®, RF Magic and our logo are among the trademarks of Entropic Communications, Inc. and/or its affiliates in the United States and certain foreign countries. Any other trademarks or trade names mentioned are the property of their respective owners.

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

*All statements included or incorporated by reference in this Annual Report on Form 10-K, or Annual Report, other than statements or characterizations of historical fact, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are not limited to, statements concerning our ability to sustain profitability; the competitive nature of the markets in which we compete and the effect of competing products and technologies; the demand for our products; the adoption of our technologies and the Multimedia over Coax Alliance, or MoCA, standard; the competitive nature of service providers; our dependence on manufacturers, sales representatives, distributors and other third parties; our ability to create and introduce new products and technologies; our ability to effectively manage our growth; our ability to successfully acquire companies or technologies that would complement our business; the ability of our contract manufacturers to produce and deliver products in a timely manner and at satisfactory prices; the transitioning of our silicon products to improved manufacturing process technologies; our ability to protect our intellectual property and avoid infringement of the intellectual property of others; our reliance on our key personnel; the effects of government regulation; our ability to obtain sufficient capital to expand our business; our ability to manage our business in the midst of adverse economic conditions; the cyclical nature of our industry; our ability to effectively transact business in foreign countries; and our ability to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002.*

*The forward-looking statements contained in this Annual Report and the documents incorporated herein by reference are based on our current expectations, estimates, approximations and projections about our industry and business, management's beliefs, and certain assumptions made by us, all of which are subject to change. Forward-looking statements can often be identified by words such as anticipates, expects, intends, plans, predicts, believes, seeks, estimates, may, will, should, would, could, potential, continue, ongoing and similar expressions, and variations or negatives of these words. Forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under Part I, Item 1A, Risk Factors of this Annual Report and in our other filings with the Securities and Exchange Commission, or SEC. These forward-looking statements reflect our management's belief and views with respect to future events and are based on estimates and assumptions as of the date of this Annual Report and are subject to risks and uncertainties. We operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements in this Annual Report or in our other filings with the SEC.*

*In addition, past financial or operating performance is not necessarily a reliable indicator of future performance and you should not use our historical performance to anticipate results or future period trends. We can give no assurances that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. Except as required by law, we undertake no obligation to revise our forward-looking statements to reflect events or circumstances that arise after the date of this Annual Report or the respective dates of documents incorporated herein by reference that include forward-looking statements. Thus, you should not assume that our silence over time means that actual events are bearing out as expressed or implied in these forward-looking statements.*

*In this Annual Report, Entropic Communications, Inc., Entropic Communications, Entropic, the Company, we, us and our refer to Entropic Communications, Inc. and its subsidiaries, taken as a whole, unless otherwise noted.*

**Table of Contents**

**PART I**

**Item 1. Business Overview**

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

We are a pioneer of key technologies that enable connected home networking of digital entertainment over existing coaxial cable. We are a founding member of Multimedia over Coax Alliance, or MoCA, a global home networking consortium that sets standards for the distribution of video and other multimedia entertainment over coaxial cable. Our products include integrated circuits and related software associated with:

home networking solutions based on the MoCA standard;

direct broadcast satellite, or DBS, services;

high-speed broadband access; and

silicon tuners.

Our products allow telecommunications carriers, cable operators and DBS service providers, which we collectively refer to as service providers, as well as providers of over-the-top, or OTT, services, to enhance and expand their service offerings and reduce deployment costs in an increasingly competitive environment. When compared to offerings from service providers, OTT services are relatively new to the market and require the use of devices like Apple TV, Sony Playstation, Roku or Xbox to receive services such as Hulu, Netflix or Vudu.

Our home networking solutions capitalize on the worldwide conversion of multimedia content, including video, from analog to digital. Multimedia content is now easy to store on digital video recorders, or DVRs, gaming consoles, digital versatile disk, or DVD, recorders, personal computers, portable devices and Internet-hosted services, also referred to as "the cloud." The ability to store this content on various devices has created islands of digital entertainment within the home. Our products bridge these islands and allow consumers to access their multimedia content throughout the home. Our MoCA-compliant chipsets can be embedded in a wide variety of consumer electronic devices. Service providers can employ our solutions to offer consumer applications such as multi-room DVR, online gaming, personal computer-to-television content sharing and streaming of downloaded movies stored on a personal computer or the cloud to a television. Additionally, products incorporating our MoCA solutions can be purchased directly by consumers to connect consumer electronic devices within the home such as personal computers, televisions and game consoles to the home's broadband connection such as digital subscriber line, or DSL, routers or cable modems and passive optical networks, or xPONs, and thereby enable the devices to benefit from OTT services that are made available on the Internet. Our MoCA home networking solutions are now being deployed into consumer homes to support multi-room DVR service by Comcast Corp, or Comcast, Cox Communications, Inc., or Cox, DIRECTV Holdings LLC, or DIRECTV, DISH Network LLC, or DISH Network, Time Warner Cable Inc., or Time Warner Cable, and Verizon Communications, Inc., or Verizon, as well as by a number of smaller service providers.

We have extensive core competencies in video communications, networking algorithms and protocols, system-on-a-chip design, embedded software, mixed signal and radio frequency integrated circuit design, and communications and radio frequency systems. We use our considerable experience with service provider-based deployments to create solutions that address the complex

## **Table of Contents**

requirements associated with delivering multiple streams of HD video into and throughout the home while seamlessly coexisting with video, voice and data services that are using the same coaxial cable infrastructure.

We were incorporated in Delaware in January 2001. Our principal executive offices are located at 6290 Sequence Drive, San Diego, California 92121, and our telephone number is (858) 768-3600. Our corporate website address is [www.entropic.com](http://www.entropic.com). Our current and future annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other filings with the Securities and Exchange Commission, or SEC, are, and will continue to be, available, free of charge, through the investor relations section of our website as soon as reasonably practicable after we electronically file such material with, or furnish them to, the SEC. The information contained on, or accessible through, our website is not intended to be part of this or any other report we file with, or furnish to, the SEC. Our common stock trades on The NASDAQ Global Select Market under the symbol ENTR.

## **Industry Background**

Intense competition among service providers and OTT service providers seeking to maximize revenues is driving a revolution in the delivery of video and other multimedia content into and throughout the home. According to research by IMS Research, or IMS, the number of U.S. pay-television households with HD video is expected to grow from 59 million in 2011 to approximately 99 million by 2015, representing a compound annual growth rate of approximately 14%. These service providers are making significant infrastructure investments to differentiate their offerings by adding new video services such as HD video, video-on-demand and multi-room DVR, as well as bundled video, voice and broadband data, or triple-play, services. In fact, consumers typically pay a higher price for video services than for traditional voice and broadband services. A successful video offering is critical for service providers to increase average revenue per user, drive subscriber growth and reduce subscriber turnover.

Several favorable consumer entertainment trends are contributing to the increasing video and multimedia revenue opportunity for service providers and OTT service providers. These trends include:

**Increasing availability of digital multimedia content.** The conversion of multimedia content from an analog to a digital format and the increasing number of broadcast content providers who make their video content available for online video streaming are significantly increasing the amount and variety of video, music, photos and other multimedia content that consumers buy, receive and store.

**Introduction of new video formats requiring greater bandwidth.** The development and introduction of digital video formats starting with SD, and progressing to HD, three dimensional, or 3D, and ultra high definition television, or UHDTV, not only provide the consumer with a higher quality viewing experience, but also increase the data throughput by up to 16 times the current HD requirements.

**Proliferation of connected digital multimedia devices within the home.** As a result of the increasing availability of multimedia content from sources inside the home and from the Internet, connected digital multimedia devices such as high-definition televisions, or HDTVs, desktop and laptop personal computers, DVD players, tablets, Blu-ray players, portable media players, gaming consoles, DVRs and OTT set-top boxes can now be found in U.S. households in increasing numbers.

**Introduction of new multimedia applications.** An increasing number of multimedia applications utilize digital video and other multimedia content for consumer home entertainment. Some examples of these applications include video time shifting, or the

---

**Table of Contents**

ability to pause, fast forward and rewind live or stored video, the ability to watch and record multiple television shows at once, video or movie on demand, personal computer-to-television content sharing, multi-room and online gaming, streaming of downloaded movies stored on a personal computer to a television, and OTT services that directly deliver Internet video content into the home.

**Increasing consumer adoption of OTT services.** Consumer demand for fully customizable viewing experiences that allow them to select the time, place and content has increased the availability of OTT services such as those offered from AppleTV, Boxee, GoogleTV, Netflix, BestBuy, Amazon and Wall-Mart/Vudu, all of which benefit from having a high-speed, highly reliable network connection to digital multimedia devices, such as connected HD video and game consoles, within a home.

These trends have resulted in a growing number of islands of stored multimedia content within the home, including SD video and HD video, movies, broadcast television programs and personally created content. Service providers and original equipment manufacturers, or OEMs, have identified opportunities to seamlessly bridge these islands and enable the sharing of such content across devices and between rooms throughout the home. At the same time, as the popularity of online video streaming continues to grow, broadcast service providers recognize the growing need to provide combined broadband and broadcast services to retain their existing subscribers. To address this opportunity and meet evolving customer expectations, service providers are introducing new customer premises equipment and service offerings such as multi-room DVR, which allows for video placeshifting, or the ability to access content from multiple locations and devices, and a new class of devices that connect the coaxial network in the home to online services. By providing more advanced customer premises equipment, service providers are able to more easily introduce new services, simplify and enhance the user experience, and maintain content security and service reliability. We believe service providers are competitively positioned to provide these services because they already have licensed access and distribution rights to premium video content and have established the infrastructure that enables carrier class quality-of-service, or QoS.

The stringent communications requirements associated with high-quality HD video, 3D video and other multimedia content present a significant challenge for service providers today. In response, service providers require solutions that enable the distribution of such content into and throughout the home while maintaining the high-quality standards demanded by subscribers. For any such technology solution to succeed, we believe it must satisfy the following requirements:

**High bandwidth, reliability and full QoS for HD video.** Due to the fact that video is typically a streaming, real-time, visual experience, video quality can rapidly degrade with errors or delays in packet delivery. A high-quality video experience requires reliable first-pass transmission, very low packet error rate, low latency and low jitter. Moreover, video consumes up to 10 times more bandwidth than typical voice and data services and has higher QoS requirements. A connected home with capacity to support multiple high-quality HD video streams requires a high bandwidth network with net throughput in excess of 100 megabits per second for today's services, which is believed to be increasing to greater than 250 megabits per second for services planned in the future.

**Cost-effective deployment.** It is important for service providers to leverage the existing installed network infrastructure inside and outside the home to minimize incremental cost and expedite new service deployments. Service providers prefer plug-and-play installation of new services as opposed to having to dispatch a service vehicle to customer premises, often referred to as a truck roll. Service providers are focused on saving installation time and minimizing customer service calls, thereby reducing total costs to deliver video services. In some cases, service providers may install customer premise equipment that is capable of providing services that are not ordered by the customer at the time of installation but which



## Table of Contents

may be switched on remotely at a later time, thereby potentially avoiding the need for future truck rolls.

**Customer ease of use.** Most consumers have little tolerance for complicated devices and service disruptions. Therefore, mainstream consumer adoption requires an easy to use and compelling service offering and plug-and-play service installation with minimal ongoing maintenance.

**Co-existence with other services and devices.** Consumers currently subscribe to a broad array of communications services, including traditional voice, broadcast television, broadband access and cellular wireless services that are delivered using a number of different technologies. In addition, consumers may use a multitude of computing, communications and consumer electronics devices, such as personal computers, video players, gaming consoles, set-top boxes and televisions. Any successful home networking or access solution must seamlessly co-exist with existing services and devices with minimal interference or degradation in performance.

**Security.** The ability to ensure the secure delivery of content and consumer privacy is a key element of any successful bundled service offering. Therefore, home networking and access solutions require data encryption and other security mechanisms. To address these requirements, service providers are exploring home networking and access technology platforms that enable delivery of new services into and throughout the home. There are a variety of other technologies for delivering video into and throughout the home. Broadband access technology solutions include data over cable service interface specifications, or DOCSIS, versions of Digital Subscriber Line, or xDSL, Ethernet, xPON, 3<sup>rd</sup> Generation Partnership Project Long Term Evolution and Worldwide Interoperability for Microwave Access, or WiMAX. Home networking technology solutions include Ethernet, G.hn, HomePNA, HomePlug, HomePlug AV, HD-PLC, IEEE P1901 and Wi-Fi. We believe each of these other technologies currently have limitations in meeting all the requirements necessary to effectively deliver multiple streams of SD video, HD video and 3D video and other multimedia content into and throughout the home.

## **Our Solutions**

Entropic Communications provides systems solutions comprised of silicon integrated circuits and software as a platform to enable delivery of multiple streams of HD video and other multimedia content into and throughout the home. Our solutions are based upon our ability to combine the following core competencies:

**Video communications, networking algorithms and protocols.** We have extensive experience in defining and developing physical layer and media access controller protocols as well as networking, routing and security protocols. This includes expertise in advanced equalization, modulation and coding techniques, and contention-free media access controller protocols required for high QoS video delivery.

**System-on-a-chip design, mixed signal and embedded software capabilities.** Our ability to integrate multiple complex functions into a single silicon solution is a result of our significant experience in many disciplines, including embedded system architecture, high-speed very large-scale integration design, microcontrollers, embedded software, packet processing and high-performance mixed signal design. Our mixed signal design expertise includes designing high-performance analog-to-digital and digital-to-analog converters. We also have in-depth experience in packaging design and automated high-volume test development, which allows us to develop cost-effective solutions.

**Radio frequency integrated circuit design expertise.** We have extensive experience developing highly-integrated radio frequency integrated circuits. Our broad radio frequency

## **Table of Contents**

systems and design capability allow us to provide solutions that seamlessly integrate radio frequency functionality within a digital communications platform. We have extensive experience with the complex task of integrating digital, high-speed mixed signal and radio frequency integrated circuit designs into complementary metal-oxide semiconductor, or CMOS, systems-on-a-chip.

**Broad communications and radio frequency systems-level capabilities.** Our system-level knowledge is the result of significant experience supplying solutions for service provider networks and includes an understanding of the critical elements in coaxial cable and satellite networks, such as service provider equipment and other devices both inside and outside the home.

**Domain expertise in operator-based deployments.** We have close working relationships with service providers, their original design manufacturer, or ODM, and OEM partners, and the consumer electronics markets that they serve. Our extensive experience with service provider deployments allows us to deliver rapid time-to-market solutions over multiple generations of customer premises equipment and access equipment. These close working relationships allow us to serve as a trusted advisor and contribute to and gain insight into future service provider, ODM and OEM roadmaps.

Our product lines include home networking, broadband access, DBS outdoor unit solutions and silicon tuners. Our solutions target applications in HD video and other multimedia content distribution networks through cable, satellite, telecommunications and terrestrial mediums. Our solutions are currently used in consumer electronic and service provider customer premises equipment, including set-top boxes, broadband routers, optical network terminals, coax line terminals, low-noise block converters, multi-room DVRs, residential gateways and Ethernet-to-coax adapters, and can potentially be used in other devices, such as digital televisions, gaming consoles, connected HDTVs, OTT set-top-boxes, media servers and network attached storage devices.

### ***Home Networking***

Our home networking solutions target a large and rapidly growing market. Our home networking solutions are based on the MoCA standard. We are a founding member of MoCA, which was established in 2004 and includes as its members many major service providers, communications equipment companies, semiconductor manufacturers and consumer electronics companies. MoCA-based products use existing coaxial cable to create a robust Internet protocol-based network for easy sharing of HD video and other multimedia content throughout the home. MoCA is being deployed as the home networking standard for Verizon's FiOS offering and for high-definition set-top boxes, or HD set-top boxes, for DIRECTV, DISH Network, Comcast, Time Warner Cable, Cox and other service providers. We believe that additional service providers are in the process of evaluating, adopting or deploying MoCA-based technology for digital home entertainment networking.

The implementation of home networking chipsets based on the MoCA specification requires expertise in multiple technical disciplines as well as extensive integration and testing. Any home network technology using the existing coaxial cable must overcome the inherent constraints of such infrastructure. The in-home coaxial cable network was designed to isolate individual cable outlets from each other in order to eliminate potential video signal interference between television sets that reside at different coaxial cable outlets in the home. The successful implementation of MoCA requires integrated circuits that support high wire speed signal transmission and enable low-level signal detection, real-time error correction and recovery. The broad range of expertise required for such implementation includes physical layer and media access controller system engineering, radio frequency integrated circuit and high-speed mixed signal design, complex baseband system-on-a-chip experience and embedded software expertise. In addition, MoCA designs

## Table of Contents

must undergo a formal certification process in order to ensure interoperability and full compliance with the MoCA specification.

We have been working on home networking technologies on which the MoCA specification is based since 2001 and began shipping production quantities of MoCA-compliant chipsets in December 2004. In September of 2009, we began shipping our third generation of MoCA-compliant products and announced the first complete MoCA 2.0 solution in January 2011. Our MoCA-compliant chipsets are incorporated in equipment being deployed by Verizon, DIRECTV, Comcast, Time Warner Cable, Cox and other service providers. Our MoCA-compliant products can be used to support on demand video services, online video streaming services, personal computer-to-television content sharing, multi-room DVR and online gaming. We see a growing need for a highly reliable wired home networking solution to support these new multimedia applications. We believe that our new MoCA 2.0 chipset will answer the growing demand for powerful connectivity within the home.

We believe that our pioneering role in developing the MoCA standard and our success to date in providing these solutions position us well to continue to be the leading provider of MoCA-compliant connected home entertainment solutions. Our MoCA-compliant home networking solutions provide the following key benefits:

**High data rates.** In field trials defined and conducted by MoCA, our first generation solutions consistently delivered net throughput in excess of 110 megabits per second in real world conditions with no loss in performance when multiple devices were connected to the network. This performance enables sharing of multiple simultaneous streams of HD video. Our second and third generation solutions continue to have a physical layer rate of up to 250 megabits per second and have increased net throughput to up to 175 megabits per second. With our MoCA 2.0 solutions, we have demonstrated a physical layer rate of 600 megabits per second and an increased net throughput of up to 400/500 megabits per second in its basic, single channel configuration and up to 500/800 megabits per second in enhanced (or turbo mode), in a bonded channel configuration, as described in the MoCA 2.0 specification. MoCA 2.0 also supports channel bonding to yield net throughputs between 800 megabits per second and 1 gigabit per second. The physical layer rate refers to the maximum speeds of the physical layer of our integrated circuits, while net throughput refers to the rate at which data is actually made available to applications and experienced by users.

**High-quality video experience.** Our solutions provide a reliable and high-quality video experience for the consumer that meets service provider requirements. Our solutions operate at frequencies on the coaxial cable that do not interfere with other services or devices. Our physical layer and media access controller provide a very low native packet error rate, without the need for retransmissions, that is essential for service provider-quality HD video. Our media access controller is time coordinated, which eliminates collisions in the network. Our solution also provides two methods of ensuring QoS, prioritized QoS and reserved bandwidth scheme, known as parameterized QoS.

**Ease of installation and use.** Our solutions leverage the existing coaxial cable infrastructure and do not require expensive new wiring in the home. The plug-and-play installation of our solutions makes it easy for consumers to install and use, and allows service providers to rapidly deploy, new services. Each of these features enables service providers to minimize costly truck rolls.

**Security and reliability.** Our solutions operate on coaxial cable, which is a shielded, wired medium that can be simply isolated from neighboring home networks through both logical and physical means. We support service provider-based conditional access systems and related digital rights management and provide basic encryption for consumer privacy of personal multimedia content. In addition, our solutions create a self-healing network that provides high levels of fault tolerance and reliability.

## **Table of Contents**

**Remote upgrade and diagnostics.** Our solutions allow service providers to remotely upgrade firmware which gives them the ability to continuously enhance the features of their service offerings without truck rolls. Our solutions' remote diagnostics tools also allow service providers to remotely diagnose and potentially remediate the home coaxial cable environment.

### ***DBS Outdoor Unit***

Our DBS outdoor unit solutions target the large and growing digital broadcast satellite market. In a traditional satellite installation, the ability to select multiple channels simultaneously frequently requires multiple cables from the satellite dish to the set-top box. For example, in order to simultaneously view and record separate programs from the full channel lineup with DVRs in three rooms in a house, a user typically needs six separate cables from outside the home. Our DBS outdoor unit products can significantly reduce the deployment costs for digital broadcast satellite providers by allowing them to send multiple video streams from individual or multiple satellites into the home over a single cable. This simplified cabling architecture enables digital broadcast satellite providers to deploy set-top boxes, with multiple tuner capabilities, in multiple rooms and roll out new services without expensive installation and retrofitting while at the same time improving aesthetics of the home by not damaging walls while installing multiple cables. We believe that our solutions can improve the competitiveness of digital broadcast satellite services by reducing subscriber acquisition costs, decreasing deployment costs for additional services and enabling a more attractive product offering.

Our DBS outdoor unit products include band translation switch and channel stacking switch integrated circuits, which are highly complex single-chip radio frequency integrated circuits that integrate multiple independent signal receivers and multiple discrete analog functions onto a single silicon die. Moreover, as many as four channel stacking switch integrated circuits can be linked to provide up to 12 digital broadcast satellite signals on a single cable. Our band translation switch products were specifically designed to operate with DISH Network Corporation's, or DISH Network's, service offerings. We sell our channel stacking switch products to customers who incorporate them into products deployed by other DBS service providers. We are the pioneers in developing band translation switch and channel stacking switch radio frequency integrated circuits and we have helped to define the standard for satellite signal distribution over a single cable in conjunction with members of the European Committee for Electrotechnical Standardization, or CENELEC. We believe that single cable standardization will lead to more rapid adoption and further expand the market for our products. Our band translation switch products are currently used in outdoor equipment deployed by DISH Network and one other North American operator and our channel stacking switch products are currently used in outdoor equipment deployed by DIRECTV, Via Embratel, Sky Italia, BSkyB and other service providers.

### ***Broadband Access***

Our broadband access solutions are designed to meet broadband access requirements in areas characterized by fiber optic networks that terminate within one kilometer of a customer premises. In particular, our solutions allow cable service operators with fiber optic deployments to offer broadband triple-play services that are competitive with very high-speed digital subscriber line, or VDSL, services offered by telecommunications carriers. We believe that this is a large potential target market for our broadband access products and we have several deployments underway with service providers in China. Our broadband access solutions also have applications in vertical markets beyond broadband residential access. Our broadband access solutions have been incorporated into systems currently being deployed in hospitality networks, providing video and broadband services over coax to multiple hotel residents.

## **Table of Contents**

Our broadband access solutions use coaxial cable infrastructure to deliver last kilometer connectivity for high-speed broadband access to single-family homes and multiple dwelling units. They incorporate the same physical layer used in our home networking products and a different network-optimized media access controller technology. Our broadband access solutions offer high performance with net throughput in excess of 100 megabits per second. The point-to-multi-point architecture of our solutions currently supports up to 63 subscribers on a single radio frequency channel. Our solutions are capable of supporting four distinct channels simultaneously over a single coaxial cable. As a result, this increases the number of subscribers that can be supported and the net throughput that is available by a multiple of the number of channels that are activated, in a single distribution cable. Our high-speed broadband access solutions enable service providers to offer bundled triple-play services over their existing services and cable infrastructure.

### ***Silicon Tuner***

We provide silicon tuner integrated circuits for cable and terrestrial applications that conform to most major digital and analog video broadcast standards, including the U.S. and international broadcasting standards. Many set-top boxes and integrated digital televisions have multiple tuners to enable advanced features such as DVR, watch-and-record functionality and picture-in-picture viewing, further expanding the market for tuner integrated circuits. Our tuner integrated circuits integrate radio frequency functions, including those performed by a surface acoustic wave, or SAW, filter, with other major discrete components onto a single die while maintaining the performance of traditional non-silicon can tuners. Our highly integrated solutions significantly reduce our customers' design costs and shrink the tuner footprint in consumer electronics devices. We believe that the performance and small footprint of our tuners will lead to greater adoption of multiple-tuner applications across a broad range of consumer electronics over time.

### **Our Strategy**

Our goal is to be the leading provider of systems solutions for the connected home entertainment market by enabling the delivery of multiple streams of HD video and other multimedia content into and throughout the home. The key elements of our strategy are to:

**Extend our technology leadership.** We believe that our success has been, and will continue to be, largely attributable to our interdisciplinary skill set that we leverage to create innovative systems-level solutions. As the incumbent supplier of key MoCA-compliant technologies in service provider-based deployments, we gain critical insight into next generation product and system requirements. We have and will continue to use these insights to enhance our products. For example, as a result of our leadership in developing MoCA 1.0 and 1.1 compliant solutions, we were a leading contributor to the development of the next generation MoCA 2.0 specification, which was adopted by MoCA in June 2010. We intend to extend our technology leadership by focusing on our research and development efforts and through targeted technology acquisitions.

**Expand relationships with industry leaders and customers.** We work very closely with leading service providers, ODMs and OEMs around the world to increase the adoption of connected home entertainment solutions that utilize our technology. We have been selected in deployments by leading service providers including Verizon, DIRECTV, Comcast, Cox and Time Warner Cable, among others, and leading ODMs and OEMs such as Motorola Mobility Inc. (formerly Motorola, Inc.), or Motorola, Wistron NeWeb Corporation, or Wistron, and Actiontec Electronics, Inc., or Actiontec. We believe that expanding our relationships with these companies and further aligning our product and technology roadmap with their strategies will contribute to our future growth. We intend to expand our existing customer relationships by securing additional design wins with our customers and by positioning our connected home entertainment technology as the key differentiator in next generation

**Table of Contents**

customer premises equipment. We also intend to expand our relationships with consumer electronics OEMs to increase adoption of our solutions and further develop a retail market for connected home entertainment solutions.

**Continue to broaden our solutions and pursue complementary acquisitions.** We seek to provide our customers with full platform solutions. Historically, we have used acquisitions to broaden our technology and solutions capabilities and expand our customer base. For example, our company was originally focused on the development of MoCA home networking solutions and we later expanded our product offerings to include broadband access, DBS outdoor unit and silicon television tuner solutions by acquiring RF Magic, Inc., or RF Magic, in 2007. Over time, we intend to address the large and growing connected home entertainment market by adding additional features and capabilities to our products and provide full platform solutions and opportunistically pursue acquisitions that contribute complementary technology or provide access to new customers.

**Expand our presence in international markets.** Historically, we have been principally focused on ODMs and OEMs that supply equipment for service provider-based deployments in the United States. We intend to continue to expand our sales and technical support organization to broaden our service provider reach in international markets, primarily in Asia, Europe and South America. For example, we are actively marketing our MoCA home networking solutions in Europe and South America, our broadband access solutions in China, our DBS outdoor unit solutions in Europe and South America and our tuner products in Europe, Africa and Asia.

**Drive industry standards.** We use our technology leadership to define specifications and drive industry standards, such as MoCA, which we believe will lead to widespread adoption of our solutions. In Europe, we have actively worked with members of CENELEC to develop a standard for satellite signal distribution over a single cable. We intend to continue to participate in other standards-setting bodies that we believe will influence our target markets, including CableLabs, the ITU, the Institute of Electrical and Electronics Engineers, or IEEE, the RVU Alliance and Digital Living Network Alliance.

**Table of Contents****Our Products**

We offer products that provide solutions for the delivery of HD video, SD video and other multimedia content into and throughout the connected home. Our products include home networking, DBS outdoor unit, broadband access and silicon tuner solutions. The chart below lists, for each of our products, its description, target markets and representative target devices or applications:

<b>Product</b>	<b>Description</b>	<b>Target Markets</b>	<b>Representative Target Devices or Applications</b>
<b>Home Networking</b>			
EN101x	Coaxial network interface radio frequency integrated circuit	Networked home entertainment devices	Multi-room DVR, set-top box, digital television, gaming console, home media server, residential gateway, personal computer and optical network terminal
EN12xx	Coaxial network interface radio frequency integrated circuit	Networked home entertainment devices	Multi-room DVR, set-top box, digital television, gaming console, home media server, residential gateway, personal computer and optical network terminal
EN2xxx	Coaxial network controller integrated circuit	Networked home entertainment devices	Multi-room DVR, set-top box, digital television, gaming console, home media server, residential gateway, personal computer and optical network terminal
<b>Broadband Access</b>			
EN101x	Coaxial network interface radio frequency integrated circuit	Broadband access, internet protocol television, and voice over internet protocol	Optical network terminal, point-of-entry network controller, and access customer premises equipment for single family homes and multiple dwelling units
EN3011	Access network controller integrated circuit	Broadband access, internet protocol television and voice over internet protocol	Optical network terminal and point-of-entry network controller for single family homes and multiple dwelling units
EN3230	Access client integrated circuit	Broadband access, internet protocol television and voice over internet protocol	Access customer premises equipment for single family homes and multiple dwelling units
<b>DBS Outdoor Unit</b>			
RF5000	Band translation switch-Dual 2-channel integrated circuit	U.S. digital broadcast satellite	Low-noise block converter and multi-switch digital broadcast satellite products for single family homes and multiple dwelling units
RF510x	Band translation switch-Triple 2-channel integrated circuit	U.S. digital broadcast satellite	Low-noise block converter and multi-switch digital broadcast satellite products for single family homes and multiple dwelling units
RF520x	Channel stacking switch-3-channel integrated circuit	U.S. digital broadcast satellite	Low-noise block converter and multi-switch digital broadcast satellite products for single family homes and multiple dwelling units
RF521x	Channel stacking switch-3-channel integrated circuit	Global digital broadcast satellite	Low-noise block converter and multi-switch digital broadcast satellite products for single family homes and multiple dwelling units
<b>Silicon Tuners</b>			
EN4020	Universal silicon tuner integrated circuit	Global terrestrial and cable television	Digital television, digital set-top box, DVR, DVD recorder, personal computer television and cable modem products
EN4021	Universal silicon tuner integrated circuit	Global terrestrial and cable television	Digital/analog television, digital set-top box, DVR, DVD recorder, personal computer television and cable modem products

## **Table of Contents**

### **Our Technology**

We believe that we possess the expertise and experience, the breadth and depth of technologies, and the skills required to address and compete effectively in our target markets. These capabilities result from our in-depth understanding of the environments in which we operate, knowledge and experience with customer and operator requirements, and extensive communications system understanding.

#### ***Home Networking***

Our home networking products are based on an innovative platform technology that allows very high-speed and reliable communications between coaxial cable home outlets without the need to modify the home coaxial cable system and without interfering with existing cable television services. This technology has been designed to address the very difficult communications environment of the coaxial cable home network architecture. We have developed an in-depth understanding of the home coaxial cable environment as a result of extensive testing and characterization of both the coaxial cable home network and its components, such as splitters, cables, taps and home entertainment devices including television sets and set-top boxes. These tests provided us with a large database of home coaxial cable network characteristics from which we have developed a set of tools and models that we use to optimize our solutions for this environment.

Coaxial home cabling is designed for vertical communications to and from the cable system head-end to the devices connected to coaxial cable outlets in the home, such as television sets and set-top boxes, and has in the past primarily been used for the delivery of cable television, data (cable modem) and, more recently, voice over Internet protocol services, or VoIP. The in-home coaxial cable architecture has been specifically designed to prevent inter-outlet communications through the use of splitters with high port-to-port isolation. This leads to a highly dispersive physical layer channel, over which it is difficult for typical digital communication systems to operate. The historical inability to address these issues associated with in-home coaxial cable architecture has contributed to the creation of islands of digital entertainment within the home.

Our home networking technology is a full-mesh, peer-to-peer network. It overcomes the inherent limitations of home coaxial cable and enables high-speed horizontal communications between the outlets in cable homes. This is accomplished through a combination of an adaptive physical layer that optimizes the signal modulation in order to maximize the channel capacity of the in-home coaxial cable network and a unique media access controller protocol that maintains very low latency independent of network load by allocating channel resources without contention or retransmission. The system simplifies installation and maintenance requirements through the use of an ad-hoc network controller functionality, which makes the network self-healing and provides redundancy. Our home networking solution is implemented using an efficient and flexible architecture through an optimized combination of hardware, firmware, software and cost effective radio frequency integrated circuit and system-on-a-chip implementations.

Our home networking technology was selected as the basis for the first generation MoCA standard for home networking over coaxial cable after a selection process that involved an extensive and successful field trial conducted by MoCA. The field trial demonstrated that our home networking technology repeatedly achieved a very reliable net throughput in excess of 110 megabits per second at acceptable packet error rate levels to support in-home video distribution at quality levels appropriate for service provider-based pay-television deployments. This net throughput allows for the simultaneous delivery of more than four full-rate HDTV channels and other services, such as voice and data.



## **Table of Contents**

In 2007, MoCA adopted and approved its second generation of specifications, known as MoCA 1.1, which addressed the evolving needs of service providers for more bandwidth, increased device support and guaranteed QoS. Our EN2210 and EN2510 solutions, which are MoCA 1.1 compliant, deliver a net throughput of up to 175 megabits per second, support up to 16 nodes, provide parameterized QoS and offer security through the use of a shielded, wired connection in combination with state of the art packet-level encryption technology. The components of our EN2210 and EN2510 products are designed to easily and cost-effectively distribute multiple streams of HD quality video entertainment via a highly reliable home network. In June 2010, the MoCA 2.0 standard was adopted by MoCA. MoCA 2.0 offers two performance configurations, basic and enhanced (or turbo), with net throughput of 400/500 megabits per second in a single channel configuration and 500/800 megabits per second in bonded channel configurations, respectively.

### ***DBS Outdoor Unit***

Our DBS outdoor unit solutions simplify the installation required to support simultaneous reception of multiple channels from multiple satellites over a single cable. This capability is critical to allow a satellite receiver to enable picture-in-picture viewing or to record and watch two or more programs simultaneously, using a single cable. In cable television systems, all the channels are available over the coaxial cable connected to the television set or the cable set-top box. In satellite systems, the number of channels available from multiple satellites typically exceeds the channel carrying capabilities of the connecting cable. The channel stacking switch and band translation switch technologies are designed to select desired satellite channels and re-arrange them for delivery to the indoor set-top box over a single connecting cable. This single cable connects the outdoor unit to either many set-top boxes in and around the home or a media center inside the home, and delivers all the programs being viewed on the various devices inside the home. In a legacy system that does not use the channel stacking switch and band translation switch technologies, additional cables may be required as the numbers of simultaneously viewed satellite channels or the number of simultaneously viewed programs increases.

The implementation of such complex radio frequency processing in an integrated radio frequency integrated circuit is accomplished with our radio frequency system architecture and design capabilities, including the design of multiple, independently operable, low noise oscillators on a single die, cross-point switching and high isolation techniques realized in both circuit design and advanced floor planning methodologies.

### ***Broadband Access***

Our broadband access solutions use coaxial cable infrastructure to deliver last kilometer connectivity for high-speed broadband access to single-family homes and multiple dwelling units. Our solutions are designed to work on passive coaxial cable networks. This means that a fiber node in the hybrid fiber coaxial, or HFC, network, or the xPON terminates at the last active device in a coaxial cable wide area network. This termination point is typically within 600 meters of a customer's premises. For active or passive coaxial cable distribution plants extending up to 1.2 kilometers, cable operators can use a c.LINK-compliant distribution amplifier which increases coverage while delivering the same throughput performance. Our solutions are based on our c.LINK access technology and provide efficient communications between an access node, such as a fiber termination in the basement of an apartment building, and the cable outlets in each apartment throughout the building. Other applications of our broadband access solutions can be supported in similar cable infrastructure topologies. For example, our broadband access solutions are being deployed in video surveillance products operating over coax infrastructure in point to multi-point topologies. In addition, our broadband access solutions have been incorporated into systems currently under evaluation in hospitality networks, providing video and broadband services over coax to multiple hotel residents.

## **Table of Contents**

Our c.LINK access technology utilizes a single radio frequency channel for communicating in both the upstream and downstream directions. This allows flexibility in the allocations of bandwidth transmitted in either direction. For example, if a user has a significant amount of information to send from a computer, such as video files or photos loading to a server on the Internet, the c.LINK access technology can allocate the available bandwidth for the requisite time duration to this upstream direction. Also, since the access node device and the customer devices do not transmit and receive simultaneously, the access node device can share much of the front-end circuitry for both transmit and receive functions, resulting in additional cost savings. Since communications to different nodes in the network and to or from each device are accomplished through the time division of the radio frequency channel, a single device using our c.LINK access technology at the access node can communicate with as many as 63 customer devices, resulting in a cost-effective solution for high-speed broadband access. The time division protocol also provides each customer device a deterministic time slot to access the network. It is designed to guarantee true QoS under a variety of traffic conditions. Our solution is also able to simultaneously support up to four channels over a single coaxial cable. As a result, our solution is scalable in multiples of 63 subscribers based on the number of active channels over a single distribution cable supporting, a potential physical layer rate of over 1 gigabit per second. In addition to scalability, our c.LINK access technology can operate in a wide range of operating frequencies between 800MHz and 1500MHz.

### ***Silicon Tuners***

Our radio frequency technology is well suited for the design of low-cost, high-performance, low-power and small footprint, terrestrial and cable, single and multiple tuner integrated circuits. Our silicon tuner integrated circuits integrate radio frequency functions, including those performed by a SAW filter, with other major discrete components into a single die while maintaining the performance of traditional non-silicon can tuners. Our system architecture is capable of addressing today's legacy standard interfaces to digital demodulation integrated circuits, and at the same time is optimized for future interfaces. This architecture is also ideal for an integrated, multiple tuner, single integrated circuit implementation. Our low noise, high dynamic range front-end and low phase noise design combined with the integrated, tunable, high selectivity radio frequency filters ensures that we can meet the stringent requirements of both digital and analog terrestrial and cable applications. Our fully-integrated, auto-calibrated, analog signal processing and high isolation techniques, including advanced floor-planning methodologies, enable us to design multi-standard, multiple tuners on a single silicon die.

Our new generation of silicon integrated circuit tuners provide a single hardware platform that is software localized for different markets. This new generation silicon tuner significantly increases manufacturing and test efficiency for our customers by allowing them to produce a single hardware platform, thus streamlining the procurement and manufacturing process to enable net cost savings.

### **Customers**

We work closely with ODMs, OEMs and leading service providers around the world to increase the adoption of connected home entertainment solutions that incorporate our technology. Service providers that utilize our products are mainly served by major consumer electronic ODMs and OEMs of connected home entertainment solutions. We have been selected by leading equipment manufacturers such as Actiontec, Cisco Systems, Inc., or Cisco, Motorola, Samsung Electronics Co., Ltd., or Samsung, Technicolor (Thomson), Wistron and Zinwell Corporation, or Zinwell, for deployments by leading service providers such as DIRECTV, DISH Network, Comcast, Time Warner Cable, Cox and Verizon.

We currently rely, and expect to continue to rely, on a limited number of customers for a significant portion of our net revenues. For example, for the year ended December 31, 2011, Wistron

## **Table of Contents**

and Motorola accounted for 25% and 17% of our net revenues, respectively. For the year ended December 31, 2010, Wistron and Motorola accounted for 21% and 17% of our net revenues, respectively. For the year ended December 31, 2009, Actiontec and Motorola accounted for 16% and 27% of our net revenues, respectively. In addition, we depend on a limited number of service providers that purchase products from customers that incorporate our products.

For the year ended December 31, 2011, 89% of our net revenues were derived from Asia, 11% were derived from North America and less than 1% were derived from Europe. For the year ended December 31, 2010, 93% of our net revenues were derived from Asia, 6% were derived from North America and 1% were derived from Europe. For the year ended December 31, 2009, 92% of our net revenues were derived from Asia, 6% were derived from North America and 2% were derived from Europe. Many of our ODM and OEM customers in Asia incorporate our chipsets into products that they sell to U.S.-based service providers.

## **Research and Development**

We believe our future success depends, in part, on our ability to introduce enhancements to our existing products and to develop new products for existing and emerging markets. We work closely with service providers and their ODM and OEM partners to understand their requirements and align our research and development efforts to meet their system requirements. We are also actively engaged in advancing the MoCA standard through our research and development efforts. We have assembled a team of highly skilled design engineers with core competencies in complex communications chipsets, radio frequency integrated circuits and embedded application software expertise. Our engineers are responsible for new product development efforts while continuing to enhance existing products and provide critical technical support to our customers.

As of December 31, 2011, we had 194 full-time employees engaged in research and development. For the years ended December 31, 2011, 2010 and 2009, the total amount that we spent on research and development activities was \$60.1 million, \$48.7 million and \$45.2 million, respectively.

## **Manufacturing**

We use third-party foundries and assembly and test contractors to manufacture, assemble and test our products. This outsourced manufacturing approach allows us to focus our resources on the design, sales and marketing of our products and avoid the cost associated with owning and operating our own manufacturing facility. Our engineers work closely with foundries and other contractors to increase yields, lower manufacturing costs and improve quality.

We currently outsource the manufacturing of our home networking and our broadband access products, principally to Taiwan Semiconductor Manufacturing Company, or TSMC, and the manufacturing of our DBS outdoor unit and silicon tuner products to TowerJazz, the name under which Tower Semiconductor Ltd. and its fully owned U.S. subsidiary Jazz Semiconductor operate. Our products are shipped from such third-party foundries to third-party assembly and testing facilities. Our home networking and our broadband access chipsets are primarily assembled and tested by Amkor Technologies, Inc., or Amkor, while our DBS outdoor unit and silicon tuner products are primarily assembled by Amkor and tested by Giga Solution Tech. Co., Ltd., or Giga Solution. We have implemented a robust quality management system designed to assure high levels of product quality for our customers. We have completed and have been awarded ISO 9001:2000 certification. In addition, the independent foundries, assembly and test subcontractors identified above have been awarded ISO 9001:2000 certifications, among others.

## **Table of Contents**

### **Sales and Marketing**

We sell our products worldwide through multiple channels, including our direct sales force and our network of domestic and international sales representatives and distributors. We have strategically located our direct sales personnel in the United States, Europe, China, Taiwan, Japan and Korea, where each salesperson targets a specific end-user market. Our sales directors focus their efforts on leading ODMs and OEMs. We also have field application engineers who provide technical support and assistance to existing and potential customers in designing, testing, qualifying and certifying systems that incorporate our products.

Our sales and marketing strategy is to achieve design wins with leading ODMs and OEMs and mass deployment of our solutions with service providers worldwide. This requires us to work extensively and collaboratively with our ODM and OEM customers as well as the service providers who purchase products from them. As a result, we believe that our established relationships allow us faster time to market and will lead to greater proliferation of our products.

Our marketing group focuses on our product strategy and management, product development roadmaps, product positioning, new product launch and transition, demand assessment and competitive analysis. The group also ensures that product development activities, product launch, channel marketing program activities, and ongoing demand and supply planning occur in a well-managed and timely manner in coordination with our development, operations and sales groups as well as our service provider representatives, ODMs and OEMs. Our marketing group also has programs in place to work closely with service providers in the role of a trusted advisor for MoCA deployments and initiatives designed to heighten industry awareness of our company, products and technologies, including participating in technical conferences, support of industry initiatives such as MoCA, publication of technical white papers and exhibition at trade shows.

### **Backlog**

Our sales are made primarily pursuant to standard purchase orders for delivery of products. Quantities of our products to be delivered and delivery schedules are frequently revised to reflect changes in our customers' needs. Additionally, customer orders generally can be canceled or rescheduled without significant penalty to the customer. For these reasons, our backlog of product inventory as of any particular date is not representative of actual sales for any succeeding period and, therefore, we believe that our backlog is not necessarily a reliable indicator of future net revenue levels.

### **Competition**

The markets for our products are extremely competitive and are characterized by rapid technological change, evolving industry standards and new demands for features and performance of multimedia content delivery solutions. We believe the principal competitive factors in our markets include the following:

the adoption of our products and technologies by service providers, ODMs and OEMs;

the performance and cost effectiveness of our products relative to our competitors' products;

our ability to deliver high quality and reliable products in large volumes and on a timely basis;

our ability to build close relationships with service providers, ODMs and OEMs;

our success in developing and utilizing new technologies to offer products and features not previously available in the marketplace that are technologically superior to those offered by our competitors;

## **Table of Contents**

our ability to identify new and emerging markets and market trends;

our ability to recruit design and application engineers and other technical personnel; and

our ability to protect our intellectual property and obtain licenses to the intellectual property of others on commercially reasonable terms.

We believe that we compete favorably with respect to each of these criteria. However, conditions in our markets could change rapidly and significantly as a result of technological advancements or the adoption of new standards for the delivery of HD video and other multimedia content. In addition, many of our current and potential competitors have longer operating histories, significantly greater resources, stronger name recognition and a larger base of customers than we do. This may allow our competitors to respond more quickly than we are able to respond to new or emerging technologies or changes in customer requirements or it may allow them to deliver products that are priced lower than our products or which include features and functions that are not included in our products.

In the market for home networking solutions, we are currently the only deployed high-volume supplier of MoCA-compliant chipsets. In the near-term, therefore, we believe our primary competition in this market will be from companies that offer products based on non-MoCA home networking solutions, such as Ethernet, HomePNA, Home Plug AV and Wi-Fi, and potentially G.hn when products incorporating the standard for that technology are introduced to the market. However, Broadcom Corporation, or Broadcom, has announced the availability of several multi-format video decoder system-on-a-chip solutions with integrated MoCA functionality as well as system-on-a-chip solutions that incorporate xPON technology with integrated MoCA functionality. Broadcom's home networking reference designs have achieved MoCA 1.0 and MoCA 1.1 certification from the MoCA certification board. We have been competing with Broadcom integrated MoCA solutions and expect to continue to compete with Broadcom and other semiconductor manufacturers in the manufacture and sale of MoCA-compliant chipsets in the future. In the broadband access market, our broadband access products compete with other, more well-established high-speed wide area networking technologies such as DOCSIS, xDSL, xPON and WiMAX. While we believe that our products compete favorably against alternative technologies in these markets, the ultimate competitiveness of our products is highly dependent on, and sensitive to, the particular facts and circumstances of each service provider and its end user customers, such as the type of media content being distributed, the environment in which the distribution is taking place, the available network bandwidth and distribution mediums, and the number of devices connected to a network. In the DBS market, our band translation switch and channel stacking switch products face competition from discrete solution providers and other semiconductor manufacturers. In the market for tuners, our silicon tuners face competition from silicon and non-silicon tuners that offer similar functionality. In the transition to and adoption of CMOS technology to deliver silicon tuners, we believe that we are currently the market leader in compliance with existing standards and quality of performance. As the integrated silicon tuner market is maturing, the number of competitive players in the market is being reduced and other competitive offerings will become available.

## **Intellectual Property**

Our success and future revenue growth depend, in part, on our ability to develop and protect our intellectual property. We rely primarily on patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies and processes. However, these measures may not provide meaningful protection for our intellectual property. We review our technological developments to identify features that provide us with a technological or commercial advantage and we file patent applications when we deem it to be appropriate to protect these features in the United States and internationally in select countries. In addition to developing patented technology internally, we continually evaluate the acquisition and

## Table of Contents

licensing of intellectual property from third-parties that complements our business. As of December 31, 2011, we held 62 issued U.S. patents, one of which was reexamined by the U.S. Patent and Trademark Office and for which a reexamination certificate was issued. In addition, as of December 31, 2011, we had 87 foreign patents and another 227 patent applications that were pending in the United States and foreign countries, of which six applications have been allowed. The term of an issued patent in the United States is at least 20 years from its filing date, unless subject to a terminal disclaimer. The U.S. Patent and Trademark Office provides term extensions for those applications that have been pending for more than three years and for which the duration of the pendency is not the fault of the applicant. Accordingly, many of our patents may receive a longer term due to the benefit of such patent term extensions. Taking such patent terms and any terminal disclaimers into account, the remaining terms of our issued U.S. patents range from 14 to 17 years and the remaining terms for counter-part patents in most foreign jurisdictions are similar, provided we pay the applicable maintenance fees throughout the terms of our issued U.S. and granted foreign patents.

We are the owner of several registered trademarks in the United States and in certain foreign countries, including Entropic, Entropic Communications, c.LINK and RF Magic.

In connection with our membership in MoCA, we are required to license any of our patent claims that are essential to implement the MoCA specification to other MoCA members under reasonable and non-discriminatory terms. Because our core home networking technology is a primary component of the MoCA specification, we are required to license portions of this technology to other MoCA members, including other semiconductor manufacturers that may compete with us in the sale of MoCA-compliant chipsets. However, only essential patent claims necessary to implement the MoCA specification are subject to this requirement. We are not required to license patent claims that are not essential to implement the MoCA specification, nor are we required to license patent claims that are unrelated to the MoCA specification. To date we have not entered into a license of our MoCA-related patent claims, so the terms of any required license have not been established.

In addition to the licensing requirements of standards bodies to which we belong, such as MoCA, in connection with our sales or product development activities, we are also sometimes required by our customers or service providers to license to unrelated third-parties, on reasonable and non-discriminatory terms, patents and patent applications associated with technologies purchased or used by, or developed with or for, such customers or service providers. We expect that in the future we may be required to agree to such licensing arrangements in order to secure sales, receive development funds or settle disputes.

In addition to our patent rights, we hold significant intellectual property in the form of proprietary trade secrets which we rely on to compete. Designing integrated circuits that comply with the MoCA specification or implement our DBS outdoor unit solutions is technically difficult and requires the application of a wide range of complex engineering disciplines. During the course of creating the technology on which the MoCA standard is based, we developed significant proprietary know-how and techniques for overcoming the engineering challenges involved in designing MoCA-compliant products. We retain such know-how and techniques as proprietary trade secrets that we are not required to license to others as a result of our membership in MoCA. Similarly, we have developed significant proprietary know-how and techniques for implementing our DBS outdoor unit solutions in satellite installations. Consequently, even though we are required to license patent claims that are essential to implement the MoCA standard to other MoCA members and have agreed to license patents and patent applications related to other technologies, such as our DBS outdoor unit solutions, to third-parties on reasonable and non-discriminatory terms, we believe that such licensees would need to overcome significant engineering challenges and develop or obtain comparable proprietary know-how and techniques in order to design products that compete successfully against ours.

## **Table of Contents**

We generally enter into nondisclosure agreements with our employees, consultants and strategic partners, and typically control access to and distribution of our proprietary information. Our employees are generally required to assign their intellectual property rights to us and to treat all technology as our confidential information.

## **Government Regulation**

As a company that provides systems solutions comprised of silicon integrated circuits with embedded software, we are subject to certain government regulations, including U.S. export controls and foreign countries' import regulations, as well as customs duties and export quotas, regulations relating to the materials that comprise our products (such as the European Union's Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment and equivalent regulations adopted by China), and regulations placing constraints on our customers and service providers' services (such as the Federal Communications Commission's regulations relating to radio frequency signals emitted in the United States and laws and regulations regarding local cable franchising).

## **Employees**

As of December 31, 2011, we employed a total of 344 people on a full-time basis, including 194 in research and development, 107 in sales, marketing and general and administrative, and 43 in operations. We also engage temporary employees and consultants. Our ability to attract and retain qualified personnel is essential to our continued success. None of our employees is subject to a collective bargaining agreement. We have never experienced a work stoppage and we consider our relations with our employees to be good.

**Table of Contents****EXECUTIVE OFFICERS OF THE COMPANY**

The following table sets forth information regarding our executive officers as of January 30, 2012.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Patrick Henry	49	Chief executive officer and member of our board of directors since September 2003 and president since February 2008. Mr. Henry also served as chairman of our board of directors from July 2007 to January 2009 and as our president from September 2003 to July 2007. From February 2003 to September 2003, he was president and chief executive officer of Pictos Technologies Inc., a developer of digital imaging products which was acquired by ESS Technology. Prior to 2003, Mr. Henry served as chief executive officer of Lincom Wireless, Inc., a chip manufacturing company focused on Wi-Fi products; vice president and general manager at LSI Logic Corporation, a provider of silicon, systems and software technologies; and senior vice president at C-Cube Microsystems Inc., a developer of digital video integrated circuits. Mr. Henry holds a B.S. in engineering science and mechanics from the Georgia Institute of Technology and an M.B.A. from the University of Southern California.
David Lyle	47	Chief financial officer since June 2007. From August 2005 to June 2007, Mr. Lyle was the chief financial officer at RF Magic, acquired by Entropic in June 2007. Prior to RF Magic, Mr. Lyle was finance director and controller for the mobile communications business unit at Broadcom, a provider of highly-integrated semiconductor solutions. He joined Broadcom in July 2004 through its acquisition of Zyray Wireless Inc., a WCDMA baseband co-processor company, where he served as chief financial officer beginning in January 2004. Prior to 2004, Mr. Lyle served as chief financial officer at Mobilian Corporation, a wireless data communications semiconductor company, and in various finance roles at Intel Corporation, a semiconductor company. At Intel, Mr. Lyle served in the microprocessor and networking groups and in the strategic investment arm of Intel, now known as Intel Capital. Mr. Lyle holds a B.S. in business from the University of Southern California, an M.B.A. from Arizona State University and an M.I.M. from The Thunderbird School of Global Management.



**Table of Contents**

Name	Age	Position
Tom Lookabaugh	50	Chief technology officer since July 2009. Prior to joining Entropic, from March 2006 to June 2009, Dr. Lookabaugh was the chief executive officer of NGNA, LLC, d/b/a PolyCipher, a cable industry joint venture owned by Comcast, Time Warner Cable and Cox, focused on developing and operating a new technology for authenticating and authorizing cable services known as the Downloadable Conditional Access System for the U.S. cable industry. Prior to PolyCipher, from September 2001 through February 2006, Dr. Lookabaugh was on the faculty at the University of Colorado at Boulder where he was an assistant professor and a faculty director of the Interdisciplinary Telecommunications Program and an assistant professor in the Computer Science Department. Dr. Lookabaugh holds a B.S. in engineering physics from the Colorado School of Mines, three M.S. degrees - in electrical engineering, engineering management and statistics - and a Ph.D. in electrical engineering from Stanford University.
Vinay Gokhale	48	Senior vice president, marketing and business development since January 2009. Prior to joining Entropic, from September 2006 until January 2009, Mr. Gokhale served as vice president, wireless segment at SiRF Technology, Inc., a supplier of products related to global positioning systems. From September 2002 until September 2006, Mr. Gokhale served at Impinj Inc., a developer of ultra high frequency, or UHF, radio frequency identification, or RFID, solutions for both item-level and supply-chain tagging. Initially, Mr. Gokhale served as vice president, marketing, and later as executive vice president, RFID products. From July 1995 until September 2002, Mr. Gokhale served in various positions of increasing responsibility at Conexant Systems, Inc., or Conexant, a provider of solutions for imaging, video, audio and internet connectivity applications, and held the position of vice president and business unit director for Conexant's wireless data business unit. Mr. Gokhale holds B.S. and M.S. degrees in electrical engineering from University of California, Irvine and an M.B.A. from Stanford University.

**Table of Contents**

Name	Age	Position
Michael Farese	65	Senior vice president, engineering and operations since June 2010. Prior to joining Entropic, from September 2007 until May 2010, Dr. Farese served as chief executive officer at Bitwave Semiconductor, Inc., a fabless semiconductor company and innovator in the development of programmable radio integrated circuits. From September 2005 until September 2007, Dr. Farese served as the senior vice president of engineering at Palm, Inc., a leading developer of PDAs and wireless smartphones. From March 2002 until July 2005, Dr. Farese served as president and chief executive officer at WJ Communications, Inc., a radio frequency semiconductor company providing radio frequency integrated circuits, or RFICs, to the wireless infrastructure market, and from October 1999 until January 2002, Dr. Farese served as the president and chief executive officer at Tropian, Inc., a provider of cellular application-specific integrated circuits. Dr. Farese has also held senior management positions at Motorola, Nokia Inc. and Ericsson Inc. Dr. Farese holds a B.S. in electrical engineering from Rensselaer Polytechnic Institute, a M.S. degree in electrical engineering from Princeton University and a Ph.D. in electrical engineering from Rensselaer Polytechnic Institute. Dr. Farese is a member of the board of directors of Quicklogic Corporation and PMC-Sierra Inc.
Lance Bridges	50	Vice president and general counsel since January 2009. Mr. Bridges joined Entropic in May 2007 as vice president of corporate development, general counsel and secretary. Prior to joining Entropic, Mr. Bridges was a partner at Cooley LLP, where he practiced law since 1991. Mr. Bridges holds a B.A. in economics from the University of California, San Diego, a J.D. from the University of California, Berkeley School of Law (Boalt Hall) and an M.B.A. from the Walter A. Haas School of Business Administration, University of California, Berkeley.
Trevor Renfield	40	Corporate controller and principal accounting officer since October 2010. Prior to joining Entropic, from August 2007 until October 2010, Mr. Renfield served as vice president, finance and treasurer at DivX, Inc., a creator, distributor and licensor of digital video technologies. From January 2004 until August 2007, Mr. Renfield served as the senior director of finance at Novatel Wireless, Inc., a provider of wireless broadband access solutions, and from June 2003 until January 2004, Mr. Renfield served as the director of financial reporting at Remec, Inc. (acquired by Powerwave Technologies in 2005), a wireless infrastructure business. Mr. Renfield holds a Bachelors in Accounting from the University of South Africa and is a Certified Public Accountant.

## **Table of Contents**

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

*Investing in our common stock involves a high degree of risk. Before deciding to purchase, hold or sell our common stock, you should carefully consider the following information, the other information in this Annual Report on Form 10-K, or Annual Report, and in our other filings with the Securities and Exchange Commission, or SEC. If any of these risks were to occur, our business, financial condition, results of operations or prospects could be materially and adversely affected. In that event, the trading price of our common stock could decline, and you could lose all or part of your investment. These risks and uncertainties may be interrelated or co-related, and as a result, the occurrence of one risk might directly affect other risks described below, make them more likely to occur or magnify their impact. Moreover, the risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business.*

### **Risks Related to Our Business**

*We have had net operating losses for most of the time we have been in existence, had an accumulated deficit of \$150.6 million as of December 31, 2011 and only recently became profitable on an annual basis, and we are unable to predict whether we will remain profitable.*

We were incorporated in 2001, did not commence shipping production quantities of our home networking products until December 2004 and only recently became profitable on an annual basis. Consequently, any predictions about future performance may not be as accurate as they could be if we had a longer history of successfully commercializing our home networking solutions and profitable operations. You should not rely on our operating results for any prior quarterly or annual periods as an indication of our future operating performance.

For the years ended December 31, 2011 and 2010, we generated net income of \$26.6 million and \$64.7 million, respectively, and for the year ended December 31, 2009, we incurred a net loss of \$13.2 million. Although we have been profitable on an annual basis since 2010, we have incurred substantial net losses since our inception and, as of December 31, 2011, we had an accumulated deficit of \$150.6 million. We may incur operating losses in the future as we continue to make significant expenditures related to the development of our products and the expansion of our business. Our ability to sustain profitability depends on the extent to which we can maintain or increase revenue and control our costs in order to, among other things, counter any unforeseen difficulties, complications, product delays or other unknown factors that may require additional expenditures, or unforeseen difficulties or costs associated with the integration of acquired assets or businesses. Because of the numerous risks and uncertainties associated with our growth prospects, product development, sales and marketing and other efforts, we are unable to predict the extent of our profitability or future losses. If we are unable to achieve adequate growth, we may not sustain profitability.

*We face intense competition and expect competition to increase in the future, with many of our competitors being larger, more established and better capitalized than we are.*

The markets for our products are extremely competitive and have been characterized by rapid technological change, evolving industry standards, rapid changes in customer requirements, short product life cycles and frequent introduction of next generation and new products, as well as competing technologies. This competition could make it more difficult for us to sell our products and result in increased pricing pressure, reduced gross profit as a percentage of revenues or gross margins, increased sales and marketing expenses and failure to increase or the loss of market share or expected market share. Semiconductor products in particular have a history of declining prices driven by customer insistence on lower prices as the cost of production is reduced and as demand falls when competitive products or newer, more advanced products are introduced. If market prices

---

**Table of Contents**

decrease faster than product costs, our gross margins and operating margins would be adversely affected. Moreover, we expect increased competition from other established and emerging companies both domestically and internationally. In particular, we currently face, or in the future expect to face, competition from companies such as Broadcom Corporation, or Broadcom, STMicroelectronics N.V., or STMicro, Trident Microsystems, Inc., Sigma Designs, Inc., Cisco Systems, Inc., Intel Corporation, Marvell Technology Group Ltd., MaxLinear, Inc., Qualcomm Incorporated, Lantiq Deutschland GmbH and Vixs Systems, Inc., in the sale of MoCA compliant chipsets and technology, and from companies such as Broadcom, NXP Semiconductors N.V., PLX Technology, Inc., and STMicro, in the sale of direct broadcast satellite outdoor unit products. For example, Broadcom has announced the availability of several multi-format video decoder system-on-a-chip solutions with integrated MoCA functionality. Broadcom's system-on-a-chip design platforms, which are based on Broadcom's MoCA-enabled system-on-a-chip product, have achieved MoCA 1.0 and MoCA 1.1 certification from the MoCA certification board and Broadcom, among other companies, have announced sampling of multiple system-on-a-chip with integrated MoCA 2.0 functionality. In addition, current and potential competitors may establish cooperative relationships among themselves or with third parties. If so, competitors or alliances that include our competitors may emerge and could acquire significant market share. Further, our current and potential competitors may also enter into licensing arrangements with third parties with respect to MoCA chipsets or technology on licensing terms that are more favorable than the licensing terms that we would be able to offer through the direct licensing of our MoCA chipsets and technology to such third parties. We expect these trends to continue as companies attempt to strengthen or maintain their market positions in an evolving industry. In addition, our competitors could develop products or technologies that cause our products and technologies to become non-competitive or obsolete, or cause us to substantially reduce our prices.

Currently, we face competition from a number of established companies that offer products based on competing technologies, such as Data over Cable Service Interface Specifications, or DOCSIS, versions of Digital Subscriber Line, or DSL, Ethernet, HomePNA, HomePlug AV, Broadband over Power Line, High Performance Network Over Coax, or HiNOC, Wi-Fi and WiMAX. Although some of these competing technologies were not originally designed to operate over coaxial cables, our competitors have modified certain technologies, including HomePNA, HomePlug AV, Broadband over Power Line and Wi-Fi, to work on the same in-home coaxial cables that our MoCA-based products use. We also expect to face competition from companies that offer products based on G.hn technology in the future. Many of our competitors and potential competitors are substantially larger and have longer operating histories, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than we do. Given their capital resources, many of these larger organizations are in a better position to withstand any significant reduction in customer purchases or market downturns. Many of our competitors also have broader product lines and market focus, allowing them to bundle their products and services and effectively use other products to subsidize lower prices for those products that compete with ours or to provide integrated product solutions that offer cost advantages to their customers. In addition, many of our competitors have been in operation much longer than we have and therefore have better name recognition and more long-standing and established relationships with service providers, original design manufacturers, or ODMs, and original equipment manufacturers, or OEMs.

Our ability to compete depends on a number of factors, including:

the adoption of our products and technologies by service providers, ODMs and OEMs;

the performance and cost effectiveness of our products relative to our competitors' products;

our ability to deliver high quality and reliable products in large volumes and on a timely basis;

## Table of Contents

our ability to build close relationships with service providers, ODMs, OEMs, retailers and consumer electronics manufacturers;

our success in developing and utilizing new technologies to offer products and features previously not available in the marketplace that are technologically superior to those offered by our competitors;

our ability to identify new and emerging markets and market trends;

our ability to reduce our product costs and receive favorable pricing from our suppliers;

our ability to recruit design and application engineers and other technical personnel;

our ability to protect our intellectual property and obtain licenses to the intellectual property of others on commercially reasonable terms;

our ability to expand MoCA penetration outside of the United States; and

our ability to create a retail market for MoCA products in consumer electronics devices, such as televisions.

Our inability to address any of these factors effectively, alone or in combination with others, could seriously harm our business, operating results and financial condition.

In addition, consolidation by industry participants could result in competitors with further increased market share, larger customer bases, greater diversified product offerings and greater technological and marketing expertise, which would allow them to compete more effectively against us. Current and potential competitors may also gain such competitive advantages by establishing financial or strategic relationships with existing or potential customers, suppliers or other third-parties. These new competitors or alliances among competitors, customers, or suppliers could emerge rapidly and acquire significant market share. In addition, some of our suppliers and customers offer, or may in the future offer, products that compete with our products. Depending on the participants, industry consolidation or the formation of strategic relationships could have a material adverse effect on our business and results of operations by reducing our ability to compete successfully in our current markets and the markets we are seeking to serve.

***We depend on a limited number of customers, and ultimately service providers, for a substantial portion of our revenues, and the loss of, or a significant shortfall in, orders from any of these parties could significantly impair our financial condition and results of operations.***

We derive a substantial portion of our revenues from a limited number of customers. For example, for the year ended December 31, 2011, Wistron and Motorola accounted for 25% and 17% of our net revenues, respectively; for the year ended December 31, 2010, Wistron and Motorola accounted for 21% and 17% of our net revenues, respectively; and for the year ended December 31, 2009, Actiontec and Motorola accounted for 16% and 27% of our net revenues, respectively. Our inability to generate anticipated revenues from our key existing or targeted customers, or a significant shortfall in sales to certain of these customers would significantly reduce our revenues and adversely affect our operating results. Our operating results in the foreseeable future will continue to depend on our ability to sell our products to existing and other large customers.

In addition, we depend on a limited number of service providers that purchase products from our customers which incorporate our home networking or digital broadcast satellite outdoor unit solutions. If these service providers, or other service providers that elect to use our products, reduce or eliminate purchases of our customers' products which incorporate our products, this would significantly reduce our revenues and adversely affect our operating results. In addition, any sudden or unexpected slowdown in deployments by service providers that incorporate our products may lead



## Table of Contents

to an inventory buildup by our customers who may, in turn, postpone taking delivery of our products or wait to clear their existing inventory before ordering more products from us, which, in turn, may adversely affect our results. Our operating results for the foreseeable future will continue to depend on a limited number of service providers' demand for products which incorporate our products.

We may have conflicts with our customers or the service providers that purchase products from our customers that incorporate our products. Any such conflict could result in events that have a negative impact on our business, including:

reduced purchases of our products or our customers' products that incorporate them;

uncertainty regarding ownership of intellectual property rights;

litigation or the threat of litigation; or

settlements or other business arrangements imposing obligations on us or restrictions on our business, including obligations to license intellectual property rights or make cash payments.

***If we fail to develop and introduce new or enhanced products on a timely basis, our ability to attract and retain customers could be impaired, and our competitive position may be harmed.***

To compete successfully, we must design, develop, market and sell new or enhanced products that provide increasingly higher levels of performance and reliability and meet the cost expectations of our customers. The introduction of new products by our competitors, the market acceptance of products based on new or alternative technologies, or the emergence of new industry standards could render our existing or future products obsolete. Our failure to anticipate or timely develop new or enhanced products or technologies in response to technological shifts could result in decreased revenues and an increase in design wins by our competitors. In particular, we may experience difficulties with product design, manufacturing, marketing or certification that could delay or prevent our development, introduction or marketing of new or enhanced products. If we fail to introduce new or enhanced products that meet the needs of our customers or penetrate new markets in a timely fashion, we may lose market share and our operating results will be adversely affected. In addition, a design loss to one of our competitors may negatively impact our financial results for several years.

***Our results could be adversely affected if our customers or the service providers who purchase their products are unable to successfully compete in their respective markets.***

Our customers and the service providers that purchase products from our customers face significant competition from their competitors. We rely on these customers' and service providers' ability to develop products and/or services that meet the needs of their customers in terms of functionality, performance, availability and price. If these customers and service providers do not successfully compete, they may lose market share, which would negatively impact the demand for our products. For example, for our home networking products, there is intense competition among service providers to deliver video and other multimedia content into and throughout the home. For the sale of our home networking products, we are currently dependent on the ability of a limited number of service providers to compete in the market for the delivery of high-definition television-quality video, or HD video, and other multimedia content. Therefore, factors influencing the ability of these service providers to compete in this market, such as competition from alternative content providers or laws and regulations regarding local cable franchising or satellite broadcasting rights, could have an adverse effect on our ability to sell home networking products. In addition, our digital broadcast satellite outdoor unit products are primarily supplied to digital broadcast satellite service providers by our ODM and OEM customers. Digital broadcast satellite service providers are facing significant competition from telecommunications carriers and cable service operators as they compete for customers in terms of video, voice and data services. Moreover, ODMs and OEMs who market

## **Table of Contents**

satellite set-top boxes using our silicon tuners are competing with a variety of Internet protocol-based video delivery solutions, including versions of DSL technology and certain fiber optic-based solutions. Many of these technologies compete effectively with satellite set-top boxes and do not require tuners such as the ones we sell. If our customers and the service providers who purchase products from our customers that incorporate our products do not successfully compete, they may lose market share, which would reduce demand for our products.

***If the market for HD video and other multimedia content delivery solutions based on the MoCA standard does not develop as we anticipate, our revenues may decline or fail to grow, which would adversely affect our operating results.***

We derive, and expect to continue to derive for the foreseeable future, a significant portion of our revenues from sales of our home networking products based on the MoCA standard. The market for multimedia content delivery solutions based on the MoCA standard is relatively new, still evolving and difficult to predict. Currently, the growth of the MoCA-based multimedia content delivery market and the success of our business are largely driven by the adoption and deployment of existing and future generations of the technology by service providers, ODMs and OEMs and, to a lesser extent, by consumer adoption of such technology which is dependent on upgrades from standard definition television services to high-definition television services, or HD services, and on the availability of over-the-top, or OTT, services that directly deliver Internet video content into the home. It is difficult to predict whether the MoCA standard will continue to achieve and sustain high levels of demand and market acceptance by service providers or consumers, the rate at which consumers will upgrade to HD services, whether the availability of OTT services will continue to grow or whether consumers beyond the early technology adopters will embrace OTT services in increasing numbers, if at all.

Some service providers, ODMs and OEMs have adopted, and others may adopt, multimedia content delivery solutions that rely on technologies other than the MoCA standard or may choose to wait for the introduction of products and technologies that serve as a replacement or substitute for, or represent an improvement over, MoCA-based solutions. The alternative technology solutions, which compete with MoCA-based solutions, include DOCSIS, versions of DSL, Ethernet, HomePNA, HomePlug AV, Broadband over Power Line, HiNOC, Wi-Fi and WiMAX. It is critical to our success that additional service providers, including telecommunications carriers, digital broadcast satellite service providers and cable operators, adopt the MoCA standard for home networking and deploy MoCA solutions to their customers. If the market for MoCA-based solutions does not continue to develop or develops more slowly than we expect, or if we make errors in predicting adoption and deployment rates for these solutions, our revenues may be significantly adversely affected. Our operating results may also be adversely affected by any delays in consumer upgrade to HD services, delays in consumer adoption of OTT services, or if the market for OTT services develops more slowly than we expect.

***Even if service providers, ODMs and OEMs adopt multimedia content delivery solutions based on the MoCA standard, we may not compete successfully in the market for MoCA-compliant chipsets.***

As a member of MoCA, we are required to license any of our patent claims that are essential to implement the MoCA specifications to other MoCA members on reasonable and non-discriminatory terms. As a result, we are required to license some of our important intellectual property to other MoCA members, including other semiconductor manufacturers that may compete with us in the sale of MoCA-compliant chipsets. Furthermore, there may be disagreements among MoCA members as to specifically which of our patent claims we are required to license to them. If we are unable to differentiate our MoCA-compliant chipsets from other MoCA-compliant chipsets by offering superior pricing and features outside MoCA specifications, we may not be able to compete effectively in the



## **Table of Contents**

market for such chipsets. Moreover, although we are currently and actively involved in the ongoing development of the MoCA standard, we cannot guarantee that future MoCA specifications will incorporate technologies or product features we are developing or that our products will be compatible with future MoCA specifications. As additional members, including our competitors, continue to join MoCA, they and existing members may exert greater influence on MoCA and the development of the MoCA standard in a manner that is adverse to our interests. If our home networking products fail to comply with future MoCA specifications, the demand for these products could be severely reduced.

***The semiconductor and communications industries are highly cyclical and subject to rapid change and evolving industry standards and, from time to time, have experienced significant downturns in customer demand as well as unexpected increases in demand resulting in production capacity constraints. These factors could impact our operating results, financial condition and cash flows and may increase the volatility of the price of our common stock.***

The semiconductor and communications industries are highly cyclical and subject to rapid change and evolving industry standards and, from time to time, have experienced significant downturns in customer demand. These downturns are characterized by decreases in product demand, excess customer inventories and accelerated erosion of prices; factors which have caused, and could continue to cause, substantial fluctuations in our net revenue and in our operating results. Any downturns in the semiconductor and communications industries may be severe and prolonged, and any failure of these industries to fully recover from downturns could harm our business. For example, because a significant portion of our expense is fixed in the near term or is incurred in advance of anticipated sales, during these downturns we may not be able to decrease our expenses rapidly enough to offset unanticipated shortfalls in revenues during industry downturns, which would adversely affect our operating results. Even as the industry recovers from a downturn, some OEMs and ODMs may continue to slow down their research and development activities, cancel or delay new product development, reduce their inventories and/or take a cautious approach to acquiring products, which may negatively impact our business.

The semiconductor and communications industries also periodically experience increased demand and production capacity constraints, which may affect the ability of companies such as ours to ship products to customers. Any factor adversely affecting either the semiconductor or communications industries in general, or the particular segments of any of these industries that our products target, may adversely affect our ability to generate revenue and could negatively impact our operating results, cash flow and financial condition. The semiconductor and communications industries may experience supply shortages due to sudden increases in demand beyond foundry capacity. In addition to capacity issues, during periods of increased demand these industries may also experience difficulty obtaining sufficient manufacturing, assembly and test resources from manufacturers. If, as a result of these industry issues, we are unable to meet our customers' increased demand for our products, we would miss opportunities for additional revenue and could experience a negative impact on our relationships with affected customers. Further, in response to the cyclical and rapidly changing nature of the semiconductor and communications industries, our operating results may fluctuate from period to period as we adjust our inventory and production requirements to meet the changing demands of our customers, which could impact our financial condition and cash flows and may increase the volatility of the price of our common stock.

***Our operating results have fluctuated significantly in the past and we expect them to continue to fluctuate in the future, which could lead to volatility in the price of our common stock.***

Our operating results have fluctuated in the past and are likely to continue to fluctuate, on an annual and a quarterly basis, as a result of a number of factors, many of which are outside of our

**Table of Contents**

control. These fluctuations in our operating results may cause our stock price to fluctuate as well. The primary factors that are likely to affect our quarterly and annual operating results include:

changes in demand for our products or those offered by service providers and our customers;

the timing and amount of orders, especially from significant service providers and customers;

the seasonal nature of the sales of products that incorporate our products by certain service providers which may affect the timing of orders for our products;

the level and timing of capital spending of service providers, both in the United States and in international markets;

competitive market conditions, including pricing actions by us or our competitors;

adverse market perception of MoCA-compliant products;

any delay in the development, certification or adoption associated with new MoCA standards (e.g., MoCA 2.0) by the alliance, OEMs or service providers;

our unpredictable and lengthy sales cycles;

the mix of products and product configurations sold;

our ability to successfully define, design and release new products on a timely basis that meet customers or service providers needs;

costs related to acquisitions of complementary products, technologies or businesses;

new product introductions and enhancements, or the market anticipation of new products and enhancements, by us or our competitors;

the timing of revenue recognition on sales arrangements, which may include multiple deliverables and the effect of our use of inventory hubbing arrangements;

unexpected changes in our operating expenses;

## Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

general economic conditions (including the recent industry and economic downturn) and political conditions in the countries where we operate or our products are sold or used;

our ability to attain and maintain production volumes and quality levels for our products, including adequate allocation of wafer, assembly and test capacity for our products by our subcontractors;

our customers' ability to obtain other components needed to manufacture their products;

the cost and availability of components and raw materials used in our products, including, without limitation, the price of gold and copper;

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

our inability to obtain continuous cost reductions from wafer, assembly and test vendors;

productivity of our sales and marketing force;

our inability to reduce operating expenses in a particular quarter if revenues for that quarter fall below expectations;

future accounting pronouncements and changes in accounting policies;

disputes between content owners and service providers that result in the delay or elimination of the mass production and sale of products using our technology;

## **Table of Contents**

labor disputes or other disruptions that result in the cancellation of widely-viewed televised events (e.g., sporting events) causing potential or existing subscribers to cancel or delay the purchase of products that incorporate our technology from service providers, or that otherwise impact the demand for our products or technology;

costs associated with litigation; and

changes in domestic and international regulatory environments.

Unfavorable changes in any of the above factors, many of which are beyond our control, could significantly harm our business and results of operations. You should not rely on the results of prior periods as an indication of our future performance.

***Adverse U.S. and international economic conditions have affected and may continue to adversely affect our revenues, margins and profitability.***

Since September 2008, the credit markets and the financial services industry in the United States and Europe have been experiencing a period of unprecedented turmoil and upheaval. These conditions, together with the recent adverse economic conditions facing the broader economy and, in particular, the semiconductor and communications industries, have adversely affected, and may continue to adversely affect, our business as service providers cut back or delay deployments that include our products and to the extent that consumers decrease their discretionary spending for enhanced video offerings from service providers, which may in turn lead to cautious or reduced spending by service providers and, in turn, may lead to a decrease in orders for our products, thereby adversely affecting our operating results. Our operating results may also be adversely affected if the State of California adopts laws to suspend net operating loss deductions as it has done in the past in response to the sharp decrease in tax revenue collections caused by the current adverse economic conditions.

We may also experience adverse conditions in our cost base due to changes in foreign currency exchange rates that reduce the purchasing power of the U.S. dollar, increase research and development expenses and otherwise harm our business. These conditions may harm our margins and prevent us from sustaining profitability if we are unable to increase the selling prices of our products or reduce our costs sufficiently to offset the effects of effective increases in our costs. Our attempts to offset the effects of cost increases through controlling our expenses, passing cost increases on to our customers or any other method may not succeed.

***The success of our digital broadcast satellite outdoor unit products depends on the demand for our products within the satellite digital television market and the growth of this overall market.***

In addition to our MoCA home networking products, we also derive a significant portion of our revenues from sales of our digital broadcast satellite outdoor unit products into markets served by digital broadcast satellite providers and their ODM and OEM partners. The digital broadcast satellite market may not grow in the future as anticipated or a significant market slowdown may occur, which would in turn reduce the demand for applications or devices, such as multi-switch and low-noise block converters that rely on our digital broadcast satellite outdoor unit products. Because of the intense competition in the satellite, terrestrial and cable digital television markets, the unproven technology of many products addressing these markets and the short product life cycles of many consumer applications or devices, it is difficult to predict the potential size and future growth rate of the markets for our digital broadcast satellite outdoor unit products. If the demand for our digital broadcast satellite outdoor unit products is not as great as we expect, or if we are unable to produce competitive products to meet that demand, our revenues could be adversely affected.

## **Table of Contents**

***Market-specific risks affecting the digital television, digital television set-top box and digital television peripheral markets could impair our ability to successfully sell our silicon tuners.***

The market for digital television applications in digital televisions, digital television set-top boxes and digital television peripherals is characterized by certain market-specific risks, any of which may adversely affect our ability to sell our silicon tuners. For example, sellers of module tuners or tuner silicon providers that offer similar or better functionality than our silicon tuner solutions may dramatically lower their prices and become more competitive than we are in the tuner market. In addition, our silicon tuners may not meet the specifications or have the feature sets desired by our customers or may not be architecturally compatible with other components in the customers' designs. Our efforts to penetrate the digital television market, in particular, will depend on our ability to overcome these and other challenges. To the extent our efforts are adversely affected by any of these risks or are otherwise unsuccessful, the demand for our silicon tuner products may not develop as anticipated or decline which could adversely affect our revenues, financial condition and results of operations.

***The success of our silicon tuners is highly dependent on our relationships with demodulator manufacturers.***

Our silicon tuners are designed to be interoperable with various specific demodulator integrated circuit products that are designed and manufactured by other companies. Historically, we have relied on strategic relationships with various demodulator manufacturers to enable both parties to offer an interoperable tuner/demodulator solution to mutual end customers. Although we work in concert with third-party demodulator manufacturers to complete highly functional reference designs, we have no control over their future product plans and product roadmaps and could be effectively designed out of future customer applications by the refusal of a demodulator manufacturer to continue to support our products. Likewise, our ability to acquire new customers is dependent on the cooperation of third-party demodulator manufacturers. If such third-party manufacturers decide to partner with one of our competitors or to provide their own tuner solutions, we would effectively be prevented from selling our products to potential new customers. Furthermore, our dependence on these third-party demodulator manufacturers often limits our strategic direction. If we were to design products that were competitive with any of such demodulator manufacturers, they may choose to stop working with us.

If any of the current or prospective demodulator manufacturers with whom we have or intend to have relationships with were to stop working with us in favor of other tuner manufacturers or in favor of deploying their own tuner products, we would be effectively designed out of current and potential customers' products and the demand for our silicon tuners would be substantially reduced.

***The market for our broadband access products is limited and these products may not be widely adopted.***

Our broadband access products are designed to meet broadband access requirements in areas characterized by fiber optic network deployments that terminate within one kilometer of customer premises. We believe the primary geographic markets for our broadband access products are currently in certain Asian countries such as China, Japan, Korea, and parts of Europe where there are many multi-dwelling units and fiber optic networks that extend to or near a customer premises. We do not expect to generate significant revenues from sales of our broadband access products in North America, which is generally characterized by low-density housing, or in developing nations which do not generally have extensive fiber optic networks. To the extent our efforts to sell our broadband access products into currently targeted markets are unsuccessful, the demand for these products may not develop as anticipated or may decline, either of which could adversely affect our future

---

**Table of Contents**

revenues. Moreover, these markets have a large number of service providers and varying regulatory standards, both of which may delay any widespread adoption of our products and increase the time during which competing technologies could be introduced and displace our products.

In addition, if areas characterized by fiber optic networks that terminate within one kilometer of customer premises do not continue to grow, or we are unable to develop broadband access products that are competitive outside of these areas, the demand for our broadband access products may not grow and our revenues may be limited. Even if the markets in which our broadband access products are targeted continue to grow or we are able to serve additional markets, customers and service providers may not adopt our technology. There are a growing number of competing technologies for delivering high-speed broadband access from the service provider's network to the customer's premises. For example, our broadband access products face competition from products using DOCSIS, versions of DSL, Ethernet and 4G LTE solutions. Moreover, there are many other access technologies that are currently in development including some low cost proprietary solutions. If service providers adopt competing products or technologies, the demand for our broadband access products will decline and we may not be able to generate significant revenues from these products.

***We intend to expand our operations and increase our expenditures in an effort to grow our business. If we are not able to manage this expansion and growth, or if our business does not grow as we expect, we may not be able to realize a return on the resources we devote to expansion.***

We anticipate that we will continue to expand our infrastructure and grow our headcount to accommodate changes in our research and development strategy and achieve planned expansion of our product offerings, projected increases in our customer base and anticipated growth in the number of our product deployments. Our growth may place a strain on our administrative and operational infrastructure. Our success in managing our growth will be dependent upon our ability to:

enhance our operational, financial and management controls, reporting systems and procedures;

expand our facilities and equipment and develop new sources of supply for the manufacture, assembly and testing of our semiconductor products;

successfully hire, train, motivate and productively deploy additional employees, including technical personnel; and

expand our international resources.

Our inability to address effectively any of these factors, alone or in combination with others, could harm our ability to execute our business strategy.

Further, we intend to continue to grow our business by entering new markets, developing new product offerings and pursuing new customers. If we fail to timely or efficiently expand operational and financial systems in connection with such growth or if we fail to implement or maintain effective internal controls and procedures, resulting operating inefficiencies could increase costs and expenses more than we planned and might cause us to lose the ability to take advantage of market opportunities, enhance existing products, develop new products, satisfy customer requirements, respond to competitive pressures, control our inventory or otherwise execute our business plan. Failure to implement or maintain such controls and procedures could also impact our ability to produce timely and accurate financial statements. Additionally, if we increase our operating expenses in anticipation of the growth of our business and such growth does not meet our expectations, our financial results likely would be negatively impacted.

---

**Table of Contents**

***Our joint development arrangements with customers, companies that we have investments in and other third parties may not be successful.***

We have entered into joint development arrangements with customers, companies we have investments in and other third parties, and we expect to enter into new joint development arrangements from time to time in the future. Currently we have investments in, and various obligations and commitments to, third parties related to these joint development arrangements. Joint development arrangements can magnify several risks for us, including loss of control over the development and development timeline of jointly developed products. Accordingly, we face increased risk that our joint development activities may result in products that are not commercially successful or that are not available in a timely fashion. In addition, any third party with whom we enter into a joint development arrangement may fail to commit sufficient resources to the joint development, change its policies or priorities and abandon or fail to perform its obligations related to the joint development. The failure to timely develop commercially successful products through our joint development activities as a result of any of these and other challenges could have a material adverse affect on our business, results of operations, and financial condition.

We are currently in the process of developing an integrated chip that combines our MoCA functionality with a third party's independently developed transcoding technology. We lack experience in developing a highly integrated chip of this nature, and therefore may encounter unexpected engineering challenges and difficulties. This integrated chip, which is being jointly developed with Zenverge, Inc., or Zenverge, will be significantly more complex than other chips that we have developed in the past. Consequently, it might take longer and cost more to develop than we currently anticipate. In addition, given the complexity of this integrated chip and its related software, we may not be successful in addressing quality and reliability issues, which could result in a final product that is less reliable than other chips we have developed. If this occurs, or if other customer requirements or program objectives are not met, the integrated chip may not achieve widespread market acceptance and our sales may not meet our expectations or be sufficient to provide us with an adequate return on our investment. There can be no assurances that our joint development arrangement with Zenverge will be successful or that the resulting integrated chip will be cost-competitive or include all of the functionality we hope to include in such chip.

***Any acquisition, strategic relationship, joint venture or investment could disrupt our business and harm our financial condition.***

We actively pursue acquisitions, strategic relationships, joint ventures, collaborations and investments that we believe may allow us to complement our growth strategy, increase market share in our current markets or expand into adjacent markets, or broaden our technology and intellectual property. For example, we are currently pursuing the acquisition of the set-top-box business, or STB business, of Trident Microsystems, Inc. and certain of its subsidiaries, collectively Trident. Such transactions may be complex, time consuming and expensive, and may present numerous challenges and risks including:

difficulties in assimilating any acquired workforce and merging operations;

attrition and the loss of key personnel;

an acquired company, asset or technology, or a strategic collaboration or licensed asset or technology not furthering our business strategy as anticipated;

our overpayment for a company, asset or technology or changes in the economic or market conditions or assumptions underlying our decision to make an acquisition;

an acquisition, strategic relationship, joint venture or investment in an unproven development stage company not furthering our business strategy as anticipated as a result of limited financial or other resources, lack of management experience or expertise or for other reasons unknown to us at the time of such transaction;

**Table of Contents**

our inability to liquidate an investment in a privately held company when we believe it is prudent to do so which results in a significant reduction in value or loss of our entire investment;

difficulties entering and competing in new product or geographic markets and increased competition, including price competition;

significant problems or liabilities, including increased intellectual property and employment related litigation exposure, associated with acquired businesses, assets or technologies;

in connection with any such transaction, the need to use a significant portion of our available cash, issue additional equity securities that would dilute the then-current stockholders' percentage ownership, make unanticipated follow-on investments or incur substantial debt or contingent liabilities in an effort to preserve any value in the initial transaction;

requirements to devote substantial managerial and engineering resources to any strategic relationship, joint venture or collaboration, which could detract from our other efforts or significantly increase our costs;

lack of control over the actions of our business partners in any strategic relationship, joint venture, collaboration or investment, which could significantly delay the introduction of planned products or otherwise make it difficult or impossible to realize the expected benefits of such relationship; and

requirements to record substantial charges and amortization expense related to certain intangible assets, deferred stock compensation and other items.

Any one of these challenges or risks could impair our ability to realize any benefit from our acquisitions, strategic relationships, joint ventures or investments after we have expended resources on them.

We have no assurance that we will ultimately be successful in acquiring the STB business of Trident. In addition, from time to time we may enter into other negotiations for acquisitions, relationships, joint ventures or investments that are not ultimately consummated. These negotiations could result in significant diversion of our management's time, as well as substantial out-of-pocket costs, which could materially and adversely affect our operating results during the periods in which such costs are incurred.

We cannot forecast the number, timing or size of future acquisitions, strategic relationships, joint ventures or investments, or the effect that any such transactions might have on our operating or financial results. Any such transaction could disrupt our business and harm our operating results and financial condition.

***We may not realize the anticipated financial and strategic benefits from the businesses we have acquired or be able to successfully integrate such businesses with ours.***

We will need to overcome challenges, some of which may be significant, in order to realize the benefits or synergies from the acquisitions we have completed to date and any acquisitions that we may complete from time to time in the future, including the proposed acquisition of the STB business of Trident. These challenges include the following:

integrating businesses, operations and technologies;

retaining and assimilating key personnel;



retaining existing customers and attracting additional customers;

creating uniform standards, controls, procedures, policies and information systems;

meeting the challenges inherent in efficiently managing an increased number of employees, including some at geographic locations distant from our headquarters and senior management; and

## Table of Contents

implementing appropriate systems, policies, benefits and compliance programs.

Integration in particular may involve considerable risks and may not be successful. These risks include the following:

the potential disruption of our ongoing business and distraction of our management;

the potential strain on our financial and managerial controls and reporting systems and procedures;

unanticipated expenses and potential delays related to integration of the operations, technology and other resources of the acquired companies;

the impairment of relationships with employees, suppliers and customers; and

potential unknown or contingent liabilities.

The inability to integrate successfully any businesses we acquire, or any significant delay in achieving integration, could delay introduction of new products and require expenditure of additional resources to achieve integration. For example, although we recorded significant amounts of goodwill and other intangible assets in connection with the acquisitions we completed in 2007 and 2008, as a result of the industry and macro-economic turmoil that began in mid-2008 and its effects on our market value and business outlook, we had to reduce the carrying amount of all of these long-lived assets and, as of December 31, 2011, we had recorded an aggregate impairment charge of \$113.4 million against our goodwill and intangible assets carrying value related to these acquisitions.

Investors should not rely on attempts to combine our historical financial results with those of any of our acquired businesses as separate operating entities to predict our future results of operations as a combined entity.

***Our acquisition of the assets used in or related to the set-top-box business of Trident Microsystems, Inc. may not be completed, which may result in a decrease in our stock price.***

On January 18, 2012, we entered into an agreement with Trident and certain of its subsidiaries, to acquire the assets of Trident used in or related to Trident's STB business. Our agreement with Trident was executed following its approval by the United States Bankruptcy Court for the District of Delaware and the establishment of bid procedures for an auction that allows other qualified bidders to submit higher and otherwise better offers, as required under Section 363 of the U.S. Bankruptcy Code. The closing of our acquisition of Trident's STB Business, or the Acquisition, which is expected to occur in the first quarter of 2012, remains subject to higher or otherwise better offers and customary closing conditions. In the event a higher or otherwise better offer is accepted by Trident, or if either of us is unable to satisfy the closing conditions set forth in our agreement, the Acquisition may not be consummated and we may experience a decrease in our stock price.

***The average selling prices of our products have historically decreased over time and will likely do so in the future, which may reduce our revenues and gross margin.***

Our products and products sold by other companies in our industry have historically experienced a decrease in average selling prices over time. We anticipate that the average selling prices of our products will continue to decrease in the future in response to competitive pricing pressures, increased sales discounts and new product introductions from our competitors. For example, we expect that other chipset manufacturers who are members of MoCA will produce competing chipsets and create pricing pressure for such products. Broadcom's announcements about the availability of competing chipsets in certain applications will put further pressure on pricing. Our future operating

## **Table of Contents**

results may be harmed due to the decrease of our average selling prices. To maintain our current gross margins or increase our gross margins in the future, we must develop and introduce on a timely basis new products and product enhancements, continually reduce our product costs and manage product transitions in a timely and cost-effective manner. Our failure to do so would likely cause our revenues and gross margins to decline, which could have a material adverse effect on our operating results and cause the value of our common stock to decline.

### ***Fluctuations in the mix of products we sell may adversely affect our financial results.***

Because of differences in selling prices and manufacturing costs among our products, the mix and types of products sold affect the average selling price of our products and have a substantial impact on our revenues and profit margins. To the extent our sales mix shifts toward increased sales of our relatively lower-margin products, our overall gross margins will be negatively affected. Fluctuations in the mix and types of our products sold may also affect the extent to which we are able to recover our costs and expenditures that are associated with a particular product, and as a result, can negatively impact our financial results.

### ***Our product development efforts are time-consuming, require substantial research and development expenditures and may not generate an acceptable return.***

Our product development efforts require substantial research and development expense. Our research and development expense was \$60.1 million and \$48.7 million for the years ended December 31, 2011 and 2010, respectively. There can be no assurance that we will achieve an acceptable return on our research and development efforts.

The development of our products is also highly complex. Due to the relatively small size of our product design teams, our research and development efforts in our core technologies may lag behind those of our competitors, some of whom have substantially greater financial and technical resources. In the past, we have occasionally experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. Unanticipated problems in developing products could also divert substantial engineering resources, which may impair our ability to develop new products and enhancements and could substantially increase our costs. Furthermore, we may expend significant amounts on a research and development program that may not ultimately result in a commercially successful product, and we have in the past terminated ongoing research and development programs before they could be brought to successful conclusions. As a result of these and other factors, we may be unable to develop and introduce new products successfully and in a cost-effective and timely manner, and any new products we develop and offer may never achieve market acceptance. Any failure to develop future products that are commercially successful would have a material adverse effect on our business, financial condition and results of operations.

### ***Our products typically have lengthy sales cycles, which may cause our operating results to fluctuate, and a service provider, ODM or OEM customer may decide to cancel or change its service or product plans, which could cause us to lose anticipated sales.***

Our products typically have lengthy sales cycles. A service provider must first evaluate our products. This initial evaluation period can vary considerably based on the service provider and product being evaluated, and could take a significant amount of time to complete. Products incorporating new technologies generally require longer periods for evaluation. After this initial evaluation period, if a service provider decides to adopt our products, that service provider and the applicable ODM or OEM customers will need to further test and evaluate our products prior to completing the design of the equipment that will incorporate our products. Additional time is needed to begin volume production of equipment that incorporates our products. Due to these lengthy sales

## **Table of Contents**

cycles, we may experience significant delays from the time we incur research and development and sales expenses until the time, if ever, that we generate sales from these products. The delays inherent in these lengthy sales cycles increase the risk that a customer will decide to cancel or change its product plans. From time to time, we have experienced changes, delays and cancellations in the purchase plans of our customers. A cancellation or change in plans by a service provider, ODM or OEM customer could prevent us from realizing anticipated sales. In addition, our anticipated sales could be lost or substantially reduced if a significant service provider, ODM or OEM customer reduces or delays orders during our sales cycle or chooses not to release equipment that contains our products. We may invest significant time and effort in marketing to a particular customer that does not ultimately result in a sale to that customer. As a result of these lengthy and uncertain sales cycles for our products, it is difficult for us to predict if or when our customers may purchase products in volume from us, and our operating results may vary significantly from quarter to quarter, which may negatively affect our operating results for any given quarter.

***If we do not complete our design-in activities before a customer's design window closes, we will lose the design opportunity, which could adversely affect our future sales and revenues and harm our customer relationships.***

The timing of our design-in activities with key customers and prospective customers may not align with their open design windows, which may or may not be known to us, making design win predictions more difficult. If we miss a particular customer's design window, we may be forced to wait an entire year or even longer for the next opportunity to compete for the customer's next design. The loss of a particular design opportunity could eliminate or substantially delay revenues from certain target customers and markets, which could have a material adverse effect on our results of operations and future prospects as well as our customer relationships.

***Our products must interoperate with many software applications and hardware found in service providers' networks and other devices in the home, and if they do not interoperate properly our business would be harmed.***

Our products must interoperate with service providers' networks and other devices in the home, which often have varied and complex specifications, utilize multiple protocol standards, software applications and products from multiple vendors, and contain multiple generations of products that have been added over time. As a result, we must continually ensure that our products interoperate properly with existing and planned future networks. To meet these requirements, we must undertake development efforts that involve significant expense and the dedication of substantial employee resources. We may not accomplish these development efforts quickly or cost-effectively, if at all. If we fail to maintain or anticipate compatibility with products, software or equipment found in our customers' networks, we may face substantially reduced demand for our products, which would adversely affect our business, operating results and financial condition.

From time to time, we may enter into collaborations or interoperability arrangements with equipment and software vendors providing for the use, integration or interoperability of their technology with our products. These arrangements would give us access to and enable interoperability with various products or technologies in the connected home entertainment market. If these relationships fail to achieve their goals, we would have to devote substantially more resources to the development of alternative products and the support of our existing products, or the addressable market for our products may become limited. In many cases, these parties are either companies that we compete with directly in other areas or companies that have extensive relationships with our existing and potential customers and may have influence over the purchasing decisions of these customers. A number of our competitors have stronger relationships than we do with some of our existing and potential customers and, as a result, our ability to have successful

## **Table of Contents**

arrangements with these companies may be harmed. Our failure to establish or maintain key relationships with third-party equipment and software vendors may harm our ability to successfully sell and market our products. We are currently devoting significant resources to the development of these relationships. Our operating results could be adversely affected if these efforts do not result in the revenues necessary to offset these investments.

In addition, if we find errors in the software or hardware used in service providers' networks or problematic network configurations or settings we may have to modify our products so that they will interoperate with these networks. This could cause longer installation times for our products and order cancellations, either of which would adversely affect 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 sell our products to customers who integrate them into their products. We do not obtain firm, long-term purchase commitments from our customers. We have limited visibility as to the volume of our products that our customers are selling or carrying in their inventory. In addition, certain service providers are affected by seasonality in their deployment of products that incorporate our products, which may in turn impact the timing of our sales. Because production lead times often exceed the amount of time required to fulfill orders, we often must build inventory in advance of orders, relying on an imperfect demand forecast to project volumes and product mix. Our demand forecast accuracy, and our ability to manage our inventory carrying levels accurately, 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. We have in the past had customers dramatically decrease and increase their requested production quantities with little or no advance notice to us. Even after an order is received, our customers may cancel these orders, postpone taking delivery or request a decrease in production quantities. Any such cancellation, postponement of delivery or decrease in production quantity 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, reduced profit margins and excess or obsolete inventory which we may be unable to sell to other customers or which we may be required to sell at reduced prices or write off entirely. Furthermore, changes to our customers' requirements may result in disputes with our customers which could adversely impact our future relationships with those 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 of supply, which could affect our ongoing relationships with these customers and potentially reduce our market share. 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.

***Our ability to accurately predict revenues and inventory needs, and to effectively manage inventory levels, may be adversely impacted due to our use of inventory hubbing arrangements.***

We are party to an inventory hubbing arrangement with Motorola and we may enter into similar arrangements with other customers in the future. Pursuant to these arrangements, we ship our products to a designated third-party warehouse, or hub, rather than shipping them directly to the customer. The products generally remain in the hub until the customer removes them for incorporation into its own products. In the absence of any hubbing arrangement, we generally recognize revenues on sales of our products upon shipment of those products to the buyer. Under

---

**Table of Contents**

our hubbing arrangement with Motorola, however, we maintain ownership of our products in the hub, and therefore do not recognize the related revenue until the date Motorola removes them from the hub. As a result, our ability to accurately predict future revenues recognized from sales to Motorola or any other customers with which we implement hubbing arrangements may be impaired, and we may experience significant fluctuations in our quarterly operating results depending on when Motorola or any such other customers remove our products from the hub, which they may do with little or no lead time. In the short term, we may experience an increase in operating expenses as we build and ship inventory to the hub and will not recognize revenues from sales of this inventory, if at all, until Motorola or any such other customers remove it from the hub at a later time. Furthermore, because we continue to own but do not maintain control over our products after they are shipped to the hub, our ability to effectively manage inventory levels may be impaired as our shipments under the hubbing arrangement increase and we may be exposed to additional risk that the inventory in the hub becomes obsolete before sales are recognized.

*We extend credit to our customers, sometimes in large amounts, but there is no guarantee every customer will be able to pay our invoices when they become due.*

As part of our routine business, we extend credit to customers purchasing our products. While our customers may have the ability to pay on the date of shipment or on the date credit is granted, their financial condition could change and there is no guarantee that customers will ever pay the invoices. Rapid changes in our customers' financial conditions and risks associated with extending credit to our customers can subject us to a higher financial risk and could have a material adverse effect on our business, financial condition and results of operations.

*We depend on a limited number of third parties to manufacture, assemble and test our products which reduces our control over key aspects of our products and their availability.*

We do not own or operate a manufacturing, assembly or test facility for our products. Rather, we outsource the manufacture, assembly and testing of our products to third-party subcontractors including Taiwan Semiconductor Manufacturing Company, Ltd., or TSMC, Jazz Semiconductor, Inc. (a wholly owned subsidiary of Tower Semiconductor, Inc), or TowerJazz, Amkor Technologies, Inc. and Giga Solution Tech. Co., Ltd. Accordingly, we are greatly dependent on a limited number of suppliers to deliver quality products on time. Our reliance on sole or limited suppliers involves several risks, including susceptibility to increased manufacturing costs if competition for foundry capacity intensifies and reduced control over the following:

supply of our products available for sale;

pricing, quality and timely delivery of our products;

prices and availability of components for our products; and

production capacity for our products, including shortages due to the difficulties of suppliers to meet production capacities because of unexpected increases in demand.

Because we rely on a limited number of third-party manufacturers, if we were required to change contract manufacturers or one of our contract manufacturers became unable or unwilling to continue manufacturing our products, we may sustain lost revenues, increased costs and damage to our customer relationships. In addition, we would need to expend significant time and effort to locate new third-party manufacturers, if available, and have them qualified by us and our customers.

Manufacturing defects may not be detected by the testing process performed by our subcontractors. If defects are discovered after we have shipped our products, we may be exposed to warranty and consequential damages claims from our customers. Such claims may have an adverse impact on our revenues and operating results. Furthermore, if we are unable to deliver quality products, our reputation would be harmed, which could result in the loss of future orders and business with our customers.

---

## **Table of Contents**

***When demand for manufacturing capacity is high, we may take various actions to try to secure sufficient capacity, which may be costly and negatively impact our operating results.***

The ability of each of our subcontractors' manufacturing facilities to provide us with chipsets is limited by their available capacity and existing obligations. Although we have purchase order commitments to supply specified levels of products to our customers, we do not have a guaranteed level of production capacity from any of our subcontractors' facilities to produce our products. Facility capacity may not be available when we need it or at reasonable prices. In addition, our subcontractors may allocate capacity to the production of other companies' products and thereby reduce deliveries to us on short notice.

In order to secure sufficient manufacturing facility capacity when demand is high and mitigate the risks associated with an inability to meet our customers' demands for our products, we may enter into various arrangements with subcontractors that could be costly and harm our operating results, including:

option payments or other prepayments to a subcontractor;

nonrefundable deposits with or loans to subcontractors in exchange for capacity commitments;

contracts that commit us to purchase specified quantities of components over extended periods; and

purchase of testing equipment for specific use at the facilities of our subcontractors.

We may not be able to make any such arrangements 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 capacity, we may be obligated to use all of that capacity or incur penalties. These penalties and obligations may be expensive and require significant capital and could harm our business.

***We believe that transitioning certain of our silicon products to newer or better manufacturing process technologies will be important to our future competitive position. If we fail to make this transition efficiently, our competitive position could be seriously harmed.***

We continually evaluate the benefits, on a product-by-product basis, of migrating to higher performance or lower cost process technologies in order to produce higher performance, more efficient or better integrated circuits because we believe this migration is required to remain competitive. Other companies in our industry have experienced difficulty in migrating to new process technologies and, consequently, have suffered reduced yields, delays in product deliveries and increased expense levels. We may experience similar difficulties. Moreover, we are dependent on our relationships with subcontractors and the products of electronic design automation tool vendors to successfully migrate to newer or better process technologies. Our third-party manufacturers may not make newer or better process technologies available to us on a timely or cost-effective basis, if at all. If our third-party manufacturers do not make newer or better manufacturing process technologies available to us on a timely or cost-effective basis, or if we experience difficulties or delays in migrating to these processes, it could have a material adverse effect on our competitive position and business prospects.

***We rely on sales representatives and distributors to assist in selling our products, and the failure of these representatives to perform as expected could reduce our future sales.***

We sell some of our products through third-party sales representatives and distributors. Our relationships with some of these third-party sales representatives and distributors are relatively new and we are unable to predict the extent to which our third-party sales representatives and distributors will be successful in marketing and selling our products. Moreover, many third-party sales representatives and distributors also market and sell competing products. Third-party sales

## **Table of Contents**

representatives and distributors may terminate their relationships with us at any time, or with short notice, and may give greater attention to the products sold by our competitors. Our future performance will also depend, in part, on our ability to attract additional third-party sales representatives and distributors that market our products effectively, especially in markets in which we have not previously distributed our products. If we cannot retain our current third-party sales representatives and distributors and recruit additional or replacement third-party sales representatives and distributors, our revenues and operating results could be harmed.

***Our products may contain defects or errors which may adversely affect their market acceptance and our reputation and expose us to product liability claims.***

Our products are very complex and may contain defects or errors, especially when first introduced, when in full production, or when new versions are released. Despite testing, errors may occur. Product errors could affect the performance of our products, delay the development or release of new products or new versions of products, adversely affect our reputation and our customers' willingness to buy products from us, and adversely affect market acceptance of our products. Any such errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance could cause us to lose revenue or market share, increase our service costs, cause us to incur substantial costs in redesigning our products, subject us to liability for damages and divert our resources from other tasks. Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a device or application in which our product is used, it may be difficult to identify the sources of these problems. The occurrence of hardware and software errors, whether or not caused by our products, could result in the delay or loss of market acceptance of our products, and therefore delay our ability to recognize revenue from sales, and any necessary revisions may cause us to incur significant expenses. Moreover, since one of the key benefits of our home networking products is reduction of the need for truck rolls, problems with our products would likely result in a greater number of truck rolls and this in turn could adversely affect our sales. The occurrence of any such problems could harm our business, operating results and financial condition.

Any limitation of liability provisions in our standard terms and conditions of sale may not fully or effectively protect us from claims as a result of federal, state or local laws or ordinances or unfavorable judicial decisions in the United States or other countries. The use of our products also entails the risk of product liability claims. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not adequately cover any claim asserted against us. In addition, even claims that ultimately are unsuccessful could result in our expenditure of funds in litigation and divert our management's time and other resources.

***We depend on key personnel to operate our business, and if we are unable to retain our current personnel and hire additional qualified personnel, our ability to develop and successfully market our products could be harmed.***

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering and sales and marketing personnel. Despite the economic downturn that began in mid-2008 and subsequent partial recovery, there continues to be competition for qualified personnel in the markets in which we compete. In addition, the cost of living in the San Diego, California area, where our corporate headquarters is located, occasionally has been an obstacle to attracting new employees in the past, and we must consider that this may impact our ability to attract and retain employees in the future. We do not have employment agreements with most of our executive or key employees and the unexpected loss of any key employees, including Patrick Henry, our president and chief executive officer, other members of our senior management or our senior engineering personnel, or an inability to attract additional qualified personnel, including engineers and sales and marketing personnel, could delay the development, introduction and sale of



## **Table of Contents**

our products and our ability to execute our business strategy may suffer. In addition, in the event that there is a loss of key personnel, there is a potential for loss of important knowledge that may delay or negatively impact development or sale of our products and our ability to execute on our business strategy. We do not currently have any key person life insurance covering any executive officer or employee.

*If we fail to comply with environmental regulatory requirements, our operating results could be adversely affected.*

We face increasing complexity in our product design and procurement operations as we adjust to requirements relating to the materials composition of many of our products. The European Union has adopted certain directives to facilitate the recycling of electrical and electronic equipment sold in the European Union, including the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment, or RoHS, directive that restricts the use of lead, mercury and certain other substances in electrical and electronic products placed on the market in the European Union after July 1, 2006, and many other countries, including China, Taiwan and Korea, where the majority of our products are manufactured and packaged and sold, have also adopted similar directives banning or limiting the use of specified substances in products introduced into their domestic markets. We have incurred costs in connection with our compliance with these environmental laws and regulations, such as costs related to eliminating lead from our semiconductor product packaging. Other environmental regulations may be enacted in the future, including in the United States, that require us to re-engineer our products to utilize components that are compatible with these regulations. and this re-engineering and component substitution may result in additional costs to us or disrupt our operations or logistics. If we or the third-party manufacturers of our products are unable to meet future environmental regulations in a timely manner, it could have a material adverse effect on our business, results of operations and financial condition.

*Certain of our customers' products and service providers' services are subject to governmental regulation.*

Governmental regulation could place constraints on our customers and service providers' services and, consequently, reduce our customers demand for our products. For example, the Federal Communications Commission has broad jurisdiction over products that emit radio frequency signals in the United States. Similar governmental agencies regulate these products in other countries. Moreover, laws and regulations regarding local cable franchising or satellite broadcasting rights could have an adverse effect on service providers' ability to compete in the HD video and multimedia content delivery market. Although most of our products are not directly subject to current regulations of the Federal Communications Commission or any other federal or state communications regulatory agency, much of the equipment into which these products are incorporated is subject to direct governmental regulation. Accordingly, the effects of regulation on our customers or the industries in which they operate may, in turn, impede sales of our products. For example, demand for these products will decrease if equipment into which they are incorporated fails to comply with the specifications of the Federal Communications Commission.

*Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products could reduce our ability to compete and could harm our business.*

We intend to continue spending substantial amounts to grow our business. We may need to obtain additional financing to pursue our business strategy, develop new products, respond to competition and market opportunities and acquire complementary businesses or technologies. We may not be able to obtain such financing on favorable terms or at all.

## **Table of Contents**

If we were to raise additional capital through sales of our equity securities, our stockholders would suffer dilution of their equity ownership. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, pay dividends, repurchase our stock or make investments, and force us to maintain specified liquidity or other ratios, any of which could harm our business, operating results and financial condition. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

develop or enhance our products;

continue to expand our product development and sales and marketing organizations;

acquire complementary technologies, products or businesses;

expand operations, in the United States or internationally;

hire, train and retain employees; or

respond to competitive pressures or unanticipated working capital requirements.

Our failure to do any of these things could seriously harm our ability to execute our business strategy and may force us to curtail our research and development plans or existing operations.

***Our effective tax rate may increase or fluctuate, and we may not derive the anticipated tax benefits from any expansion of our international operations.***

Our effective tax rate could be adversely affected by various factors, many of which are outside of our control. Our effective tax rate is directly affected by the relative proportions of revenue and income before taxes in the various domestic and international jurisdictions in which we operate. We are also subject to changing tax laws, regulations and interpretations in multiple jurisdictions in which we operate as well as the requirements of certain tax rulings. Changes in applicable tax laws may cause fluctuations between reporting periods in which the changes take place. If our business opportunities outside the United States continue to grow, we may expand our international operations and staff to better support our expansion into international markets. We anticipate that this expansion will include the implementation of an international organizational structure that could result in an increasing percentage of our consolidated pre-tax income being derived from, and reinvested in, our international operations. Moreover, we anticipate that this pre-tax income would be subject to foreign tax at relatively lower tax rates when compared to the U.S. federal statutory tax rate and as a consequence, our future effective income tax rate may be lower than the U.S. federal statutory rate. There can be no assurance that significant pre-tax income will be derived from or reinvested in our international operations, that our international operations and sales will result in a lower effective income tax rate, or that we will implement an international organizational structure. In addition, our future effective income tax rate could be adversely affected if tax authorities challenge any international tax structure that we implement or if the relative mix of U.S. and international income changes for any reason. Accordingly, there can be no assurance that our effective income tax rate will be less than the U.S. federal statutory rate.

***Our ability to utilize our net operating loss and tax credit carryforwards may be limited, which could result in our payment of income taxes earlier than if we were able to fully utilize our net operating loss and tax credit carryforwards.***

As of December 31, 2011, we had federal and state net operating loss carryforwards of approximately \$3.6 million and \$32.2 million, respectively, and federal and state research and development tax credit carryforwards of \$14.1 million and \$14.0 million, respectively. The tax benefits related to utilization of net operating loss and tax credit carryforwards may be limited due to ownership changes or as a result of other events. For example, Section 382 of the Internal Revenue Code of 1986, as amended, imposes an annual limitation on the amount of net operating loss carryforwards and tax credit carryforwards that may be used to offset federal taxable income and



## **Table of Contents**

federal tax liabilities when a corporation has undergone a significant change in its ownership. While prior changes in our ownership, including as a result of our acquisition of RF Magic, Inc., have resulted in annual limitations on the amount of our net operating loss and tax credit carryforwards that may be utilized in the future, we do not anticipate that such annual limitations will preclude the utilization of substantially all the net operating loss and tax credit carryforwards described above in the event we remain profitable. However, to the extent our use of net operating loss and tax credit carryforwards is further limited by future offerings or transactions or by our implementation of an international tax structure or other future events, our income would be subject to cash payments of income tax earlier than it would be if we were able to fully utilize our net operating loss and tax credit carryforwards without such further limitation.

***We devote significant monetary and managerial resources to ensure our compliance with public company regulations.***

As a public company, we incur significant legal, accounting and other expenses to ensure our compliance with various public company regulations, including the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley Act, and various rules and regulations adopted by the SEC and The NASDAQ Stock Market, or NASDAQ. The Sarbanes-Oxley Act requires us to maintain effective disclosure controls and procedures and internal controls for financial reporting, and our management and other personnel devote a substantial amount of time to ensure our compliance with the Sarbanes-Oxley Act's requirements. Compliance with the Sarbanes-Oxley Act requires us to adopt processes and procedures that make some activities more time-consuming and costly, thereby adding to our cost of operations. To ensure that we are in compliance with the Sarbanes-Oxley Act, and as required by the Sarbanes-Oxley Act, we perform system and process evaluation and testing of our internal controls over financial reporting annually to allow management and our independent registered public accounting firm to report on the effectiveness of our internal controls. If we identify deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to sanctions or investigations by NASDAQ, the SEC or other regulatory authorities.

The SEC and other regulators have continued to adopt new rules and regulations and make additional changes to existing regulations that require our compliance. For example, in July 2010, the Dodd-Frank Wall Street Reform and Protection Act, or the Dodd-Frank Act, was enacted. There were significant corporate governance and executive compensation-related provisions in the Dodd-Frank Act that required the SEC to adopt additional rules and regulations in areas such as "say on pay." Our management and other personnel have devoted, and may be required to devote in the future, a substantial amount of time and costs to these compliance programs and as a result of the new corporate governance and executive compensation-related rules, regulations and guidelines prompted by the Dodd-Frank Act and further regulations and disclosure obligations expected in the future.

***If we fail to manage our exposure to global financial and securities market risks successfully, our operating results could be adversely impacted.***

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates, credit markets and prices of marketable equity and fixed-income securities. The primary objective of most of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, a majority of our marketable investments are investment grade, liquid, fixed-income securities and money market instruments denominated in U.S. dollars. If the carrying value of our investments exceeds the fair value, and the decline in fair value is deemed to be other-than-temporary, we will be required to write down the value of our investments, which could materially harm our results of operations and financial condition. Moreover, the performance of certain securities in our investment portfolio is affected by the credit condition of the U.S. financial sector. Although there have been recent signs of improvement within the U.S. financial sector, the

## **Table of Contents**

sector remains fragile and conditions may deteriorate rapidly, which could adversely affect the value, realized or unrealized, of our investments and cause us to record significant impairment losses.

### **Risks Related to Our Intellectual Property**

*Our ability to compete and our business could be jeopardized if we are unable to secure or protect our intellectual property.*

We rely on a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights. However, these legal means afford only limited protection and may not adequately protect our rights or permit us to gain or keep any competitive advantage. Our patent applications may not issue as patents at all or they may not issue as patents in a form that will be advantageous to us. Our issued patents and those that may issue in the future may be challenged, invalidated, rendered unenforceable or circumvented, which could limit our ability to stop competitors from marketing related products. Although we have taken steps to protect our intellectual property and proprietary technology, there is no assurance that third parties will not be able to invalidate, render unenforceable or design around our patents. Additionally, in September 2011, the Leahy-Smith America Invents Act, or the Leahy-Smith Act, was signed into law. The Leahy-Smith Act includes a number of significant changes to United States patent law. These include provisions that affect the way patent applications will be prosecuted and may also affect patent litigation. The United States patent office is currently developing regulations and procedures to govern administration of the Leahy-Smith Act, and many of the substantive changes to patent law associated with the Leahy-Smith Act will not become effective until one year or 18 months after its enactment. Accordingly, it is not clear what, if any, impact the Leahy-Smith Act will have on the operation of our business. However, the Leahy-Smith Act and its implementation could increase the uncertainties and costs surrounding the prosecution of our patent applications and the enforcement or defense of our issued patents, all of which could have a material adverse effect on our business and financial condition.

Furthermore, although we have entered into nondisclosure agreements and intellectual property assignment agreements with our employees, consultants and advisors, such agreements may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements. Moreover, we are required to license any of our patent claims that are essential to implement MoCA specifications to other MoCA members, who could potentially include our competitors, on reasonable and non-discriminatory licensing terms. In addition, in connection with commercial arrangements with our customers and the service providers who deploy equipment containing our products, we may be required to license our intellectual property to third parties, including competitors or potential competitors.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our trademarks, products or technology. Monitoring unauthorized use of our trademarks and technology is difficult and we cannot be certain that the steps we have taken to prevent such unauthorized use will be successful, particularly in foreign countries where the laws may not protect our proprietary rights as comprehensively as in the United States. In addition, if we become aware of a third party's unauthorized use or misappropriation of our trademarks or technology, it may not be practicable, effective or cost-efficient for us to enforce our intellectual property and contractual rights, particularly where the initiation of a claim might harm our business relationships or risk a costly and protracted lawsuit, including a potential countersuit by a competitor with patents that may implicate our products. If competitors engage in unauthorized use or misappropriation of our trademarks or technology, our ability to compete effectively could be harmed.

## **Table of Contents**

***Our participation in patent pools and standards setting organizations, or other business arrangements, may require us to license our patents to competitors and other third parties and limit our ability to enforce or collect royalties for our patents.***

In addition to our existing obligations to license our patent claims that are essential to implement the MoCA specifications to other MoCA members, in the course of participating in patent pools and other standards setting organizations or pursuant to other business arrangements, we may agree to license certain of our technologies on a reasonable and non-discriminatory basis and, as a result, our control over the license of such technologies may be limited. We may also be unable to limit to whom we license some of our technologies and may be unable to restrict many terms of the license. Consequently, our competitors may obtain the right to use our technology. In addition, our control over the application and quality control of our technologies that are included in patent pools or otherwise necessary for implementing industry standards may be limited.

***Any dispute with a MoCA member regarding what patent claims are necessary to implement MoCA specifications could result in litigation which could have an adverse effect on our business.***

We are required to grant to other MoCA members a non-exclusive and world-wide license on reasonable and non-discriminatory terms to any of our patent claims that are essential to implement MoCA specifications. The meaning of reasonable and non-discriminatory has not been settled by the courts, and accordingly, it is not a well-defined concept. If we had a disagreement with a MoCA member regarding which of our patent claims are necessary to implement MoCA specifications or regarding whether the terms of any license by us under reasonable and non-discriminatory terms fall within the scope and meaning of reasonable and non-discriminatory, this could result in litigation. Any such litigation, regardless of its merits, could be time-consuming, expensive to resolve, divert our management's time and attention and harm our reputation. In addition, any such litigation could result in us being required to license on reasonable and non-discriminatory terms certain of our patent claims which we previously believed did not need to be licensed under our MoCA agreement. Significant disagreements or any litigation between us and any MoCA member regarding patent claims necessary to implement MoCA or the scope and meaning of our reasonable and non-discriminatory terms could have an adverse effect on our business and harm our competitive position.

***Possible third-party claims of infringement of proprietary rights against us, our customers or the service providers that purchase products from our customers, or other intellectual property claims or disputes, could have a material adverse effect on our business, results of operation or financial condition.***

The semiconductor industry is characterized by a high level of litigation based on allegations of infringement of proprietary rights. Numerous U.S. and foreign issued patents and pending patent applications owned by third parties exist in the fields in which we are selling and developing products. Because patent applications take many years to issue, currently pending applications, known or unknown to us, may later result in issued patents that we infringe. In addition, third parties continue to actively seek new patents in our field. It is difficult or impossible to keep fully abreast of these developments and therefore, as we develop new and enhanced products, we may sell or distribute products that inadvertently infringe patents held by third parties.

We have in the past received, and in the future we, our customers or the service providers that purchase products from our customers may receive, inquiries from other patent holders and may become subject to claims that we infringe their intellectual property rights. Furthermore, we are, and may in the future be, engaged in joint development projects with technology partners that will result in the incorporation of technology contributed by us and our technology partners into one or more jointly developed products. Accordingly, even if our own technology and stand-alone products do not infringe third party patents, the technology that is contributed by any of our technology partners, or

## **Table of Contents**

the combination of our technology with that of our technology partners, may infringe third party patents, subjecting us through the use, manufacture, sale, offer for sale or importation of our products to claims that we infringe the intellectual property rights of others. Any intellectual property claim or dispute, regardless of its merits, could force us, our customers or the service providers that purchase our products from our customers to license the third-party's patents for substantial royalty payments or cease the sale of the alleged infringing products or use of the alleged infringing technologies, or force us to defend ourselves and possibly our customers or contract manufacturers in litigation. Any cessation of product sales by us, our customers or the service providers that purchase products from our customers could have a substantial negative impact on our revenues. Any litigation, regardless of its outcome, could result in substantial expense and significant diversion of our management's time and other resources. Moreover, any such litigation could subject us, our customers or the service providers that purchase our products from our customers to significant liability for damages (including treble damages), temporary or permanent injunctions, or the invalidation of proprietary rights or require us, our customers or the service providers that purchase products from our customers to license the third-party patents for substantial royalty or other payments.

In addition, we may also be required to indemnify our customers and contract manufacturers for damages they suffer as a result of such infringement or litigation.

***Our use of open source software and third-party technologies, including software, could impose limitations on our ability to commercialize our products.***

We incorporate open source software into our products, including certain open source code which is governed by the GNU General Public License, Lesser GNU General Public License and Common Development and Distribution License. In addition, open source software may be incorporated into the technology developed by our technology partners either with or without our knowledge and may be incorporated into our products either with or without our knowledge. The terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that these licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to seek licenses from third parties in order to continue offering our products, make our proprietary code generally available in source code form (for example, proprietary code that links in particular ways to certain open source modules), which could result in our trade secrets being disclosed to the public and the potential loss of intellectual property rights in our software, require us to re-engineer our products, discontinue the sale of our products if re-engineering cannot be accomplished on a cost-effective and timely basis, or become subject to other consequences, any of which could adversely affect our business, operating results and financial condition.

In addition to technologies we have already licensed, we may find that we need to incorporate certain proprietary third-party technologies, including software programs, into our products in the future. However, licenses to relevant third-party technologies may not be available to us on commercially reasonable terms, if at all. Therefore, we could face delays in product releases until alternative technology can be identified, licensed or developed, and integrated into our current products. Such alternative technology may not be available to us on reasonable terms, if at all, and may ultimately not be as effective as the preferred technology. Any such delays or failures to obtain licenses, if they occur, could materially adversely affect our business, operating results and financial condition.

***Because we license some of our software source code directly to customers, we face increased risks that our trade secrets will be exposed through inadvertent or intentional disclosure, which could harm our competitive position or increase our costs.***

We license some of our software source code to our customers, which increases the number of people who have access to some of our trade secrets and other proprietary rights. Contractual

## **Table of Contents**

obligations of our licensees not to disclose or misuse our source code may not be sufficient to prevent such disclosure or misuse. The costs of enforcing contractual rights could substantially increase our operating costs and may not be cost-effective, reasonable under the circumstances or ultimately succeed in protecting our proprietary rights. If our competitors access our source code, they may gain further insight into the technology and design of our products, which would harm our competitive position.

### **Risks Related to International Operations**

*We expect a significant portion of our future revenues to come from our international customers and, as a result, our business may be harmed by political and economic conditions in foreign markets and the challenges associated with operating internationally.*

We have derived, and expect to continue to derive, a significant portion of our revenues from international markets. Many of our customers in Asia incorporate our chipsets into their products that are then sold to U.S.-based service providers. Net revenues outside of the United States comprised approximately 99% of our total revenues for the years ended December 31, 2011 and 2010. International business activities involve certain risks, including:

difficulties involved in the staffing and management of geographically dispersed operations;

longer sales cycles in certain countries, especially on initial entry into a new geographical market;

greater difficulty evaluating a customer's ability to pay, longer accounts receivable payment cycles and greater difficulty in the collection of past-due accounts;

general economic conditions in each country;

challenges associated with operating in diverse cultural and legal environments;

seasonal reductions in business activity specific to certain markets;

loss of revenue, property and equipment from expropriation, natural disasters, nationalization, war, insurrection, terrorism and other political risks;

foreign taxes and the overlap of different tax structures, including modifications to the U.S. tax code as a result of international trade regulations;

foreign technical standards;

changes in currency exchange rates; and

import and export licensing requirements, tariffs, and other trade and travel restrictions.

To the extent our international sales are adversely affected by any of these risks or are otherwise unsuccessful, we could experience a reduction in revenue and our operating results could suffer.



## Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

In addition, the laws that govern the protection of intellectual property rights in certain foreign countries where we sell our products, such as China and Korea, can make recognition and enforcement of contractual and intellectual property rights more expensive and difficult than is the case in the United States. In particular, we may have difficulty preventing ODMs and OEMs in these countries from incorporating our inventions, technologies, copyrights or trademarks into their products without our authorization or without paying us licensing fees. We may also experience difficulty enforcing our intellectual property rights in these countries, where intellectual property rights are not as respected as they are in the United States, Japan and Europe. Unauthorized use of our technologies and intellectual property rights may dilute or undermine the strength of our brand. Further, if we are not able to adequately monitor the use of our technologies by foreign-based ODMs and OEMs, or enforce our intellectual property rights in foreign countries, our revenue potential could be adversely affected.

---

## **Table of Contents**

***Our products are subject to export and import controls that could subject us to liability or impair our ability to compete in international markets.***

Our products are subject to U.S. export controls and may be exported outside the United States only with the required level of export license or through an export license exception, in part because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or could limit our customers' ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, or change in the countries, persons or technologies targeted by such regulations or legislation, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers internationally.

In addition, we may be subject to customs duties and export quotas, which could have a significant impact on our revenue and profitability. The future imposition of significant increases in the level of customs duties or export quotas could have a material adverse effect on our business.

***Substantially all of our products, and the products of many of our customers, are manufactured by third-party contractors located in the Pacific Rim, a region subject to earthquakes and other natural disasters, as well as economic and political instability. 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 the Pacific Rim. The risk of an earthquake in this area is significant due to the proximity of major earthquake fault lines to the facilities of our foundry, assembly and test subcontractors. The occurrence of earthquakes or other natural disasters, such as the mudslides and widespread flooding in Thailand, or the occurrence of other catastrophic events such as a pandemic in the region, could result in the disruption of our foundry or assembly and test capacity or in the ability of our customers to purchase the raw materials or parts necessary to manufacture products, such as digital video recorders, or DVRs, into which our products are incorporated. In addition, many countries within the Pacific Rim have experienced, and continue to experience, periods of economic and political instability. Any deterioration in the economic and political conditions in the Pacific Rim that disrupts the operations of our third-party contractors could also result in the disruption of our foundry or assembly and test capacity. Any disruption caused by an earthquake or other catastrophic event or from the deterioration of economic and political conditions 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, and our customers may not, be able to obtain alternate capacity on favorable terms, if at all.

### **Risks Related to Ownership of Our Common Stock**

***Our stock price is volatile and may decline regardless of our operating performance, and you may not be able to resell your shares at or above the price at which you purchased such shares.***

The market price for our common stock is volatile and may fluctuate significantly in response to a number of factors, most of which we cannot control, including:

price and volume fluctuations in the overall stock market;

market conditions or trends in our industry or the economy as a whole;

changes in operating performance and stock market valuations of other technology companies generally, or those that sell semiconductor products in particular;

**Table of Contents**

the timing of customer or service provider orders that may cause quarterly or other periodic fluctuations in our results that may, in turn, affect the market price of our common stock;

the seasonal nature of the deployment of products that incorporate our products by certain service providers which may affect the timing of orders for our products;

the timing of revenue recognition on sales arrangements, which may include multiple deliverables, and the effect of our use of inventory hubbing arrangements;

the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;

changes in financial estimates or ratings by any securities analysts who follow our common stock, our failure to meet these estimates or failure of those analysts to initiate or maintain coverage of our common stock;

the public's response to press releases or other public announcements by us or third parties, including our filings with the SEC and announcements relating to product development, litigation and intellectual property impacting us or our business;

the sustainability of an active trading market for our common stock;

future sales of our common stock by our executive officers, directors and significant stockholders;

announcements of mergers or acquisition transactions;

announcements of technical innovations, new products or design wins by our competitors or customers;

other events or factors, including those resulting from war, incidents of terrorism, natural disasters or responses to these events; and

changes in accounting principles.

In addition, the stock markets, and in particular NASDAQ, have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were involved in securities litigation, we could incur substantial costs and our resources and the attention of management could be diverted from our business.

***If securities and/or industry analysts fail to continue publishing research about our business, if they change their recommendations adversely or if our results of operations do not meet their expectations, our stock price and trading volume could decline.***

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline. In addition, it is likely that in some future period our operating results will be below the expectations of securities analysts or investors. If one or more of the analysts who cover us downgrade our stock, or if our results of operations do not meet their expectations, our stock price could decline.

*Future sales of our common stock or the issuance of securities convertible into or exercisable for shares of our common stock may depress our stock price.*

A significant number of shares of our common stock are held by a small number of stockholders. Sales of a substantial number of shares of our common stock, the issuance of securities convertible

## **Table of Contents**

into or exercisable for shares of our common stock or the expectation or perception in the market that the holders of a large number of our shares of common stock intend to sell their shares, could significantly reduce the market price of our common stock. Although the average daily trading volume of our common stock has slowly increased in recent months, our common stock is still less liquid than the stock of companies with broader public ownership and, as a result, the trading of a relatively small volume of our common stock may have a greater impact on the trading price for our stock and lead to increased volatility in our stock price. In particular, certain venture capital funds have held shares of our common stock for a substantial period of time and may distribute shares to their limited partners or members at any time and without notice. Any such distribution may result in a substantial number of our shares being sold, which could have an adverse effect on the trading price of our common stock.

### ***Anti-takeover provisions in our charter documents and Delaware law might deter acquisition bids for us that you might consider favorable.***

Our amended and restated certificate of incorporation and bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors. These provisions:

establish a classified board of directors so that not all members of our board are elected at one time;

authorize the issuance of undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval, and which may include rights superior to the rights of the holders of common stock;

prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;

provide that the board of directors is expressly authorized to make, alter, or repeal our bylaws;

establish advance notice requirements for nominations for elections to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings; and

provide that in addition to any vote required by law or by our amended and restated certificate of incorporation, the approval by holders of at least 66-2/3% of our then outstanding common stock is required to adopt, amend or repeal any provision of our amended and restated bylaws.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law which, subject to certain exceptions, prohibits stockholders owning in excess of 15% of our outstanding voting stock from merging or combining with us. These anti-takeover provisions and other provisions under Delaware law could discourage, delay or prevent a transaction involving a change in control of our company, even if doing so would benefit our stockholders. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take other corporate actions you desire.

### ***Our principal stockholders, executive officers and directors have substantial control over the company, which may prevent you and other stockholders from influencing significant corporate decisions and may harm the market price of our common stock.***

As of December 31, 2011, our executive officers, directors and holders of five percent or more of our outstanding common stock, beneficially owned, in the aggregate, 21% of our outstanding

## **Table of Contents**

common stock. These stockholders may have interests that conflict with our other stockholders and, if acting together, have the ability to influence the outcome of matters submitted to our stockholders for approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets. Accordingly, this concentration of ownership may harm the market price of our common stock by:

delaying, deferring or preventing a change of control;

impeding a merger, consolidation, takeover or other business combination involving us; or

discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

***We do not expect to pay any cash dividends for the foreseeable future.***

The continued expansion of our business will require substantial funding. Accordingly, we do not anticipate that we will pay any cash dividends on shares of our common stock for the foreseeable future. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board of directors deems relevant. Investors seeking cash dividends in the foreseeable future should not purchase or hold our common stock.

### **Item 1B. Unresolved Staff Comments**

Not applicable.

### **Item 2. Properties**

We entered into our current lease for 90,000 square feet of space for our corporate headquarters in San Diego, California in February 2008. Our lease expires in February 2015, subject to two five-year renewal options. In addition to our corporate headquarters, we lease additional offices in San Jose, California; Bordentown, New Jersey; Tai Po, Hong Kong; Shenzhen, China; Manof, Israel; Kanagawa, Japan; Seoul, Korea; and Taipei, Taiwan.

We believe that our existing properties are in good condition and are sufficient and suitable for the conduct of our business. As our existing leases expire and as we continue to expand our operations, we believe that suitable space will be available on commercially reasonable terms.

### **Item 3. Legal Proceedings**

From time to time, we may be involved in litigation relating to claims arising out of our operations. We are not a party to any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or operating results.

For an additional discussion of certain risks associated with legal proceedings, see Part I, Item 1A, *Risk Factors* of this Annual Report.

### **Item 4. (Removed and Reserved)**

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Market Information and Holders**

During 2010 our common stock traded on The NASDAQ Global Market under the symbol ENTR. In January 2011, our common stock began trading on The NASDAQ Global Select Market under the symbol ENTR. The following table sets forth the high and low sale prices for our common stock as reported by The NASDAQ Global Market or The NASDAQ Global Select Market, as applicable, for the periods indicated:

	<b>High</b>	<b>Low</b>
<b>Year Ended December 31, 2011</b>		
Fourth Quarter	\$ 6.17	\$ 3.55
Third Quarter	\$ 9.44	\$ 3.36
Second Quarter	\$ 9.58	\$ 6.95
First Quarter	\$ 13.96	\$ 7.50
<b>Year Ended December 31, 2010</b>		
Fourth Quarter	\$ 12.25	\$ 7.47
Third Quarter	\$ 10.35	\$ 5.92
Second Quarter	\$ 6.81	\$ 4.31
First Quarter	\$ 5.24	\$ 2.91

As of January 31, 2012, there were 94 holders of record of our common stock.

**Dividend Policy**

We have never declared or paid cash dividends on shares of our common stock. We currently intend to retain all of our earnings, if any, for use in the continued expansion of our business. We do not anticipate paying any cash dividends in the foreseeable future. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board of directors deems relevant.

**Table of Contents****Stock Performance Graph\***

The graph set forth below shows a comparison of the cumulative total stockholder return on our common stock between December 31, 2007 and December 31, 2011, with the cumulative total return of (i) the Philadelphia Semiconductor Index; (ii) the NASDAQ Composite Index and (iii) the NASDAQ Electronics Components Index, over the same period. This graph assumes the investment of \$100 on December 31, 2007 in our common stock at its opening price of \$7.28 per share and in each of the Philadelphia Semiconductor Index, the NASDAQ Composite Index the NASDAQ Electronics Components Index, and further assumes the reinvestment of dividends, if any. We have not paid or declared any cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. The stock prices and stockholder returns over the periods indicated in the graph below should not be considered indicative of future stock price performance or stockholder returns.

**COMPARISON OF CUMULATIVE TOTAL RETURN FOR THE PERIOD****DECEMBER 31, 2007 THROUGH DECEMBER 31, 2011**

	<b>12/31/2007</b>	<b>12/31/2008</b>	<b>12/31/2009</b>	<b>12/31/2010</b>	<b>12/31/2011</b>
Entropic Communications, Inc.	100.00	6.87	42.17	165.93	70.19
Philadelphia Semiconductor Index	100.00	52.00	88.20	100.93	89.31
NASDAQ Composite Index	100.00	61.17	87.93	104.36	107.95
NASDAQ Electronic Components	100.00	53.91	84.35	87.95	80.42

\* The material in this section is not soliciting material, is not deemed filed with the SEC and is not to be incorporated by reference into any of our SEC filings whether made before or after the date hereof and irrespective of any general incorporation language in any such SEC filing except to the extent we specifically incorporate this section by reference.



---

## **Table of Contents**

### **Recent Sales of Unregistered Securities**

The following sets forth information regarding all unregistered securities of the Company that were sold during the year ended December 31, 2011:

- (1) As of December 31, 2010, options to purchase up to 1,451,474 shares of our common stock were outstanding under our 2001 Stock Option Plan, or 2001 Plan. Of these options, during 2011, options exercisable for up to 1,924 shares of common stock were cancelled without being exercised and options to purchase 562,724 shares of common stock were exercised at a weighted average exercise price of \$1.17 per share. As of December 31, 2011, options to purchase up to 886,826 shares of our common stock remained outstanding under the 2001 Plan.
- (2) As of December 31, 2010, options to purchase up to 349,604 shares of our common stock were outstanding under our RF Magic Plan, Inc. 2000 Incentive Stock Plan, or RF Magic Plan. Of these options, during 2011, options to purchase 115,790 shares of common stock were exercised at a weighted average exercise price of \$0.68 per share. As of December 31, 2011, options to purchase up to 233,814 shares of our common stock remained outstanding under the RF Magic Plan.
- (3) In connection with our acquisition of RF Magic, we entered into put and call option agreements pursuant to which we are obligated to issue shares of our common stock in exchange for the shares of RF Magic's common stock issuable upon exercise of stock options held by employees of RF Magic's French subsidiary. Although we acquired RF Magic's French subsidiary in connection with the acquisition, we did not assume the options held by the employees of the French subsidiary. As of December 31, 2010, there were 11,248 shares of our common stock subject to the put and call option agreements. During 2011, options to purchase the remaining 11,248 shares of common stock were exercised and exchanged at a weighted average exercise price of \$0.95 per share. As of December 31, 2011, we no longer have an obligation to issue shares of our common stock in exchange for the shares of RF Magic's common stock issuable upon exercise of options held by the employees of our French subsidiary.

All of the offers, sales and issuances of the securities described in paragraphs (1) and (2) were deemed to be exempt from registration under the Securities Act of 1933, as amended, or the Securities Act, in reliance on Rule 701 in that the transactions were under compensatory benefit plans and contracts relating to compensation as provided under Rule 701. The recipients of such securities were our employees, directors or bona fide consultants and received the securities under the 2001 Plan or RF Magic Plan, as the case may be. Appropriate legends were affixed to the securities issued in these transactions to the extent required. Each of the recipients of securities in these transactions had adequate access, through employment, business or other relationships, to information about us.

The issuance of the shares of our common stock described in paragraph (3) was deemed to be exempt from registration under the Securities Act in reliance on Section 3(A)(10) of the Securities Act after a fairness hearing before the California Department of Corporations.

### **Issuer Purchases of Equity Securities**

Pursuant to the terms of the 2001 Plan, options may be exercised prior to vesting. Shares of common stock issued prior to vesting that remain unvested are subject to a repurchase option in our favor that lapses in accordance with the original vesting schedule for the option. During the year ended December 31, 2011, we did not repurchase any shares of our common stock.

### **Item 6. Selected Financial Data**

The selected financial data set forth below are derived from our audited consolidated financial statements and may not be indicative of our future operating results. The following selected financial

**Table of Contents**

data should be read in conjunction with our consolidated financial statements and related notes thereto and Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations* included elsewhere in this Annual Report.

	Years Ended December 31,				
	2011	2010	2009	2008	2007
(in thousands, except per share data)					
<b>Consolidated Statement of Operations Data:</b>					
Net revenues	\$ 240,628	\$ 210,237	\$ 116,305	\$ 146,033	\$ 122,545
Cost of net revenues(1)	107,922	98,070	57,399	79,411	76,196
Gross profit	132,706	112,167	58,906	66,622	46,349
Operating expenses:					
Research and development(1)	60,065	48,717	45,161	55,769	35,235
Sales and marketing(1)	17,569	17,199	13,955	16,262	10,348
General and administrative(1)	14,568	13,134	10,868	12,752	8,685
Write off of in-process research and development				1,300	21,400
Amortization of intangibles			16	2,735	2,634
Restructuring charges			2,173	1,259	
Impairment of goodwill and intangible assets			208	113,193	
Total operating expenses	92,202	79,050	72,381	203,270	78,302
Income (loss) from operations	40,504	33,117	(13,475)	(136,648)	(31,953)
Loss related to equity method investment	(791)				
Other income, net	904	141	142	229	31
Income tax provision (benefit)	14,053	(31,446)	(93)	(49)	44
Net income (loss)	26,564	64,704	(13,240)	(136,370)	(31,966)
Accretion of redeemable convertible preferred stock					(118)
Net income (loss) attributable to common stockholders	\$ 26,564	\$ 64,704	\$ (13,240)	\$ (136,370)	\$ (32,084)
Net income (loss) per share basic	\$ 0.31	\$ 0.86	\$ (0.19)	\$ (2.01)	\$ (2.47)
Net income (loss) per share diluted	\$ 0.30	\$ 0.82	\$ (0.19)	\$ (2.01)	\$ (2.47)
Weighted average number of shares used to compute net income (loss) per share basic	86,258	75,040	69,834	67,733	13,011
Weighted average number of shares used to compute net income (loss) per share diluted	89,018	78,916	69,834	67,733	13,011

(1) Includes stock-based compensation as follows:

	Years Ended December 31,				
	2011	2010	2009	2008	2007
(in thousands)					
Cost of net revenues	\$ 557	\$ 384	\$ 138	\$ 251	\$ 159
Research and development	6,272	5,049	4,552	7,048	3,141
Sales and marketing	1,986	1,558	1,401	2,334	1,174

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

General and administrative	3,932	3,479	3,276	3,854	2,044
----------------------------	-------	-------	-------	-------	-------

**Table of Contents**

	2011	Years Ended December 31,			2007
		2010	2009	2008	
		(in thousands)			
<b>Consolidated Balance Sheet Data:</b>					
Cash, cash equivalents, restricted cash and marketable securities	\$ 216,526	\$ 168,761	\$ 35,252	\$ 34,410	\$ 54,498
Working capital	161,987	196,489	58,208	57,965	69,848
Total assets	318,559	278,808	83,814	86,602	226,326
Debt, software license and capital lease obligations current and long-term		137			8,791
Total stockholders' equity	297,793	248,590	68,913	70,749	190,398

---

**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the information under Part II, Item 6, Selected Financial Data and our consolidated financial statements and related notes appearing elsewhere in this Annual Report. In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including but not limited to those set forth under Part I, Item 1A, Risk Factors and elsewhere in this Annual Report.*

**Overview**

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

We are a pioneer of key technologies that enable connected home networking of digital entertainment over existing coaxial cable. We are a founding member of MoCA, a global home networking consortium that sets standards for the distribution of video and other multimedia entertainment over coaxial cable. Our products include integrated circuits and related software associated with:

home networking solutions based on the MoCA standard;

direct broadcast satellite, or DBS, services;

high-speed broadband access; and

silicon tuners.

Our products allow telecommunications carriers, cable operators and DBS service providers, which we collectively refer to as service providers, as well as providers of OTT services, to enhance and expand their service offerings and reduce deployment costs in an increasingly competitive environment. Our MoCA home networking solutions are now being deployed into consumer homes to support multi-room DVR service and OTT service offerings by Comcast, Cox, DIRECTV, DISH Network, Time Warner Cable, and Verizon, as well as by a number of smaller service providers.

In December 2004, we introduced and commenced commercial shipments of our home networking products. In the first quarter of 2006, we began commercially shipping our broadband access solutions. In May 2007, we acquired Arabella Software Ltd., or Arabella, a developer of embedded software. In June 2007, we acquired RF Magic, a provider of digital broadcast satellite outdoor unit and silicon tuner solutions. In 2008, we acquired certain specified assets of Vativ Technologies, Inc., or Vativ, a provider of high-bandwidth, advanced digital processing solutions for digital television and 10 gigabit Ethernet markets. Since inception, we have invested heavily in product development and achieved profitability on an annual basis beginning in 2010. Our net income for the year ended December 31, 2011 was \$26.6 million and \$64.7 million for the year ended December 31, 2010. Over the past two years, we have seen our revenues increase from \$116.3 million in 2009 to \$210.2 million in 2010 and to \$240.6 million in 2011. These increases are primarily due to the increased demand for our home networking products and our DBS products, which is directly related to the increased deployment of our products into consumer homes by satellite and cable operators. As of December 31, 2011, we had an accumulated deficit of \$150.6 million.

We generate the majority of our revenues from sales of our products to ODMs and OEMs that provide customer premises equipment to service providers. We price our products based on market

## **Table of Contents**

and competitive conditions and reduce the price of our products over time, as market and competitive conditions change, and as manufacturing costs are reduced. Our markets are generally characterized by declining average selling prices over the life of a product and, accordingly, we must reduce costs and successfully introduce new products and enhancements to maintain our gross margins.

We rely on a limited number of customers for a significant portion of our net revenues. Sales to these customers are in turn driven by service providers that purchase our customers' products which incorporate our products. A substantial percentage of our net revenues are dependent upon five major service providers: Comcast, DIRECTV, DISH Network, Time Warner Cable and Verizon. In addition, we are dependent on sales outside of the United States for almost all of our net revenues and expect that to continue in the future.

We use third-party foundries and assembly and test contractors to manufacture, assemble and test our products. This outsourced manufacturing approach allows us to focus our resources on the design, sales and marketing of our products and avoid the cost associated with owning and operating our own manufacturing facility. A significant portion of our cost of net revenues consists of payments for the purchase of wafers and for manufacturing, assembly and test services.

We expect research and development expenses in future years to continue to increase in total dollars as we develop additional products and expand our business, and to fluctuate over the course of the year based on the timing of our development tools and supply costs, which include outside services, masks costs and software licenses. We also anticipate that our sales and marketing expenses will increase as we expand our domestic and international sales and marketing organization and activities and build brand awareness. Due to the lengthy sales cycles that we face, we may experience significant delays from the time we incur research and development and sales and marketing expenses until the time, if ever, that we generate sales from the related products.

Since our inception, we have funded our operations using a combination of preferred stock issuances, cash collections from customers, bank credit facilities, cash received from the exercise of stock options and proceeds from public offerings of our common stock. For example, on October 5, 2010, we completed a public offering of 10,750,000 shares of our common stock, which resulted in net proceeds of approximately \$99.3 million. We intend to continue spending substantial amounts in connection with the growth of our business to pursue our business strategy, develop new products, respond to competition and market opportunities, and possibly acquire complementary businesses or technologies. For example, on January 18, 2012, we entered into an agreement with Trident Microsystems, Inc. and certain of its subsidiaries, collectively Trident, to acquire certain assets of Trident used in or related to Trident's set-top-box business, or STB Business. Our agreement with Trident was executed following its approval by the United States Bankruptcy Court for the District of Delaware and the establishment of bid procedures for an auction that allows other qualified bidders to submit higher and otherwise better offers, as required under Section 363 of the U.S. Bankruptcy Code. Pursuant to our agreement with Trident, we agreed to an aggregate purchase price of \$55.0 million for the STB Business, which will be the starting point against which other participants in the auction will bid. The closing of the transaction is subject to typical closing conditions and the receipt by Trident of higher and otherwise better offers.

## **Critical Accounting Policies and Estimates**

Our consolidated financial statements are prepared in accordance with United States generally accepted accounting principles, or GAAP. These accounting principles require us to make certain estimates and judgments that affect the reported amounts of assets and liabilities as of the dates of the consolidated financial statements, the disclosure of contingencies as of the dates of the

## **Table of Contents**

consolidated financial statements, and the reported amounts of net revenues and expenses during the periods presented. Although we believe that our judgments and estimates are reasonable under the circumstances, actual results may differ from those estimates. If actual results or events differ materially from those contemplated by us in making these estimates, our reported financial condition and results of operations for future periods could be materially affected.

We believe the following to be our critical accounting policies because they are important to the portrayal of our financial condition and results of operations and they require critical management judgments and estimates about matters that are uncertain:

revenue recognition;

inventory valuation;

accounting for investment in a privately held company;

accounting for goodwill and other intangible assets;

stock-based compensation; and

accounting for income taxes

### ***Revenue Recognition***

Our net revenues are generated principally by sales of our semiconductor products. During the years ended December 31, 2011, 2010 and 2009, product net revenues represented more than 99% of our total net revenues.

Our sales primarily occur through the efforts of our direct sales force. The remainder of our sales occurs through third-party sales representatives and distributors. During the years ended December 31, 2011, 2010 and 2009, more than 99% of our sales occurred through the efforts of our direct sales force.

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

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

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

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





## **Table of Contents**

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

We receive royalties in exchange for an exclusive right to manufacture and sell certain products. We have determined that we are not able to reliably estimate the royalties earned in the period the sales occur and, as a result, we record net revenues based on cash receipts. The royalty revenues recorded during the years ended December 31, 2011, 2010 and 2009 were \$0.3 million, \$1.2 million and \$1.9 million, respectively, and are included in net revenues in the accompanying consolidated statements of operations.

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

We provide rebates on our products to certain customers. At the time of the sale, we accrue 100% of the potential rebate as a reduction to net revenue and do not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. We reverse the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when we believe unclaimed rebates are no longer subject to payment and will not be paid. For the years ended December 31, 2011, 2010 and 2009, we reduced net revenue by \$0.8 million, \$0.6 million and \$0.7 million, respectively, in connection with our rebate programs.

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

For multiple deliverable agreements entered into after December 31, 2009, consideration is allocated at the inception of the agreement to all deliverables based on their relative selling price. The relative selling price for each deliverable is determined using vendor specific objective evidence, or VSOE, of selling price or third-party evidence of selling price if VSOE does not exist. If neither VSOE nor third-party evidence of selling price exists, we use our best estimate of the selling price for the deliverable. To date, multiple deliverable contracts have not been material to net revenues in any related period and our adoption of the new accounting guidance for determining multiple element arrangements effective January 1, 2010 did not have an impact on our operating results.

For multiple deliverable agreements entered into on or prior to December 31, 2009, consideration was generally allocated to each unit of accounting based upon its relative fair value when objective and reliable evidence of fair value existed for all units of accounting in the agreement. The fair value of an item was generally the price charged for the product, if the item was regularly sold on a stand-alone basis.

In order to establish VSOE of selling price, we must regularly sell the product and/or service on a standalone basis with a substantial majority priced within a relatively narrow range. VSOE of selling

## **Table of Contents**

price is usually the midpoint of that range. If there is not a sufficient number of standalone sales and VSOE of selling price cannot be determined, then we consider whether third-party evidence can be used to establish the selling price. If neither VSOE nor third-party evidence of selling price exists, effective January 1, 2010, we determine our best estimate of selling price using average selling prices over a rolling 12-month period as well as market conditions. If the product or service has no history of sales, we rely upon sales prices set by our pricing committee, adjusted for applicable discounts.

We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the revenue recognition but do not change the total revenue recognized on any agreement.

### ***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 calculated on a part-by-part basis and, in general, represent excess inventory value on hand compared to 12-month demand projections. Once established, these adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. We recorded charges for excess and obsolete inventory of \$1.7 million and \$0.2 million in 2011 and 2010, respectively.

We have entered into a capacity agreement with one of our third-party foundry contractors in order to guarantee minimum capacity volumes on our digital outdoor unit and silicon tuner products. Pursuant to the capacity agreement, we have made prepayments which will result in reduced prices paid on future inventory purchases up to a specified volume. The prepayments are being amortized into the cost of our inventory purchases based on the specified volume commitments under the terms of the capacity agreement. The prepaid inventory volume commitments are assessed for impairment on a periodic basis by comparing the remaining prepaid balance to our estimate of remaining purchases. There have been no impairments to date.

### **Investment in a Privately Held Company**

We account for our investments in privately held companies under the equity method of accounting since we exercise significant influence, but we do not have the elements of control that would require consolidation. The rights of the other investors are both protective and participating. Unless we are determined to be the primary beneficiary, these rights preclude us from consolidating these investments. The investments are recorded initially at cost as an investment in a privately held company, and subsequently are adjusted for our equity in net operating results and cash contributions and distributions. In addition, we record charges relating to our proportionate ownership percentage of the premium paid for our investment in excess of our share of their net worth. The fair value of this premium consists of certain intangible asset and goodwill values as determined by a valuation calculation. These intangible assets represent the excess of the book value of the privately held company as compared to the valuation of the privately held company. We are in the process of completing the valuation of our investment and have used our best estimate to calculate the amortization related expense for 2011. As of December 31, 2011 our net investment in privately held companies was \$9.2 million, which is included in other long-term assets on our balance sheet.

## **Table of Contents**

### **Goodwill and Intangible Assets**

We record goodwill and other intangible assets based on the fair value of the assets acquired. In determining the fair value of the assets acquired, we utilize extensive accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired. We use the discounted cash flow method to estimate the value of intangible assets acquired. The estimates used to value and amortize intangible assets are consistent with the plans and estimates that we use to manage our business and are based on available historical information and industry estimates and averages.

We assess goodwill and certain intangible assets for impairment using fair value measurement techniques on an annual basis, during the fourth quarter of the year or more frequently if indicators of impairment exist. We perform an interim goodwill impairment test when it is more likely than not that the fair value of a reporting unit is less than the carrying amount. We operate as one reporting unit. The goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as in a business combination. Determining the fair value of the implied goodwill is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including the size and timing of deployments by our customers and related projections and timing of future cash flows, discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, stage of products in development, determination of appropriate market comparables, and determination of whether a premium or discount should be applied to comparables.

### ***Stock-Based Compensation***

We have equity incentive plans under which incentive stock options have been granted to employees and restricted stock units and non-qualified stock options have been granted to employees and non-employees. We also have an employee stock purchase plan for all eligible employees.

Our stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense over the employee's requisite service period. We have no stock-based compensation awards with market or performance conditions. The stock-based compensation expense attributable to awards under our 2007 Employee Stock Purchase Plan, or ESPP, was determined using the Black-Scholes option pricing model.

We also grant awards to non-employees and determine the fair value of such stock-based compensation awards granted as either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. If the fair value of the equity instruments issued is used, it is measured using the stock price and other measurement assumptions as of the earlier of (i) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached, or (ii) the date at which the counterparty's performance is completed.

We recognize excess tax benefits associated with stock-based compensation to stockholders' equity only when realized. An excess tax benefit occurs when the actual tax benefit realized by us upon an employee's disposition of a share-based award exceeds the deferred tax asset, if any, associated with the award that we had recorded. When assessing whether excess tax benefits relating to stock-based compensation have been realized, we follow the with and without approach excluding any indirect effects to be realized until after the utilization of all other tax benefits available to us.

## **Table of Contents**

### ***Accounting for Income Taxes***

We estimate income taxes based on the various jurisdictions where we conduct business. Significant judgment is required in determining our worldwide income tax provision. We estimate the current tax liability and assess temporary differences that result from differing treatments of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are reflected in our balance sheets. We then assess the likelihood that deferred tax assets will be realized. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized. When a valuation allowance is established or increased, we record a corresponding tax expense in our statements of operations. We review the need for a valuation allowance each reporting period to reflect uncertainties about whether we will be able to utilize deferred tax assets before they expire. The valuation allowance analysis is based on estimates of taxable income for the jurisdictions in which we operate and the periods over which our deferred tax assets will be realizable.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. During the fourth quarter of 2010, we concluded that it was more likely than not that we would be able to realize the benefit of our federal deferred tax assets in the future. We based this conclusion on historical and projected operating performance, as well as our expectation that our operations will generate sufficient taxable income in future periods to realize the tax benefits associated with the deferred tax assets. As a result, we reduced the valuation allowance on a portion of our net deferred tax assets by \$31.6 million at December 31, 2010. We will continue to assess the need for a valuation allowance on the deferred tax asset by evaluating both positive and negative evidence that may exist. Any adjustment to the net deferred tax asset valuation allowance would be recorded in the income statement for the period that the adjustment is determined to be required. We continue to maintain a valuation allowance to offset the California deferred tax assets as realization of such assets does not meet the more-likely-than-not threshold required under accounting guidance given the present lower apportionment factors now pertaining to our income taxes in California.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not of being sustained upon audit, the second step is to measure the tax benefit as the largest amount that has more than a 50% chance of being realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. We evaluate uncertain tax positions on a quarterly basis. The evaluations are based upon a number of factors, including changes in facts or circumstances, changes in tax law, correspondence with tax authorities during the course of audits and effective settlement of audit issues.

### ***Segment Reporting***

We are organized as, and operate in, one reportable segment: the design, development and sale of silicon integrated circuits. Products within this segment are embedded in electronic devices used to enable the delivery of multiple streams of HD video and other multimedia content for entertainment purposes into and throughout the home. Our chief operating decision maker is our chief executive officer, or CEO. Our CEO reviews financial information presented on a consolidated basis for the purpose of evaluating financial performance and allocating resources. There are no segment managers who are held accountable for operations below the consolidated financial statement level. Our assets are primarily located in the United States and not allocated to any specific region. Therefore, geographic information is presented only for total revenue.

**Table of Contents****Recently Issued Accounting Standards**

In May 2011, the FASB issued Accounting Standards Update, or ASU, No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standard, or IFRS. This update amends Accounting Standards Codification Topic 820, Fair Value Measurement and Disclosure. ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011, which means that it will be effective for our fiscal quarter beginning January 1, 2012. The new guidance is to be adopted prospectively and early adoption is not permitted. We do not believe that adoption of ASU 2011-04 will have a significant impact on our financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in stockholders' equity and requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We believe the adoption of ASU 2011-05 concerns presentation and disclosure only and will not have an impact on our consolidated financial position or results of operations.

**Reclassifications**

During the year ended December 31, 2011, within our fair value of financial instrument disclosures, we have reclassified certain amounts from Level 1 to Level 2.

**Results of Operations**

The following table sets forth selected consolidated statements of operations data as a percentage of total net revenues for each of the periods indicated (in millions, except percentage amounts):

	Years Ended December 31,		
	2011	2010	2009
Net revenues	100%	100%	100%
Cost of net revenues	45	47	49
Gross profit	55	53	51
Operating expenses:			
Research and development	25	23	39
Sales and marketing	7	8	12
General and administrative	6	6	9
Restructuring charges			2
Total operating expenses	38	37	62
Income (loss) from operations	17	16	(11)
Income tax provision (benefit)	6	(15)	
Net income (loss)	11%	31%	(11)%

*Net Revenues.* We generate the majority of our revenues from sales of our products to ODMs or OEMs that provide customer premises equipment to service providers. We price our products based

## Table of Contents

on market and competitive conditions and reduce the price of our products over time, as market and competitive conditions change, and as manufacturing costs are reduced. Our markets are generally characterized by declining average selling prices over the life of a product and, accordingly, we must reduce costs and successfully introduce new products and enhancements to maintain our gross margins.

We rely on a limited number of customers for a significant portion of our net revenues. For the years ended December 31, 2011, 2010 and 2009, four customers accounted for 60%, 56% and 58% of our net revenues, respectively. In addition, we depend on a limited number of service providers that purchase products from our customers that incorporate our products. To date, only a limited number of major service providers, such as Verizon, DIRECTV, Time Warner Cable, Cox, Comcast, DISH Network and Bright House Networks LLC have publicly announced their intention to use the MoCA standard for home networking. We also primarily rely on two major service providers, DISH Network and DIRECTV, to deploy products using our DBS outdoor unit solutions. During the year ended December 31, 2009, products sold to our customers that were incorporated into products purchased by Verizon, DISH Network and DIRECTV accounted for substantially all of our net revenues. However, during the years ended December 31, 2010 and December 31, 2011, in addition to Verizon, DIRECTV and DISH Network, we also generated meaningful revenues from the sale of our products to our customers that were incorporated into products purchased by Comcast, Time Warner Cable and Cox. To date, the FiOS deployment by Verizon and the DIRECTV multi-room DVR and SWiM dish deployments have been major drivers of our net revenues. We expect that we will continue to derive significant revenues from Verizon and DIRECTV, but our reliance on Verizon and DIRECTV as the major driver of our net revenues is decreasing as other service providers, such as Time Warner Cable, Comcast, DISH Network and Cox deploy our home networking products.

Since inception, we have derived our net revenues primarily from Asia, the United States and other North American countries. Net revenues are allocated to the geographic region based on the shipping destination of customer orders. For sales to ODMs and OEMs, their geographic locations may differ from those of the ultimate end customers. Of our \$240.6 million in net revenues in 2011, \$213.5 million, \$26.3 million and \$0.8 million were derived from Asia, North America and Europe, respectively. Of our \$210.2 million in net revenues in 2010, \$195.1 million, \$12.1 million and \$3.1 million were derived from Asia, North America and Europe, respectively. Of our \$116.3 million in net revenues in 2009, \$107.1 million, \$7.0 million and \$2.2 million were derived from Asia, North America and Europe, respectively.

Accordingly, we are dependent on sales outside of the United States for most of our net revenues and expect that to continue in the future.

*Cost of Net Revenues.* We use third-party foundries and assembly and test contractors to manufacture, assemble and test our products. A significant portion of our cost of net revenues consists of payments for the purchase of wafers and for manufacturing, assembly and test services. To a lesser extent, cost of net revenues includes expenses relating to management of our contractors, the cost of shipping and logistics, royalties, inventory valuation charges taken for excess and obsolete inventory, warranty costs, changes in product cost due to changes in wafer manufacturing, assembly and test yields, allocated facilities expenses, amortization of inventory step-up and acquired developed technology. We currently outsource the manufacturing of our home networking and broadband access products principally to TSMC, and the manufacturing of our digital broadcast satellite outdoor unit and silicon tuner products to TowerJazz. Our home networking and broadband access products are primarily assembled and tested by Amkor, while our digital broadcast satellite outdoor unit and silicon tuner products are primarily assembled by Amkor and tested by Giga Solution. In September 2010, we entered into a Capacity Commitment Agreement with TowerJazz in order to guarantee minimum capacity volumes on our digital broadcast satellite outdoor unit and silicon tuner products through December 31, 2012.

**Table of Contents**

**Gross Margin.** Our gross margins have increased each year from 2009 to 2011, primarily due to decreased unit costs of our home networking chipsets principally as a result of more favorable manufacturing costs and the increase in the revenues generated from our digital broadcast satellite outdoor products, which carry a higher gross margin as compared to our home networking products. Included in cost of net revenues for the years ended December 31, 2011, 2010 and 2009 was the amortization of developed technology of \$0, \$1.6 million and \$1.6 million, respectively, which resulted from our RF Magic and Vativ acquisitions. Our gross margin has been and will continue to be affected by a variety of factors, including declines in selling prices of our products, especially as competition increases over time, product mix, the timing of cost reductions for fabricated wafers and assembly and test service costs, inventory valuation charges, purchase accounting-related charges, and changes in wafer manufacturing, assembly and test yields.

**Research and Development Expenses.** Research and development expenses primarily include costs related to personnel, third-party services that consist primarily of contract labor services, fabrication masks, architecture licenses, engineering design development software and hardware tools, allocated facilities expenses and depreciation of equipment used in research and development. While a substantial portion of our research and development activities are undertaken in support of our current and anticipated customers, we also invest in research and development to develop our technology. In the future, we expect some of the services currently performed by contractors to be performed internally.

We expect research and development expenses in future years to continue to increase in total dollars. We anticipate that our research and development expenses may fluctuate over the course of a year based on the timing of our development tools and supply costs, which include third-party services, masks costs and licenses.

**Sales and Marketing Expenses.** Sales and marketing expenses primarily include costs related to personnel, sales commissions, trade shows, marketing programs, depreciation and allocated facilities expenses. We plan to continue to increase the size of our sales and marketing organization to enable us to expand into existing and new markets. We also plan to continue to invest in expanding our domestic and international sales and marketing activities and build brand awareness. Due to the lengthy sales cycles that we face, we may experience significant delays from the time we incur research and development and sales expenses until the time, if ever, that we generate sales from these products.

**General and Administrative Expenses.** General and administrative expenses primarily include costs related to personnel, accounting and tax, legal compliance and allocated support expenses. We expect that in future years our general and administrative expenses will increase as we incur additional costs associated with supporting our business growth.

**Comparison of Years Ended December 31, 2011, 2010 and 2009**

(Tables presented in thousands, except percentage amounts)

**Net Revenues**

	Years Ended December 31,				2009
	2011	% Change	2010	% Change	
Net revenues	\$ 240,628	14%	\$ 210,237	81%	\$ 116,305

Our net revenues for 2011 were \$240.6 million, as compared to net revenues of \$210.2 million in 2010, an increase of \$30.4 million or 14%. The overall increase in net revenues was driven by higher demand for our home networking products, which were the result of deployments of MoCA enabled devices by existing and new service providers during the first half of 2011, as well as an increase in the deployment of DBS ODU products.

**Table of Contents**

Our net revenues for 2010 were \$210.2 million, as compared to net revenues of \$116.3 million in 2009, an increase of \$93.9 million or 81%. The increase in net revenues for 2010 was primarily driven by higher demand for our home networking products, including new deployments by additional service providers and by higher demand for our DBS outdoor unit products.

*Gross Profit/Gross Margin*

	Years Ended December 31,				
	2011	% Change	2010	% Change	2009
Gross profit	\$ 132,706	18%	\$ 112,167	90%	\$ 58,906
% of net revenues	55%		53%		51%

Gross profit for 2011 was \$132.7 million, an increase of \$20.5 million, or 18%, from gross profit of \$112.2 million in 2010. The increase in gross profit was primarily due to higher net revenues from the sale of our home networking products and our DBS ODU products. Gross margins increased by approximately 2% in 2011 due to lower unit costs of both our home networking products and our DBS ODU products, principally as a result of more favorable manufacturing costs.

Gross profit for 2010 was \$112.2 million, an increase of \$53.3 million, or 90%, from gross profit of \$58.9 million in 2009. This increase was primarily due to higher net revenues from the sales of our home networking products and our DBS outdoor unit products. Additionally, gross margin increased due to lower unit costs of both our home networking products and our DBS outdoor unit products, principally as a result of more favorable manufacturing costs, and a higher contribution to gross margin from the sales of our DBS outdoor unit products.

Our gross profit and gross margin are impacted by the inclusion of amortization of developed technology in cost of net revenues. The amortization results from our acquisitions of RF Magic and Vativ as we used the purchase method of accounting and, as a result of the application of the purchase method, included in cost of net revenues for 2011, 2010 and 2009 was \$0, \$1.6 million, and \$1.6 million, respectively, of amortization of developed technology.

*Research and Development Expenses*

	Years Ended December 31,				
	2011	% Change	2010	% Change	2009
Research and development	\$ 60,065	23%	\$ 48,717	8%	\$ 45,161
% of net revenues	25%		23%		39%

Research and development expenses increased by \$11.4 million, or 23%, from \$48.7 million in 2010 to \$60.1 million in 2011. This \$11.4 million increase was primarily due to increased personnel costs of \$4.9 million (of which \$1.2 million was due to stock-based compensation) which was primarily attributable to the 21% increase in the number of employees engaged in research and development activities. Other factors contributing to the increase in research and development expense include a \$5.0 million increase in development tools and supply costs, which include third-party services, masks costs and licenses that fluctuate in timing and amount from period to period, as well as an increase in overhead allocations of approximately \$1.5 million, which resulted from a general increase in research and development activities in 2011 as compared to 2010.

Research and development expenses increased by \$3.5 million, or 8%, from \$45.2 million in 2009 to \$48.7 million in 2010. This \$3.5 million increase was primarily due to increased personnel costs of \$1.6 million (of which \$0.5 million was due to stock-based compensation) which was



**Table of Contents**

primarily attributable to the combination of a 10% increase in the number of employees engaged in research and development activities and the increase in variable compensation due to the achievement of operational, financial and business development objectives in 2010. Other factors contributing to the increase in research and development expense include a \$1.9 million increase in development tools and supply costs, which include third-party services, masks costs and licenses that fluctuate in timing and amount from period to period, all of which resulted from a general increase in research and development activities due to additional research and development projects that were being worked on in 2010 as compared to 2009.

*Sales and Marketing Expenses*

	Years Ended December 31,				
	2011	% Change	2010	% Change	2009
Sales and marketing	\$ 17,569	2%	\$ 17,199	23%	\$ 13,955
% of net revenues	7%		8%		12%

Sales and marketing expenses increased by \$0.4 million, or 2%, from \$17.2 million in 2010 to \$17.6 million in 2011. This \$0.4 million increase was primarily due to increased personnel costs of \$0.2 million (of which \$0.4 million was due to stock-based compensation costs, offset by lower overall cash compensation costs of \$0.2 million). Overhead allocations contributed to the remaining increase of \$0.2 million.

Sales and marketing expenses increased by \$3.2 million, or 23%, from \$14.0 million in 2009 to \$17.2 million in 2010. This \$3.2 million increase included increased personnel costs of \$2.7 million (of which \$0.2 million was due to stock-based compensation) which was primarily attributable to the combination of a 15% increase in the number of employees engaged in sales and marketing activities and the increase in variable compensation due to the achievement of operational, financial and business development objectives in 2010. The remainder of the increase in sales and marketing expenses, including increases in marketing and trade show costs of \$0.3 million and increases in travel-related costs of \$0.3 million and was primarily due to a general increase in business activities as a result of the increase in the number of employees engaged in sales and marketing activities during 2010.

*General and Administrative Expenses*

	Years Ended December 31,				
	2011	% Change	2010	% Change	2009
General and administrative	\$ 14,568	11%	\$ 13,134	21%	\$ 10,868
% of net revenues	6%		6%		9%

General and administrative expenses increased by \$1.5 million, or 11%, from \$13.1 million in 2010 to \$14.6 million in 2011. This \$1.5 million increase was primarily driven by an increase of \$1.4 million of transaction related costs associated with the bid to acquire Trident's STB Business. The remaining increase was driven by an increase in outside services and consulting expenses of \$0.8 million and an increase in overhead allocations of \$0.2 million, offset by a decrease in personnel costs of \$0.9 million, primarily driven by a reduction in variable compensation costs.

General and administrative expenses increased by \$2.3 million, or 21%, from \$10.9 million in 2009 to \$13.1 million in 2010. This \$2.3 million increase was driven by increased personnel costs of \$2.0 million (of which \$0.2 million was due to stock-based compensation) which was primarily attributable to the combination of a 10% increase in the number of employees engaged in general and administrative activities and the increase in variable compensation due to the achievement of operational, financial and business development objectives in 2010.

## **Table of Contents**

### *Amortization of Intangible Assets*

Amortization of intangible assets of \$16,000 was incurred during 2009. The amortization of intangible assets in 2009 were from intangible assets acquired through the acquisition of RF Magic in June 2007. No amortization of intangible assets was recorded during 2010 and 2011.

### *Restructuring Charges*

We incurred restructuring charges of \$2.2 million in 2009 resulting from a restructuring plan we implemented in March 2009 that resulted in a worldwide reduction-in-force of 55 employees and the closure of our Nice, France and Kfar Saba, Israel offices. All of the terminated employees received severance payments upon their effective termination. In addition, the affected French and Israeli employees continued to receive salaries until their termination became effective upon the expiration of applicable contractual or statutory notice periods.

The continued payment of salaries to the terminated Nice and Kfar Saba employees during their respective notice periods represented a one-time termination benefit since we were required by contract or law to make these payments whether or not these employees continued to work for us through their actual termination dates.

### *Impairment of Goodwill and Intangible Assets*

The intangible assets associated with the acquisition of Arabella in 2007 were determined to be fully impaired as of March 31, 2009, as the core technology acquired was no longer being used in our ongoing business operations and there were no future cash flows associated with this technology. We made a decision in March 2009 to cease use of the technology and do not have any plans to use it in future operations. As a result, an impairment charge of \$0.2 million was recorded in the first quarter of 2009.

### *Other Income (expense), net*

Other income (expense), net, which is primarily made up of interest income earned on our marketable securities and cash equivalents, was approximately \$0.9 million for 2011, compared with \$0.1 million for 2010. This increase was due to the increase in interest income of approximately \$0.8 million as a result of an increase in our cash and marketable securities balance during the twelve months ended December 31, 2011 as compared to the same period in 2010.

Other income (expense), net, which primarily consists of interest income, was consistent at approximately \$0.1 million for the twelve months ended December 31 2009 as compared to the same period in 2010.

### *Loss related to equity method investment*

During the twelve months ended December 31, 2011, we recorded an expense of \$0.8 million which related to our investment in a privately held entity which is accounted for under the equity method of accounting. Under the equity method of accounting, the change in the carrying value of our investment in the privately held entity is reflected as an increase (decrease) in our investment account and is also recorded as equity investment income (loss). The change in the value of the investment is comprised of our proportionate share of the private company's losses plus a charge relating to the amortization of the intangible asset associated with the premium paid on our investment.

**Table of Contents***Income Taxes*

Income tax expense for the twelve months ended December 31, 2011 was \$14.1 million, or approximately 35% of pre-tax income. The effective tax rate for the twelve months ended December 31, 2011 is comprised of federal expense at statutory rates less research and development credits which resulted in a benefit of approximately 3%, offset by an increase in our tax rate of due to reserves for uncertain tax positions of approximately 3%. Our net state income tax rate was less than 0.1% for the twelve months ended December 31, 2011, due to the impact of the California single sales factor election to calculate our tax liability. Due to the expected utilization of net operating loss carryforwards and research and development credits that offset our taxes payable, our current income tax expense in 2011 is significantly higher than our actual cash tax liability.

The income tax benefit of approximately \$31.4 million for the fiscal year ended December 31, 2010, primarily represents the reversal of our valuation allowance previously offsetting our Federal deferred tax assets (see Note 7 in the Consolidated Financial Statements). Income tax expense for 2009 was related to foreign tax expenses.

**Quarterly Financial Data (Unaudited)**

The following table presents certain quarterly financial data for the eight consecutive quarters ended December 31, 2011. The unaudited quarterly information has been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, includes all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of this data. This information should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this Annual Report. We believe that our quarterly revenue, particularly the mix of revenue components, and operating results are likely to vary in the future. The operating results for any quarter are not necessarily indicative of the operating results for any future period or for any full year.

	Net Revenues	Gross Profit	Net Income (Loss)(1) (in thousands, except per share data)	Basic Net Income (Loss) Per Share	Diluted Net Income (Loss) Per Share
<b>Year Ended December 31, 2011</b>					
Fourth Quarter	\$ 56,169	\$ 30,828	\$ 2,308	\$ 0.03	\$ 0.03
Third Quarter	51,465	28,469	4,645	0.05	0.05
Second Quarter	61,473	33,827	7,756	0.09	0.09
First Quarter	71,521	39,582	11,855	0.14	0.13
<b>Year Ended December 31, 2010</b>					
Fourth Quarter	\$ 70,796	\$ 38,032	\$ 48,583(2)	\$ 0.58	\$ 0.55
Third Quarter	61,310	32,536	11,271	0.15	0.15
Second Quarter	40,680	21,849	3,092	0.04	0.04
First Quarter	37,451	19,750	1,758	0.02	0.02
<b>Year Ended December 31, 2009</b>					
Fourth Quarter	\$ 35,078	\$ 18,116	\$ 1,021	\$ 0.01	\$ 0.01
Third Quarter	30,958	15,626	(1,238)	(0.02)	(0.02)
Second Quarter	26,146	12,945	(4,287)	(0.06)	(0.06)
First Quarter	24,123	12,219	(8,736)	(0.13)	(0.13)

(1) Net income attributable to common stockholders.

(2) Includes a benefit of \$31.6 million related to the reduction of the valuation allowance previously recorded on certain of our deferred tax assets.

**Table of Contents****Liquidity and Capital Resources**

As of December 31, 2011, 2010 and 2009 we had cash, cash equivalents and investments of \$216.5 million, \$168.8 million and \$35.3 million, respectively. As of December 31, 2011, the total amount of cash held outside of the United States was approximately \$1.7 million, which is used to fund our international operating entities.

In October 2010, we completed a public offering in which 10,750,000 shares of our common stock were sold on our behalf at a price to the public of \$9.70 per share, and which resulted in gross offering proceeds of \$104.3 million and net offering proceeds of approximately \$99.3 million after deducting offering expenses paid by us.

In April 2011, our \$5.0 million revolving credit line with Silicon Valley Bank expired and we elected to not renew it.

The following table shows our cash flows from operating activities, investing activities and financing activities for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Net cash provided by operating activities	\$ 56,310	\$ 32,933	\$ 1,330
Net cash (used in) provided by investing activities	(144,084)	(74,394)	2,232
Net cash provided by financing activities	9,836	104,261	1,687
Net effect of exchange rates on cash	31	48	(68)
Net (decrease) increase in cash and cash equivalents	\$ (77,907)	\$ 62,848	\$ 5,181

**Cash Flows from Operating Activities**

Net cash provided by operating activities was \$56.3 million for the year ended December 31, 2011. Sources of cash provided by operating activities included cash generated from net income of \$26.6 million, which included non-cash charges of \$12.7 million related to deferred income taxes, \$12.7 million in stock compensation expenses, depreciation and amortization expense of \$4.4 million, amortization of premiums on marketable securities of \$4.0 million, a reserve for excess and obsolete inventory of \$1.7 million and the equity in the loss from the non-consolidated entity of \$0.8 million. Offsetting the non-cash charges were uses of cash of \$4.2 million of excess tax benefits from share-based payment arrangements and \$2.4 million related to working capital changes. Cash used for working capital purposes included an increase in our accounts receivable balance of \$7.7 million due to a higher volume of shipments in 2011, a decrease in our accounts payable balance of \$6.7 million due to the timing of payments for inventory purchases, an increase in prepaid expenses and other assets of \$3.3 million and a reduction in accrued payroll and benefit expenses of \$2.8 million primarily due to payments of fiscal year end incentive bonuses in the first quarter of 2011. These working capital uses of cash were partially offset by working capital sources of cash including an increase in accrued expenses and other liabilities of approximately \$0.2 million and a decrease in our inventory balances of \$17.9 million as we reduced our inventory levels on our MoCA products during 2011.

Net cash provided by operating activities in 2010 was \$32.9 million, primarily resulting from net income of \$64.7 million, an increase of \$15.6 million in accounts payable and other liabilities, driven primarily by an increase in inventory and compensation and benefit accruals, \$10.5 million in stock compensation expenses and depreciation and amortization expense of \$5.5 million. The increase in net cash was offset by a \$31.6 million increase in our deferred tax assets as a result of the reversal of the valuation allowance that was previously placed on these assets, \$23.6 million increase in inventory

## **Table of Contents**

primarily related to new deployments of our home networking products, an increase in our prepaid and other assets of \$5.4 million and an increase in accounts receivable of \$2.8 million due to an increase in sales during 2010.

Net cash provided by operating activities in 2009 was \$1.3 million primarily resulting from a net loss of \$13.2 million, an increase in accounts receivable of \$1.6 million due to an increase of sales during the fourth quarter of 2009 and a decrease in other liabilities of \$0.5 million, offset by \$9.3 million in stock compensation expenses, \$5.1 million in depreciation and amortization expenses, including \$1.6 million attributable to amortization of developed technology, and a \$2.3 million decrease in inventory as we sold the 2008 buildup of inventory in the first half of 2009.

### ***Cash Flows from Investing Activities***

Net cash used in investing activities was \$144.1 million in 2011 due to purchases of available-for-sale securities of \$262.1 million, a \$10.0 million investment in a privately held company which was accounted for under the equity method of accounting and purchases of property and equipment of \$4.3 million, primarily consisting of research and development equipment. These investing activity uses of cash were partially offset by sales of available-for-sale securities of \$132.3 million.

Net cash used in investing activities was \$74.4 million in 2010 due to purchases of available-for-sale securities of \$70.8 million and purchases of property and equipment of \$3.6 million, primarily consisting of research and development equipment.

Net cash provided by investing activities was \$2.2 million in 2009, consisting of maturities of short-term investments of \$4.3 million offset by purchases of property and equipment of \$2.1 million, consisting primarily of lab equipment.

### ***Cash Flows from Financing Activities***

Net cash provided by financing activities was \$9.8 million in 2011, due to proceeds of \$5.6 million due to proceeds from the issuance of common stock in connection with stock option exercises and \$4.2 million of excess tax benefits from share-based payment arrangements.

Net cash provided by financing activities was \$104.3 million in 2010, mainly due to the net proceeds of \$99.3 million received from the public offering of our common stock that was completed in October 2010 and \$5.0 million provided by the net proceeds from common stock purchases pursuant to stock option exercises and our ESPP.

Net cash provided by financing activities was \$1.7 million in 2009 provided by the net proceeds from common stock purchases pursuant to stock option exercises and our ESPP.

We believe that our cash, cash equivalents and investments of \$216.5 million as of December 31, 2011, and cash that we expect to generate from our operations will be sufficient to fund our projected operating requirements for at least the next 12 months.

We intend to continue spending substantial amounts in connection with the growth of our business and we may need to obtain additional financing to pursue our business strategy, develop new products, respond to competition and market opportunities, and possibly acquire complementary businesses or technologies.

In January 2012, we entered into an agreement to acquire the assets of Trident Microsystems, Inc. and certain of its subsidiaries, collectively Trident, in a bankruptcy auction for \$55.0 million, which

**Table of Contents**

is the starting point against which others will bid prior to the auction. The assets being bid on are the assets used in or related to Trident's set-top box business, or STB business. The closing of the transaction is subject to typical closing conditions and the receipt by Trident of higher bids. If successful in the bankruptcy auction, we will utilize approximately \$55.0 million of our cash and investment balances to fund this acquisition.

On October 5, 2010, we completed a public offering of 10,750,000 shares of our common stock, which resulted in net proceeds of approximately \$99.3 million. In the future we may not be able to obtain such financing on favorable terms or at all. If we were to raise additional capital through further sales of our equity securities, our stockholders would suffer dilution of their equity ownership. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, prohibit us from paying dividends, prohibit us from repurchasing our stock or making investments or force us to maintain specified liquidity or other ratios, any of which could harm our business, operating results and financial condition.

**Contractual Obligations**

The following table summarizes our contractual obligations as of December 31, 2011 (in thousands):

	Years Ending December 31,						Total
	2012	2013	2014	2015	2016	Thereafter	
Operating leases	\$ 6,018	\$ 5,559	\$ 2,896	\$ 193	\$	\$	\$ 14,666
Inventory and related purchase obligations	12,065						12,065
<b>Total</b>	<b>\$ 18,083</b>	<b>\$ 5,559</b>	<b>\$ 2,896</b>	<b>\$ 193</b>	<b>\$</b>	<b>\$</b>	<b>\$ 26,731</b>

**Off-Balance Sheet Arrangements**

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.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**  
**Foreign Currency Risk**

Our sales have been historically denominated in U.S. dollars and an increase in the value of U.S. dollar relative to the currencies of the countries in which our customers operate could materially affect the demand of our products by non-U.S. customers, leading to a reduction in orders placed by these customers, which would adversely affect our business. Our international sales and marketing operations incur expenses that are denominated in foreign currencies. These expenses could be materially affected by currency fluctuations; however, we do not consider this currency risk to be material as the related costs do not constitute a significant portion of our total spending. We outsource our wafer manufacturing, assembly, testing, warehousing and shipping operations; however all expenses related thereto are denominated in U.S. dollars. If the value of the U.S. dollar decreases relative to the currencies of the countries in which such contractors operate, the prices we are charged for their services may increase, which would adversely affect our business. Currently, we have not implemented any hedging strategies to mitigate risks related to the impact of fluctuations in currency exchange rates.

## **Table of Contents**

### ***Interest Rate Risk***

We typically maintain an investment portfolio of various holdings, types and maturities. We do not use derivative financial instruments. We place our cash investments 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 that meet high credit quality standards, as specified in our investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issue, issuer or type of instrument.

All of our fixed income investments are classified as available-for-sale and therefore reported on the balance sheet at market value. The fair value of our cash equivalents and investments are subject to change as a result of changes in market interest rates and investment risk related to the issuers' credit worthiness. We do not utilize financial contracts to manage our exposure in our investment portfolio to changes in interest rates. We place our cash investments in instruments that meet credit quality standards, as specified in our investment policy guidelines. We have established guidelines relative to diversification and maturities that attempt to maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of interest rate trends. We generally do not utilize derivatives to hedge against increases in interest rates which decrease market values.

At December 31, 2011, we had \$216.5 million in cash, cash equivalents and investments, all of which were stated at fair value. A 100 basis point increase or decrease in market interest rates over a three month period would not be expected to have a material impact on the fair value of the \$20.2 million of cash and cash equivalents held as of December 31, 2011, as these consisted of securities with maturities of less than three months. A 100 basis point increase or decrease in interest rates would, however, decrease or increase, respectively, the fair value of the \$196.3 million of our investments by approximately \$2.0 million.

### **Item 8. Financial Statements and Supplementary Data**

The financial statements and supplementary data required by this item are included in Part IV, Item 15, *Exhibits and Financial Statement Schedules* of this Annual Report.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

### **Item 9A. Controls and Procedures**

#### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports filed with the SEC are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and no evaluation of controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Exchange Act, prior to filing this Annual Report, we carried out an evaluation, under the supervision and with the participation of our management, including our

## **Table of Contents**

chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this Annual Report. Based on their evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this Annual Report.

### **Management's Report on Internal Control over Financial Reporting**

The management of Entropic is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework set forth in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework set forth in *Internal Control-Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2011. Ernst & Young LLP, the independent registered public accounting firm that audited the financial statements included in this Annual Report, has issued an attestation report on our internal control over financial reporting as of December 31, 2011, which is included herein.

### **Changes in Internal Control over Financial Reporting**

An evaluation was also performed under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of any change in our internal control over financial reporting that occurred during the fourth quarter of 2011 and that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. That evaluation did not identify any change in our internal control over financial reporting that occurred during the fourth quarter of 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



---

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Entropic Communications, Inc.

We have audited Entropic Communications, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Entropic Communications, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Entropic Communications, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Entropic Communications, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss) and cash flows for each of the three years in the period ended December 31, 2011 and our report dated February 3, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California

February 3, 2012

**Table of Contents**

**Item 9B. *Other Information***

Not applicable.

---

**Table of Contents****PART III**

*Certain information required by Part III is omitted from this Annual Report because we intend to file our definitive proxy statement for the 2012 annual meeting of stockholders, or 2012 Proxy Statement, pursuant to Regulation 14A promulgated under the Exchange Act, not later than 120 days after the end of the year covered by this Annual Report, and such information will be included in the 2012 Proxy Statement and is hereby incorporated herein by reference. With the exception of the information specifically incorporated herein by reference from our 2012 Proxy Statement into this Annual Report, our 2012 Proxy Statement shall not be deemed to be filed as part of this Annual Report. Without limiting the foregoing, the discussions under the headings *Report of the Audit Committee* and *Report of the Compensation Committee* in our 2012 Proxy Statement are expressly excluded from any incorporation by reference into this Annual Report and are not deemed filed with the SEC.*

**Item 10. Directors, Executive Officers and Corporate Governance**

Information about our directors is incorporated by reference from the discussion under the heading *Item 1 Election of Directors* in our 2012 Proxy Statement. Information about compliance with Section 16(a) of the Exchange Act is incorporated by reference from the discussion under the heading *Section 16(a) Beneficial Ownership Reporting Compliance* in our 2012 Proxy Statement. Information about our Code of Business Conduct and Ethics governing our employees, including our chief executive officer, chief financial officer, chief accounting officer and our directors, is incorporated by reference from the discussion under the heading *Entropic Policies on Business Ethics and Conduct* in our 2012 Proxy Statement. Information regarding the procedures by which our stockholders may recommend nominees to our board of directors is incorporated by reference from the discussion under the heading *Requirements, Including Deadlines, for Submission of Proxy Proposals, Nomination of Directors and Other Business of Stockholders* in our 2012 Proxy Statement. Information about our audit committee, including the members of the committee, and our audit committee financial expert, is incorporated by reference from the discussion under the headings *The Audit Committee* and *Audit Committee Financial Expert* in our 2012 Proxy Statement. The balance of the information required by this item is contained in the discussion entitled *Executive Officers of the Company* in Part I of this Annual Report.

**Item 11. Executive Compensation**

Information about director and executive compensation is incorporated by reference from the discussion under the headings *2011 Compensation of Non-Employee Directors; Executive Compensation; and Compensation Committee Interlocks and Insider Participation* in our 2012 Proxy Statement.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information required by this item is incorporated by reference from the discussion under the headings *Securities Ownership and Equity Compensation Plan Information* in our 2012 Proxy Statement.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information about certain relationships and transactions with related parties is incorporated by reference from the discussion under the headings *Review of Related Person Transactions* and *Transactions with Related Persons* in our 2012 Proxy Statement. Information about director independence is incorporated by reference from the discussion under the heading *Director Independence* in our 2012 Proxy Statement.

**Table of Contents**

**Item 14. *Principal Accountant Fees and Services***

Information about the fees for professional services rendered by our independent auditors in 2011 and 2010 is incorporated by reference from the discussion under the heading *Audit and Non-Audit Fees* in *Item 2 Ratification of Independent Registered Public Accounting Firm* in our 2012 Proxy Statement. Our audit committee's policy on pre-approval of audit and permissible non-audit services of our independent auditors is incorporated by reference from the section captioned *Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm* in *Item 2 Ratification of Independent Registered Public Accounting Firm* in our 2012 Proxy Statement.

**Table of Contents**

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

15(a)(1). *Financial Statements.*

The following consolidated financial statements, and related notes and Report of Independent Registered Public Accounting Firm are filed as part of this Annual Report:

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	F-1
<u>Consolidated Balance Sheets as of December 31, 2011 and 2010</u>	F-2
<u>Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009</u>	F-3
<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the years ended December 31, 2011, 2010 and 2009</u>	F-4
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009</u>	F-5
<u>Notes to Consolidated Financial Statements</u>	F-6
15(a)(2). <i>Financial Statement Schedules.</i>	

The following financial statement schedule is filed as part of this Annual Report:

	<b>Page</b>
Schedule II Consolidated Valuation and Qualifying Accounts	S-1
All other financial statement schedules have been omitted because the required information is not applicable or not present in amounts sufficient to require submission of the schedule, or because the information is included in the consolidated financial statements or the notes thereto.	

15(a)(3). *Exhibits.*

The exhibits listed in the accompanying Index to Exhibits are filed with, or incorporated by reference into, this Annual Report. The exhibit numbers on the Index to Exhibits that are followed by an asterisk (\*) indicate exhibits filed with this Annual Report. All other exhibit numbers indicate exhibits filed by incorporation by reference. Exhibit numbers 10.1 through 10.30 are management contracts or compensatory plans or arrangements.

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Entropic Communications, Inc.

We have audited the accompanying consolidated balance sheets of Entropic Communications, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a)2. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Entropic Communications, Inc. at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set for therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Entropic Communications, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 3, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California

February 3, 2012

F-1

**Table of Contents****Entropic Communications, Inc.****Consolidated Balance Sheets***(in thousands, except per share data)*

	<b>As of December 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 20,193	\$ 98,100
Marketable securities	91,625	48,275
Accounts receivable, net	25,896	18,244
Inventory	20,253	39,915
Deferred tax assets, current	13,565	14,307
Prepaid expenses and other current assets	9,927	6,226
<b>Total current assets</b>	<b>181,459</b>	<b>225,067</b>
Property and equipment, net	11,250	11,354
Long-term marketable securities	104,708	22,386
Deferred tax assets, long-term	9,600	17,304
Other long-term assets	11,542	2,697
<b>Total assets</b>	<b>\$ 318,559</b>	<b>\$ 278,808</b>
<b>Liabilities and stockholders' equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 11,559	\$ 18,278
Accrued expenses and other current liabilities	4,078	3,634
Accrued payroll and benefits	3,835	6,666
<b>Total current liabilities</b>	<b>19,472</b>	<b>28,578</b>
Deferred rent	1,098	1,568
Other long-term liabilities	196	72
Commitments and contingencies		
<b>Stockholders' equity:</b>		
Preferred stock, \$0.001 par value; 10,000 authorized; no shares issued and outstanding as of December 31, 2011 and 2010		
Common stock, \$0.001 par value; 200,000 shares authorized; 87,160 and 85,095 shares issued and outstanding as of December 31, 2011 and 2010, respectively	87	85
Additional paid-in capital	448,440	425,767
Accumulated deficit	(150,639)	(177,203)
Accumulated other comprehensive loss	(95)	(59)
<b>Total stockholders' equity</b>	<b>297,793</b>	<b>248,590</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 318,559</b>	<b>\$ 278,808</b>

See accompanying notes to consolidated financial statements.

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

	Years Ended December 31,		
	2011	2010	2009
Net revenues	\$ 240,628	\$ 210,237	\$ 116,305
Cost of net revenues	107,922	98,070	57,399
Gross profit	132,706	112,167	58,906
Operating expenses:			
Research and development	60,065	48,717	45,161
Sales and marketing	17,569	17,199	13,955
General and administrative	14,568	13,134	10,868
Amortization of intangibles			16
Restructuring charges			2,173
Impairment of goodwill and intangible assets			208
Total operating expenses	92,202	79,050	72,381
Income (loss) from operations	40,504	33,117	(13,475)
Loss related to equity method investment	(791)		
Other income, net	904	141	142
Income (loss) before income taxes	40,617	33,258	(13,333)
Income tax provision (benefit)	14,053	(31,446)	(93)
Net income (loss)	\$ 26,564	\$ 64,704	\$ (13,240)
Net income (loss) per share basic	\$ 0.31	\$ 0.86	\$ (0.19)
Net income (loss) per share diluted	\$ 0.30	\$ 0.82	\$ (0.19)
Weighted average number of shares used to compute net income (loss) per share basic	86,258	75,040	69,834
Weighted average number of shares used to compute net income (loss) per share diluted	89,018	78,916	69,834

See accompanying notes to consolidated financial statements.



**Table of Contents****Entropic Communications, Inc.****Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss)***(in thousands)*

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
	Shares	Amount				
<b>Balance as of December 31, 2008</b>	<b>69,470</b>	<b>69</b>	<b>299,305</b>	<b>(228,667)</b>	<b>42</b>	<b>70,749</b>
Issuance of common stock upon exercise of stock options for cash	1,324	1	1,156			1,157
Stock-based compensation to employees			9,307			9,307
Stock-based compensation to consultants			60			60
Repurchase of shares of unvested common stock	(64)		(25)			(25)
Net reclassification of repurchase liability for early exercise of stock options			439			439
Issuance of common stock under employee stock purchase plan	597	1	554			555
Release of restricted stock options	22					
Components of comprehensive loss:						
Net loss				(13,240)		(13,240)
Translation adjustments					(89)	(89)
Comprehensive loss						(13,329)
<b>Balance as of December 31, 2009</b>	<b>71,349</b>	<b>71</b>	<b>310,796</b>	<b>(241,907)</b>	<b>(47)</b>	<b>68,913</b>
Issuance of common stock upon exercise of stock options for cash	2,378	2	3,566			3,568
Stock-based compensation to employees			10,096			10,096
Stock-based compensation to consultants			374			374
Repurchase of shares of unvested common stock	(1)		(3)			(3)
Net reclassification of repurchase liability for early exercise of stock options			254			254
Issuance of common stock under employee stock purchase plan	619	1	1,432			1,433
Stock issued in secondary offering, net of offering costs	10,750	11	99,252			99,263
Components of comprehensive income:						
Net income				64,704		64,704
Unrealized loss on marketable securities					(36)	(36)
Translation adjustments					24	24
Comprehensive income						64,692
<b>Balance as of December 31, 2010</b>	<b>85,095</b>	<b>85</b>	<b>425,767</b>	<b>(177,203)</b>	<b>(59)</b>	<b>248,590</b>
Issuance of common stock upon exercise of stock options for cash	1,437	1	2,855			2,856
Excess tax benefit on stock option exercises			4,222			4,222
Stock-based compensation to employees			12,482			12,482
Stock-based compensation to consultants			265			265
Net reclassification of repurchase liability for early exercise of stock options			92			92
Issuance of common stock under employee stock purchase plan	539	1	3,006			3,007
Release of restricted stock options	89		(249)			(249)
Components of comprehensive income:						
Net income				26,564		26,564
Unrealized loss on marketable securities					(83)	(83)

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

Translation adjustments						47		47
Comprehensive income								26,528
<b>Balance as of December 31, 2011</b>	<b>87,160</b>	<b>\$ 87</b>	<b>\$ 448,440</b>	<b>\$ (150,639)</b>	<b>\$ (95)</b>	<b>\$</b>	<b>(95)</b>	<b>\$ 297,793</b>

See accompanying notes to consolidated financial statements.

F-4

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

	Years Ended December 31,		
	2011	2010	2009
<b>Operating activities:</b>			
Net income (loss)	\$ 26,564	\$ 64,704	\$ (13,240)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	4,396	3,832	3,478
Amortization of intangible assets		1,623	1,638
Impairment of goodwill and intangible assets			208
Deferred taxes	12,674	(31,590)	
Excess tax benefit on stock option exercises	(4,222)		
Stock-based compensation	12,747	10,470	9,367
Amortization of premiums on investments	4,012	70	
Provision for excess and obsolete inventory	1,738	156	242
Impairment of assets related to restructuring charge			94
Loss related to equity method investment	791		
Loss on disposal of assets		6	
Changes in operating assets and liabilities:			
Accounts receivable	(7,652)	(2,776)	(1,553)
Inventory	17,924	(23,718)	2,098
Prepaid expenses and other current assets	(3,684)	(2,920)	(517)
Other long-term assets	365	(2,463)	49
Accounts payable	(6,714)	12,548	559
Accrued expenses and other current liabilities	531	1,415	(490)
Accrued payroll and benefits	(2,814)	3,244	(122)
Deferred rent	(470)	(712)	(244)
Other long-term liabilities	124	(956)	(237)
Net cash provided by operating activities	56,310	32,933	1,330
<b>Investing activities:</b>			
Purchases of property and equipment	(4,294)	(3,613)	(2,107)
Purchases of marketable securities	(262,056)	(70,781)	
Sales/maturities of marketable securities	132,266		4,339
Investment in non-consolidated entity	(10,000)		
Net cash (used in) provided by investing activities	(144,084)	(74,394)	2,232
<b>Financing activities:</b>			
Net proceeds from the issuance of equity plan exercises	5,614	5,001	1,712
Net proceeds from the issuance of common stock, net of issuance costs		99,263	
Excess tax benefit on stock option exercises	4,222		
Repurchase of restricted stock		(3)	(25)
Net cash provided by financing activities	9,836	104,261	1,687
Net effect of exchange rates on cash	31	48	(68)
Net (decrease) increase in cash and cash equivalents	(77,907)	62,848	5,181
Cash and cash equivalents at beginning of period	98,100	35,252	30,071

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

Cash and cash equivalents at end of period	\$ 20,193	\$ 98,100	\$ 35,252
--	-----------	-----------	-----------

See accompanying notes to consolidated financial statements.

F-5

**Table of Contents**

**Entropic Communications, Inc.**

**Notes to Consolidated Financial Statements**

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

**Business**

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

We are a fabless semiconductor company that designs, develops and markets systems solutions to enable connected home entertainment. Our technologies change the way HD video, SD video and other multimedia content such as movies, music and photos are brought into and delivered throughout the home.

**Basis of Presentation**

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

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

**Use of Estimates**

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

**Foreign Currency Translation**

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

**Revenue Recognition**

Our net revenues are generated principally by sales of our semiconductor products. During the years ended December 31, 2011, 2010 and 2009, product net revenues represented more than 99% of our total net revenues.

Our sales primarily occur through the efforts of our direct sales force. The remainder of our sales occurs through third-party sales representatives and distributors. During the years ended December 31, 2011, 2010 and 2009, more than 99% of our sales occurred through the efforts of our direct sales force.

## **Table of Contents**

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

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

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

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

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

We receive royalties in exchange for an exclusive right to manufacture and sell certain products. We have determined that we are not able to reliably estimate the royalties earned in the period the sales occur and, as a result, we record net revenues based on cash receipts. The royalty revenues recorded during the years ended December 31, 2011, 2010 and 2009 were \$0.3 million, \$1.2 million and \$1.9 million, respectively, and are included in net revenues in the accompanying consolidated statements of operations.

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

We provide rebates on our products to certain customers. At the time of the sale, we accrue 100% of the potential rebate as a reduction to net revenue and do not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. We reverse the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when we believe unclaimed rebates are no longer subject to payment and will not be paid. For the years ended December 31, 2011, 2010 and 2009, we reduced net revenue by \$0.8 million, \$0.6 million and \$0.7 million, respectively, in connection with our rebate programs.

We occasionally enter into agreements where revenue is derived from multiple deliverables including any mix of products and/or services. These products and/or services are generally delivered

## **Table of Contents**

from approximately three months to two years after the execution date. Revenue recognition for agreements with multiple deliverables is based on the individual units of accounting determined to exist in the agreement. A delivered item is considered a separate unit of accounting when the delivered item has value to the customer on a stand-alone basis. Items are considered to have stand-alone value when they are sold separately by any vendor or when the customer could resell the item on a stand-alone basis.

For multiple deliverable agreements entered into after December 31, 2009, consideration is allocated at the inception of the agreement to all deliverables based on their relative selling price. The relative selling price for each deliverable is determined using vendor specific objective evidence, or VSOE, of selling price or third-party evidence of selling price if VSOE does not exist. If neither VSOE nor third-party evidence of selling price exists, we use our best estimate of the selling price for the deliverable. To date, multiple deliverable contracts have not been material to net revenues in any related period and our adoption of the new accounting guidance for determining multiple element arrangements effective January 1, 2010 did not have an impact on our operating results.

For multiple deliverable agreements entered into on or prior to December 31, 2009, consideration was generally allocated to each unit of accounting based upon its relative fair value when objective and reliable evidence of fair value existed for all units of accounting in the agreement. The fair value of an item was generally the price charged for the product, if the item was regularly sold on a stand-alone basis.

In order to establish VSOE of selling price, we must regularly sell the product and/or service on a standalone basis with a substantial majority priced within a relatively narrow range. VSOE of selling price is usually the midpoint of that range. If there is not a sufficient number of standalone sales and VSOE of selling price cannot be determined, then we consider whether third-party evidence can be used to establish the selling price. If neither VSOE nor third-party evidence of selling price exists, effective January 1, 2010 we determine our best estimate of selling price using average selling prices over a rolling 12-month period as well as market conditions. If the product or service has no history of sales, we rely upon sales prices set by our pricing committee, adjusted for applicable discounts.

We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the revenue recognition but do not change the total revenue recognized on any agreement.

### **Concentration of Credit Risk**

Financial instruments that potentially subject us to concentration of credit risk consist primarily of cash and cash equivalents, marketable securities, accounts receivable, leases payable and lines of credit. Our policy is to place our cash, cash equivalents and marketable securities with high quality financial institutions in order to limit our credit exposure. We extend credit to certain of our customers based on an evaluation of the customer's financial condition and a cash deposit is generally not required. We estimate potential losses on trade receivables on an ongoing basis.

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

## **Table of Contents**

### **Cash and Cash Equivalents**

Cash and cash equivalents consist of cash, money market funds, commercial paper and corporate bonds. We consider all highly liquid investments with a maturity of three months or less from the date of purchase that are readily convertible into cash to be cash equivalents.

### **Deferred Compensation**

In June 2011, we implemented a non-qualified deferred compensation plan that permits certain key employees to defer portions of their compensation, subject to annual deferral limits, and have it credited to one or more investment options in the plan. At December 31, 2011, we had marketable securities totaling \$0.2 million, related to investments in equity securities that are held in a rabbi trust under our non-qualified deferred compensation plan. The total related deferred compensation liability was \$0.2 million at December 31, 2011, all of which was classified as non-current liabilities. The non-current portion of the liability, when applicable, will be recorded in the unaudited condensed consolidated balance sheets under other long-term liabilities.

### **Marketable Securities**

We account for marketable securities by determining the appropriate classification of such securities at the time of purchase and reevaluating such classification as of each balance sheet date. As of December 31, 2011, we had classified our marketable securities of approximately \$0.2 million held under our non-qualified deferred compensation plan as trading securities. All other marketable securities were classified as available-for-sale. Cash equivalents and marketable securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive loss, a component of stockholders' equity, net of tax. The investments are adjusted for amortization of premiums and discounts to maturity and such amortization is included in interest income. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in the unaudited condensed consolidated statements of operations. To date, other than temporary losses have not been material.

### **Fair Value of Financial Instruments**

The carrying amounts of cash equivalents, marketable securities, trade receivables, accounts payable and other accrued liabilities approximate their fair value due to the relative short-term maturities. The fair value of marketable securities is determined using quoted market price for those securities. The carrying amounts of our capital lease obligations, loans payable and other long-term liabilities approximate their fair value. The fair value of capital lease obligations and loans payable was estimated based on the current interest rates available to us for debt instruments with similar terms, degrees of risk and remaining maturities.

### **Allowance for Doubtful Accounts**

We evaluate the collectability of accounts receivable based on a combination of factors. In cases where we are aware of circumstances that may impair a specific customer's ability to meet its financial obligations subsequent to the original sale, we will record a specific allowance against amounts due, and thereby reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize allowances for doubtful accounts based upon specific identification, industry and geographic concentrations, the current business environment and our historical experience. We did not record an allowance for doubtful accounts as of December 31, 2011 and 2010.



## **Table of Contents**

### **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 calculated on a part-by-part basis and, in general, represent excess inventory value on hand compared to 12-month demand projections. Once established, these adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. We recorded charges for excess and obsolete inventory of \$1.7 million and \$0.2 million in 2011 and 2010, respectively.

We have entered into a capacity agreement with one of our third-party foundry contractors in order to guarantee minimum capacity volumes on our digital outdoor unit and silicon tuner products. Pursuant to the capacity agreement, we have made prepayments which will result in reduced prices paid on future inventory purchases up to a specified volume. The prepayments are being amortized into the cost of our inventory purchases based on the specified volume commitments under the terms of the capacity agreement. The prepaid inventory volume commitments are assessed for impairment on a periodic basis by comparing the remaining prepaid balance to our estimate of remaining purchases. There have been no impairments to date.

### **Property and Equipment**

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets (three to seven years), except leasehold improvements and software which are amortized over the lesser of the estimated useful lives of the asset or the remaining lease/license term.

### **Goodwill and Intangible Assets**

We record goodwill and other intangible assets based on the fair value of the assets acquired. In determining the fair value of the assets acquired, we utilize extensive accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired. We use the discounted cash flow method to estimate the value of intangible assets acquired. The estimates used to value and amortize intangible assets are consistent with the plans and estimates that we use to manage our business and are based on available historical information and industry estimates and averages.

We assess goodwill and certain intangible assets for impairment using fair value measurement techniques on an annual basis, during the fourth quarter of the year or more frequently if indicators of impairment exist. We perform an interim goodwill impairment test when it is more likely than not that the fair value of a reporting unit is less than the carrying amount. We operate as one reporting unit. The goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as in a business combination. Determining the fair value of the implied goodwill is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including the size and

## **Table of Contents**

timing of deployments by our customers and related projections and timing of future cash flows, discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, stage of products in development, determination of appropriate market comparables, and determination of whether a premium or discount should be applied to comparables.

### **Investment in a Privately Held Company**

We account for our investments in privately held companies under the equity method of accounting since we exercise significant influence, but we do not have the elements of control that would require consolidation. The rights of the other investors are both protective and participating. Unless we are determined to be the primary beneficiary, these rights preclude us from consolidating these investments. The investments are recorded initially at cost as an investment in a privately held company, and subsequently are adjusted for our equity in net operating results and cash contributions and distributions. In addition, we record charges relating to our proportionate ownership percentage of the premium paid for our investment in excess of our share of their net worth. The fair value of this premium consists of certain intangible asset and goodwill values as determined by a valuation calculation. These intangible assets represent the excess of the book value of the privately held company as compared to the valuation of the privately held company. We are in the process of completing the valuation of our investment and have used our best estimate to calculate the amortization related expense for 2011. As of December 31, 2011 our net investment in privately held companies was \$9.2 million, which is included in other long-term assets on our balance sheet.

### **Warranty Accrual**

We generally provide a warranty on our products for a period of one year; however, it may be longer for certain customers. Accordingly, we establish provisions for estimated product warranty costs at the time revenue is recognized based upon our historical activity and, additionally, for any known product warranty issues. Warranty provisions are recorded as a cost of net revenues. The determination of such provisions requires us to make estimates of product return rates and expected costs to replace or rework the products under warranty. When the actual product failure rates, cost of replacements and rework costs differ from our estimates, revisions to the estimated warranty accrual are made. Actual claims are charged against the warranty reserve.

### **Guarantees and Indemnifications**

In the ordinary course of business, we have 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 financial statements.

### **Software Development Costs**

Software development costs are capitalized beginning when technological feasibility has been established and ending when a product is available for sale to customers. To date, the period between achieving technological feasibility and when the software is made available for sale to customers has been relatively short and software development costs qualifying for capitalization have not been significant. As such, all software development costs have been expensed as incurred in research and development expense.

### **Stock-Based Compensation**

We have equity incentive plans under which incentive stock options have been granted to employees and restricted stock units and non-qualified stock options have been granted to employees and non-employees. We also have an employee stock purchase plan for all eligible employees.

## **Table of Contents**

Our stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense over the employee's requisite service period. We have no stock-based compensation awards with market or performance conditions. The stock-based compensation expense attributable to awards under our 2007 Employee Stock Purchase Plan, or ESPP, was determined using the Black-Scholes option pricing model.

We also grant awards to non-employees and determine the fair value of such stock-based compensation awards granted as either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. If the fair value of the equity instruments issued is used, it is measured using the stock price and other measurement assumptions as of the earlier of (i) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached, or (ii) the date at which the counterparty's performance is completed.

We recognize excess tax benefits associated with stock-based compensation to stockholders' equity only when realized. An excess tax benefit occurs when the actual tax benefit realized by us upon an employee's disposition of a share-based award exceeds the deferred tax asset, if any, associated with the award that we had recorded. When assessing whether excess tax benefits relating to stock-based compensation have been realized, we follow the "with and without" approach excluding any indirect effects to be realized until after the utilization of all other tax benefits available to us.

## **Income Taxes**

We estimate income taxes based on the various jurisdictions where we conduct business. Significant judgment is required in determining our worldwide income tax provision. We estimate the current tax liability and assess temporary differences that result from differing treatments of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are reflected in our balance sheets. We then assess the likelihood that deferred tax assets will be realized. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized. When a valuation allowance is established or increased, we record a corresponding tax expense in our statements of operations. We review the need for a valuation allowance each reporting period to reflect uncertainties about whether we will be able to utilize deferred tax assets before they expire. The valuation allowance analysis is based on estimates of taxable income for the jurisdictions in which we operate and the periods over which our deferred tax assets will be realizable.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. During the fourth quarter of 2010 we concluded that it was more likely than not that we would be able to realize the benefit of our federal deferred tax assets in the future. We based this conclusion on historical and projected operating performance, as well as our expectation that our operations will generate sufficient taxable income in future periods to realize the tax benefits associated with the deferred tax assets. As a result, we reduced our valuation allowance on our net deferred tax assets by \$31.6 million at December 31, 2010. We will continue to assess the need for a valuation allowance on the deferred tax asset by evaluating both positive and negative evidence that may exist. Any adjustment to the net deferred tax asset valuation allowance would be recorded in the income statement for the period that the adjustment is determined to be required. We continue to maintain a valuation allowance to offset the California deferred tax assets as realization of such assets does not meet the more-likely-than-not threshold required under accounting guidance given the present lower apportionment factors now pertaining to our income taxes in California.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if

## **Table of Contents**

the weight of available evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not of being sustained upon audit, the second step is to measure the tax benefit as the largest amount that has more than a 50% chance of being realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. We evaluate uncertain tax positions on a quarterly basis. The evaluations are based upon a number of factors, including changes in facts or circumstances, changes in tax law, correspondence with tax authorities during the course of audits and effective settlement of audit issues.

## **Segment Reporting**

We are organized as, and operate in, one reportable segment: the design, development and sale of silicon integrated circuits. Products within this segment are embedded in electronic devices used to enable the delivery of multiple streams of HD video and other multimedia content for entertainment purposes into and throughout the home. Our chief operating decision maker is our chief executive officer, or CEO. Our CEO reviews financial information presented on a consolidated basis for the purpose of evaluating financial performance and allocating resources. There are no segment managers who are held accountable for operations below the consolidated financial statement level. Our assets are primarily located in the United States and not allocated to any specific region. Therefore, geographic information is presented only for total revenue.

## **Recently Issued Accounting Standards**

In May 2011, the FASB issued Accounting Standards Update, or ASU, No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards, or IFRS. This update amends Accounting Standards Codification Topic 820, Fair Value Measurement and Disclosure. ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011, which means that it will be effective for our fiscal quarter beginning January 1, 2012. The new guidance is to be adopted prospectively and early adoption is not permitted. We do not believe that adoption of ASU 2011-04 will have a significant impact on our financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in stockholders' equity and requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We believe the adoption of ASU 2011-05 concerns presentation and disclosure only and will not have an impact on our consolidated financial position or results of operations.

## **Reclassifications**

During the year ended December 31, 2011, within our fair value of financial instrument disclosures, we have reclassified certain amounts from Level 1 to Level 2.

**Table of Contents****2. Supplemental Financial Information****Marketable Securities**

We have marketable securities and financial instruments that are classified as either available-for-sale or trading securities. As of December 31, 2011, our short-term investment portfolio included \$0.2 million of trading securities invested in a defined set of mutual funds directed by the participants in our non-qualified deferred compensation plan. As of December 31, 2011, these securities had no net unrealized gains and a cost basis of \$0.2 million.

The following tables summarize available-for-sale investments by security type as of December 31, 2011 and December 31, 2010 (in thousands):

		As of December 31, 2011		
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
Commercial paper	\$ 12,084	\$ 2	\$ (19)	\$ 12,067
Corporate notes/bonds	73,453	27	(62)	73,418
U.S. Treasury and agency notes/bonds	5,966	10		5,976
Total marketable securities, short-term				
	91,503	39	(81)	91,461
Corporate notes/bonds, long-term				
	72,017	23	(143)	71,897
U.S. Treasury and agency notes/bonds, long-term				
	30,502	26	(19)	30,509
State and municipal bonds, long-term				
	2,301	3	(2)	2,302
<b>Total</b>	<b>\$ 196,323</b>	<b>\$ 91</b>	<b>\$ (245)</b>	<b>\$ 196,169</b>

		As of December 31, 2010		
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
Commercial paper	\$ 18,978	\$	\$ (6)	\$ 18,972
Corporate notes/bonds	21,647	2	(20)	21,629
U.S. Treasury and agency notes/bonds	7,675	1	(2)	7,674
Total marketable securities, short-term				
	48,300	3	(28)	48,275
Corporate notes/bonds, long-term				
	22,412	2	(28)	22,386
<b>Total</b>	<b>\$ 70,712</b>	<b>\$ 5</b>	<b>\$ (56)</b>	<b>\$ 70,661</b>

There were \$7,000 and \$0 net realized gains on our available-for-sale securities in each of years ended December 31, 2011 and 2010, respectively.

**Table of Contents**

The following table summarizes the contractual maturities of our available-for-sale securities (in thousands):

	As of December 31, 2011
Less than one year	\$ 91,461
Due in one to five years	104,708
Due after five years	
	\$ 196,169

**Fair Value Measurements***Financial Instruments*

Cash and cash equivalents consist primarily of bank deposits with third-party financial institutions and highly liquid money market securities with original maturities at date of purchase of 90 days or less and are stated at cost which approximates fair value.

Marketable securities are recorded at fair value, defined as the exit price in the principal market in which we would transact representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Level 1 instruments are valued based on quoted market prices in active markets for identical instruments and include our investments in money market and mutual funds. Level 2 securities are valued using quoted market prices for similar instruments, non-binding market prices that are corroborated by observable market data, or discounted cash flow techniques and include our investments in corporate bonds and notes, U.S. government agency securities, U.S. treasury bills, state and municipal bonds and commercial paper. Level 3 instruments are valued based on unobservable inputs that are supported by little or no market activity and reflect our own assumptions in measuring fair value. We have no marketable securities classified as Level 3 instruments. There were no transfers between different levels during the year ended December 31, 2011.

The fair value measurements of our cash equivalents and marketable securities consisted of the following at December 31, 2011 and 2010 (in thousands):

	Fair Value Measurements as of December 31, 2011			
	Total	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents	\$ 11,036	\$ 11,036	\$	\$
<b>Short-term investments:</b>				
Commercial paper	12,067		12,067	
Corporate notes/bonds	73,419		73,418	
US Treasury and agency notes/bonds	5,976		5,976	
Mutual funds	163	163		
<b>Long-term investments:</b>				
Corporate notes/bonds	71,897		71,897	
U.S. Treasury and agency notes/bonds	30,509		30,509	
State and municipal bonds	2,302		2,302	
 Total assets at fair value	 \$ 207,369	 \$ 11,199	 \$ 196,169	 \$
<b>Liabilities:</b>				
 Non-qualified deferred compensation plan	 \$ 163	 \$	 \$	 \$ 163



**Table of Contents**

	Fair Value Measurements as of December 31, 2010			
	Total	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents	\$ 88,783	\$ 88,783	\$	\$
<b>Short-term investments:</b>				
Commercial paper	18,972		18,972	
Corporate notes/bonds	21,629		21,629	
US Treasury and agency notes/bonds	7,674		7,674	
<b>Long-term investments:</b>				
Corporate notes/bonds	22,386		22,386	
<b>Total assets at fair value</b>	<b>\$ 159,444</b>	<b>\$ 88,783</b>	<b>\$ 70,661</b>	<b>\$</b>
<b>Liabilities:</b>				
Deferred compensation	\$ 513	\$	\$	\$ 513

*Deferred Compensation Liability*

Our deferred compensation liability was fully settled as of December 31, 2011. These liabilities had represented bonus compensation associated with certain stock option grants. Based on the terms of these option grants, a guaranteed cash payment was required to be made in the event that the stock price did not achieve certain price levels. The fair value of this liability was remeasured quarterly using the Black Scholes option pricing model which considers the potential payout, the remaining time until payout, volatility of the underlying shares, and the risk-free interest rate to calculate the liability that may be due under the arrangement.

The change in liability for the years ended December 31, 2011, 2010 and 2009 is included in compensation expense as follows (in thousands):

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)
Liability as of December 31, 2008	\$ 352
Increase in compensation expense	209
Liability as of December 31, 2009	561
Decrease in compensation expense	(48)
Liability as of December 31, 2010	513
Increase in compensation expense	295
Settlement of compensation	(808)
Liability as of December 31, 2011	\$

*Nonrecurring Fair Value Measurements*

We measure certain assets at fair value on a nonrecurring basis. These assets include cost and equity method investments when they are deemed to be other-than-temporarily impaired, assets acquired and liabilities assumed in an acquisition or in a nonmonetary exchange, and property, plant and equipment and intangible assets that are written down to fair value when they are held for sale or determined to be impaired. During the years ended December 31, 2011, 2010 and 2009, we did not have any significant assets or liabilities that were measured at fair value on a nonrecurring basis in periods subsequent to initial recognition.



**Table of Contents****Inventory**

The components of inventory are as follows (in thousands):

	As of December 31,	
	2011	2010
Work in process	\$ 6,499	\$ 15,015
Finished goods	13,754	24,900
<b>Total inventory</b>	<b>\$ 20,253</b>	<b>\$ 39,915</b>

**Property and Equipment**

Property and equipment consist of the following (in thousands, except for years):

	Useful Lives (in years)	As of December 31,	
		2011	2010
Office and laboratory equipment	5	\$ 13,940	\$ 11,573
Computer equipment	3 - 5	3,997	3,104
Furniture and fixtures	3 - 7	1,709	1,805
Leasehold improvements	Lease term	5,648	5,389
Licensed software	1 - 3	1,648	1,390
Construction in progress		585	225
		27,527	23,486
Accumulated depreciation		(16,277)	(12,132)
<b>Property and equipment, net</b>		<b>\$ 11,250</b>	<b>\$ 11,354</b>

Depreciation and amortization expense for the years ended December 31, 2011 and 2010 was \$4.4 million and \$3.8 million, respectively.

**Investment in a Privately Held Company**

In September 2011, we purchased shares of convertible preferred stock in Zenverge, Inc., a privately-held venture capital funded technology company, for a total investment cost of \$10.0 million, which at the time of the investment represented a 16.3% equity interest in the company. We also entered into a strategic partnership to co-develop an integrated chip that combines our MoCA functionality with this entity's independently developed technology. As a result of our joint development arrangement with this company and the appointment of our CEO as a member of the company's board of directors, we have determined that the ability to exercise significant influence over the company exists, and, accordingly, we have accounted for this investment following the equity method. The investment is recorded initially at cost as an investment in a privately held company, and subsequently is adjusted for our equity in net operating results and cash contributions and distributions. In addition, we record charge relating to our proportionate ownership percentage of the premium paid for our investment in excess of our share of their net worth. The fair value of this premium consists of certain intangible asset and goodwill values as determined by a valuation calculation. These intangible assets represent the excess of the book value of the privately held company as compared to the valuation of the privately held company. We are in the process of completing the valuation of our investment and have used our best estimate to calculate the amortization related expense for 2011. For the year ended December 31, 2011, the change in the carrying value of our investment was \$0.8 million, which is reflected as a decrease in our investment. As of December 31, 2011, the carrying amount of our investment in a privately held company was \$9.2 million, which is the extent of our exposure related to our investment in this entity.



**Table of Contents****Accrued Warranty**

The following table presents a rollforward of our product warranty liability, which is included within accrued expenses and other current liabilities in the consolidated balance sheets (in thousands):

	As of December 31,	
	2011	2010
Beginning balance	\$ 97	\$ 147
Expirations	(83)	(115)
Accruals for warranties issued during the year	106	73
Settlements made during the year	(15)	(8)
Change in warranty rate	(90)	
Ending balance	\$ 15	\$ 97

**Accrued Bonuses**

We maintained a discretionary management bonus plan in 2011 and 2010. The potential bonus payments made under each of these plans were based significantly on the achievement of operational, financial and business development objectives for the calendar year. As of December 31, 2011, no management bonuses were accrued or paid under this plan since the operational, financial and business development objectives were not met in 2011. During 2010, we had exceeded all of the performance targets specified by the 2010 bonus plan. As such, we incurred \$3.9 million in management bonuses for the year ended December 31, 2010, of which \$1.5 million was paid during 2010 and the remaining amount was paid in 2011. Any actual bonus amounts awarded will be at the discretion of the compensation committee of our board of directors and in accordance with the terms of the plan.

In addition to the 2010 management bonus plan, we also accrued for a discretionary bonus pool in the amount of \$0.3 million as of December 31, 2010. This bonus pool was approved by the compensation committee of our board of directors. No specific criteria was established by the compensation committee for awards under this bonus pool and the amount and timing of individual awards to eligible employees was made at the discretion of the compensation committee or the individuals to whom the committee delegates its authority. We did not have a discretionary bonus pool for the year ended December 31, 2011.

**Restructuring Activity**

We incurred restructuring charges totaling \$2.2 million in 2009 pursuant to a restructuring plan we implemented in March 2009 that resulted in a worldwide reduction-in-force of 55 employees and the closure of our Nice, France and Kfar Saba, Israel offices. All of the terminated employees received severance payments upon their effective termination. In addition, the affected French and Israeli employees continued to receive salaries until their termination became effective upon the expiration of applicable contractual or statutory notice periods.

We believe that the continued payment of salaries to the terminated Nice and Kfar Saba employees during their respective notice periods represented a one-time termination benefit since we were required by contract or law to make these payments whether or not these employees continued to work for us through their actual termination date. We also recorded restructuring charges relating to the termination of operating leases and other contract costs in the period in which we ceased to exercise the rights conveyed to us by the applicable contract.

**Table of Contents**

The following table presents a rollforward of our restructuring liability as of December 31, 2010, which is included within accrued payroll and benefits in the consolidated balance sheets (in thousands):

	Operating Lease Commitments	Impairment of Property, Equipment and Related Expenses	Impairment of Other Long- Term Assets	Employee Separation Expenses	Total
Liability as of December 31, 2009	\$	\$	\$	\$ 9	\$ 9
Cash payments				(9)	(9)
Liability as of December 31, 2010	\$	\$	\$	\$	\$

The intangible assets associated with the acquisition of Arabella Software Ltd., or Arabella, in 2007 were determined to be fully impaired as of March 31, 2009, as the core technology acquired would no longer be used in our ongoing business operations and there would be no future cash flows associated with this technology. We made a decision in March 2009 to cease use of the technology and do not have any plans to use it in future operations. As a result, an impairment charge of \$0.2 million was recorded in the first quarter of 2009.

**Purchase Commitments**

We had firm purchase order commitments for the acquisition of inventory as of December 31, 2011 and 2010 of \$12.1 million and \$26.0 million, respectively.

**Net Income (Loss) Per Common Share**

We compute basic income (loss) per share of common stock by dividing net income (loss) by the weighted average number of shares of common stock outstanding for the period. Diluted income (loss) per share is computed using the weighted average number of shares of common stock and dilutive common equivalent shares outstanding for the period. Common equivalent shares from stock options and other common stock equivalents are excluded from the computation when their effect is antidilutive.

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated (in thousands, except per share data):

	Years Ended December 31,		
	2011	2010	2009
<b>Numerator:</b>			
Net income (loss) basic and diluted	\$ 26,564	\$ 64,704	\$ (13,240)
<b>Denominator:</b>			
Weighted average number of shares of common stock outstanding	86,269	75,184	70,298
Less: Restricted stock	(11)	(144)	(464)
Weighted average number of shares used to compute net income (loss) per share basic	86,258	75,040	69,834
<b>Effect of dilutive securities:</b>			
Restricted Stock	11	144	
ESPP Shares	55	114	
Stock award common shares equivalents	2,694	3,618	

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

Weighted average number of shares used to compute net income (loss) per share diluted	89,018	78,916	69,834
Net income (loss) per share basic	\$ 0.31	\$ 0.86	\$ (0.19)
Net income (loss) per share diluted	\$ 0.30	\$ 0.82	\$ (0.19)

F-19

**Table of Contents**

Potentially dilutive securities that were not included in the diluted net income (loss) per share calculations because they would be antidilutive, for any reason, are as follows (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Stock options outstanding	4,434	2,263	9,141
Stock reserved for issuance under put and call option agreements			35
Restricted stock			312
Total	4,434	2,263	9,488

**3. Goodwill and Intangible Assets**

In conjunction with our March 2009 restructuring plan, we determined that the intangible assets associated with the acquisition of Arabella in 2007 were fully impaired, as the core technology acquired would no longer be used in our ongoing business operations and there would be no future cash flows associated with this technology. As a result, an impairment charge of \$0.2 million was recorded in 2009.

The rollforward of intangible assets is as follows (in thousands):

	Beginning Balance	December 31, 2010		Net
		Amortization	Impairment	
Developed technology	\$ 1,623	\$ (1,623)	\$	\$

	Beginning Balance	December 31, 2009		Net
		Amortization	Impairment	
Developed technology	\$ 3,469	\$ (1,638)	\$ (208)	\$ 1,623

**4. Credit Facilities**

In April 2011, our \$5.0 million revolving credit line with Silicon Valley Bank expired and we decided not to renew it.

**5. Commitments and Contingencies**

We have multiple operating leases for facilities and software license agreements expiring through 2015. The terms of certain leases provide for rental payments on a graduated scale. We recognize rent expense on a straight-line basis over the respective lease periods and have accrued for rent expense incurred, but not paid. As of December 31, 2011, we had no outstanding capital leases.

The minimum future payments under all non-cancellable operating leases with an initial term of one year or more as of December 31, 2011 were as follows (in thousands):

Years Ending December 31,	
2012	\$ 6,018
2013	5,559
2014	2,896
2015	193
2016	

Thereafter

	\$ 14,666
--	-----------

F-20

## **Table of Contents**

Operating lease expense for the years ended December 31, 2011, 2010 and 2009 was \$5.6 million, \$5.2 million and \$5.5 million, respectively.

From time to time, we may be involved in litigation relating to claims arising out of our operations. We are not a party to any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on its business, financial condition or operating results.

## **6. Stockholders Equity**

### **Common Stock**

On October 5, 2010, we completed a public offering in which 10,750,000 shares of our common stock were sold on our behalf at a price to the public of \$9.70 per share, and which resulted in gross offering proceeds of \$104.3 million and net offering proceeds of approximately \$99.3 million after deducting the offering expenses.

### **Preferred Stock**

We are authorized to issue 10,000,000 shares of undesignated preferred stock at \$0.001 par value per share. Our board of directors may determine the rights, preferences, privileges, qualifications, limitations and restrictions granted or imposed upon any series of preferred stock. As of December 31, 2011, no preferred stock was outstanding.

### **Equity Incentive Plans**

We have in effect equity compensation plans under which incentive stock options, non-qualified stock options and restricted stock units have been granted to employees, directors and consultants to purchase shares of our common stock at a price not less than the fair market value of the stock at the date of grant except in the event of a business combination.

#### ***2007 Equity Incentive Plan***

Our 2007 Equity Incentive Plan, or the 2007 Plan, became effective upon the execution of the underwriting agreement in connection with our initial public offering and replaced our 2001 Stock Option Plan, or the 2001 Plan. The 2007 Plan provides for the grant of incentive and non-statutory stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, performance stock awards and other forms of equity compensation, or collectively Stock Awards. As of December 31, 2011, there were 21,054,000 shares of common stock reserved under the 2007 Plan. This share amount is automatically increased by the amount equal to the number of shares subject to any outstanding option under the 2001 Plan that expires or is forfeited following the date that the 2007 Plan became effective. In addition, the share reserve will automatically increase on January 1 of each year through 2017 by the lesser of 5% of the total number of shares of common stock outstanding on December 31 of the preceding calendar year, 7,692,000 shares of common stock, or a lesser amount of shares of common stock to be determined by the board of directors prior to the first day of the calendar year. Our board of directors may amend or terminate the 2007 Plan at any time. Generally, options outstanding vest over periods not exceeding four years and are exercisable for up to ten years from the grant date. In January 2012, 4,358,000 shares of common stock, which was 5% of the outstanding shares of common stock as of December 31, 2011, were added to the 2007 Plan.

#### ***2007 Non-Employee Directors Plan***

Our 2007 Non-Employee Directors Plan, or Directors Plan, became effective upon the execution of the underwriting agreement in connection our initial public offering. As of December 31, 2011, an aggregate of 652,000 shares of common stock were reserved for future issuance under the Directors



---

**Table of Contents**

plan. This share amount will automatically increase on January 1 of each year through 2017 by an amount equal to the excess of: the number of shares subject to options granted during the preceding calendar year, over the number of shares, if any, added back to the share reserve during the preceding calendar year. Upon election to our board of directors, each non-employee director will receive an initial grant of a non-qualified option to purchase 51,000 shares of our common stock, which will vest in forty-eight equal monthly installments. Further, non-employee directors receive an automatic annual grant of a non-qualified option to purchase 13,000 shares of common stock, which will vest in twelve equal monthly installments. The exercise price of any options granted to a non-employee director under the Directors' Plan is equal to 100% of the fair market value of our common stock on the date of the grant. The Directors' Plan provides that options granted under the plan will become fully vested and exercisable in the event of a change of control. In January 2012, 59,000 shares of common stock, which was equal to the number of shares subject to grants made under the Directors' Plan in 2011, less the shares added back from cancellations, were added to the Directors' Plan.

***2007 Employee Stock Purchase Plan***

Under the terms of our ESPP, all eligible employees may purchase shares of common stock at 85% of the lower of the fair market value on the first date of each twelve-month offering period or the purchase date. Employees may authorize us to withhold up to 15% of their compensation during any offering period, subject to certain limitations, to purchase shares of our common stock under the ESPP. The ESPP authorized up to 4,873,000 shares of common stock for purchase by our employees during the year ended December 31, 2011. The ESPP share reserve will automatically increase on January 1 of each year through 2017 by the lesser of 1.5% of the total number of shares of common stock outstanding on December 31 of the preceding calendar year, 2,308,000 shares of common stock, or a lesser amount of shares of common stock to be determined by our board of directors prior to the first day of the calendar year. In January 2012, 1,307,000 shares of common stock, which was 1.5% of the outstanding shares of common stock as of December 31, 2011, were added to the ESPP.

***RF Magic 2000 Incentive Stock Plan***

In connection with our acquisition of RF Magic, we assumed RF Magic's 2000 Incentive Stock Plan, or the RF Magic Plan, including all of the outstanding stock options issued under the RF Magic Plan, except those held by employees of RF Magic's French subsidiary. The stock options under the RF Magic Plan that we assumed became options to purchase an aggregate of 2,685,000 shares of our common stock. The stock options held by employees of RF Magic's French subsidiary that we did not assume remained as options to purchase RF Magic's common stock. At the time of the acquisition an aggregate of 195,000 shares of RF Magic's common stock were issuable upon exercise of the unassumed RF Magic options. The unassumed RF Magic options are a subject to put and call option agreements between us, RF Magic and the holders of these options. Under these put and call option agreements, each share of RF Magic common stock issued upon exercise of the unassumed RF Magic options will be exchanged for 0.9344 shares of our common stock, which is equal to the number of shares of our common stock issued in exchange for each outstanding share of RF Magic in the acquisition. We reserved 182,000 shares of our common stock for future issuance under the put and call option agreements as of December 31, 2007. In 2011 and 2010, 11,000 shares and 18,000 shares of our common stock, respectively, were issued in connection with the exercise of RF Magic options subject to put and call option agreements. As of December 31, 2011, there were no remaining options outstanding under the RF Magic Plan.

Stock option grants under the 2001 Plan and RF Magic Plan are subject to an early exercise provision. Those under the RF Magic Plan allow for early exercise upon approval by our board of directors. Shares of common stock obtained upon early exercise of unvested options or by restricted

**Table of Contents**

stock purchase rights are subject to our repurchase at the applicable original issue price and will vest according to the respective agreement. As of December 31, 2011, 2010 and 2009, 0, 53,000 and 302,000 shares, respectively, were subject to our repurchase rights.

The consideration received for the exercise of an unvested stock option is considered a deposit of the exercise price, and thus is a liability that is recorded by us. The liability associated with this potential for repurchase, and the related shares, are only reclassified into equity as the option award vests. As a result, we have recorded liabilities as of December 31, 2011, 2010 and 2009 of \$0, \$0.1 million and \$0.3 million, respectively, for the unvested shares issued upon early exercise of stock options.

**Combined Incentive Plan Activity**

A summary of our stock option award activity and related information under our existing incentive plans for the years ended December 31, 2011, 2010 and 2009 is set forth below. The following summary excludes options to purchase up to 0, 11,000 and 35,000 shares of our common stock subject to put and call option agreements for RF Magic options outstanding as of December 31, 2011, 2010 and 2009, respectively.

	(in thousands, except per share data)		
	Number of Stock Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Outstanding as of December 31, 2008	10,154	\$ 2.23	\$ 263
Granted	3,785	2.18	
Exercised	(1,221)	0.91	
Cancelled/forfeited/expired	(3,577)	3.51	
Outstanding as of December 31, 2009	9,141	1.88	\$ 11,916
Granted	3,463	5.23	
Exercised	(2,359)	1.51	
Cancelled/forfeited/expired	(526)	2.94	
Outstanding as of December 31, 2010	9,719	3.10	\$ 87,225
Granted	3,001	8.08	
Exercised	(1,425)	2.00	
Cancelled/forfeited/expired	(224)	5.40	
Outstanding as of December 31, 2011	11,071	4.55	\$ 16,171

The weighted-average grant date fair value per share of employee stock options granted during the years ended December 31, 2011, 2010 and 2009 was \$5.52, \$3.51 and \$1.49, respectively. Stock-based compensation expense related to employees for the years ended December 31, 2011, 2010 and 2009 was \$12.5 million, \$10.1 million and \$9.3 million, respectively. The weighted average remaining contractual term of options outstanding as of December 31, 2011 was 7.5 years. The total intrinsic value of options exercised during the years ended December 31, 2011, 2010 and 2009 was \$9.2 million, \$14.0 million and \$2.1 million, respectively. Option exercises were settled with shares of common stock.

As of December 31, 2011, outstanding options to purchase 4,756,000 shares were exercisable with a weighted average exercise price of \$2.87 per share and an aggregate intrinsic value of \$11.2 million. The weighted average remaining contractual term of options exercisable as of December 31, 2011 was 6.6 years.

**Table of Contents**

During the year ended December 31, 2011, 539,000 shares of our common stock were purchased through the ESPP which resulted in proceeds to us of \$3.0 million.

Restricted stock unit activity for the years ended December 31, 2011, 2010 and 2009 was as follows:

	Number of Shares	Restricted Stock Units Outstanding Weighted Average Grant-Date Fair Value per Share
Balance at December 31, 2008	51,500	\$ 3.89
Restricted stock units granted	10,000	2.61
Restricted stock units cancelled	(29,750)	3.88
Restricted stock units vested	(21,750)	3.90
Balance at December 31, 2009	10,000	2.61
Restricted stock units granted	251,175	4.82
Restricted stock units cancelled	(12,000)	2.97
Balance at December 31, 2010	249,175	4.82
Restricted stock units granted	517,384	8.24
Restricted stock units cancelled	(23,800)	7.54
Restricted stock units vested	(117,088)	4.80
Balance at December 31, 2011	625,671	7.55

Stock based compensation expense associated with the above restricted stock unit awards for the years ended December 31, 2011, 2010 and 2009, was \$1.4 million, \$0.4 million and (\$0.1) million, respectively.

As of December 31, 2011, we had 11,864,000 authorized shares available for future issuance under all of our equity incentive plans.

**Stock-Based Compensation Expense**

Stock-based compensation expense recognized in our statement of operations in 2011, 2010 and 2009 included compensation expense for stock-based options and awards granted subsequent to December 31, 2005, based on the grant date fair value. For options and awards granted, expenses are amortized under the straight-line method. Stock-based compensation expense recognized in the statement of operations has been reduced for estimated forfeitures of options that are subject to vesting. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

We allocated stock-based compensation expense as follows (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Cost of net revenues	\$ 557	\$ 384	\$ 138
Research and development	6,272	5,049	4,552
Sales and marketing	1,986	1,558	1,401
General and administrative	3,932	3,479	3,276
Total stock-based compensation expense	\$ 12,747	\$ 10,470	\$ 9,367



**Table of Contents**

We granted options and other stock awards to consultants in connection with their service agreements. For the years ended December 31, 2011, 2010 and 2009, we recorded compensation expense related to these awards of \$0.2 million, \$0.4 million and \$0.1 million, respectively. The fair value of the awards was estimated using a Black-Scholes option-pricing model.

We reviewed and updated our forfeiture rate, expected term and volatility assumptions during the year ended December 31, 2011 and there was no significant impact. The risk-free interest rate is based on zero coupon U.S. Treasury instruments with maturities similar to those of the expected term of the award being valued. We use a combination of our historical experience, the contractual term and the average option term of a comparable peer group to determine the expected life of our option grants. The peer group historical term is used due to the limited trading history of our common stock. The estimated volatility incorporates historical volatility of similar entities whose share prices are publicly available. The expected dividend yield was based on our expectation of not paying dividends on common stock for the foreseeable future.

The total fair value of options and awards for each of the years ended December 31, 2011, 2010 and 2009, was \$9.2 million, \$7.4 million and \$9.4 million, respectively. The fair value of stock options granted to employees, directors and consultants was estimated at the grant date using the following assumptions:

	Years Ended December 31,		
	2011	2010	2009
Expected life (years)	5.0 - 5.1	5.0 - 6.1	6.1
Contractual term (years) for consultant options	10	10	10
Risk-free interest rate	1.0% - 2.2%	1.3% -3.1%	2.4% -3.2%
Expected volatility	86% to 87%	80% to 85%	76% to 80%
Expected dividend yield			

The fair value of stock options granted under the ESPP was estimated at the grant date using the following assumptions:

	Years Ended December 31,		
	2011	2010	2009
Expected life (years)	0.5 - 1.0	0.5 - 1.0	0.5 - 1.0
Risk-free interest rate	0.1% to 0.4%	0.2% to 0.5%	0.1% to 0.9%
Expected volatility	42% to 100%	63% to 151%	82% to 180%
Expected dividend yield			

In May 2009, we completed an offer to exchange, or the Offer to Exchange, certain employee stock options to purchase shares of our common stock that were outstanding under our 2007 Plan, 2001 Plan and RF Magic Plan, on a three-for-two basis for replacement options granted under the 2007 Plan at an exercise price of \$1.99 per share, which was the closing price of our common stock on May 15, 2009, as reported by The NASDAQ Global Market. At the expiration of the Offer to Exchange, we accepted elections to exchange options to purchase 1,600,000 shares of common stock and, as a result, we granted replacement options to purchase 1,000,000 shares of common stock. The replacement options have new vesting schedules with vesting dates that are determined by adding an additional vesting period of 12 months, or a shorter duration upon a change of control, to each vesting date under the existing vesting schedule of the options being replaced. However, no replacement option will vest sooner than 12 months from its date of grant, unless a change of control occurs. The incremental value attributed to the option awards exchanged resulted in approximately \$60,000 of stock-based compensation, which will be recognized over the vesting period of the new option awards.

**Table of Contents**

As of December 31, 2011, we estimate there were \$22.1 million in total unrecognized compensation costs related to employee stock option agreements, which are expected to be recognized over a weighted-average period of 1.5 years. As of December 31, 2011, we estimate there were \$1.2 million of unrecognized compensation costs related to the shares expected to be purchased through the ESPP, which are expected to be recognized over a remaining weighted-average period of 0.5 years.

**Shares Reserved for Future Issuance**

The following shares of common stock are reserved for future issuance (in thousands):

	As of December 31,	
	2011	2010
Exercise of stock awards issued and outstanding	11,071	9,719
Authorized for grants under equity incentive plans	11,864	9,977
Subsidiary stock options subject to put and call options agreements		11
<b>Total</b>	<b>22,935</b>	<b>19,707</b>

**7. Income Taxes**

The domestic and international components of income (loss) before provision (benefit) from income taxes are presented as follows (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Domestic	\$ 39,553	\$ 32,340	\$ (12,011)
International	1,064	918	(1,322)
<b>Income (loss) before taxes</b>	<b>\$ 40,617</b>	<b>\$ 33,258</b>	<b>\$ (13,333)</b>

Income tax provision (benefit) consists of the following (in thousands):

	Years Ended December 31,		
	2011	2010	2009
<b>Current:</b>			
Federal	\$ 1,198	\$	\$ (100)
State	13	(7)	2
Foreign	168	151	5
<b>Total current</b>	<b>\$ 1,379</b>	<b>\$ 144</b>	<b>\$ (93)</b>
<b>Deferred:</b>			
Federal	\$ 12,674	\$ (31,590)	\$
State			
<b>Total deferred</b>	<b>12,674</b>	<b>(31,590)</b>	
<b>Total income tax benefit</b>	<b>\$ 14,053</b>	<b>\$ (31,446)</b>	<b>\$ (93)</b>



**Table of Contents**

The following is a reconciliation of the expected statutory federal income tax provision to our actual income tax benefit (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Tax computed at the federal statutory rate	\$ 14,216	\$ 11,640	\$ (4,113)
State tax, net of federal benefit	62	1,226	(253)
Goodwill impairment			83
Permanent items	87	(702)	978
Stock-based compensation	618	71	1,891
Research credits	(4,276)	(4,513)	(4,509)
Tax reserves	942	(2,795)	1,787
Change in tax rates		(2,152)	(17)
Change in valuation allowance	2,609	(35,906)	4,055
Difference in foreign tax rate	(205)	(169)	5
Tax attribute write-off		1,854	
Income tax benefit	\$ 14,053	\$ (31,446)	\$ (93)

The significant components of our deferred tax assets and liabilities were comprised of the following at December 31, 2011 and 2010 (in thousands):

	As of December 31,	
	2011	2010
Deferred tax assets:		
Net operating loss carryforwards	\$ 2,648	\$ 13,718
R&D and MIC credit carryforwards	21,841	17,352
Capitalized R&D	1,831	3,081
Other, net	660	1,745
Stock-based compensation	6,594	4,000
Acquired intangibles	2,890	2,405
Total deferred tax assets	36,464	42,301
Valuation allowance for deferred tax assets	(13,299)	(10,690)
Net deferred tax assets	\$ 23,165	\$ 31,611

At December 31, 2011, we had total federal and state net operating loss, or NOL, carryforwards of approximately \$3.6 million and \$32.2 million, respectively. Approximately \$1.3 million of the federal NOL relates to stock option deductions which, upon realization, will result in an increase to paid-in capital and a decrease in income taxes payable. If not utilized, the federal and state NOL carryforwards will begin to expire in 2021 and 2013, respectively.

As of December 31, 2011, we had federal and state research and development tax credit, or R&D, carryforwards of approximately \$14.1 million and \$14.0 million, respectively. The federal R&D tax credit carryforwards will begin to expire in 2021 unless previously utilized. The California R&D tax credit will carryforward indefinitely; however, we presently expect that only a minor portion of this credit will be utilized each year thereby requiring such a long future period of California profits that it does not meet the more-likely-than-not criteria.

As of December 31 2010, based on the weight of available evidence, including profitability in 2010 and the availability of expected future taxable income, we concluded that it is more likely than not that the benefits of Federal deferred income tax assets will be realized. Accordingly, we reduced





**Table of Contents**

the valuation allowances on our Federal gross deferred income tax assets. We continue to maintain a valuation allowance to offset the California deferred tax assets as realization of such assets does not meet the more-likely-than-not threshold required under accounting guidance given the present lower apportionment factors now pertaining to our income taxes in California.

The net change in the total valuation allowance was an increase of \$2.6 million for the year ended December 31, 2011. For the year ended December 31, 2010, the valuation allowance decreased by \$35.9 million and for the year ended December 31, 2009, the valuation allowance increased by \$4.1 million.

Pursuant to Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, utilization of NOLs and credit carryforwards may be subject to an annual limitation due to future ownership change limitations provided by the Internal Revenue Code and similar state provisions. The tax benefits related to future utilization of federal and state NOLs and tax credit carryforwards may be limited or lost if cumulative changes in ownership exceed 50% within any three-year period. While there may have been prior changes in ownership, it is anticipated that we will be able to utilize substantially all of our remaining federal and state NOLs and tax credit carryforwards

We recognize excess tax benefits associated with the exercise of stock options directly to stockholders' equity only when realized. Accordingly, deferred tax assets are not recognized for NOLs resulting from excess tax benefits. At December 31, 2011, deferred tax assets did not include \$0.4 million of excess tax benefits from share-based compensation.

As of December 31, 2011 and 2010, our unrecognized tax benefits totaled \$7.6 million and \$6.7 million, respectively, of which \$6.3 million and \$5.4 million, respectively, would impact the effective tax rate if recognized.

The following table summarizes the activity related to our unrecognized tax benefits (in thousands):

Balance as of December 31, 2009	\$ 9,520
Decreases related to prior year tax positions	(3,843)
Increases related to current year tax positions	1,048
Balance as of December 31, 2010	\$ 6,725
Decreases related to prior year tax positions	(831)
Increases related to current year tax positions	1,657
Balance as of December 31, 2011	\$ 7,551

We do not expect unrecognized tax benefits to change significantly over the next 12 months.

We file income tax returns in the United States and in various state jurisdictions with varying statutes of limitations. We are no longer subject to income tax examination by Federal and State tax authorities for years prior to 2008, however, NOL and R&D credit carryforwards arising prior to that year are subject to adjustment. Our policy is to recognize interest expense and penalties related to income tax matters as a component of income tax expense. As of December 31, 2011, the amount accrued for interest and penalties associated with uncertain tax positions was nominal. We are currently under a tax audit in Israel for tax years 2007 through 2009.

**8. Employee Benefits**

We have a defined contribution 401(k) plan for employees who are at least 21 years of age. Under the terms of the plan, employees may make voluntary contributions as a percentage of compensation,

**Table of Contents**

but not in excess of the maximum amounts allowed under the Internal Revenue Code. Our contributions to the plan are discretionary. We contributed \$0.5 million to the plan during the year ended December 31, 2011. We made no contributions during the years ended December 31, 2010 and 2009.

**9. Supplemental Disclosure of Cash-Flow and Non-Cash Activity****Cash-Flow**

The following table sets forth supplemental disclosure of cash flow information (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Cash paid for taxes	\$ 1,859	\$ 23	\$ 57
<b>Non-Cash Activity</b>			

The following table sets forth supplemental disclosure of non-cash activity (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Repurchase liability for early exercise of stock options	92	254	439
Currency translation adjustment	(47)	24	(88)
Unrealized loss on investments, net of tax	83	31	

**10. Significant Customer, Vendor and Geographic Information****Customers**

Based on direct shipments, customers that exceeded 10% of total net revenues and accounts receivable were as follows:

	Net Revenues Years Ended December 31,			Accounts Receivable As of December 31,	
	2011	2010	2009	2011	2010
Actiontec Electronics, Inc.	*	*	16%	10%	*
Foxconn Electronics, Inc.	*	*	*	12%	*
Motorola Mobility, Inc.	17%	17%	27%	15%	26%
Samsung Electronics Co., Ltd.	*	*	*	*	11%
Wistron NeWeb Corporation	25%	21%	*	35%	18%

\* Customer accounted for less than 10% of total net revenues or accounts receivable, as applicable, for the period indicated

**Vendors**

We had three vendors that represented a significant portion of total purchases (exclusive of payroll and related costs) as follows:

	Years Ended December 31,		
	2011	2010	2009
Amkor Technology, Inc.	28%	27%	27%
Taiwan Semiconductor Manufacturing Company, Ltd.	23%	32%	25%

Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

Tower Semiconductor Ltd.	15%	17%	*
--------------------------	-----	-----	---

\* Vendor accounted for less than 10% of total purchases (exclusive of payroll and related costs) for the period indicated

F-29

**Table of Contents****Geographic Information**

Net revenues are allocated to the geographic region based on the shipping destination of customer orders. Net revenues by geographic region were as follows (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Asia	\$ 213,524	\$ 195,056	\$ 107,117
Europe	756	3,079	2,193
United States	872	2,969	3,097
North America, other	25,476	9,133	3,898
	\$ 240,628	\$ 210,237	\$ 116,305

As of December 31, 2011 and 2010, long-lived assets, which represent property, plant and equipment, net of accumulated depreciation, located outside of the United States was \$1.2 million and \$0.5 million, respectively.

**11. Subsequent Event**

On January 4, 2012, we announced that we agreed to become a stalking horse bidder to acquire the assets of Trident Microsystems, Inc. and certain of its subsidiaries, or Trident, used in or related to Trident's set-top box business, or STB Business, for a purchase price of \$55.0 million, subject to a working capital adjustment, or the Acquisition, pursuant to an Asset Purchase Agreement, or Purchase Agreement.

Trident filed the Purchase Agreement with the United States Bankruptcy Court for the District of Delaware along with Trident's motion seeking the establishment of bid procedures for an auction that allows other qualified bidders to submit higher or otherwise better offers, as required under Section 363 of the U.S. Bankruptcy Code. On January 18, 2012, the Court approved the bid procedures and Trident and Entropic executed the Purchase Agreement. The closing of the Acquisition, which is expected to occur in the first quarter of 2012, remains subject to higher or otherwise better offers approval by the United States Bankruptcy Court and customary closing conditions. If Trident accepts an offer other than our Purchase Agreement, we will be entitled to be paid a break-up fee and a reimbursement of certain of our transaction expenses.

Pursuant to the Purchase Agreement, we will acquire all of Trident's specific STB Business products, patents and other intellectual property owned by Trident, certain contracts and prepaid expenses, certain tangible assets, accounts receivable, inventory and equipment. Trident will retain its digital television, PC television, audio and terrestrial demod businesses. We will also acquire leased facilities in Austin, Texas, San Diego, California, Belfast, Northern Ireland and Hyderabad, India and the right to use other facilities of Trident under short term Facilities Use Agreements. We will assume certain specified liabilities of Trident.

**Table of Contents****12. Quarterly Financial Data (Unaudited)**

The following table presents certain quarterly financial data for the eight consecutive quarters ended December 31, 2011. The unaudited quarterly information has been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, includes all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of this data. We believe that our quarterly revenue, particularly the mix of revenue components, and operating results are likely to vary in the future. The operating results for any quarter are not necessarily indicative of the operating results for any future period or for any full year.

	Net Revenues	Gross Profit	Net Income (Loss)(1) (in thousands, except per share data)	Basic Net Income (Loss) Per Share	Diluted Net Income (Loss) Per Share
<b>Year Ended December 31, 2011</b>					
Fourth Quarter	\$ 56,169	\$ 30,828	\$ 2,308	\$ 0.03	\$ 0.03
Third Quarter	51,465	28,469	4,645	0.05	0.05
Second Quarter	61,473	33,827	7,756	0.09	0.09
First Quarter	71,521	39,582	11,855	0.14	0.13
<b>Year Ended December 31, 2010</b>					
Fourth Quarter	\$ 70,796	\$ 38,032	\$ 48,583(2)	\$ 0.58	\$ 0.55
Third Quarter	61,310	32,536	11,271	0.15	0.15
Second Quarter	40,680	21,849	3,092	0.04	0.04
First Quarter	37,451	19,750	1,758	0.02	0.02
<b>Year Ended December 31, 2009</b>					
Fourth Quarter	\$ 35,078	\$ 18,116	\$ 1,021	\$ 0.01	\$ 0.01
Third Quarter	30,958	15,626	(1,238)	(0.02)	(0.02)
Second Quarter	26,146	12,945	(4,287)	(0.06)	(0.06)
First Quarter	24,123	12,219	(8,736)	(0.13)	(0.13)

(1) Net income attributable to common stockholders.

(2) Includes a net benefit of \$31.6 million related to the reduction of the valuation allowance previously recorded on certain of our deferred tax assets.

**Table of Contents****SCHEDULE II CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS****ENTROPIC COMMUNICATIONS, INC.***(in thousands)*

<b>Description</b>	<b>Balance at Beginning of Year</b>	<b>Charged to Costs and Expenses</b>	<b>Deductions</b>	<b>Balance at End of Year</b>
<b>Year Ended December 31, 2011</b>				
Deducted from asset accounts:				
Allowance for doubtful accounts	\$	\$	\$	\$
Reserve for excess and obsolete inventory	1,789	1,738	(243)	3,284
<b>Total</b>	<b>\$ 1,789</b>	<b>\$ 1,738</b>	<b>\$ (243)</b>	<b>\$ 3,284</b>
<b>Year Ended December 31, 2010</b>				
Deducted from asset accounts:				
Allowance for doubtful accounts	\$	\$	\$	\$
Reserve for excess and obsolete inventory	2,607	156	(974)	1,789
<b>Total</b>	<b>\$ 2,607</b>	<b>\$ 156</b>	<b>\$ (974)</b>	<b>\$ 1,789</b>
<b>Year Ended December 31, 2009</b>				
Deducted from asset accounts:				
Allowance for doubtful accounts	\$	\$	\$	\$
Reserve for excess and obsolete inventory	1,949	1,182	(524)	2,607
<b>Total</b>	<b>\$ 1,949</b>	<b>\$ 1,182</b>	<b>\$ (524)</b>	<b>\$ 2,607</b>

S-1

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ENTROPIC COMMUNICATIONS, INC.**

By: /s/ **PATRICK HENRY**  
**Patrick Henry**

**President and Chief Executive Officer**

Date: February 3, 2012

Each of the undersigned directors and officers of Entropic Communications, Inc., hereby severally constitute Patrick Henry, David Lyle and Trevor Renfield, and each of them singly, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, and we hereby grant unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming that all said attorneys-in-fact and agents, or any of them or their or his substitute or substituted, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ <b>PATRICK HENRY</b>  <b>Patrick Henry</b>	President, Chief Executive Officer and Member of the Board of Directors  <i>(Principal Executive Officer)</i>	February 3, 2012
/s/ <b>DAVID LYLE</b>  <b>David Lyle</b>	Chief Financial Officer  <i>(Principal Financial Officer)</i>	February 3, 2012
/s/ <b>TREVOR RENFIELD</b>  <b>Trevor Renfield</b>	Corporate Controller and Principal Accounting Officer <i>(Principal Accounting Officer)</i>	February 3, 2012
/s/ <b>UMESH PADVAL</b>  <b>Umesh Padval</b>	Chairman of the Board of Directors	February 3, 2012
/s/ <b>ROBERT L. BAILEY</b>  <b>Robert L. Bailey</b>	Member of the Board of Directors	February 3, 2012
/s/ <b>THOMAS BARUCH</b>  <b>Thomas Baruch</b>	Member of the Board of Directors	February 3, 2012
/s/ <b>KEITH BECHARD</b>  <b>Keith Bechard</b>	Member of the Board of Directors	February 3, 2012



Edgar Filing: ENTROPIC COMMUNICATIONS INC - Form 10-K

/s/ KENNETH MERCHANT

Member of the Board of Directors

February 3, 2012

**Kenneth Merchant**

/s/ THEODORE TEWKSBURY

Member of the Board of Directors

February 3, 2012

**Theodore Tewksbury**

**Table of Contents**

**Exhibit Index**

**Exhibit**

<b>Number</b>	<b>Description of Document</b>
2.1(13)	Asset Purchase Agreement dated January 18, 2012 by and between the Registrant and Trident Microsystems, Inc. and certain of its subsidiaries.
3.1(1)	Amended and Restated Certificate of Incorporation of the Registrant.
3.2(2)	Amended and Restated Bylaws of the Registrant.
4.1	Reference is made to Exhibits 3.1 and 3.2.
4.2(3)	Form of Common Stock Certificate of the Registrant.
10.1+(4)	2007 Equity Incentive Plan and Form of Option Agreement, Form of Option Grant Notice thereunder and Notice of Exercise.
10.2+(5)	2007 Non-Employee Directors Stock Option Plan and Form of Option Agreement, Forms of Grant Notice and Notice of Exercise thereunder.
10.3+(4)	2007 Employee Stock Purchase Plan and Form of Offering Document thereunder.
10.4+(3)	2001 Equity Incentive Plan and Form of Stock Option Agreement, Form of Notice Grant of Stock Option and Form of Stock Option Exercise Notice thereunder.
10.5+(3)	RF Magic, Inc. 2000 Incentive Stock Plan and Form of Stock Option Agreement and Form of Stock Option Grant Notice thereunder.
10.6+(6)	Entropic Communications, Inc. Management Bonus Plan.
10.7+(3)	Form of Indemnity Agreement by and between the Registrant and each of its directors and executive officers.
10.8+(3)	Form of Employee Innovations and Proprietary Rights Assignment Agreement by and between the Registrant and each of its executive officers.
10.9+(7)	Employment Offer Letter dated April 18, 2007 by and between the Registrant and Lance Bridges.
10.10+(8)	Retention Bonus Agreement dated March 31, 2009 by and between the Registrant and Lance Bridges.
10.11+(9)	Amended and Restated Change of Control Agreement dated December 7, 2009 by and between the Registrant and Lance Bridges.
10.12+(9)	Amended and Restated Executive Employment Agreement dated December 7, 2009 by and between the Registrant and Patrick Henry.
10.13+(10)	Employment Offer Letter dated June 15, 2007 by and between the Registrant and David Lyle.
10.14+(8)	Retention Bonus Agreement dated March 31, 2009 by and between the Registrant and David Lyle.
10.15+(9)	Amended and Restated Change of Control Agreement dated December 7, 2009 by and between the Registrant and David Lyle.
10.16+(3)	Director Offer Letter dated March 25, 2007 by and between the Registrant and Kenneth Merchant.
10.17+(3)	Director Offer Letter dated November 23, 2004 by and between the Registrant and Umesh Padval.
10.18+(10)	Director Offer Letter dated June 9, 2009 by and between the Registrant and Keith Bechard.

**Table of Contents**

**Exhibit**

<b>Number</b>	<b>Description of Document</b>
10.19+(11)	Director Offer Letter dated August 29, 2010 by and between Registrant and Dr. Ted Tewksbury.
10.20+(11)	Director Offer Letter dated September 1, 2010 by and between Registrant and Robert Bailey.
10.21+(6)	Amended and Restated Employment Offer Letter and Relocation Agreement dated March 31, 2010 by and between the Registrant and Tom Lookabaugh.
10.22+(6)	Amended and Restated Change of Control Agreement dated December 3, 2009 by and between the Registrant and Tom Lookabaugh.
10.23+(6)	Amended and Restated Employment Offer Letter and Relocation Agreement dated March 31, 2010 by and between the Registrant and Vinay Gokhale.
10.24+(6)	Amended and Restated Change of Control Agreement dated December 15, 2009 by and between the Registrant and Vinay Gokhale.
10.25+(12)	Amended and Restated Offer Letter and Relocation Agreement dated May 19, 2011 by and between the Registrant and Michael Farese.
10.26+(12)	Amended and Restated Relocation Agreement dated May 19, 2011 by and between the Registrant and Michael Farese.
10.27+(5)	Change of Control Agreement dated June 1, 2010 by and between the Registrant and Michael Farese.
10.28(3)	Office Lease dated August 31, 2007 by and between the Registrant and Kilroy Realty, L.P.
10.29(3)	Promoter Member Agreement dated November 20, 2003, as amended, by and between the Registrant and Multimedia over Coax Alliance.
10.30#(3)	Corporate Supply Agreement dated March 2, 2006 by and between the Registrant and Motorola Mobility, Inc. (formerly Motorola, Inc.)
10.31#(3)	Development and License Agreement dated September 15, 2002 by and between RF Magic, Inc. and STMicroelectronics N.V.
10.32+(12)	Entropic Communications, Inc. Nonqualified Deferred Compensation Plan.
10.33+(12)	Form of Restricted Stock Unit Award Grant Notice and Restricted Stock Unit Agreement-Recipients Not Eligible to Participate Under the Nonqualified Deferred Compensation Plan.
10.34+(12)	Form of Restricted Stock Unit Award Grant Notice and Restricted Stock Unit Agreement-Recipients Eligible to Participate Under the Nonqualified Deferred Compensation Plan.
21.1*	Subsidiaries of the Registrant.
23.1*	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.1*	Power of Attorney (included as part of the signature page).
31.1*	Certification of the Chief Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32*	Certifications of the Chief Executive Officer and Chief Financial Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS**	XBRL Instance Document.

**Table of Contents****Exhibit**

<b>Number</b>	<b>Description of Document</b>
101.SCH**	XBRL Taxonomy Extension Schema Document.
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document.

+ Indicates management contract or compensatory plan.

# Confidential treatment has been granted with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.

\* Filed herewith.

\*\* Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 460T, these interactive data files are deemed not filed and otherwise are not subject to liability.

- (1) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on December 13, 2007.
  - (2) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on December 5, 2008.
  - (3) Incorporated herein by reference to the Registrant's Registration Statement on Form S-1 (No. 333-144899), as amended, filed with the SEC.
  - (4) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K filed with the SEC on March 3, 2008.
  - (5) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K filed with the SEC on February 3, 2011.
  - (6) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on April 14, 2010.
  - (7) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on April 8, 2008.
  - (8) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on April 6, 2009.
  - (9) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on December 7, 2009.
  - (10) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on June 17, 2009.
  - (11) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on September 7, 2010.
  - (12) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on May 24, 2011.
  - (13) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on January 20, 2012.
- XBRL Interactive Data File will be filed by amendment to this Form 10-K within 30 days of the filing date of this Form 10-K, as permitted by Rule 405(a)(2)(ii) of Regulation S-T.