

SIGMA DESIGNS INC  
Form 10-Q  
September 11, 2008  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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(MARK ONE)

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

For the quarterly period ended August 2, 2008

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-32207

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

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California  
(State or other jurisdiction of  
incorporation or organization)

94-2848099  
(I.R.S. Employer  
Identification No.)

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

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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 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

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company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting  
R company

(Do not check if a smaller  
reporting company)

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

As of September 5, 2008, the Company had 26,353,214 shares of Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	August 2, 2008	February 2, 2008
Assets		
Current Assets:		
Cash and cash equivalents	\$ 75,762	\$ 174,089
Short-term marketable securities	44,816	44,401
Accounts receivable, net	39,628	40,205
Inventories	45,150	26,283
Deferred tax assets	5,155	5,155
Prepaid expenses and other current assets	6,897	5,547
Total current assets	217,408	295,680
Long-term marketable securities	59,070	57,242
Software, equipment and leasehold improvements, net	14,007	8,783
Long-term investments	263	263
Goodwill	7,254	5,020
Intangible assets, net	12,786	4,303
Deferred tax assets, net of current portion	5,787	7,513
Other non-current assets	938	662
Total assets	\$ 317,513	\$ 379,466
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 14,536	\$ 18,484
Accrued liabilities	11,190	14,018
Total current liabilities	25,726	32,502
Other long-term liabilities	1,812	1,372
Total liabilities	27,538	33,874
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Preferred stock - no par value, 2,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock and additional paid-in capital; no par value; 100,000,000 shares authorized; 30,502,913 issued and 26,310,601 outstanding at August 2, 2008 and 30,031,060 shares issued and outstanding at February 2, 2008	355,520	341,194
Treasury stock, at cost, 4,192,312 shares at August 2, 2008 and no shares at February 2, 2008	(85,941)	—
Accumulated other comprehensive income	636	811
Retained earnings	19,760	3,587
Total shareholders' equity	289,975	345,592
Total liabilities and shareholders' equity	\$ 317,513	\$ 379,466

See accompanying notes to the unaudited condensed consolidated financial statements

These statements have been adjusted for the change in method of accounting for inventories. See Item 1, Note 2,  
Change in accounting policy

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

	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Net revenue	\$ 58,212	\$ 42,548	\$ 115,094	\$ 78,564
Cost of revenue	28,691	20,240	57,553	38,446
Gross profit	29,521	22,308	57,541	40,118
Operating expenses:				
Research and development	10,377	8,364	21,233	14,453
Sales and marketing	2,783	2,692	5,424	4,924
General and administrative	3,634	2,456	10,102	6,705
Acquired in-process research and development	—	—	1,571	—
Total operating expenses	16,794	13,512	38,330	26,082
Income from operations	12,727	8,796	19,211	14,036
Interest and other income, net	1,064	400	3,232	720
Income before income taxes	13,791	9,196	22,443	14,756
Provision for income taxes	4,200	608	6,270	799
Net income	\$ 9,591	\$ 8,588	\$ 16,173	\$ 13,957
Net income per share:				
Basic	\$ 0.36	\$ 0.36	\$ 0.59	\$ 0.60
Diluted	\$ 0.35	\$ 0.32	\$ 0.57	\$ 0.52
Shares used in computing net income per share:				
Basic	26,488	23,867	27,392	23,423
Diluted	27,347	26,814	28,415	26,820

See accompanying notes to the unaudited condensed consolidated financial statements

These statements have been adjusted for the change in method of accounting for inventories. See Item 1, Note 2,  
 Change in accounting policy

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

	Six Months Ended	
	August 2, 2008	August 4, 2007
Cash flows from operating activities:		
Net income	\$ 16,173	\$ 13,957
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,572	1,556
Acquired in-process research and development	1,571	—
Share-based compensation expense	7,157	3,039
Shareholder note receivable written off	—	29
Provision to record excess and obsolete inventory	1,142	316
Provision for sales returns, discounts and doubtful accounts	783	268
Deferred income taxes	1,726	—
Loss on disposal of software, equipment and leasehold improvements	1	—
Gains on sale of long-term investments	—	(31)
Accretion of contributed leasehold improvements	(62)	(58)
Changes in operating assets and liabilities:		
Accounts receivable	691	(10,009)
Inventories	(16,772)	(1,113)
Prepaid expenses and other current assets	(1,199)	(245)
Other non-current assets	(276)	(41)
Accounts payable	(4,178)	(4,006)
Accrued liabilities	(2,892)	2,657
Other long-term liabilities	502	(172)
Net cash provided by operating activities	7,939	6,147
Cash flows from investing activities:		
Purchase of marketable securities	(63,291)	(43,459)
Sales and maturities of marketable securities	60,736	42,625
Purchases of software, equipment and leasehold improvement	(6,500)	(418)
Cash paid in connection with acquisition	(18,576)	—
Recovery of long-term investment loss	—	31
Net cash used in investing activities	(27,631)	(1,221)
Cash flows from financing activities:		
Treasury stock purchases	(85,941)	—
Repayment of bank borrowings	—	(109)
Collection of shareholder notes receivable	—	29
Net proceeds from exercise of employee stock options and stock purchase rights	2,975	4,162
Excess tax benefit on share-based compensation	4,194	—
Net cash provided by (used in) financing activities	(78,772)	4,082
Effect of foreign exchange rates changes on cash and cash equivalents	137	47
Increase (decrease) in cash and cash equivalents	(98,327)	9,055

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Cash and cash equivalents at beginning of period	174,089	24,413
Cash and cash equivalents at end of period	\$ 75,762	\$ 33,468

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

Supplemental disclosure of cash flow information:

Cash paid for interest	\$	—	\$	9
Cash paid for income taxes		4		116

See accompanying notes to the unaudited condensed consolidated financial statements

These statements have been adjusted for the change in method of accounting for inventories. See Item 1, Note 2,  
Change in accounting policy

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

1. Organization and summary of significant accounting policies

Organization and nature of operations: Sigma Designs, Inc. (the “Company”) specializes in integrated system-on-chip solutions for the IPTV, Blu-ray and other media players, prosumer and industrial audio/video, HDTV and other markets. The Company sells its products to manufacturers, designers and to a lesser extent, to distributors who, in turn, sell to manufacturers.

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

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“US GAAP”) for interim financial information and with the instructions to Securities and Exchange Commission (“SEC”) Form 10-Q and Article 10 of SEC Regulation S-X. They do not include all of the information and footnotes required by US GAAP for complete financial statements. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto for the year ended February 2, 2008 included in the Company’s Annual Report on Form 10-K.

The condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly the Company’s consolidated financial position at August 2, 2008 and February 2, 2008, the consolidated results of its operations for the three months and six months ended August 2, 2008 and August 4, 2007, and the consolidated cash flows for the six months ended August 2, 2008 and August 4, 2007. The results of operations for the three months and six months ended August 2, 2008 and August 4, 2007 are not necessarily indicative of the results to be expected for future quarters or the year.

Reclassifications: Certain reclassifications have been made to prior year balances in order to conform to the current year’s presentation.

Accounting period: Each of the Company’s fiscal quarters presented herein includes 13 weeks and ends on the last Saturday of the period. The second quarter of fiscal 2009 ended on August 2, 2008. The second quarter of fiscal 2008 ended on August 4, 2007.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“US GAAP”) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, the Company evaluates its estimates, including those related to the collectability of accounts receivable, the valuation of inventory on a lower of cost or market basis, the valuation of share-based compensation, expected future cash flows and useful lives of investments, goodwill, intangible assets and other long-lived assets, income taxes, warranty obligations and litigation and settlement costs. The Company bases its estimates on historical experience and on other assumptions that its management believes are reasonable under the circumstances. These estimates form the basis for making judgments about the carrying values of assets and liabilities when those values are not readily apparent from other sources. Actual results may differ materially from management’s estimates.

Fair value of financial instruments: For certain of the Company’s financial instruments, including cash and cash equivalents, accounts receivable, short-term marketable securities, accounts payable and other current liabilities, the

carrying amounts approximate their fair value due to the relatively short maturity of these items.

Cash and cash equivalents: The Company considers all highly liquid debt instruments purchased with a remaining maturity of 90 days or less to be cash equivalents.

Short- and long-term marketable securities: Short-term marketable securities represent highly liquid debt instruments with a remaining maturity date at acquisition date of greater than 90 days but less than one year and are stated at fair value. Long-term marketable securities represent securities with contractual maturities greater than one year from the date of acquisition. The Company's marketable securities are classified as available-for-sale because the sale of such securities may be required prior to maturity. The differences between amortized cost (cost adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income) and fair value, representing unrealized holding gains or losses, are recorded separately as a component of accumulated other comprehensive income (loss) within shareholders' equity. Any gains and losses on the sale of debt securities are determined on a specific identification basis.

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The Company's marketable securities include primarily auction rate securities ("ARS") and corporate commercial paper and bonds. The Company monitors these securities for impairment and recognizes an impairment charge if a decline in the fair value of these marketable securities is judged to be other-than-temporary. Significant judgment is used to identify events or circumstances that would likely have a significant adverse effect on the future value of the marketable securities. The Company considers various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, forecasted recovery, and its ability and intent to hold the marketable securities for a period of time sufficient to allow for any anticipated recovery in market value. ARS are bought and sold in the marketplace through a bidding process sometimes referred to as a "Dutch auction." After the initial issuance of the securities, the interest rate on the securities resets periodically, at intervals set at the time of issuance (e.g., every twenty-eight, thirty-five or forty-two days, etc.), based on the market demand at the reset period. These securities are generally classified as short-term marketable securities due to the auction reset feature. However, if auction rate securities fail to clear at the reset auction and the Company is unable to estimate the date the auction rate securities will next clear, they are classified as long-term marketable securities consistent with their stated contractual maturities. At August 2, 2008 the Company held nine auction rate securities, with a cost of \$43.0 million, all of which failed to clear at recent auctions. The Company does not expect to incur other-than-temporary declines in value associated with these auction rate securities and has classified all auction rate securities held at August 2, 2008 as long-term marketable securities consistent with their stated maturities which range from 30 to 40 years.

The Company's nine auction rate securities are higher education student loan backed securities issued by agencies of nine different states. All are backed by a guaranty from a U.S. government agency. These instruments were purchased on the Company's behalf by its cash investment advisor, UBS. As a result of the auction failures and lack of liquidity for these securities, UBS announced its proposal of a comprehensive settlement agreement in principle for its clients holding auction rate securities, in which all the auction rate securities currently in the Company's portfolio could be redeemed at par value. The offer to redeem will be at the Company's option during a two year period beginning in June 2010.

**Inventories:** Inventories are stated at the lower of standard cost (approximating a first-in, first-out basis) or market value. The Company evaluates its ending inventories for excess quantities and obsolescence on a quarterly basis. This evaluation includes analysis of historical and forecasted sales levels by product. A provision is recorded for inventories on hand in excess of forecasted demand. In addition, the Company writes off inventories that are considered obsolete. Obsolescence is determined from several factors, including competitiveness of product offerings, market conditions and product life cycles. Increases to the allowance for excess and obsolete inventory are charged to cost of revenue. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. If this lower-costed inventory is subsequently sold, the related allowance is matched to the movement of related product inventory, resulting in lower costs and higher gross margins for those products.

As a result of this inventory review, the Company charged approximately \$0.4 million, and \$0.1 million to cost of revenue for the three months ended August 2, 2008 and August 4, 2007, respectively, and \$1.1 million and \$0.3 million for six months ended August 2, 2008 and August 4, 2007, respectively.

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

Long-term investments: Investments in private equity securities of less than 20% owned companies are accounted for using the cost method unless the Company can exercise significant influence or the investee is economically dependent upon the Company, in which case the equity method is used. The Company evaluates its long-term investments for impairment annually according to Emerging Issues Task Force Issue No. 03-01, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (“EITF 03-01”). EITF 03-01 provides guidance for evaluating whether an investment is other-than-temporarily impaired and requires certain disclosures with respect to these investments. The guidance also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requirements for disclosures about unrealized losses that have not been recognized as other-than-temporary impairments.

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Goodwill and Intangible assets: Goodwill and intangible assets is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. The amounts and useful lives assigned to intangible assets acquired, other than goodwill, impact the amount and timing of future amortization.

The Company reviews goodwill with indefinite lives for impairment annually and whenever events or changes in circumstances indicate the carrying value may not be recoverable in accordance with SFAS No. 142, Goodwill and Other Intangible Assets ("FAS 142"). Purchased intangible assets with finite useful lives are amortized using the straight-line method over their estimated useful lives and are reviewed for impairment under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("FAS 144"). Determining the fair value of a reporting unit is judgmental in nature and involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and forecasted operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions and determination of appropriate market comparables. The Company bases its fair value estimates on assumptions it believes to be reasonable. Actual future results may differ from those estimates.

Revenue recognition: The Company derives its revenue primarily from three principal sources: product sales, product development contracts and service contracts. The Company generally recognizes revenue for product sales and service contracts in accordance with Staff Accounting Bulletin ("SAB") No. 104, Revenue Recognition, under which revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the fee is fixed or determinable, and collectability is reasonably assured.

Revenue from product sales to OEMs, distributors and end users are generally recognized upon shipment, as shipping terms are predominantly FOB shipping point, except that revenue is deferred when management cannot reasonably estimate the amount of returns or where collectability is not assured. In those situations, revenue is recognized when collection subsequently becomes probable and returns are estimable. Allowances for sales returns, discounts and warranty costs are recorded at the time that revenue is recognized.

Product development agreements typically require that the Company provide customized software to support customer-specific designs. Accordingly, this revenue is accounted for under the AICPA Statement of Position ("SOP") 97-2, Software Revenue Recognition. The Company offers post-contract customer support ("PCS") on a contractual basis for additional fees, typically with a one year term. In instances where software is bundled with the PCS, vendor specific objective evidence does not exist to allocate the total fee to all undelivered elements of the arrangement and, therefore, revenue and related costs are deferred until all elements, except PCS, are delivered. The total fee is then recognized ratably over the PCS term (typically one year) after the software is delivered. The Company classifies development costs related to product development agreements as cost of revenue. Product development revenue was approximately \$0.1 million and \$0.3 million for the three months ended August 2, 2008 and August 4, 2007, respectively, and \$0.1 million and \$0.6 million for the six months ended August 2, 2008 and August 4, 2007, respectively.

Revenue from service contracts consist of fees for providing engineering support services, and are recognized ratably over the contract term. Expenses related to support service revenue are included in cost of revenue. Support service revenue was \$13,000 and \$0.1 million for the three months ended August 2, 2008 and August 4, 2007, respectively, and \$40,000 and \$0.7 million for the six months ended August 2, 2008 and August 4, 2007, respectively.

Foreign currency: The functional currency of the Company's foreign subsidiaries is the local currency of each country. Accordingly, gains and losses from the translation of the financial statements of the foreign subsidiaries are included in shareholders' equity. Transaction gains and losses, which are included in the other expenses, net, in the accompanying consolidated statements of operations, have not been significant for all years presented.

Concentration of credit risk: Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term and long-term marketable securities, long-term investments and accounts receivable. The majority of the Company's cash, cash equivalents and short-term and long-term marketable securities are on deposit with four financial institutions. The Company performs ongoing credit evaluations of its customers and generally does not require collateral for sales on credit. The Company reviews its accounts receivable balances to determine if any receivables will potentially be uncollectible and includes any amounts that are determined to be uncollectible in its allowance for doubtful accounts. As of August 2, 2008 and February 2, 2008, two and three customers accounted for approximately 77% and 75%, respectively, of the Company's net outstanding trade receivables.

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Income taxes: Deferred income taxes reflect the net tax effects of any temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, and any operating losses and tax credit carryforwards. Income taxes are accounted for under an asset and liability approach in accordance with SFAS No. 109, Accounting for Income Taxes (“FAS 109”). Deferred tax liabilities are recognized for future taxable amounts and deferred tax assets are recognized for future deductions, net of a valuation allowance, to reduce deferred tax assets to amounts that are more likely than not to be realized. The income tax provision for the three months and six months ended August 2, 2008 was \$4.2 million and \$6.3 million, respectively. The income tax provision for the three months and six months ended August 4, 2007 was \$0.6 million and \$0.8 million, respectively.

In July 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109 (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity’s financial statements in accordance with SFAS 109 and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized as the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 on February 4, 2007, the beginning of its fiscal 2008. For the three months and six months ended August 2, 2008, the Company recorded a net increase of \$0.7 million and \$0.8 million, respectively, in unrecognized tax benefits.

Share-based compensation: The Company applies SFAS No. 123(R) Share-Based Payment, (“SFAS 123(R)”) to measure and recognize compensation expense for all share-based payment awards made to employees and directors based on estimated fair values.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period in the Company’s unaudited condensed consolidated statements of operations.

Share-based compensation expense recognized in periods after January 28, 2006 is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Share-based compensation expense recognized in the Company’s unaudited condensed consolidated statements of operations for periods after the adoption of SFAS 123(R) includes compensation expense for share-based payment awards granted prior to, but not yet vested, as of January 28, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to January 28, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). As share-based compensation expense recognized in the unaudited condensed consolidated statements of operations for fiscal 2008 and for the first two quarters of fiscal 2009 is based on awards ultimately expected to vest, it has been adjusted for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The effect of recording employee share-based compensation expense on the unaudited condensed consolidated statements of operations for the three months and six months ended August 2, 2008 and August 4, 2007 was as follows (in thousands, except per share amounts):

Three Months Ended		Six Months Ended	
August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007



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Share-based compensation expense by type of award:

Stock options	\$	2,209	\$	1,431	\$	6,843	\$	2,589
Employee stock purchase plan		179		156		282		213
Total share-based compensation expense		2,388		1,587		7,125		2,802
Tax effect of share-based compensation expense		(651)		(93)		(2,146)		(164)
Net effect on net income	\$	1,737	\$	1,494	\$	4,979	\$	2,638

Effect on net income per share:

Basic	\$	0.07	\$	0.06	\$	0.18	\$	0.11
Diluted	\$	0.06	\$	0.06	\$	0.18	\$	0.10

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Long-lived assets: The Company accounts for long-lived assets, including purchased intangible assets, in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Long-lived assets are evaluated for impairment whenever events or changes in circumstances, such as a change in technology, indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than its carrying amount.

Research and development and software development costs: Costs incurred in the research and development of the Company's products are expensed as incurred. Costs associated with the development of computer software are expensed prior to the establishment of technological feasibility and capitalized in certain cases thereafter until the product is available for general release to customers.

Recent accounting pronouncements: In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS 159"). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. The standard's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the Company's choice to use fair value on its earnings. It also requires companies to display the fair value of those assets and liabilities for which the Company has chosen to use fair value on the face of the balance sheet. The new standard does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS 157 and SFAS No. 107, Disclosures about Fair Value of Financial Instruments. SFAS 159 is effective for fiscal years beginning after November 15, 2007, and the Company did not elect to adopt the fair value option under SFAS 159.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination and requires related acquisition costs to be expensed in the period incurred. SFAS 141R is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 141R on its condensed consolidated results of operations and financial condition.

2. Change in accounting policy

Effective for the second quarter of fiscal 2009, the Company changed its method of accounting for valuing the portion of its raw material inventory known as tested wafers or die bank. Previously, the expense associated with yield loss from the initial testing of wafers was expensed to cost of revenue until the wafers were moved into the next stage of production. Historically, the Company has absorbed the value of rejected die only when the wafers were moved into work in process ("WIP"). Now, the Company accounts for the yield loss from the initial testing by immediately absorbing the cost of the rejected die as they are tested.

In the second quarter of fiscal 2009, the Company significantly upgraded its enterprise resource planning (ERP) system, which provided better tools to more accurately track and value its die bank. In addition, in light of the Company's rapid growth in fiscal 2008, its die bank segment of inventory had not been significant in any single period until the first quarter of fiscal 2009. As a result of increased significance of the die bank inventory, which the Company currently anticipates will continue, combined with an improved ERP system, the Company believes that absorbing the yield loss into its inventory consistently throughout the manufacturing process is preferable to the prior

accounting method. In making this determination, the Company also considered the accounting practices of other fabless semiconductor companies and the added clarity and ease of understanding that such a change would have on its reported results for investors provided by the additional cost component.

The Company has accounted for this change in method of accounting in accordance with Statement of Financial Accounting Standards (SFAS) No. 154, "Accounting Changes and Error Corrections." SFAS 154 requires that all elective accounting changes be made on a retrospective basis. Accordingly, the Company retrospectively adjusted the unaudited condensed statement of operations for the three months ended May 3, 2008 and the unaudited consolidated balance sheet as of May 3, 2008 to reflect the results of absorbing the yield loss associated with the sorted wafers in inventory and the direct tax effect of this adjustment. Prior to the first quarter of fiscal 2009, the Company did not maintain a material level of die bank within its inventory. Therefore, the Company has determined that no material retrospective adjustments were necessary for periods before fiscal 2009.

The following table sets forth the retrospective adjustments to results for the quarter ended May 3, 2008:

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Table of ContentsUnaudited Condensed Consolidated Balance Sheet  
(in thousands)

		May 3, 2008	
	As Previously Reported	Adjustment	Adjusted
Inventories	\$ 34,541	\$ 2,387	\$ 36,928
Total current assets	217,012	2,387	219,399
Total assets	309,836	2,387	312,223
Accrued liabilities and other	13,369	472	13,841
Total current liabilities	30,873	472	31,345
Total liabilities	32,631	472	33,103
Total shareholders' equity	277,205	1,915	279,120
Total liabilities and shareholders' equity	309,836	2,387	312,223

Unaudited Condensed Consolidated Statement of  
Income  
(in thousands, except per share data)

	Three Months Ended May 3, 2008		
	As Previously Reported	Adjustment	Adjusted
Cost of revenue	\$ 31,249	\$ (2,387)	\$ 28,862
Gross profit	25,633	2,387	28,020
Net income from operations	4,097	2,387	6,484
Net income before income taxes	6,265	2,387	8,652
Provision for income taxes	1,598	472	2,070
Net income	\$ 4,667	\$ 1,915	\$ 6,582
Basic net income per share	\$ 0.16	\$ 0.07	\$ 0.23
Diluted net income	\$ 0.16	\$ 0.06	\$ 0.22

3. Cash, cash equivalents and marketable securities

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

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	August 2, 2008			February 2, 2008		
	Book Value	Unrealized Gain/(Loss)	Fair Value	Book Value	Unrealized Gain/(Loss)	Fair Value
Money market funds	\$ 46,345	\$ —	\$ 46,345	\$ 165,719	\$ —	\$ 165,719
Corporate commercial paper	28,211	(9)	28,202	33,354	35	33,389
Corporate bonds	11,577	(20)	11,557	17,177	180	17,357
US agency discount notes	34,390	(17)	34,373	4,926	25	4,951
US agency non-callable	—	—	—	7,000	30	7,030
Auction rate securities	43,000	—	43,000	43,900	—	43,900
Total cash equivalents and marketable securities	\$ 163,523	\$ (46)	\$ 163,477	\$ 272,076	\$ 270	\$ 272,346
Cash on hand held in the United States			3,691			2,257
Cash on hand held overseas			12,480			1,129
Total cash on hand			16,171			3,386
Total cash, cash equivalents and marketable securities			\$ 179,648			\$ 275,732

## Reported as:

Cash and cash equivalents	\$ 75,762	\$ 174,089
Short-term marketable securities	44,816	44,401
Long-term marketable securities	59,070	57,242
	\$ 179,648	\$ 275,732

The amortized cost and estimated fair value of cash equivalents and marketable securities, by contractual maturity as measured on the date of purchase, are shown below (in thousands). Actual maturities may differ from contractual maturities.

(In thousands)	August 2, 2008		February 2, 2008	
	Book Value	Fair Value	Book Value	Fair Value
Due in 1 year or less	\$ 104,403	\$ 104,407	\$ 214,959	\$ 215,104
Due in greater than 1 year	59,120	59,070	57,117	57,242
Total	\$ 163,523	\$ 163,477	\$ 272,076	\$ 272,346

Historically, the Company classified its auction rate securities as short-term marketable securities because the Company was able to liquidate them at its discretion at the reset period. As of August 2, 2008, the carrying value of the Company's nine auction rate securities totaled \$43.0 million. During first and second quarters of fiscal 2009, all of the auctions associated with these securities failed. These failures are not believed to be a credit issue, but rather caused by a lack of liquidity. The auction rate securities held by the Company are primarily backed by student loans and are over-collateralized, and substantially insured and guaranteed by the United States Federal Department of Education. In addition, all auction rate securities held by the Company are rated by major independent rating agencies as either AAA or Aaa. Under the contractual terms, the issuer is obligated to pay penalty interest rates should an auction fail. The Company does not expect to need to access these funds in the short-term; however, in the event the Company needed to access these funds, they are not expected to be accessible until one of the following occurs: a successful auction occurs, the issuer redeems the issue, a buyer is found outside of the auction process or the

underlying securities mature. In August 2008, the Company's cash investment advisor announced its proposal of a comprehensive settlement agreement in principle for its clients holding auction rate securities, in which all the auction rate securities currently in the Company's portfolio could be redeemed at par value. The offer to redeem will be at the Company's option during a two year period beginning in June 2010. The Company does not expect to incur other-than-temporary declines in value associated with these auction rate securities and has classified all auction rate securities held at August 2, 2008 as long-term marketable securities consistent with their stated maturities which range from 30 to 40 years.

Although there is uncertainty with regard to the short-term liquidity of these securities, the Company continues to believe that the carrying value represents the fair value of these marketable securities because of the overall quality of the underlying investments and the anticipated future market for such investments. In addition, the Company has the intent and ability to hold these securities until the earlier of: the market for auction rate securities stabilizes, the issuer refinances the underlying security, a buyer is found outside of the auction process at acceptable terms, the underlying securities have matured or the Company accepts the investment manager's offer to redeem the securities. The Company's investment firm that holds its auction rate securities provided an estimated value as of August 2, 2008 of approximately \$40.8 million with an unrealized loss of \$2.2 million. The Company has reviewed the assumptions underlying this valuation change and has not recorded this unrealized loss of \$2.2 million. The Company does not believe the valuation calculated by the investment firm represents the fair value and accordingly the Company has not recorded an unrealized loss for these adjustments.

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Based on the cash and short-term marketable securities balance of \$120.6 million and expected positive operating cash flows, the Company does not anticipate a lack of liquidity associated with the auction rate securities will adversely affect the Company’s ability to conduct business, and the Company has the ability to hold the securities throughout the currently estimated recovery period. The Company will continue to evaluate any changes in the market value of the failed auction rate securities that have not been liquidated subsequent to quarter-end. Depending upon future market conditions, the Company may be required to record an other-than-temporary decline in market value at that time.

4. Fair values of assets and liabilities

On February 3, 2008, the Company adopted Statement of Financial Accounting Standards 157, Fair Value Measurements, (“SFAS 157”). The standard defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).” The standard establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS 157, among other things, requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Fair Value Hierarchy

SFAS 157 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 - Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect management’s estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flows models and similar techniques.

Determination of Fair Value

The Company’s cash equivalents and marketable securities, with the exception of auction-rate securities, are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of marketable securities valued based on quoted market prices in active markets include most U.S. government and agency securities, sovereign government obligations, and money market securities. Auction-rate securities are classified within Level 3 as significant assumptions are not observable in the market. During the three and six months ended August 2, 2008, the Company recorded no impairment loss relating to the value of auction-rate securities. There were no realized gain or losses recorded for these auction-rate securities in the three and six months ended August 2, 2008.

The table below presents the balances of the Company’s assets measured at fair value on a recurring basis (in thousands):





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	Fair Value Measurement at Reporting Date			
	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs Level 3
Money market funds	\$ 46,345	\$ 46,345	\$ —	\$ —
Corporate commercial paper	28,202	28,202	—	—
Corporate bonds	11,557	11,557	—	—
US agency discount notes	34,373	34,373	—	—
Auction rate securities	43,000	—	—	43,000
Total cash equivalents and marketable securities	\$ 163,477	\$ 120,477	\$ —	\$ 43,000

The Company's financial assets measured at fair value on a reoccurring basis, consisting of auction rate securities, using significant unobservable inputs (Level 3) for the three months ended August 2, 2008 had no activity.

## 5. Inventories

Inventories consist of the following (in thousands):

	August 2, 2008	February 2, 2008
Raw materials	\$ 28,484	\$ 12,838
Work-in-process	7,514	2,735
Finished goods	9,152	10,710
Total	\$ 45,150	\$ 26,283

## 6. Acquisition

## VXP acquisition

On February 8, 2008, the Company acquired certain assets and assumed certain liability obligations of the VXP Image Processing business ("VXP"), which specializes in video processing technology that the Company intends to use to bring studio quality video to consumer television, from Genuum Corporation for \$18.6 million in cash including transaction costs. Forty-four employees joined the Company as part of the acquisition.

In connection with the VXP acquisition, the Company obtained a valuation of the intangible assets acquired in order to allocate the purchase price in accordance with SFAS No. 141, Business Combinations ("SFAS 141"). In accordance with SFAS 141, the total purchase price was allocated to VXP's net tangible and intangible assets based upon its fair values as of February 8, 2008. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill. Approximately \$0.1 million of the goodwill is deductible for tax purposes. The purchase price in the transaction was allocated as follows (in thousands):

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	Amount	Estimated Useful Life
Cash consideration	\$ 18,200	
Transaction costs	376	
Total consideration	\$ 18,576	
Net tangible assets	\$ 4,555	
Identifiable intangible assets:		
Developed technology	8,504	2 to 7 years
In process research and development	1,571	N/A
Customer relationships	1,123	7 years
Trademarks	298	5 years
Software license	291	8 years
Goodwill	2,234	
Total consideration	\$ 18,576	

## 7. Goodwill and Intangible assets

## Goodwill

Total goodwill as of August 2, 2008 was \$7.3 million. Goodwill attributable to the February 8, 2008 VXP acquisition was approximately \$2.2 million and the remaining goodwill balance was attributable to the fiscal 2007 Blue 7 acquisition.

## Intangible assets

Acquired intangible assets, subject to amortization, were as follows as of August 2, 2008 (in thousands, except for years):

	Cost	Accumulated Amortization	Net	Estimated Useful Life
Developed technology	\$ 13,803	\$ (2,587)	\$ 11,216	2 to 7 years
Noncompete agreements	1,400	(1,147)	253	3 years
Customer relationships	1,123	(76 )	1,047	7 years
Trademarks	298	(28)	270	5 years
	\$ 16,624	\$ (3,838)	\$ 12,786	

Amortization expense related to acquired intangible assets was \$0.7 million and \$1.4 million for the three months and six months ended August 2, 2008, respectively, and \$0.3 million and \$0.6 million for the three months and six months ended August 4, 2007, respectively. As of August 2, 2008, the Company expects the amortization expense in future periods to be as shown below (in thousands):

Fiscal year	Developed Technology	Noncompete Agreements	Customer Relationships	Trademarks	Total
2009	\$ 1,142	\$ 234	\$ 80	\$ 30	\$ 1,486
2010	2,280	19	160	60	2,519
2011	2,125	—	160	60	2,345
2012	2,121	—	160	60	2,341

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2013	2,121	—	160	60	2,341
Thereafter	1,427	—	327	—	1,754
	\$ 11,216	\$ 253	\$ 1,047	\$ 270	\$ 12,786

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## 8. Product warranty

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

Details of the change in accrued warranty as of August 2, 2008 and August 4, 2007 are as follows (in thousands):

Three Months Ended	Balance Beginning of Period	Additions	Deductions	Balance End of Period
August 2, 2008	\$ 1,705	\$ 178	\$ (293)	\$ 1,590
August 4, 2007	519	405	(169)	755
Six Months Ended				
August 2, 2008	\$ 1,564	\$ 534	\$ (508)	\$ 1,590
August 4, 2007	556	485	(286)	755

## 9. Commitments and contingencies

## Commitments

## Leases

The Company's primary facility is leased under a non-cancelable lease which expires in September 2012. The Company also leases facilities in Canada, France, Hong Kong and Singapore under non-cancelable leases. Future minimum annual payments under operating leases are as follows (in thousands):

Fiscal years	Operating Leases
Remainder of fiscal 2009	\$ 830
2010	1,703
2011	1,716
2012	1,677
2013	1,378
Thereafter	3,410
Total minimum lease payments	\$ 10,714

## Purchase commitments

The Company places non-cancelable orders to purchase semiconductor products from its suppliers on an eight to twelve week lead-time basis. The total amount of outstanding non-cancelable purchase orders was approximately \$5.5 million as of August 2, 2008.

## Indemnifications

The Company's standard terms and conditions of sale include a patent infringement indemnification provision for claims from third parties related to the Company's intellectual property. The terms and conditions of sale generally limit the scope of the available remedies to a variety of industry-standard methods including, but not limited to, a right to control the defense or settlement of any claim, procure the right for continued usage, and a right to replace or modify the infringing products to make them non-infringing. Such indemnification provisions are accounted for in accordance with SFAS No. 5, Accounting for Contingencies ("FAS 5"). To date, the Company has not incurred or accrued any costs related to any claims under such indemnification provisions.

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401(k) tax deferred savings plan

The Company maintains a 401(k) tax deferred savings plan for the benefit of qualified employees who are U.S. based. Under the 401(k) tax deferred savings plan, U.S. based employees may elect to reduce their current annual taxable compensation up to the statutorily prescribed limit, which is \$16,000 in calendar year 2008. Employees age 50 or over may elect to contribute an additional \$5,000. In January 2008, the Company implemented a matching contribution program whereby it matches employee contributions made by each employee at a rate of \$0.25 per \$1.00 contributed. The matching contributions to the 401(k) Plan totaled \$0.1 million and \$0.3 million for the three months and six months ended August 2, 2008, respectively.

Group Registered Retirement Savings Plan

The Company maintains a Group Registered Retirement Savings Plan for the benefit of qualified employees who are based in Canada. Under the Registered Retirement Savings Plan (RRSP), Canadian based employees may elect to reduce their annual taxable compensation up to the statutorily prescribed limit which is \$20,000 in calendar year 2008. In April 2008, the Company implemented a matching contribution program whereby it matches employee contributions made by each employee up to 2.5% of their annual salary. The matching contributions to the Group Registered Retirement Saving Plan totaled \$15,000 and \$26,000 for the three months and six months ended August 2, 2008, respectively.

Contingencies

Litigation

Certain current and former directors and officers of the Company have been named as defendants in several shareholder derivative actions filed in the United States District Court for the Northern District of California, which have been consolidated under the caption *In re Sigma Designs, Inc. Derivative Litigation* (the "Federal Action") and in a substantially similar shareholder derivative action filed in the Superior Court for Santa Clara County, California captioned *Korsinsky v. Tran, et al.* (the "State Action").

Plaintiffs in the Federal and State Actions allege that the individual defendants breached their fiduciary duties to the Company in connection with the alleged backdating of stock option grants during the period from 1994 through 2005 and that certain defendants were unjustly enriched. Plaintiffs in the Federal Action assert derivative claims against the individual defendants based on alleged violations of Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934, and Rules 10b-5 and 14a-9 promulgated there under. They also allege that the individual defendants aided and abetted one another's alleged breaches of fiduciary duty and violated California Corporations Code section 25402 and bring claims for an accounting and rescission. In the State Action, plaintiffs also allege that the individual defendants wasted corporate assets. Both Actions seek to recover unspecified money damages, disgorgement of profits and benefits and equitable relief. The Federal Action also seeks treble damages, rescission of certain defendants' option contracts, imposition of a constructive trust over executory option contracts and attorney's fees. The Company is named as a nominal defendant in both the Federal and State Actions; thus, no recovery against the Company is sought.

In January 2007, the Company filed a motion to dismiss the Federal Action on the ground that the plaintiffs had not made a pre-litigation demand on its Board of Directors and had not demonstrated that such a demand would have been futile. The defendant directors and officers joined in that motion, and filed a motion to dismiss the Federal Action for failure to state a claim against each of them. Pursuant to a joint stipulation, plaintiffs filed an Amended Consolidated Shareholder Derivative Complaint ("Amended Complaint") on August 13, 2007. On September 19, 2007, the Company and the individual defendants each filed a motion to dismiss the Amended Complaint on the same grounds as their previous motions to dismiss. Plaintiffs filed oppositions to the motions to dismiss on October 19, 2007. Defendants

filed replies in support of their motions to dismiss on November 5, 2007. Thereafter, the parties reached an agreement to settle the action. On May 28, 2008, the parties to both the Federal Action and the State Action executed a definitive settlement agreement. The settlement, which is subject to the approval of the United States District Court for the Northern District of California, will result in dismissal of both the Federal Action and the State Action. The parties filed a Joint Motion for Preliminary Approval of Settlement on May 29, 2008, and the Court granted this motion on June 24, 2008. The Company published a notice of the proposed settlement on June 27, 2008; no objections to the proposed settlement were submitted in response. Plaintiffs filed a Motion for Final Approval of Settlement on July 29, 2008. At a hearing on this motion held on August 8, 2008, the Court took the matter under submission; and the Court subsequently requested further information regarding the settlement. On September 5, 2008, the parties filed a joint submission in response to this request.



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In January 2007, the Company also filed a motion to dismiss or stay the State Action in favor of the earlier filed Federal Action. The defendant directors and officers joined in that motion. Pursuant to a joint stipulation, the Court ordered that the State Action be stayed in favor of the earlier-filed Federal Action. Thereafter, as stated above, the parties to the Federal Action reached an agreement to settle that action. On May 28, 2008, the parties to both the Federal Action and the State Action executed a definitive settlement agreement. The settlement, which is subject to the approval of the United States District Court for the Northern District of California, will result in dismissal of both the Federal Action and the State Action. On June 9, 2008, pursuant to joint stipulation, the Court ordered that the State Action continue to be stayed pending entry of an Order and Final Judgment approving the settlement in the Federal Action. All amounts due under the settlement were accrued as of February 2, 2008.

The Company has previously disclosed in press releases that the Securities and Exchange Commission (“SEC”) has initiated an informal inquiry into the Company’s stock option granting practices. The SEC requested that the Company voluntarily produce documents relating to, among other things, its stock option practices. The Company responded to the SEC’s requests in July and August of 2006 and has received no further requests since that time. The Company intends to continue cooperating with the SEC should the Company receive any additional requests.

In May 2007, the IRS began an employment tax audit for the Company’s fiscal 2004 and 2005. The Company has also requested that fiscal 2006 be included in this audit cycle. The focus of the IRS employment tax audit related to tax issues connected to the Company’s granting stock options with exercise prices per share that were less than the fair market value per share of the common stock underlying the option on the option’s measurement date for financial reporting purposes. The Company has recently settled this IRS audit (including the year 2006), although the Company is still waiting to receive the notice of assessment resulting from such settlement for interest on the agreed tax and penalty amounts. The amounts settled were in alignment with the amounts previously provided for. The Company will soon be reporting these IRS adjustments to the California Employment Development Department (“EDD”) and will then meet with the EDD to determine the corresponding state tax, penalty and/or interest adjustments.

In August 2007, the IRS began an income tax audit for the Company’s fiscal 2005. The IRS has proposed several adjustments. The Company has accepted most of the adjustments, which will not have a material financial impact to the Company’s operations and financial condition. The Company is in discussions with the IRS concerning an additional proposed adjustment, which concerns an area that is not complete. The Company intends to perform additional development work to resolve this proposed adjustment.

## 10. Net income per share

Basic net income per share for the periods presented is computed by dividing net income by the weighted average number of common shares outstanding. Diluted net income per share for the periods presented is computed by including shares subject to repurchase as well as dilutive options.

The following table sets forth the basic and diluted net income per share computed for the three months and six months ended August 2, 2008 and August 4, 2007 (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Numerator:				
Net income, as reported	\$ 9,591	\$ 8,588	\$ 16,173	\$ 13,957
Denominator:				
Weighted average common shares outstanding - basic	26,488	23,867	27,392	23,423

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Effect of dilutive securities:

Escrowed shares related to Blue7 acquisition	—	—	—	16
Stock options	859	2,947	1,023	3,381
Shares used in computation - diluted	27,347	26,814	28,415	26,820
Net income per share:				
Basic	\$ 0.36	\$ 0.36	\$ 0.59	\$ 0.60
Diluted	\$ 0.35	\$ 0.32	\$ 0.57	\$ 0.52

A summary of the excluded potentially dilutive securities as of the three months and six months ended August 2, 2008 and August 4, 2007 are as follows (in thousands):

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	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Stock options excluded because exercise price in excess of average stock price	1,554	301	1,431	273

## 11. Comprehensive income

The reconciliation of net income to total comprehensive income is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Net income	\$ 9,591	\$ 8,588	\$ 16,173	\$ 13,957
Other comprehensive income				
Unrealized loss on available-for-sale securities	(55)	(14)	(314)	(13)
Foreign currency translation adjustment	(17)	1	139	60
Total comprehensive income	\$ 9,519	\$ 8,575	\$ 15,998	\$ 14,004

## 12. Stock option plans

## Stock option plans

The Company has adopted stock option plans that provide for the grant of stock option awards to employees and directors, which are designed to reward employees and directors for their long-term contributions to the Company and provide an incentive for them to remain with the Company. As of August 2, 2008, the Company had two stock option plans: the 2003 Director Stock Option Plan (the "2003 Director Plan") and the 2001 Employee Stock Option Plan (the "2001 Option Plan").

A total of 207,500 shares of common stock are currently reserved for issuance under the 2003 Director Plan of which 97,500 have been granted as of August 2, 2008.

The total stock option activity is summarized as follows:

	Number of Shares Outstanding	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Balance, February 2, 2008	3,941,819	\$ 16.78		
Granted	293,680	29.62		
Cancelled	(14,021)	33.05		
Exercised	(368,517)	5.56		
Balance, May 3, 2008	3,852,961	\$ 18.80	7.28	\$ 24,740

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Granted	76,000		19.86		
Cancelled	(68,968)		29.79		
Exercised	(45,704)		5.37		
Balance, August 2, 2008	3,814,289		18.78	7.21	\$ 21,192
Ending Vested and Expected to Vest	3,647,315	\$	18.47	7.15	\$ 20,731
Ending Exercisable	1,579,354	\$	10.53	5.58	\$ 14,155

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The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$17.21 as of August 2, 2008, which would have been received by the option holders had all options holders exercised their options as of that date. The aggregate exercise date intrinsic value of options that were exercised under its stock option plans was \$0.6 million and \$12.6 million for the three months ended August 2, 2008 and August 4, 2007, respectively, determined as of the date of option exercise. The aggregate exercise date intrinsic value of options that were exercised under its stock option plans was \$11.3 million and \$28.4 million for the six months ended August 2, 2008 and August 4, 2007, respectively, determined as of the date of option exercise. The total fair value of options, which vested during the three months ended August 2, 2008 and August 4, 2007 was \$2.3 million and \$1.0 million, respectively. The total fair value of options, which vested during the six months ended August 2, 2008 and August 4, 2007 was \$5.8 million and \$1.9 million, respectively. At August 2, 2008, 755,417 shares were available for future grants.

The options outstanding and currently exercisable at August 2, 2008 were in the following exercise price ranges:

Options Outstanding			Options Exercisable			
Range of Exercise Prices		Number of Shares Outstanding at August 2, 2008	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price Per Share	Number of Shares Exercisable at August 2, 2008	Weighted Average Exercise Price Per Share
\$ 0.95	\$ 3.4	435,848	4.32	\$ 2.27	405,526	\$ 2.21
\$ 3.50	\$ 7.4	381,466	4.13	\$ 5.24	289,680	\$ 5.11
\$ 7.65	\$ 9.89	507,901	6.38	\$ 8.66	249,078	\$ 8.22
\$ 11.06	\$ 11.06	555,899	8.05	\$ 11.06	184,859	\$ 11.06
\$ 11.40	\$ 13.88	407,940	7.13	\$ 11.69	206,593	\$ 11.66
\$ 15.91	\$ 23.45	410,135	9.02	\$ 20.67	49,250	\$ 16.88
\$ 25.70	\$ 28.63	197,200	8.76	\$ 27.95	61,529.00	\$ 27.95
\$ 31.57	\$ 31.57	161,500	9.00	\$ 31.57	32,839	\$ 31.57
\$ 41.58	\$ 41.58	100,000	4.53	\$ 41.58	100,000	\$ 41.58
\$ 45.83	\$ 45.83	656,400	9.26	\$ 45.83	-	\$ -
\$ 0.95	\$ 45.83	3,814,289	7.21	\$ 18.78	1,579,354	\$ 10.53

As of August 2, 2008, the unrecorded share-based compensation balance related to stock options outstanding excluding estimated forfeitures was \$40.1 million and will be recognized over an estimated weighted average amortization period of 3.22 years. The amortization period is based on the expected vesting term of the options.

#### Employee stock purchase plan

Under the Company's 2001 Employee Stock Purchase Plan (the "2001 Purchase Plan"), employees are granted the right to purchase shares of common stock at a price per share that is 85% of the fair market value at the beginning or end of each six-month offering period, whichever is lower. As of August 2, 2008, 196,796 shares under the 2001 Purchase Plan remain available for future purchase.

#### Valuation of share-based compensation

The fair value of share-based compensation awards is estimated at the grant date using the Black-Scholes option valuation model. The determination of fair value of share-based compensation awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly

complex and subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, and actual employee stock option exercise behavior.

The weighted-average estimated values of employee stock options granted during the three months ended August 2, 2008 and August 4, 2007 was \$12.48 and \$19.40 per share, respectively. The weighted-average estimated values of employee stock options granted during the six months ended August 2, 2008 and August 4, 2007 was \$17.43 and \$18.79 per share, respectively. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the employee stock purchase plan during the three months ended August 2, 2008 and August 4, 2007 was \$5.92 and \$8.47, per share, respectively. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the employee stock purchase plan during the six months ended August 2, 2008 and August 4, 2007 was \$5.92 and \$8.47, per share, respectively. The fair value of each option and employee stock purchase right grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

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	Three Months Ended			
	August 2, 2008		August 4, 2007	
	Stock Options	Stock Purchase Plan	Stock Options	Stock Purchase Plan
Expected volatility	67.36%	95.06%	66.01%	60.04%
Risk-free interest rate	3.38%	2.17%	4.57%	4.93%
Expected term (in years)	5.95	0.50	6.04	0.50
Dividend yield	None	None	None	None

	Six Months Ended			
	August 2, 2008		August 4, 2007	
	Stock Options	Stock Purchase Plan	Stock Options	Stock Purchase Plan
Expected volatility	70.35%	95.06%	66.77%	60.04%
Risk-free interest rate	3.34%	2.17%	4.57%	4.93%
Expected term (in years)	5.72	0.50	6.10	0.50
Dividend yield	None	None	None	None

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

For options granted prior to January 29, 2006 and valued in accordance with SFAS 123, forfeitures were recognized as they occurred and the graded-vested method continues to be used for expense attribution related to options that were unvested as of January 29, 2006. For options granted after January 29, 2006 and valued in accordance with SFAS 123(R), forfeitures are estimated such that the Company only recognizes expense for those shares expected to vest, and adjustments are made if actual forfeitures differ from those estimates. The straight-line method is being used for expense attribution of all awards granted on or after January 29, 2006.

#### Non-employee related share-based compensation expense

In accordance with the provisions of SFAS 123(R) and Emerging Issues Task Force, Issue 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees For Acquiring, or in Conjunction With Selling, Goods or Services ("EITF 96-18"), the Company recorded share-based compensation expense for options issued to non-employees based on the fair value of the options as estimated on the measurement date which is typically the grant date, using the Black-Scholes option pricing model. The Black-Scholes option pricing model applied to non-employee equity awards includes assumptions regarding expected stock price volatility of 67.36%, risk-free interest rates of 3.45%, expected term of options of 6.46 years and dividend yields of zero percent for the three months ended August 2, 2008. The Black-Scholes option pricing model applied to non-employee equity awards includes assumptions regarding expected stock price volatility of 69.33%, risk-free interest rates of 3.42%, expected term of options of 6.60 years and dividend yields of zero percent for the six months ended August 2, 2008. Total non-employee share-based compensation recorded during the three and six months ended August 2, 2008 was \$15,000

and \$32,000, respectively. Total non-employee share-based compensation recorded during the three and six months ended August 4, 2007 was \$36,000 and \$91,000, respectively.



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## 13. Significant customers

For the three months ended August 2, 2008, two customers accounted for 31% and 29%, respectively, of net revenue. For the three months ended August 4, 2007, four customers accounted for 18%, 17%, 15% and 12%, respectively, of net revenue. For the six months ended August 2, 2008, two customers accounted for 23% and 22%, respectively, of net revenue. For the six months ended August 4, 2007, five customers accounted for 17%, 14%, 13%, 12% and 11%, respectively, of net revenue.

Two customers accounted for 42% and 35%, respectively, of total accounts receivable at August 2, 2008. Three customers accounted for 46%, 15% and 14%, respectively, of total accounts receivable at February 2, 2008.

## 14. Related party transactions

During June 2005, the Company loaned \$0.5 million to Blue7, a California corporation, in which the Company had invested \$1.0 million, for an approximately 17% ownership interest. One of the Company's board members had invested \$0.1 million for a 2% ownership interest during fiscal 2005. In November 2005 and January 2006, the Company loaned an additional \$0.3 million and \$0.2 million, respectively, to Blue7. During fiscal 2007, the total loan balance of \$0.9 million was forgiven and accounted for as part of the Blue7 acquisition cost. Also, related to the Blue7 acquisition in fiscal 2007, 2,645 shares of stock options were granted to a Blue7 consultant, who was one of the Company's board members. During the first quarter of fiscal 2008, 1,984 of these shares were exercised and remaining 661 shares were cancelled.

The Company maintains an investment in Envivio, Inc., in which the Company has current invested capital of \$0.3 million for an ownership fraction of less than 1% ownership interest. Three of the Company's board members have investments in this same firm, with an aggregate ownership fraction of less than 1% ownership interest. The Company's Chairman and Chief Executive Officer ("CEO"), Think Tran, is a member of Envivio's Board of Directors.

## 15. Segment and geographical information

SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information ("SFAS 131") provides annual and interim reporting standards for an enterprise's business segments and related disclosures about its products, services, geographical areas and major customers.

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. The Company is organized as, and operates in, one reportable segment. The Company's operating segment consists of its geographically based entities in the United States, Canada, Singapore, Hong Kong and France. The Company's chief operating decision-maker reviews consolidated financial information, accompanied by information about revenue by product group, target market and geographic region. The Company does not assess the performance of its product groups, target markets geographic regions on other measures of income or expense, such as depreciation and amortization, gross margin or net income.

The following table sets forth net revenue to each geographic region, and the percentage of net revenue represented by each geographic region (in thousands):

		Three Months Ended				Six Months Ended	
August		August		August 2,		August	
2,	% of	4,	% of	August 2,	% of	4,	% of
2008		2007		2008		2007	

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	Net Revenue		Net Revenue		Net Revenue		Net Revenue	
Asia	\$ 29,514	51%	\$ 26,646	63%	\$ 60,640	53%	\$ 48,209	61%
Europe	25,677	44%	14,096	33%	47,752	41%	25,197	32%
North America	3,008	5%	1,776	4%	6,664	6%	5,075	6%
Other regions	13	*	30	*	38	*	83	*
Net revenue	\$ 58,212	100%	\$ 42,548	100%	\$ 115,094	100%	\$ 78,564	99%

\* These regions provided less than 1% of our net revenue in these periods

The following table sets forth net revenue of significant countries (in thousands):

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	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Singapore	\$ 17,005	\$ 7,535	\$ 25,535	\$ 10,212
Netherland	\$ 14,318	\$ 22	\$ 21,746	\$ 107
China	\$ 4,785	\$ 2,467	\$ 10,293	\$ 5,814
Belgium	\$ 4,382	\$ 2,512	\$ 5,581	\$ 5,736
France	\$ 4,309	\$ 9,431	\$ 13,824	\$ 16,302
Japan	\$ 2,380	\$ 7,886	\$ 9,434	\$ 10,781
Taiwan	\$ 2,341	\$ 2,581	\$ 5,383	\$ 6,070
Korea	\$ 1,646	\$ 5,332	\$ 7,008	\$ 13,431
Rest of the world	\$ 7,046	\$ 4,782	\$ 16,290	\$ 10,111
	\$ 58,212	\$ 42,548	\$ 115,094	\$ 78,564

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

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

### Overview

We are a leading fabless provider of highly integrated system-on-chip, or SoC, solutions that are used to deliver multimedia entertainment throughout the home. Our SoC solutions combine our semiconductors and software and are a critical component of multiple high-growth, consumer applications that process digital video and audio content, including IPTV set-top boxes, Blu-ray DVD players, high definition televisions (HDTV), media communication devices and other products. Our semiconductors are capable of a range of media processing and communication functions, including high definition digital video decoding for multiple compression standards, graphics acceleration, video image processing, audio decoding, wireless communications, CPU and display control. Our software provides system control as well as media processing and system security management. Together, our semiconductors and software form a complete SoC solution that we believe provides our customers with a foundation to quickly develop feature-rich consumer entertainment products. We believe we are the leading provider of digital media processor SoCs for set-top boxes in the IPTV market and a leading provider of such SoCs for the Blu-ray player market, in

terms of units shipped.

Our primary target markets are IPTV, Blu-ray and other media players, prosumer and industrial audio/video and HDTV markets. The IPTV market consists of consumer and commercial products that distribute and receive streaming video using internet protocol, or IP. The Blu-ray and other media players market consists primarily of consumer Blu-ray DVD players, multi-function products and portable media devices that perform playback of digital media stored on optical or hard disk formats. The prosumer and industrial audio/video market consists of studio quality audio/video receivers and monitors, digital projectors and medical video monitors. The HDTV market consists of digital television sets offering high definition capability, including flat-panel and projection devices. We also sell products into other markets such as the PC-based add-in market. We currently derive minor revenues from sales of our products into these other markets.

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Our primary product group consists of our SoC solutions. To a much lesser extent, we provide other products, such as customized development boards and wireless devices. For the six months ended August 2, 2008 and August 4, 2007, we derived 99% and 96%, respectively, of our net revenue from our SoC solutions. Our SoC solutions consist of highly integrated semiconductors and software that process digital video and audio content. Our net revenue from sales of our SoC solutions increased \$38.2 million, or 50%, for the six months ended August 2, 2008 as compared to the corresponding periods in the prior fiscal year. This increase in our SoCs sales was in part attributable to many of our customers commercially launching products incorporating our SoCs after successful initial trials. We began volume shipments in January 2006 of our SMP8630 series, which is our latest SoC solution for our target markets. This product series represented 84% and 76% of our net revenue for the six months ended August 2, 2008 and August 4, 2007, respectively. We believe our success with the SMP8630 series product demonstrates our success in the growing IPTV and recently emerging Blu-ray player markets.

We do not enter into long-term commitment contracts with our customers and receive substantially all of our net revenue based on purchase orders. We forecast demand for our products based not only on our assessment of the requirements of our direct customers, but also on the anticipated requirements of the telecommunications carriers that our customers serve. We work with both our direct customers and these carriers to address the market demands and the necessary specifications for our technologies. However, our failure to accurately forecast demand can lead to product shortages that can impede production by our customers and harm our relationship with these customers or lead to excess inventory, which could negatively impact our gross margins in a particular period.

Many of our target markets are characterized by intense price competition. In addition, the semiconductor industry is highly competitive and, as a result, we expect our average selling prices to decline over time. However, on occasion, we have reduced our prices for individual customer volume orders as part of our strategy to obtain a competitive position in our target markets. The willingness of customers to design our SoCs into their products depends to a significant extent upon our ability to sell our products at competitive prices. If we are unable to reduce our costs sufficiently to offset any declines in product selling prices or are unable to introduce more advanced products with higher margins in a timely manner, we could see declines in our market share or gross margins. We expect our gross margins will vary from period to period due to changes in our average selling prices, volume order discounts, mix of product sales, our costs, the extent of development fees, changes in estimated useful lives of production testing equipment and provisions for inventory obsolescence. We also experienced a negative impact to our gross margins for the six months ended August 2, 2008 as a result of inventory acquired of \$3.2 million from Gennum Corporation in connection with our acquisition of certain assets of its VXP business.

We expect our revenue from the IPTV, the Blu-ray and other media players and the HDTV markets to grow with increasing demand in these markets. Our revenue derived from the IPTV market may fluctuate in future periods, as this revenue is based on IPTV service deployments by telecommunications service providers, the timing of which are uncertain. We expect our operating expenses will increase in absolute dollars as our revenue grows.

## Share Repurchase Program

On February 27, 2008, we announced that our Board of Directors had approved a share repurchase program that authorized us to repurchase up to 2.0 million shares of our common stock. On March 18, 2008, we announced that our Board of Directors had approved an increase of 3.0 million additional shares to the program, resulting in a total amount authorized to be repurchased under the share repurchase program of 5.0 million shares. The amount and timing of specific repurchases are subject to market conditions, applicable legal requirements and other factors, including management's discretion. Repurchases may be conducted in the open market or in privately negotiated transactions and the repurchase program may be modified, extended or terminated by the Board of Directors at any time. There is no guarantee as to the exact number of shares that will be repurchased under the program. As of August 2, 2008, we had purchased a cumulative total of approximately 4.2 million shares of our common stock

pursuant to the repurchase program for an aggregate purchase price of \$85.9 million at an average price of \$20.50 per share.

#### Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations are based on our unaudited condensed consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements, and the reported amounts of revenue and expenses during the period reported. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. Management bases its estimates and judgments on historical experience, market trends, and other factors that are believed to be reasonable under the circumstances. These estimates form the basis for judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from what we anticipate, and different assumptions or estimates about the future could change our reported results. Except for the update provided below on the valuation of inventory, management believes the critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended February 2, 2008 reflect the more significant judgments and estimates used in preparation of our financial statements.

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Valuation of inventory:

Inventories are stated at the lower of standard cost (approximating a first-in, first-out basis) or market value. Management periodically reviews our inventories for excess and obsolete inventory items and adjusts carrying costs to estimated net realizable values when they are determined to be less than cost. This review requires an estimation of the future demand for our products and these reserves are recorded when the inventory on hand exceeds management's estimate of future demand for each product. Once the inventory is written down, a new cost basis is established.

Management evaluates our ending inventories for excess quantities and obsolescence on a quarterly basis. This evaluation includes analysis of historical and forecasted sales levels by product. A provision is recorded to write down inventories on hand in excess of forecasted demand. In addition, we write off inventories that are considered obsolete. Obsolescence is determined from several factors, including competitiveness of product offerings, market conditions and product life cycles. Increases to the allowance for excess and obsolete inventory are charged to cost of revenue. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. If this lower-costed inventory is subsequently sold, the related allowance is matched to the movement of related product inventory, resulting in lower costs and higher gross margins for those products in the period in which the sale is recognized.

Effective for the second quarter of fiscal 2009, management changed its method of accounting for valuing the portion of its raw material inventory known as tested wafers or die bank. Previously, the expense associated with yield loss from the initial testing of wafers was expensed to cost of revenue until the wafers were moved into the next stage of production. Historically, the value of rejected die was absorbed into inventory only when the wafers were moved into work in process, or WIP. Now, we account for the yield loss from the initial testing by immediately absorbing the cost of the rejected die as they are tested.

In the second quarter of fiscal 2009, we significantly upgraded our enterprise resource management (ERP) system, which provided better tools to more accurately track and value our die bank. In addition, in light of our rapid growth in fiscal 2008, the die bank segment of our inventory had not been significant in any single period until the first quarter of fiscal 2009. As a result of the increased significance of die bank inventory, which we currently anticipate will continue, combined with an improved ERP system, management believes that absorbing the yield loss into our inventory valuation consistently throughout the manufacturing process is preferable to the prior accounting method. In making this determination, management also considered the accounting practices of other fabless semiconductor companies and the added clarity and ease of understanding that such a change would have on its reported results for investors provided by the additional cost component.

We have accounted for this change in method of accounting in accordance with Statement of Financial Accounting Standards (SFAS) No. 154, "Accounting Changes and Error Corrections." SFAS 154 requires that all elective accounting changes be made on a retrospective basis. Accordingly, we have retrospectively adjusted the unaudited condensed statement of operations for the three months ended May 3, 2008 and the unaudited consolidated balance sheet as of May 3, 2008 to reflect the results of absorbing the yield loss associated with the sorted wafers in inventory and the direct tax effect of this adjustment. Prior to the first quarter of fiscal 2009, we did not maintain a material level of die bank within inventory. Therefore, management has determined that no material retrospective adjustments were necessary for periods before fiscal 2009.

As a result of this change in accounting method, the net value of die bank inventory as of May 3, 2008 has increased by \$2.4 million and cost of goods sold for the quarter ended on that date has decreased by the same amount. The provision for income taxes for the first fiscal quarter has been increased by \$0.5 million as a result of applying a

retrospective tax rate recalculated based upon the increased gross margin and income before taxes. As a result of these retrospective adjustments, gross margin for the three months ended May 3, 2008 improved from 45.1% to 49.3% and net income increased by \$1.9 million, or \$0.06 per diluted share, compared to the previously reported results under the prior accounting method. Adjustments to the balance sheet as of May 3, 2008 were an increase to inventories of \$2.4 million, a \$0.5 million increase to accrued liabilities for the increased income tax provision and an increase of \$1.9 million to shareholders' equity.



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This change in accounting method has an inconsequential impact on all periods prior to the three months ended May 3, 2008, and thus, no further retrospective adjustments are necessary.

## Results of Operations

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

	Three Months Ended				Six Months Ended			
	August 2, 2008	% of Net Revenue	August 4, 2007	% of Net Revenue	August 2, 2008	% of Net Revenue	August 4, 2007	% of Net Revenue
Net revenue	\$ 58,212	100%	\$ 42,548	100%	\$ 115,094	100%	\$ 78,564	100%
Cost of revenue	28,691	(49)%	20,240	(48)%	57,553	(50)%	38,446	(49)%
Gross profit	29,521	51%	22,308	52%	57,541	50%	40,118	51%
Operating expenses:								
Research and development	10,377	(18)%	8,364	(20)%	21,233	(18)%	14,453	(18)%
Sales and marketing	2,783	(5)%	2,692	(6)%	5,424	(5)%	4,924	(6)%
General and administrative	3,634	(6)%	2,456	(6)%	10,102	(9)%	6,705	(9)%
Acquired in-process research and development	—	—	—	—	1,571	(1)%	—	-
Total operating expenses	16,794	(29)%	13,512	(32)%	38,330	(33)%	26,082	(33)%
Income from operations	12,727	22%	8,796	20%	19,211	17%	14,036	18%
Interest income and other income, net	1,064	2%	400	1%	3,232	3%	720	1%
Income before income taxes	13,791	24%	9,196	21%	22,443	20%	14,756	19%
Provision for income taxes	4,200	(7)%	608	(1)%	6,270	(5)%	799	(1)%
Net income	\$ 9,591	17%	\$ 8,588	20%	\$ 16,173	15%	\$ 13,957	18%

## Net revenue

The following table sets forth net revenue and percent change in net revenue (in thousands):

	Three Months Ended			Six Months Ended		
	August 2, 2008	% change	August 4, 2007	August 2, 2008	% change	August 4, 2007
Net revenue	\$ 58,212	37%	\$ 42,548	\$ 115,094	46%	\$ 78,564

Our net revenue for the three and six months ended August 2, 2008 increased approximately \$15.7 million and \$36.5 million, as compared to the corresponding periods in the prior fiscal year. The increase in net revenue for the three and six months ended August 2, 2008 compared to the prior year periods was primarily due to strong growth in our

SOCs sold into the IPTV market.

Net revenue by target market

We sell our products into four primary markets, which are the IPTV market, the Blu-ray and other media players market, the prosumer and industrial audio/video market and the HDTV market. We also sell our products, to a lesser extent, into several other markets, such as the PC-based add-in market, which we refer to collectively as our other market. The following table sets forth our net revenue by target market and the percentage of net revenue represented by our product sales to each target market (in thousands):

	Three Months Ended				Six Months Ended			
	August 2, 2008	% of Net Revenue	August 4, 2007	% of Net Revenue	August 2, 2008	% of Net Revenue	August 4, 2007	% of Net Revenue
IPTV	\$ 49,239	85%	\$ 28,391	67%	\$ 92,236	80%	\$ 56,309	72%
Blu-ray and other media players	4,482	8%	11,042	26%	15,932	14%	18,095	23%
Prosumer and industrial audio/video	2,729	5%	—	*	3,820	*	—	*
HDTV	130	*	2,299	5%	567	0%	2,810	4%
Other	1,632	2%	816	2%	2,539	6%	1,350	1%
Net revenue	\$ 58,212	100%	\$ 42,548	100%	\$ 115,094	100%	\$ 78,564	100%

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**IPTV:** The increase of \$20.8 million, or 73%, and \$35.9 million, or 64%, in net revenue from sales into the IPTV market for the three and six months ended August 2, 2008, respectively, as compared to the corresponding periods in the prior fiscal year was primarily attributable to the increased volume of SoCs shipped to our customers in the IPTV market incorporating our SoCs into their products, primarily our SMP8630 SoC series.

**Blu-ray and other media players:** The decrease of \$6.6 million, or 59%, in net revenue from the Blu-ray and other media players market for the three months ended August 2, 2008 as compared to the corresponding period in the prior fiscal year was primarily attributable to decreased sales volume of our customers' products incorporating our SoCs. The decrease of \$2.2 million, or 12%, in net revenue from the Blu-ray and other media players market for the six months ended August 2, 2008 as compared to the corresponding period in the prior fiscal year was primarily attributable to decreased sales volume of our customers' products incorporating our SoCs. The decrease in both the three and six month periods was primarily due to an overall slowdown in the Blu-ray market in the second quarter of fiscal 2009.

**Prosumer and industrial audio/video:** We reported an increase in net revenue from sales into the prosumer and industrial audio/video market of \$2.7 million, or 100%, and \$3.8 million, or 100% and for the three and six months ended August 2, 2008, respectively, compared to the corresponding periods in the prior fiscal year. These increases were driven by our entry into these markets through our acquisition of the VXP product line in February 2008.

**HDTV:** We reported a decrease in net revenue from sales into the HDTV market of \$2.2 million, or 94%, for the three months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. We reported a decrease in net revenue from sales into the HDTV market of \$2.2 million, or 80%, for the six months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. The decrease in both the three and six month periods was due to a temporary increase in demand from a single customer during the second quarter of fiscal 2008.

**Other:** Our other markets consist of PC add-ins and other ancillary markets. Sales to our other markets for the three months ended August 2, 2008 increased \$0.8 million, or 100%, compared to the corresponding period in the prior year. Sales to our other markets for the six months ended August 2, 2008 increased \$1.2 million, or 88%, compared to the corresponding period in the prior year.

## Net revenue by product group

Our primary product group consists of our SoC solutions. To a lesser extent, we derive net revenue from other products and services. The following table sets forth net revenue in each of our product groups and the percentage of net revenue represented by each product group (in thousands):

	August 2, 2008	Three Months Ended		Six Months Ended		August 2, 2008	August 4, 2007	% of Net Revenue
		% of Net Revenue	% of Net Revenue	% of Net Revenue	% of Net Revenue			
SoCs	\$ 57,813	99%	\$ 41,354	97%	\$ 113,991	99%	\$ 75,746	96%
Other	399	1%	1,194	3%	1,103	1%	2,818	4%
Net revenue	\$ 58,212	100%	\$ 42,548	100%	\$ 115,094	100%	\$ 78,564	100%

**SoCs:** Our SoCs are targeted toward manufacturers and large volume designer and manufacturer customers building products for the IPTV, Blu-ray and other media players, prosumer and industrial audio/video and HDTV markets. The increase of \$16.4 million, or 40%, in net revenue from SoCs for the three months ended August 2, 2008

compared to the corresponding period in the prior fiscal year was due primarily to increased demand in sales of IPTV products. The increase of \$38.2 million, or 50%, in net revenue from SoCs for the six months ended August 2, 2008 compared to the corresponding period in the prior fiscal year was due primarily to increased demand in sales of IPTV products.

Other: We derive revenue from other products and services, including engineering support services from sales of hardware and software, engineering development for customization of SoCs and other accessories and wireless devices. The decrease of \$0.8 million, or 64%, for the three months ended August 2, 2008 compared to the corresponding period in the prior fiscal year was due to lower sales of our engineering development kits related to our SoCs and support services. The decrease of \$1.7 million, or 61%, for the six months ended August 2, 2008 compared to the corresponding period in the prior fiscal year was due to lower sales of our engineering development kits related to our SoCs and support services.

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## Net revenue by geographic region

The following table sets forth our net revenue by geographic region and the percentage of net revenue represented by each geographic region based on the invoicing location of each customer (in thousands):

	Three Months Ended				Six Months Ended			
	August 2, 2008	% of Net Revenue	August 4, 2007	% of Net Revenue	August 2, 2008	% of Net Revenue	August 4, 2007	% of Net Revenue
Asia	\$ 29,514	51%	\$ 26,646	63%	\$ 60,640	53%	\$ 48,209	61%
Europe	25,677	44%	14,096	33%	47,752	41%	25,197	32%
North America	3,008	5%	1,776	4%	6,664	6%	5,075	7%
Other regions	13	*	30	*	38	*	83	*
Net revenue	\$ 58,212	100%	\$ 42,548	100%	\$ 115,094	100%	\$ 78,564	100%

\* These regions provided less than 1% of our net revenue in these periods

Asia: Our net revenue in absolute dollars from Asia increased \$---2.9 million, or 11% in the three months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. Our net revenue from Asia represented 51% and 63% of our net revenue for the three months ended August 2, 2008 and August 4, 2007, respectively. This 12% decrease as a percentage of revenue was primarily due to the disproportionate increase in sales into Europe during the three months ended August 2, 2008.

Our net revenue in absolute dollars from Asia increased \$---12.4 million, or 26% in the six months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. Our net revenue from Asia represented 53% and 61% of our net revenue for the six months ended August 2, 2008 and August 4, 2007, respectively. This 8% decrease as a percentage of revenue was primarily due to the disproportionate increase in sales into Europe during the six months ended August 2, 2008.

The following table sets forth the percentage of net revenue from countries in the Asia region that accounted for 10% or more of our net revenue:

	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Singapore	29%	18%	22%	13%
Japan	*	19%	*	14%
Korea	*	13%	*	17%

\* Net revenue from this country was less than 10% of our net revenue

Europe: Our net revenue in absolute dollars from Europe increased \$11.6 million, or 82%, for the three months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. The increase in our net revenue from Europe was primarily attributable to major deployments by our European customers using our IPTV SoCs in their products.

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Our net revenue in absolute dollars from Europe increased \$22.6 million, or 90%, for the six months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. The increase in our net revenue from Europe was primarily attributable to major deployments by our European customers using our IPTV SoCs in their products.

Our revenue from Europe in any given period may also fluctuate depending on whether our European customers place their orders locally or through their non-European manufacturers who incorporate our SoCs into their products.

The following table sets forth the percentage of net revenue from countries in Europe that accounted for 10% or more of our net revenue:

	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Netherlands	25%	*	19%	*
France	*	22%	12%	21%

\* Net revenue from this country was less than 10% of our net revenue

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North America: Our net revenue from North America increased \$1.2 million, or 7%, for the three months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. The increase in the comparative three month period was primarily attributable to increased demand for our SoC solutions for the IPTV market and revenue from sales of our VXP products, which we commenced selling in February 2008 following the asset acquisition from Gennum Corporation, partially offset by the continuation of the trend that companies located in North America who incorporate our products in their finished goods are moving their production orders to large designers and manufacturers located in the Asia or Europe regions.

Our net revenue from North America increased \$1.6 million, or 31%, for the six months ended August 2, 2008 compared to the corresponding period in the prior fiscal year. The increase in the comparative six month period was primarily attributable to increased demand for our SoC solutions for the IPTV market and revenue from sales of our VXP products into the prosumer and industrial audio/video market, which we commenced selling in February 2008 following the asset acquisition from Gennum Corporation, partially offset by the continuation of the trend that companies located in North America who incorporate our products in their finished goods are moving their production orders to large designers and manufacturers located in the Asia or Europe regions.

Our revenue from North America in any given period fluctuates depending on whether our customers place their orders locally or through overseas manufacturers who incorporate our SoC's into their products.

For the three months and six months ended August 2, 2008, our net revenue generated outside North America was 95% and 94% of our net revenue, respectively, as compared to 96% and 93%, respectively, in the corresponding periods in the prior fiscal year.

## Major Customers

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

Customer	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Cisco Systems	31%	*	23%	11%
MTC Singapore	29%	18%	22%	13%
Macnica, Inc.	*	17%	*	12%
Freebox SA	*	15%	*	14%
Uniquist Corp.	*	12%	*	17%

\* These customers provided less than 10% of our net revenue in these periods

## Gross Profit and Gross Margin

The following table sets forth gross profit and gross margin (in thousands):

	Three Months Ended			Six Months Ended		
	August 2, 2008	% change	August 4, 2007	August 2, 2008	% change	August 4, 2007
Gross profit	\$ 29,521	32%	\$ 22,308	\$ 57,541	43%	\$ 40,118
Gross margin	50.7%		52.4%	50.0%		51.1%

The gross margin percentage was relatively unchanged for the three and six months ended August 2, 2008 compared to the three and six months ended August 4, 2007.

#### Operating Expenses

The following table sets forth operating expenses and percent change in operating expenses (in thousands):

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	Three Months Ended			Six Months Ended		
	August 2, 2008	% change	August 4, 2007	August 2, 2008	% change	August 4, 2007
Research and development expenses	\$ 10,377	24%	\$ 8,364	\$ 21,233	47%	\$ 14,453
Sales and marketing expenses	2,783	3%	2,692	5,424	10%	4,924
General and administrative expenses	3,634	48%	2,456	10,102	51%	6,705
Acquired in-process R&D	—	—	—	1,571	100%	—
Total operating expenses	\$ 16,794	24%	\$ 13,512	\$ 38,330	47%	\$ 26,082

Research and development expenses: Research and development expenses increased by \$2.0 million, or 24%, during the three months ended August 2, 2008 as compared with the corresponding period in the prior fiscal year. This increase is primarily attributable to an increase of \$2.4 million in salaries, wages and benefit expenses due to increased headcount, offset by a decrease of \$1.1 million in share-based compensation expense; an increase of \$0.5 million in license fees, consulting services, supplies and non-recurring engineering costs to develop our products; and an increase of \$0.2 million in depreciation and amortization and other expenses.

Research and development expenses increased by \$6.8 million, or 47%, during the six months ended August 2, 2008 as compared with the corresponding period in the prior fiscal year. This increase is primarily attributable to an increase of \$5.2 million in salaries, wages and benefit expenses due to increased headcount, offset by a decrease of \$0.4 million in share-based compensation expense; an increase of \$1.5 million in license fees, consulting services, supplies and non-recurring engineering costs to develop our products; and an increase of \$0.5 million in depreciation and amortization and other expenses.

Sales and marketing expenses: Sales and marketing expenses increased by \$0.1 million, or 3%, during the three months ended August 2, 2008 as compared with the corresponding period in the prior fiscal year. This increase is primarily attributable to an increase of \$0.3 million in salaries, wages, commission and benefit expenses, offset by a decrease of \$0.3 million in share-based compensation expense; and an increase of \$0.1 million in depreciation and amortization and other expenses.

Sales and marketing expenses increased by \$0.5 million, or 10%, during the six months ended August 2, 2008 as compared with the corresponding period in the prior fiscal year. This increase is primarily attributable to an increase of \$0.5 million in salaries, wages, commission and benefit expenses, offset by a decrease of \$0.1 million in share-based compensation expense; and an increase of \$0.2 million in depreciation and amortization and other expenses.

General and administrative expenses: General and administrative expenses increased by \$1.2 million, or 48%, during the three months ended August 2, 2008 as compared with the corresponding period in the prior fiscal year. This increase is primarily attributable to an increase of \$0.5 million in salaries, wages and benefit expenses, offset by a decrease of \$0.1 million in share-based compensation expense; an increase of \$0.1 million in professional fees related primarily to audit and tax services; an increase of \$0.4 million in legal and other professional fees; an increase of \$0.1 million in insurance expense; and an increase of \$0.1 million in travel, entertainment and other expenses.

General and administrative expenses increased by \$3.4 million, or 51%, during the six months ended August 2, 2008 as compared with the corresponding period in the prior fiscal year. This increase is primarily attributable to an increase of \$0.6 million in salaries, wages and benefit expenses, an increase of \$2.4 million in share-based compensation expense; an increase of \$0.8 million in professional fees related primarily to audit and tax services; an increase of \$0.3 million in insurance expense; and an increase of \$0.2 million in travel, entertainment and other

expenses; all of which was partially offset by a decrease of \$1.0 million in legal and other professional fees, which were higher in the same quarter of the prior fiscal year mostly related to the review of our historical stock option granting practices of previous fiscal years.

Acquired in-process research and development: Acquired in-process research and development, or IPR&D, totaled \$1.6 million as a result of the VXP acquisition completed on February 8, 2008. The amounts allocated to IPR&D were determined through established valuation techniques used in the high technology industry and were expensed upon acquisition as it was determined that the underlying projects had not reached technological feasibility and no alternative future uses existed. IPR&D is a one-time expense related to the VXP acquisition recognized during the quarter in which we closed the VXP acquisition.

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

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	Three Months Ended		Six Months Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
Cost of revenue	\$ 92	\$ 101	\$ 175	\$ 189
Research and development expenses	1,241	868	2,652	1,552
Sales and marketing expenses	382	280	740	488
General and administrative expenses	689	464	3,591	810
Total share-based compensation	\$ 2,404	\$ 1,713	\$ 7,158	\$ 3,039

Accounting for employee stock options grants will continue to have an adverse impact on our results of operations. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees or assume unvested equity awards in connection with acquisitions.

Amortization of intangible assets: Amortization expense of \$0.6 million and \$1.1 million for acquired developed technology for three and six months ended August 2, 2008, respectively, and \$0.2 million and \$0.4 million, for the corresponding period of the prior fiscal year, is classified as cost of sales. Amortization expense of \$0.1 million and \$0.2 million for other purchased intangible assets for the three months and six months ended August 2, 2008, respectively, and \$0.1 million and \$0.2 million, for the corresponding period of the prior fiscal year, is classified as research and development expense. Amortization expense of \$0.1 million and \$0.1 million for other purchased intangible assets for the three months and six months ended August 2, 2008, respectively, and no amortization expense for the corresponding period of the prior fiscal year, is classified as sales and marketing expense. At August 2, 2008, the unamortized balance from purchased intangible assets was \$12.8 million which will be amortized to future periods based on their respective remaining estimated useful lives. If we purchase additional intangible assets in the future, our cost of revenue or other operating expenses will increase by the amortization of those assets.

## Interest and other income, net

The following table sets forth net interest and other income and the percent change in interest and other income, net (in thousands):

	Three Months Ended			Six Months Ended		
	August 2, 2008	% change	August 4, 2007	August 2, 2008	% change	August 4, 2007
Interest and other income, net	\$ 1,064	166%	\$ 400	\$ 3,232	349%	\$ 720

The increases of \$0.7 million, or 166%, and \$2.5 million, or 349%, for the three months and six months ended August 2, 2008 compared with the corresponding periods in the prior fiscal year was due primarily to an increase in interest income earned on cash, cash equivalents and marketable securities, the balances of which increased significantly during fiscal 2008 as a result of cash generated from operations and the follow-on public offering of our common stock completed in October 2007, offset by a decrease in our cash as a result of our share repurchases.

## Provision for income taxes

We recorded a provision for income taxes of \$4.2 million and \$6.3 million for the three months and six months ended August 2, 2008, respectively, and \$0.6 million and \$0.8 million, respectively, for the corresponding periods of the prior fiscal year. The effective tax rate for 2009 was approximately 30% and 28% for the three months and six months ended August 2, 2008, respectively. Our fiscal 2009 effective tax rate differs from the combined federal and state statutory rate of 41% primarily due to our international operations strategy, which resulted in a foreign tax

differential benefit.

#### Liquidity and Capital Resources

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

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	August 2, 2008	February 2, 2008
Cash and cash equivalents	\$ 75.8	\$ 174.1
Short-term marketable securities	44.8	44.4
	\$ 120.6	\$ 218.5

As of August 2, 2008, our principal sources of liquidity consisted of cash and cash equivalents and short-term marketable securities of \$120.6 million, which represents a decrease of \$97.9 million from \$218.5 million at February 2, 2008. The decrease in cash and cash equivalents and marketable securities was primarily the result of our repurchase of 4.2 million shares of our common stock for approximately \$85.9 million, which we completed during the six months ended August 2, 2008.

## Cash flows from operating activities

The following table sets forth the net (decrease) or increase in cash and cash equivalents summarized by operating, investing and financing activities (in millions):

	Six Months Ended	
	August 2, 2008	August 4, 2007
Net cash (used in) provided by:		
Operating activities	\$ 7.9	\$ 6.1
Investing activities	(27.6)	(1.2)
Financing activities	(78.7)	4.1
Effect of foreign rate changes on cash and cash equivalents	0.1	0.1
Net (decrease) increase in cash and cash equivalents	\$ (98.3)	\$ 9.1

Net cash provided by operating activities was \$7.9 million for the six months ended August 2, 2008. The cash provided by our operating activities for the six months ended August 2, 2008 was primarily due to net income of \$16.2 million, non-cash charges of \$15.9 million, a \$0.7 million decrease in accounts receivable and a \$0.5 million increase in other long-term liabilities. These amounts were partially offset by a \$16.8 million increase in inventories, a \$7.1 million decrease in accounts payable and other accrued liabilities and a \$1.5 million increase in prepaid expenses and other assets. The increase in inventory for the six months ended August 2, 2008 was due primarily to strategic purchases of raw materials. The decrease in accounts payable and accrued liabilities is due primarily to the timing of payments for inventories, tax liabilities and software licenses. The increase in prepaid expenses and other assets is primarily due to purchases of production mask sets to be used in manufacturing our products. The decrease in accounts receivable for the six months ended August 2, 2008 was primarily the result of decreased billings due to decreased product shipments during the quarter, which was substantially offset by increased sales to customers with payment terms greater than net 30 days. Non-cash charges included share-based compensation of \$7.2 million in the six months ended August 2, 2008.

Net cash provided by operating activities was \$6.1 million for the six months ended August 4, 2007. The cash provided by our operating activities in the six months ended August 4, 2007 was primarily due to net income of \$14.0 million, non-cash expenses of \$1.6 million of depreciation and amortization and \$2.4 million of compensation expenses related to the tender offer of our common stock initiated in the second quarter, partially offset by increases in

accounts receivable of \$10.0 million and inventory of \$1.1 million and a decrease in accounts payable of \$4.0 million. We incurred non-cash expenses of \$3.1 million for share-based compensation expense in the six months ended August 4, 2007.

The increases in inventory and accounts receivable in the six months ended August 4, 2007 were associated with the increase in our net revenues during the period primarily as a result of increased sales into the IPTV market.

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

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Cash flows from investing activities

Net cash used in our investing activities was \$27.6 million for the six months ended August 2, 2008 which was primarily due to cash paid in connection with acquisition of VXP Group of \$18.6 million, purchase of software, equipment and leasehold improvement of \$6.5 million and net purchases of marketable securities of \$2.6 million.

Net cash used in our investing activities was \$1.2 million for the six months ended August 4, 2007, primarily due to our purchase of short-term investments of \$43.5 million and capital equipment of \$0.4 million, offset by the maturities of the short term investments of \$42.6 million.

Cash flows from financing activities

Net cash used in financing activities was \$78.8 million in the six months ended August 2, 2008, which was the result of \$85.9 million for the purchase of 4.2 million shares of our common stock, partially offset by \$4.2 million of excess tax benefit from share-based compensation and \$3.0 million of proceeds from the exercise of employee stock options.

Net cash provided by financing activities was \$4.1 million in the six months ended August 4, 2007, which primarily consisted of \$4.2 million of proceeds from the exercise of employee stock options, partially offset by our repayment of our outstanding term loan of \$0.1 million.

Liquidity

To date, our primary sources of funds have been proceeds from common stock issuances. In certain periods, including fiscal 2008 and the first six months of fiscal 2009, cash generated from operations has also been a source of funds. While we generated cash from operations in the six months ended August 2, 2008 and August 4, 2007, it is possible that our operations will consume cash in future periods. Based on our currently anticipated cash needs, we believe that our current reserve of cash and cash equivalents will be sufficient to meet our primary uses of cash, which include our anticipated working capital requirements, obligations, capital expenditures, strategic investments and other cash needs for at least the next twelve months. Cash will continue to fluctuate based upon our ability to grow revenue and the timing of payments to us from customers and from us to vendors, the timing of inventory purchases and subsequent manufacture and sale of our products.

At August 2, 2008, we held approximately \$43.0 million of investments, currently classified in our long-term marketable securities, with an auction reset feature, which are referred to as "auction rate securities." In recent months, the auctions failed for all of our auction rate securities. There is no assurance that future auctions will succeed and, as a result, our ability to liquidate our investments and fully recover the carrying value of our auction rate securities in the near term may be limited or not exist. An auction failure means that the parties wishing to sell securities could not. All of our auction rate securities were rated AAA or Aaa at the time of purchase, the highest rating, by a rating agency. As of August 2, 2008, all of our auction rate securities remained rated AAA or Aaa. If the issuers of these auction rate securities are unable to successfully close future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. We believe that the underlying credit quality of the assets backing our auction rate securities has not been impacted by the reduced liquidity of these investments. In August 2008, our cash investment advisor announced its proposal of a comprehensive settlement agreement in principle for its clients holding auction rate securities, in which all the auction rate securities currently in our portfolio could be redeemed at par value. The offer to redeem will be at our option during a two year period beginning in June 2010. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity on these investments will affect our ability to execute our current business plan.

Contractual obligations and commitments

We do not have guaranteed price or quantity commitments with any of our suppliers. We generally maintain products for sale through distributors based on forecasts rather than firm purchase orders. Additionally, we generally manufacture products for sale to our customers and acquire the necessary materials to manufacture those products, only after receiving purchase orders from such customers. Purchase orders with delivery dates longer than 12 weeks from the date of the order are typically cancelable until four weeks prior to the scheduled delivery date without substantial penalty to our customers. For our larger volume designer and manufacturer customers, purchase orders for our products are generally non-cancelable between four and 12 weeks of scheduled delivery dates, and within four weeks of scheduled delivery dates are also generally non-reschedulable.

The following table sets forth the amounts of payments due under specified contractual obligations as of August 2, 2008 (in thousands):

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Contractual Obligations	Payments Due by Period				Total
	1 year or less	1 - 3 years	3 - 5 years	thereafter	
Operating leases	\$ 830	\$ 3,419	\$ 3,055	\$ 3,410	10,714
Non-cancelable purchase orders	5,550	—	—	—	5,550
	\$ 6,380	\$ 3,419	\$ 3,055	\$ 3,410	\$ 16,264

## Off-balance sheet transactions

As of August 2, 2008, we did not have any off-balance sheet arrangements.

## Recent accounting pronouncements

In February 2007 the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS 159"). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. The standard's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new standard does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, Fair Value Measurements, and SFAS No. 107, Disclosures about Fair Value of Financial Instruments. SFAS 159 is effective for fiscal years beginning after November 15, 2007, and we did not elect to adopt the fair value option under SFAS 159.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements, the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination and requires related acquisition costs to be expensed in the period incurred. SFAS 141R is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the potential impact, if any, of the adoption of SFAS 141R on our condensed consolidated results of operations and financial condition.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

**Interest Rate Sensitivity:** As of August 2, 2008 and February 2, 2008, we held approximately \$179.6 million and \$275.7 million, respectively, of cash, cash equivalents, short-term marketable securities and long-term marketable securities. If short-term interest rates were to decrease 10%, the decreased interest income associated with these money market funds and marketable securities would not have a significant impact on our net income and cash flows.

As of August 2, 2008, we held approximately \$43.0 million of investments, currently classified in our long-term marketable securities, with an auction reset feature, which are referred to as "auction rate securities." In late February

and March 2008, auctions failed for all of our auction rate securities and there is no assurance that future auctions will succeed and as a result our ability to liquidate our investments and fully recover the carrying value of our marketable securities in the near term may be limited or not exist. An auction failure means that the parties wishing to sell securities could not. All of our auction rate securities, including those subject to the failure, were rated AAA or Aaa at the time of purchase, the highest rating, by a rating agency. If the issuers of these auction rate securities are unable to successfully close future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these marketable securities. We believe that the underlying credit quality of the assets backing our auction rate securities have not been impacted by the reduced liquidity of these investments. We are continuing to evaluate the credit quality, classification and valuation of our auction rate securities; however, we are not yet able to quantify the amount of impairment, if any, or change in classification in these investments at this time. If these auctions continue to fail and the credit ratings of these investments deteriorate, the fair value of these auction rate securities may decline and we may incur impairment charges in connection with these securities, which would negatively affect our reported earnings, cash flow and financial condition. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity of these investments will affect our ability to execute our current business plan.

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Our short-term marketable securities generally consist of the U.S. government agency and high grade corporate debt securities with an average original maturity of less than one year. Our long-term marketable securities generally consist of state and U.S. government agency and high grade corporate debt securities with an original maturity of more than one year, but no more than two years. If short-term interest rates were to decrease 10%, the decreased interest income associated with these short-term investments would not have a significant impact on our net income and cash flows.

Foreign Currency Exchange Rate Sensitivity: The Hong Kong dollar, Canadian dollar and Euro are the primary financial currencies of our subsidiaries in Hong Kong, Canada and France, respectively. We do not currently enter into foreign exchange forward contracts to hedge certain balance sheet exposures and inter-company balances against future movements in foreign exchange rates. However, we do maintain cash balances denominated in the Hong Kong dollar, Canadian dollar, Euro and Singapore dollar. If foreign exchange rates were to weaken against the U.S. dollar immediately and uniformly by 10% from the exchange rate at August 2, 2008 or February 2, 2008, the fair value of these foreign currency amounts would decline by an insignificant amount.

**ITEM 4. CONTROLS AND PROCEDURES**

We are committed to maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our periodic reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, 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 management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures and implementing controls and procedures.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of August 2, 2008, the end of the period covered by this Report.

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the six months ended August 2, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting., except in second quarter of fiscal 2009, we upgraded our enterprise resource planning (ERP) system.

**Inherent Limitations on Internal Control**

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of management override or improper acts, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future

conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to management override, error or improper acts may occur and not be detected. Any resulting misstatement or loss may have an adverse and material effect on our business, financial condition and results of operations.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

Lawsuits related to our historical stock option granting practices

Certain of our current and former directors and officers have been named as defendants in several shareholder derivative actions filed in the United States District Court for the Northern District of California, which have been consolidated under the caption *In re Sigma Designs, Inc. Derivative Litigation* (the "Federal Action") and in a substantially similar shareholder derivative action filed in the Superior Court for Santa Clara County, California captioned *Korsinsky v. Tran, et al.* (the "State Action").

Plaintiffs in the Federal and State Actions allege that the individual defendants breached their fiduciary duties to us in connection with the alleged backdating of stock option grants during the period from 1994 through 2005 and that certain defendants were unjustly enriched. Plaintiffs in the Federal Action assert derivative claims against the individual defendants based on alleged violations of Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934, and Rules 10b-5 and 14a-9 promulgated there under. They also allege that the individual defendants aided and abetted one another's alleged breaches of fiduciary duty and violated California Corporations Code section 25402 and bring claims for an accounting and rescission. In the State Action, plaintiffs also allege that the individual defendants wasted corporate assets. Both Actions seek to recover unspecified money damages, disgorgement of profits and benefits and equitable relief. The Federal Action also seeks treble damages, rescission of certain defendants' option contracts, imposition of a constructive trust over executory option contracts and attorney's fees. We are named as a nominal defendant in both the Federal and State Actions; thus, no recovery against us is sought.

In January 2007, we filed a motion to dismiss the Federal Action on the ground that the plaintiffs had not made a pre-litigation demand on our Board of Directors and had not demonstrated that such a demand would have been futile. The defendant directors and officers joined in that motion, and filed a motion to dismiss the Federal Action for failure to state a claim against each of them. Pursuant to a joint stipulation, plaintiffs filed an Amended Consolidated Shareholder Derivative Complaint ("Amended Complaint") on August 13, 2007. On September 19, 2007, the Company and the individual defendants each filed a motion to dismiss the Amended Complaint on the same grounds as their previous motions to dismiss. Plaintiffs filed oppositions to the motions to dismiss on October 19, 2007. Defendants filed replies in support of their motions to dismiss on November 5, 2007. Thereafter, the parties reached an agreement to settle the action. On May 28, 2008, the parties to both the Federal Action and the State Action executed a definitive settlement agreement. The settlement, which is subject to the approval of the United States District Court for the Northern District of California, will result in dismissal of both the Federal Action and the State Action. The parties filed a Joint Motion for Preliminary Approval of Settlement on May 29, 2008, and the Court granted this motion on June 24, 2008. The Company published a notice of the proposed settlement on June 27, 2008; no objections to the proposed settlement were submitted in response. Plaintiffs filed a Motion for Final Approval of Settlement on July 29, 2008. At a hearing on this motion held on August 8, 2008, the Court took the matter under submission; and the

Court subsequently requested further information regarding the settlement. On September 5, 2008, the parties filed a joint submission in response to this request.

In January 2007, we also filed a motion to dismiss or stay the State Action in favor of the earlier filed Federal Action. The defendant directors and officers joined in that motion. Pursuant to a joint stipulation, the Court ordered that the State Action be stayed in favor of the earlier-filed Federal Action. Thereafter, as stated above, the parties to the Federal Action reached an agreement to settle that action. On May 28, 2008, the parties to both the Federal Action and the State Action executed a definitive settlement agreement. The settlement, which is subject to the approval of the United States District Court for the Northern District of California, will result in dismissal of both the Federal Action and the State Action. On June 9, 2008, pursuant to joint stipulation, the Court ordered that the State Action continue to be stayed pending entry of an Order and Final Judgment approving the settlement in the Federal Action.

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We previously disclosed in press releases that the Securities and Exchange Commission (“SEC”) has initiated an informal inquiry into our stock option granting practices. The SEC requested that we voluntarily produce documents relating to, among other things, our stock option practices. We responded to the SEC’s requests in July and August of 2006 and have received no further requests since that time. We intend to continue cooperating with the SEC should we receive any additional requests.

In May 2007, the IRS began an employment tax audit for our fiscal 2004 and 2005. We have also requested that fiscal 2006 be included in this audit cycle. The focus of the IRS employment tax audit related to tax issues connected to our granting stock options with exercise prices per share that were less than the fair market value per share of the common stock underlying the option on the option’s measurement date for financial reporting purposes. We recently settled this IRS audit (including the year 2006), although we are still waiting to receive the notice of assessment resulting from such settlement for interest on the agreed tax and penalty amounts. The amounts settled were in alignment with the amounts previously provided for. We will soon be reporting these IRS adjustments to the California Employment Development Department (“EDD”) and will then meet with the EDD to determine the corresponding state tax, penalty and/or interest adjustments.

In August 2007, the IRS began an income tax audit for our fiscal 2005 federal income tax return. The IRS has proposed several adjustments. We have accepted most of the adjustments, which will not have a material financial impact to our operations and financial condition. We are in discussions with the IRS concerning an additional proposed adjustment, which concerns an area that is not complete. We intend to perform additional development work to resolve this proposed adjustment.

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business and Our Industry

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

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

For six months ended August 2, 2008, Cisco Systems and MTC Singapore accounted for 23% and 22%, respectively, of our net revenue. For six months ended August 4, 2007, Uniquist, Freebox SA, MTC Singapore, Macnica and

Cisco Systems accounted for 17%, 14%, 13%, 12% and 11%, respectively, of our net revenue.



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

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

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

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

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

Our quarterly revenue and operating results depend upon the volume and timing of customer orders received during a given quarter and the percentage of each order that we are able to ship and recognize as net revenue during each quarter. Customers may change their cycle of product orders from us, which would affect the timing of our product shipments. For example, we experienced a decline in orders from significant customers in the first quarter of fiscal 2009 compared to other recently completed quarters. Any failure or delay in the closing of orders expected to occur within a quarterly period, particularly from significant customers, would adversely affect our operating results. Further, to the extent we receive orders late in any given quarter, we may be unable to ship products to fill those orders during the same quarter in which we received the corresponding order, which could have an adverse impact on our operating results for that quarter.

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

We place orders with our suppliers based on our forecasts of our customers' demand. Our forecasts are based on multiple assumptions, each of which may introduce errors into our estimates. When the demand for our customers' products increases significantly, we may not be able to meet demand on a timely basis, and we may need to expend a significant amount of time working with our customers to allocate limited supply and maintain positive customer relations. If we underestimate customer demand, we may forego revenue opportunities, lose market share and damage our customer relationships. Conversely, if we overestimate customer demand, we may allocate resources to manufacturing products that we may not be able to sell when we expect to or at all. As a result, we would have excess or obsolete inventory, resulting in a decline in the value of our inventory, which would increase our cost of revenue and create a drain on our liquidity. Our failure to accurately manage inventory against demand would adversely affect our financial results.

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

We expect our SoCs to account for the substantial majority of our net revenue for the foreseeable future. For the three months and six months ended August 2, 2008, sales of our SoCs represented 99% and 99%, respectively, of our net revenue. Even if the consumer electronic markets that we target continue to expand, manufacturers of consumer products in these markets may not choose to utilize our SoCs in their products. The markets for our products are characterized by frequent introduction of new technologies, short product life cycles and significant price competition. If we or our customers are unable to manage product transitions in a timely and cost effective manner, our net revenue would suffer. In addition, frequent technological changes and introduction of next generation products may result in inventory obsolescence which would increase our cost of revenue and adversely affect our operating performance. If demand for our SoCs declines or fails to grow or we are unable to develop new products to meet our customers' demand, our net revenue could be harmed

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

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

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

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

The review of our historical stock option granting practices and the restatement of our prior financial statements may result in additional litigation, regulatory proceedings and government enforcement actions, which could harm our business, financial condition, results of operations and cash flows.

Our historical stock option granting practices and the related restatement of our historical financial statements, which we completed in connection with the audit of our financial statements for fiscal 2007, have exposed us to greater risks

associated with litigation, regulatory proceedings and government enforcement actions. For more information regarding our current litigation and related inquiries, please see the section entitled "Legal Proceedings" under Part II, Item 1. We have provided the results of our internal review and investigation of our stock option practices to the SEC, and in that regard we have responded to informal requests for documents and additional information. We intend to continue to cooperate with the SEC and any other governmental agency which may become involved in this matter. We cannot give any assurance regarding the outcomes from litigation, regulatory proceedings or government enforcement actions relating to our past stock option practices. The resolution of these matters will be time consuming, expensive and may distract management from the conduct of our business. Furthermore, if we are subject to adverse findings in litigation, regulatory proceedings or government enforcement actions, we could be required to pay damages or penalties or have other remedies imposed, which could harm our business, financial condition, results of operations and cash flows.

In addition, the SEC may disagree with the manner in which we accounted for and reported, or not reported, the financial impact of determining the correct measurement dates for our stock option grants. Accordingly, there is a risk that we may have to further restate our prior financial statements, amend prior filings with the SEC or take other actions not currently contemplated.

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As a result of our internal review of our historical stock option granting practices, we were unable to timely file our periodic reports with the SEC during fiscal 2007. We were also subject to delisting proceedings in front of the Nasdaq Listing Qualifications Staff. After we filed all of our outstanding periodic reports with the SEC in April 2007, we received a Nasdaq Listing Qualifications Staff letter stating that the Nasdaq Listing Qualifications Staff determined that we had demonstrated compliance with all Nasdaq Marketplace Rules. Accordingly, our securities continue to be listed on the Nasdaq Global Market. However, if the SEC disagrees with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock option grants, there could be further delays in filing subsequent SEC reports or other actions that might result in the delisting of our common stock from the Nasdaq Global Market.

We have reported material weaknesses in our controls over financial reporting in fiscal 2005 through 2007. If we are unable to maintain effective internal control over financial reporting, our ability to report our financial results on a timely and accurate basis may be adversely affected, which in turn could cause the market price of our common stock to decline.

As of February 2, 2008, our management, including our principal executive officer and principal financial officer, assessed the effectiveness of our internal control over financial reporting. Based on this assessment, our management determined we had remediated the prior year's material weaknesses and that our internal control over financial reporting was effective as of February 2, 2008. However, prior to this we had ongoing material weaknesses in our internal control over financial reporting since the fiscal year ended January 31, 2005, the first year in which we were required to evaluate our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002. Further, in September 2006, we announced that our historical financial statements should no longer be relied upon as a result of our preliminary determination of an internal review relating to our practices in administering stock option grants. We continued to have material weaknesses in our internal control over financial reporting, which resulted from ineffective internal controls over financial reporting for the year ended February 2, 2007. In August 2007, we filed an amendment to our annual report on Form 10-K for fiscal 2007, in order to correct certain clerical errors in our financial statements and financial statement footnotes.

Effective controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our operating results could be harmed and the market price of our common stock could decline. We cannot be certain that we will be able to maintain adequate controls over our financial processes and reporting in the future. If we identify additional material weaknesses in the future, our ability to report our financial results on a timely and accurate basis may be adversely affected. In addition, if we cannot maintain effective internal control over financial reporting and disclosure controls and procedures, investors may lose confidence in our reported financial information, which could cause the market price of our common stock to decline.

We are subject to risks arising from our international operations.

We derive a substantial portion of our net revenue from our customers outside of North America and we plan to continue expanding our business in international markets in the future. For the three months and six months ended August 2, 2008, we derived 95% and 94%, respectively, of our revenue from customers outside of North America. We also have significant international operations, including a significant newly established operation in Singapore, research and development facilities in France and Canada and a sales office in Hong Kong. As a result of our international business, we are affected by economic, regulatory and political conditions in foreign countries, including the imposition of government controls, changes or limitations in trade protection laws, unfavorable changes in tax treaties or laws, difficulties in collecting receivables and enforcing contracts, natural disasters, labor unrest, earnings expatriation restrictions, misappropriation of intellectual property, changes in import/export regulations, tariffs and freight rates, economic instability, public health crises, acts of terrorism and continued unrest in many regions and other factors, which could have a material impact on our international revenue and operations. In

particular, in some countries we may experience reduced intellectual property protection. Our results of operations could also be adversely affected by exchange rate fluctuations, which could increase the sales price in local currencies of our products in international markets. Overseas sales and purchases to date have been denominated in U.S. dollars. We do not currently engage in any hedging activities to reduce our exposure to exchange rate risks. Moreover, local laws and customs in many countries differ significantly from those in the United States. In many foreign countries, particularly in those with developing economies, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or United States laws or regulations applicable to us. Violations of laws or key control policies by our employees, contractors or agents could result in financial reporting problems, fines, penalties, or prohibition on the importation or exportation of our products and could have a material adverse effect on our business results.

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

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

We have a history of fluctuating operating results, including a net loss in fiscal 2006, and we may not be able to sustain or increase profitability in the future, which may cause the market price of our common stock to decline.

We have a history of fluctuating operating results. We reported a net loss of \$1.6 million in fiscal 2006, net income of \$6.2 million in fiscal 2007, net income of \$70.2 million in fiscal 2008, net income of \$4.7 million in first fiscal quarter of 2009 and net income of \$9.6 million in second fiscal quarter of 2009. To sustain or increase profitability, we will need to successfully develop new products and product enhancements and sustain higher revenue while controlling our cost and expense levels. In recent years, we made significant investments in our product development efforts and have expended substantial funds to enhance our sales and marketing efforts and otherwise operate our business. However, we may not realize the benefits of these investments. Although we were profitable in fiscal 2008, we may not continue to be profitable. For example, our net income decreased from \$35.3 million in the fourth quarter of 2008 to \$4.7 million in the first quarter of fiscal 2009. We may incur operating losses in future quarterly periods or fiscal years, which in turn could cause the price of our common stock to decline.

Litigation due to stock price volatility or other factors, such as the current shareholder derivative lawsuits against certain of our current and former officers and directors, could cause us to incur substantial costs and divert our management's attention and resources.

In the past, securities class action litigation often has been brought against a company following periods of volatility in the market price of its securities. Companies such as ours in the semiconductor industry and other technology industries are particularly vulnerable to this kind of litigation due to the high volatility of their stock prices. While we are not aware of any such contemplated class action litigation against us, we may in the future be the target of securities litigation. In addition, we and certain of our current and former officers and directors are subject to various shareholder derivative lawsuits. A description of these lawsuits can be found under the section entitled "Legal Proceedings" under Part II, Item 1. Although we recently executed a definitive settlement agreement that provides for dismissal of these shareholder derivative lawsuits, the agreement remains subject to court approval. If this settlement is not approved, we would be required to continue to litigate these matters. These lawsuits are, and any future lawsuits to which we may become a party will likely be, expensive and time consuming to investigate, defend and resolve. Such costs, which include investigation and defense, the diversion of our management's attention and resources, and any losses resulting from these claims, could significantly increase our expenses and adversely affect our profitability and cash flow.

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

We may not be able to accurately anticipate future market needs or be able to develop new products or product enhancements to meet such needs or to meet them in a timely manner.

Our ability to develop and deliver new products successfully will depend on various factors, including our ability to:

- accurately predict market requirements and evolving industry standards;
- accurately design new SoC products;
- timely complete and introduce new product designs;

timely qualify and obtain industry interoperability certification of our products and the equipment into which our products will be incorporated;



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ensure that our subcontractors have sufficient foundry, assembly and test capacity and packaging materials and achieve acceptable manufacturing yields;

shift our products to smaller geometry process technologies to achieve lower cost and higher levels of design integration; and

- gain market acceptance of our products and our customers' products.

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

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

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

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

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

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

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

We are a fabless semiconductor company, and thus we do not own or operate a fabrication or manufacturing facility. We depend on independent manufacturers, each of whom is a third-party manufacturer for numerous companies, to manufacture, assemble and test our products. We currently rely on Taiwan Semiconductor Manufacturing Corporation, or TSMC, to produce substantially all of our SoCs. We rely on Advanced Semiconductor Engineering, Inc., or ASE, to assemble, package and test substantially all of our products. Although we have contracts with both of these manufacturers, those contracts do not require them to manufacture our products or perform services on our behalf on a long-term basis, in any specific quantity or at any specific price. Neither TSMC nor ASE has provided contractual assurances to us that adequate capacity will be available for us to meet future demand for our products. These third-party manufacturers may allocate capacity to the production of other companies' products while reducing product deliveries or the provision of services to us on short notice, or they may increase the prices of the products and services they provide to us with little or no notice. In particular, other clients that are larger and better financed than we are or that have long-term agreements with TSMC or ASE may cause either or both of them to reallocate capacity to those clients, decreasing the capacity available to us.

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

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

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

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

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

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

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

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

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

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

We may engage in investments in and acquisitions of other businesses and technologies, which could divert management's attention and prove difficult to integrate with our existing business and technology.

We continue to consider investments in and acquisitions of other businesses, technologies or products, to improve our market position, broaden our technological capabilities and expand our product offerings. For example, we completed the acquisition of certain assets and 44 new employees from the VXP Group of Gennum Corporation in February 2008 and the acquisition of Blue7 Communications, or Blue7, in February 2006. However, we may not be able to acquire, or successfully identify, companies, products or technologies that would enhance our business. Once we identify a strategic opportunity, the process to consummate a transaction could divert management's attention from the operation of our business causing our financial results to decline.

If we are able to acquire companies, products or technologies, we could experience difficulties in integrating them. Integrating acquired businesses involves a number of risks, including:

- potential disruption of our ongoing business and the diversion of management resources from other business concerns;
  - unexpected costs or incurring unknown liabilities;
  - difficulties relating to integrating the operations and personnel of the acquired businesses;
    - adverse effects on the existing customer relationships of acquired companies; and
- adverse effects associated with entering into markets and acquiring technologies in areas in which we have little experience.

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

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

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

- changes in tax laws in the countries in which we operate or the interpretation of such tax laws;
  - changes in the valuation of our deferred tax assets;

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

- changes in share-based compensation expense;
- changes in generally accepted accounting principles; and

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

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

If the recent worsening of credit market conditions continues or increases, it could have a material adverse impact on our investment portfolio.

Recent U.S. sub-prime mortgage defaults have had a significant impact across various sectors of the financial markets, causing global credit and liquidity issues. The short-term funding markets experienced credit issues during the second half of fiscal 2007 and continuing into the first quarter of fiscal 2009, leading to liquidity issues and failed auctions in the auction rate securities market. If the global credit market continues to deteriorate, the liquidity of our investment portfolio may be impacted and we could determine that some of our investments are impaired. This could materially adversely impact our results of operations and financial condition.

Included in our marketable securities portfolio at August 2, 2008 were auction rate securities that we purchased for \$43.0 million. These securities have failed to trade at recent auctions due to insufficient bids from buyers. If these auctions continue to fail and the credit ratings of these investments deteriorate, the fair value of these auction rate securities may decline and we may incur impairment charges in connection with these securities, which would negatively affect our reported earnings cash flow and financial condition. Although our cash management advisor, UBS, has indicated that absent other solution to the limited market for our ARS, it will redeem all these securities at par value after June 2010, there is a risk that intention may not be achieved for reasons outside our control.

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

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

- market acceptance of our products;
- the need to adapt to changing technologies and technical requirements;
- the existence of opportunities for expansion;
- access to and availability of sufficient management, technical, marketing and financial personnel; and
- the number of shares we repurchase under our share repurchase program.



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If our capital resources are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity securities or debt securities or obtain debt financing. We recently announced a share repurchase program under which our board of directors authorized us to repurchase up to 5.0 million shares of our common stock. In the six months ended August 2, 2008, we used an aggregate of \$85.9 million to purchase 4.2 million shares of our common stock. Although we are not obligated to repurchase any additional shares under this share repurchase program, to the extent we elect to repurchase shares or to the extent we have already spent our cash resources, the amount of cash we used or may use could limit our ability to execute our business plans and require us to raise additional capital in the future in order to fund any repurchases or for other purposes. The sale of additional equity securities or convertible debt securities would result in additional dilution to our shareholders. Additional debt would result in increased expenses and could result in covenants that would restrict our operations. We have not made arrangements to obtain additional financing and there is no assurance that financing, if required, will be available in amounts or on terms acceptable to us, if at all.

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

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

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

Our ability to compete may be affected by our ability to protect our proprietary information. As of February 2, 2008, we held 30 patents and these patents will expire within the next five to sixteen years. These patents cover the technology underlying our products. We have filed certain patent applications and are in the process of preparing others. We cannot assure you that any additional patents for which we have applied will be issued or that any issued patents will provide meaningful protection of our product innovations. Like other semiconductor companies, we rely primarily on trade secrets and technological know-how in the conduct of our business. We use measures such as confidentiality agreements to protect our intellectual property. However, these methods of protecting our intellectual property may not be sufficient.

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

Our business may become subject to seasonality as a result of our target markets. We sell a significant number of our SoCs into the consumer electronics market. Our customers who manufacture products for the consumer market typically experience seasonality in the sales of their products, which in turn may affect the timing and volume of orders for our SoCs. Although we have not experienced seasonality to date in sales of our products, due to the overall growth in demand for our SoCs, we may, in the future, experience lower sales in our second fiscal quarter and higher sales in our third fiscal quarter as a result of the seasonality of demand associated with the consumer electronics markets into which we sell our products. As a result, our operating results may vary significantly from quarter to

quarter.

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

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

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Risks Related to Our Common Stock

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

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

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

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

Accordingly, you may not be able to resell your shares of common stock at or above the price you paid. In the past, we and other companies that have experienced volatility in the market price of their securities have been, and in the future we may be, the subject of securities class action litigation.

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

The market for our common stock has been subject to significant volatility, which is expected to continue. For example, the high and low selling prices per share of our common stock on the Nasdaq Global Market ranged from a high of \$73.00 on December 10, 2007 to a low of \$13.57 on July 1, 2008. This volatility is often unrelated or disproportionate to our operating performance. These fluctuations, as well as general economic and market conditions, could cause the market price of our common stock to decline.

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

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

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

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

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

On February 26, 2008, our Board of Directors approved a share repurchase program that authorized the repurchase of up to 2.0 million shares of our common stock. On March 18, 2008, our Board of Directors amended the current program and increased the aggregate number of authorized shares by 3.0 million. This share repurchase program shall expire in a year from the date of adoption. As of August 2, 2008, 0.8 million authorized shares remained available for repurchase. We repurchased common stock in the second quarter of fiscal year 2009 using available cash resources as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Share that May Yet Be Purchased under the Plan
Month #1 (May 4, 2008 - June 7, 2008)	—	—	—	—
Month #2 (June 8, 2008 - July 5, 2008)	—	—	—	—
Month #3	356,287	\$ 15.01	356,287	807,688

(July 6, 2008 - August 2,  
2008)

Total:	356,287	\$	15.01	356,287	807,688
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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At our annual meeting of shareholders on July 10, 2008, our shareholders voted on and approved two proposals as follows:

1. Our shareholders elected four directors to serve until our next annual meeting of shareholders or until their successors are duly elected and qualified. The four directors so elected and the voting results with respect thereto were as follows:

Name	Votes For	Votes Against	Votes Abstaining	Broker Non-Votes
Thinh Q. Tran	25,260,228	1,107,535	—	—
William J. Almon	24,531,416	1,836,347	—	—
Julien Nguyen	24,497,956	1,869,807	—	—
Lung C. Tsai	24,534,331	1,833,432	—	—

2. Our shareholders ratified the appointment of Armanino McKenna LLP as our independent registered public accounting firm for our fiscal year ending January 31, 2009. The results were as follows:

For:	21,143,794
Against:	49,132
Abstained:	406,494
Broker Non-Votes:	—

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

## (a) Exhibits

The following exhibits are filed herewith:

- 18.1 Letter regarding change in accounting principles
- 31.1 Certification of the President and Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer and Secretary pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 32.1 Certificate of President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (1)
- 32.2

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

(1) The certificates contained in Exhibits 32.1 and 32.2 are not deemed “filed” for purposes of Section 18 of the Securities and Exchange Act of 1934 and are not to be incorporated by reference into any filing of the registrant under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof irrespective of any general incorporation by reference language contained in any such filing, except to the extent that the registration specifically incorporates it by reference.



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SIGNATURES

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

SIGMA DESIGNS, INC.

Date: September 11, 2008

By: /s/ Think Q. Tran  
Think Q. Tran

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

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

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

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