GSI TECHNOLOGY INC
Form 10-Q
February 08, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2018

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 001-33387

GSI Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware	77-0398779
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1213 Elko Drive

Sunnyvale, California 94089

(Address of principal executive offices, zip code)

(408) 331-8800

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act.

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

The number of shares of the registrant’s common stock outstanding as of January 31, 2019: 22,044,083

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GSI TECHNOLOGY, INC.

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2018

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PART I — FINANCIAL INFORMATION

Item 1.Financial Statements

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	December 31, 2018	March 31, 2018
	(In thousands, except share and per share amounts)	
ASSETS		
Cash and cash equivalents	$ 40,529	$ 40,241
Short-term investments	16,557	18,124
Accounts receivable, net	8,160	5,279
Inventories	5,949	5,547
Prepaid expenses and other current assets	2,558	2,080
Total current assets	73,753	71,271
Property and equipment, net	9,184	8,172
Long-term investments	10,183	7,923
Goodwill	7,978	7,978
Intangible assets, net	2,781	2,989
Other assets	198	1,207
Total assets	$ 104,077	$ 99,540
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 2,348	$ 1,841
Accrued expenses and other liabilities	5,865	5,563
Total current liabilities	8,213	7,404
Income taxes payable	631	619

Other accrued expenses	4,026	4,702
Total liabilities	12,870	12,725
Commitments and contingencies (Note 7)		
Stockholders’ equity:		
Preferred stock: $0.001 par value authorized: 5,000,000 shares; issued and outstanding: none	—	—
Common Stock: $0.001 par value authorized: 150,000,000 shares; issued and outstanding: 21,992,084 and 21,407,247 shares, respectively	22	21
Additional paid-in capital	31,483	27,391
Accumulated other comprehensive loss	(108)	(142)
Retained earnings	59,810	59,545
Total stockholders’ equity	91,207	86,815
Total liabilities and stockholders’ equity	$ 104,077	$ 99,540

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

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GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
	(In thousands, except per share amounts)			
Net revenues	$ 14,702	$ 11,118	$ 38,800	$ 31,452
Cost of revenues	4,663	5,443	14,942	15,315
Gross profit	10,039	5,675	23,858	16,137
Operating expenses:				
Research and development	5,171	4,231	15,773	12,726
Selling, general and administrative	2,632	2,481	7,902	7,771
Total operating expenses	7,803	6,712	23,675	20,497
Income (loss) from operations	2,236	(1,037)	183	(4,360)
Interest income, net	195	113	488	309
Other expense, net	(99)	(14)	(224)	(9)
Income (loss) before income taxes	2,332	(938)	447	(4,060)
Provision for income taxes	70	590	182	720
Net income (loss)	$ 2,262	$ (1,528)	$ 265	$ (4,780)
Net income (loss) per share:				
Basic	$ 0.10	$ (0.07)	$ 0.01	$ (0.23)
Diluted	$ 0.10	$ (0.07)	$ 0.01	$ (0.23)
Weighted average shares used in per share calculations:				
Basic	21,979	21,165	21,798	21,003
Diluted	22,769	21,165	23,139	21,003

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

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GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
	(In thousands)			
Net Income (loss)	$ 2,262	$ (1,528)	$ 265	$ (4,780)
Net unrealized gain (loss) on available-for-sale investments	18	(48)	34	(48)
Total comprehensive income (loss)	$ 2,280	$ (1,576)	$ 299	$ (4,828)

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

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GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended December 31,	
	2018	2017
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	$ 265	$ (4,780)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Allowance for sales returns, doubtful accounts and other	40	(22)
Provision for excess and obsolete inventories	874	1,166
Depreciation and amortization	1,073	948
Stock-based compensation	1,686	1,521
Amortization of premium (discount) on investments	(25)	69
Changes in assets and liabilities:		
Accounts receivable	(2,921)	826
Inventory	(1,276)	1,250
Prepaid expenses and other assets	(219)	115
Accounts payable	532	(119)
Accrued expenses and other liabilities	768	(1,579)
Net cash provided by (used in) operating activities	797	(605)
Cash flows from investing activities:		
Purchase of investments	(16,057)	(6,748)
Maturities of short-term investments	15,423	10,500
Decrease in MikaMonu escrow deposit	750	1,222
Purchases of property and equipment	(1,948)	(436)
Net cash provided by (used in) investing activities	(1,832)	4,538
Cash flows from financing activities:		
Payment of MikaMonu escrow deposit	(364)	(850)
Payment of contingent consideration	(720)	—
Repurchase of common stock	(102)	—
Proceeds from issuance of common stock under employee stock plans	2,509	2,921
Net cash provided by financing activities	1,323	2,071
Net increase in cash and cash equivalents	288	6,004

Cash and cash equivalents at beginning of the period	40,241	33,736
Cash and cash equivalents at end of the period	$ 40,529	$ 39,740
Non-cash financing activities:		
Purchases of property and equipment through accounts payable and accruals	$ 34	$ 256
Supplemental cash flow information:		
Net cash paid for income taxes	$ 11	$ 42

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

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GSI TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of GSI Technology, Inc. and its subsidiaries (“GSI” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the interim financial statements do not include all of the information and footnotes required by GAAP for annual financial statements. These interim financial statements contain all adjustments (which consist of only normal, recurring adjustments) that are, in the opinion of management, necessary to state fairly the interim financial information included therein. The Company believes that the disclosures are adequate to make the information not misleading. However, these financial statements should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

The consolidated results of operations for the nine months ended December 31, 2018 are not necessarily indicative of the results to be expected for the entire fiscal year.

Significant accounting policies

Except for the accounting policy for revenue recognition, which was updated as a result of adopting a new accounting standard related to revenue recognition, there have been no material changes to our significant accounting policies that were disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

See “Recent accounting pronouncements” below for additional information on the impact of the adoption of the new accounting standard for revenue recognition on the Company’s consolidated financial statements.

Recent accounting pronouncements

In August 2018, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement”. The standard amends the disclosure requirements for recurring and nonrecurring fair value measurements by removing, modifying, and adding certain disclosures. The standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. The Company does not anticipate the adoption of this guidance to have a material impact on its consolidated financial statements and related disclosures.

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, “Disclosure Update and Simplification”, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. The Company anticipates its first presentation of changes in shareholders' equity will be included in its Form 10-Q for the quarter ended June 30, 2019.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The standard eliminates the second step in the goodwill impairment

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test which requires an entity to determine the implied fair value of the reporting unit's goodwill. Instead, an entity should recognize an impairment loss if the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, with the impairment loss not to exceed the amount of goodwill allocated to the reporting unit. The standard is effective for annual and interim goodwill impairment tests conducted in fiscal years beginning after December 15, 2019, with early adoption permitted. The Company does not anticipate the adoption of this guidance to have a material impact on its consolidated financial statements and related disclosures.

In November 2016, the FASB issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash". ASU 2016-18 requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. As a result, companies will no longer present transfers between cash and cash equivalents, and restricted cash and restricted cash equivalents in the statement of cash flows. The Company adopted ASU 2016-18 in the quarter ended June 30, 2018. Implementation of this guidance did not have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," ASU 2016-13 replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, the Company will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted beginning April 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, "Elements of Financial Statements," and, therefore, recognition of those lease assets and lease liabilities represents a change of previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Although the Company is currently evaluating the impact the pronouncement will have on its consolidated financial statements and related disclosures, the Company expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. The accounting standard update also updates certain presentation and disclosure requirements. The Company adopted ASU 2016-01 in the quarter ended June 30, 2018. Implementation of this guidance did not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" and has subsequently issued several supplemental and/or clarifying ASUs (collectively, "ASC 606"). The new accounting standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The new standard requires a company to recognize revenue as control of goods or services transfers to a customer at an amount that reflects the expected consideration to be received in exchange for those goods or services. It defines a five-step approach for recognizing revenue, which may require a company to use more judgment and make more estimates than under the current standard. The Company adopted ASC 606 on April 1, 2018 using the modified retrospective transition method.

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The Company determines revenue recognition through the following steps: (1) identification of the contract with a customer; (2) identification of the performance obligations in the contract; (3) determination of the transaction price; (4) allocation of the transaction price to the performance obligations in the contract; and (5) recognition of revenue when, or as, we satisfy a performance obligation.

The adoption of ASC 606 was applied to all contracts and did not have a significant impact on the Company's retained earnings as the timing of Company's revenue recognition under the new standard coincides with the way the Company previously recognized revenue. There was no impact on the opening retained earnings balance as of April 1, 2018 due to the adoption of ASC 606.

The majority of the Company's customer contracts, which may be in the form of purchase orders, contracts or purchase agreements, contain performance obligations for delivery of agreed upon products. Delivery of all performance obligations contained within a contract with a customer typically occurs at the same time (or within the same accounting period). Transfer of control typically occurs at the time of shipment or at the time the product is pulled from consignment as that is the point at which delivery has occurred, title and the risks and rewards of ownership have passed to the customer, and the Company has a right to payment. Thus, the Company will generally recognize revenue upon shipment of the product.

Because all of the Company's performance obligations relate to contracts with a duration of less than one year, the Company elected to apply the optional exemption practical expedient provided in ASC 606 and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period.

The Company adjusts the transaction price for variable consideration. Variable consideration is not typically significant and primarily results from stock rotation rights and quick pay discounts provided to our distributors. As a practical expedient, the Company is recognizing the incremental costs of obtaining a contract, specifically commission expenses that have a period of benefit of less than twelve months, as an expense when incurred. Additionally, the Company has adopted an accounting policy to recognize shipping costs that occur after control transfers to the customer as a fulfillment activity.

The Company's contracts with customers do not typically include extended payment terms. Payment terms vary by contract type and type of customer and generally range from 30 to 60 days from shipment. Additionally, the Company has right to payment upon shipment.

The Company records revenue net of sales tax, value added tax, excise tax and other taxes collected concurrent with product sales. The impact of such taxes on products sales is immaterial. The Company has also elected to recognize the cost for freight and shipping when control over the products sold passes to customers and revenue is recognized.

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs and the accrued warranty liability were not material as of December 31, 2018.

The majority of the Company's revenue is derived from sales of SRAM products which represent approximately 99% of total revenues in the nine months ended December 31, 2018.

The majority of the Company's revenue is derived from sales to distributors and contract manufacturers which represented approximately 57% and 42% of net revenue, respectively, for the nine months ended December 31, 2018.

Nokia, the Company’s largest customer, purchases products directly from the Company and through contract manufacturers and distributors. Based on information provided to the Company by its contract manufacturers and distributors, purchases by Nokia represented approximately 46% of the Company’s net revenues in the nine months ended December 31, 2018.

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The Company historically deferred recognition of revenue on shipments to its distributors under prior revenue guidance because it lacked fixed and determinable pricing for contracts in which the distributors had rights to price concessions from the Company upon shipment to the distributors' customers. During fiscal 2018, the Company revised all of its distribution agreements to eliminate the uncertainty in pricing, allowing the Company to recognize revenue at the time of shipment to the distributors. As a result, the implementation of the new revenue guidance did not have a significant impact on the Company's consolidated financial statements. See "Note 9 - Segment and Geographic Information" for revenue by shipment destination.

NOTE 2—NET INCOME (LOSS) PER COMMON SHARE

The Company uses the treasury stock method to calculate the weighted average shares used in computing diluted net income (loss) per share. The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
	(In thousands, except per share amounts)			
Net income (loss)	$ 2,262	$ (1,528)	$ 265	$ (4,780)
Denominators:				
Weighted average shares—Basic	21,979	21,165	21,798	21,003
Dilutive effect of employee stock options	784	—	1,335	—
Dilutive effect of employee stock purchase plan options	6	—	6	—
Weighted average shares—Dilutive	22,769	21,165	23,139	21,003
Net income (loss) per common share—Basic	$ 0.10	$ (0.07)	$ 0.01	$ (0.23)
Net income (loss) per common share—Diluted	$ 0.10	$ (0.07)	$ 0.01	$ (0.23)

The following shares of common stock underlying outstanding stock options, determined on a weighted average basis, were excluded from the computation of diluted net income (loss) per share as they had an anti-dilutive effect:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
	(In thousands)			
Shares underlying options and ESPP shares	3,961	2,969	2,470	2,785

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NOTE 3—BALANCE SHEET DETAIL

	December 31, 2018	March 31, 2018
	(In thousands)	
Inventories:		
Work-in-progress	$ 2,470	$ 2,226
Finished goods	3,479	3,321
	$ 5,949	$ 5,547

	December 31, 2018	March 31, 2018
	(In thousands)	
Accounts receivable, net:		
Accounts receivable	$ 8,263	$ 5,342
Less: Allowances for sales returns, doubtful accounts and other	(103)	(63)
	$ 8,160	$ 5,279

	December 31, 2018	March 31, 2018
	(In thousands)	
Prepaid expenses and other current assets:		
Prepaid tooling and masks	$ 705	$ 163
Escrow deposit	1,000	750
Other receivables	407	370
Other prepaid expenses and other current assets	446	797
	$ 2,558	$ 2,080

	December 31, 2018	March 31, 2018
	(In thousands)	
Property and equipment, net:		
Computer and other equipment	$ 18,990	$ 17,845
Software	4,057	4,072
Land	3,900	3,900
Building and building improvements	3,691	2,310
Furniture and fixtures	102	82
Leasehold improvements	832	766
Construction in progress	—	965
	31,572	29,940
Less: Accumulated depreciation	(22,388)	(21,768)
	$ 9,184	$ 8,172

Depreciation expense was $317,000 and $245,000 for the three months ended December 31, 2018 and 2017, respectively, and $865,000 and $714,000 for the nine months ended December 31, 2018 and 2017, respectively. The construction in progress related primarily to a facility expansion at our Sunnyvale headquarters and was placed in service in fiscal 2019.

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	December 31, 2018	March 31, 2018
	(In thousands)	
Other assets:		
Escrow deposit	$ —	$ 1,000
Non-current deferred income taxes	75	75
Deposits	123	132
	$ 198	$ 1,207

The escrow deposit at March 31, 2018 included approximately $1.0 million placed in escrow in connection with the Company's acquisition of MikaMonu Group Ltd. ("MikaMonu") on November 23, 2015. During the quarter ended December 31, 2018, $1.0 million was reclassified to current assets.

The following tables summarize the components of intangible assets and related accumulated amortization balances at December 31, 2018 and March 31, 2018 (in thousands):

	As of December 31, 2018		
	Gross Carrying Amount	Accumulated amortization	Net Carrying Amount
Intangible assets:			
Product designs	$ 590	$ (590)	$ —
Patents	4,220	(1,439)	2,781
Software	80	(80)	—
Total	$ 4,890	$ (2,109)	$ 2,781

	As of March 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets:			
Product designs	$ 590	$ (590)	$ —

Patents	4,220	(1,231)	2,989
Software	80	(80)	—
Total	$ 4,890	$ (1,901)	$ 2,989

Amortization of intangible assets included in cost of revenues was $58,000 and $78,000 for the three months ended December 31, 2018 and 2017, respectively, and $208,000 and $235,000 for the nine months ended December 31, 2018 and 2017, respectively.

As of December 31, 2018, the estimated future amortization expense of intangible assets in the table above is as follows (in thousands):

Fiscal year ending March 31,	
2019 (remaining three months)	$ 59
2020	233
2021	233
2022	233
2023	233
Thereafter	1,790
Total	$ 2,781

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	December 31, 2018	March 31, 2018
	(In thousands)	
Accrued expenses and other liabilities:		
Accrued compensation	$ 3,530	$ 2,786
Accrued professional fees	31	31
Accrued commissions	326	299
Contingent consideration	470	1,102
Accrued retention payment	384	291
Miscellaneous accrued expenses	1,124	1,054
	$ 5,865	$ 5,563

	December 31, 2018	March 31, 2018
	(In thousands)	
Other accrued expenses:		
Contingent consideration	$ 4,026	$ 4,411
Other long-term accrued liabilities	—	291
	$ 4,026	$ 4,702

NOTE 4—GOODWILL

Goodwill represents the difference between the purchase price and the estimated fair value of the identifiable assets acquired and liabilities assumed in a business combination. The Company tests for goodwill impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset is more likely than not impaired. The Company has one reporting unit. The Company assesses goodwill for impairment on an annual basis on the last day of February in the fourth quarter of its fiscal year.

The Company had a goodwill balance of $8.0 million as of both March 31, 2018 and December 31, 2018. The goodwill resulted from the acquisition of MikaMonu Group Ltd. in fiscal 2016.

The Company utilized a two-step quantitative analysis to complete its annual impairment test during the fourth quarter of fiscal 2018 and concluded that there was no impairment, as the fair value of its sole reporting unit exceeded its carrying value. The Company determined that the second step of the impairment test was not necessary. No triggering event took place subsequent to the fiscal 2018 annual assessment that necessitated a quantitative impairment analysis for the Company's one reporting unit.

NOTE 5—INCOME TAXES

The current portion of the Company's unrecognized tax benefits was $0 at both December 31, 2018 and March 31, 2018. The long-term portion at December 31, 2018 and March 31, 2018 was $631,000 and $619,000, respectively, of which the timing of the resolution is uncertain. As of December 31, 2018, $2.4 million of unrecognized tax benefits had been recorded as a reduction to net deferred tax assets. As of December 31, 2018, the Company's net deferred tax assets of $6.7 million were subject to a valuation allowance of $6.6 million. As of March 31, 2018, the Company's net deferred tax assets of $6.0 million were subject to a valuation allowance of $5.9 million.

On December 22, 2017, the "Tax Cuts and Jobs Act" ("H.R. 1") was signed into law, significantly impacting several sections of the Internal Revenue Code. Following the enactment of H.R. 1, the SEC staff issued SAB 118, which provides guidance on accounting for the tax effects of the law. SAB 118 provides a measurement period that should not extend beyond one year from the enactment date of H.R. 1 for companies to complete the accounting under ASC 740. In accordance with SAB 118, the Company must reflect the income tax effects of those aspects of H.R. 1 for which the accounting under ASC 740 is complete. To the extent that the Company's accounting for certain income tax effects of H.R. 1 is incomplete but the Company is able to determine a reasonable estimate, the Company must record a provisional estimate in the financial statements. If the Company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax law that were in effect immediately before the enactment of H.R 1.

H.R. 1 includes significant changes to the U.S. corporate income tax system, including a permanent reduction in the corporate income tax rate from 35% to 21%, limitations on the deductibility of interest expense and executive compensation and the transition of U.S. international taxation from a worldwide tax system to a territorial tax system. We re-measured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. The re-measurement of our deferred tax balance of $1.1 million was offset by application of our valuation allowance. We calculated our best estimate of the impact of H.R. 1 in the fiscal 2018 year-end income tax provision, including the impact of the one-time transition tax, in accordance with our understanding of H.R. 1 and guidance available as of the date of this filing and recorded a tax expense of $367,000 in the year ended March 31, 2018 related to the transition tax associated with deemed repatriation of foreign earnings. Pursuant to Staff Accounting Bulletin No. 118, adjustments to the provisional amounts recorded by the Company that are identified within a subsequent measurement period of up to one year from the enactment date will be included as an adjustment to tax expense from continuing operations in the period the amounts are determined. During the quarter ended December 31, 2018, the Company completed its assessment of the impact of H.R. 1 and recorded an immaterial additional liability that is included in Income Taxes Payable in the Condensed Consolidated Balance Sheet as of December 31, 2018.

H.R. 1 subjects a U.S. shareholder to tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. The Company has elected to treat GILTI book-tax differences as a period cost. In addition, the Company has elected to use the incremental cash tax savings approach (with and without method) in determining its U.S. valuation allowance.

At December 31, 2018, the Company has estimated the impact of the GILTI income inclusion as part of the Company’s estimate of its fiscal 2019 income taxes. Due to the Company’s valuation allowance in the United States, it is projected that there will be no net income tax effect related to GILTI in the Company’s fiscal year ending March 31, 2019.

Management believes that within the next twelve months the Company will not have a significant reduction in uncertain tax benefits, including interest and penalties, related to positions taken with respect to credits and loss carryforwards on previously filed tax returns.

The Company’s policy is to include interest and penalties related to unrecognized tax benefits within the provision for income taxes in the Condensed Consolidated Statements of Operations.

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Fiscal years 2013 through 2018 remain open to examination by federal tax authorities, and fiscal years 2011 through 2018 remain open to examination by California tax authorities.

The Company’s estimated annual effective income tax rate was approximately (22.6%) and (13.7%) as of December 31, 2018 and 2017, respectively. The annual effective tax rates as of December 31, 2018 and 2017 vary from the United States statutory income tax rate primarily due to valuation allowances in the United States, whereby pre-tax losses do not result in the recognition of corresponding income tax benefits and expenses, the foreign tax differential, and the impact of recent tax reform.

NOTE 6—FINANCIAL INSTRUMENTS

Fair value measurements

Authoritative accounting guidance for fair value measurements provides a framework for measuring fair value and related disclosures. The guidance applies to all financial assets and financial liabilities that are measured

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on a recurring basis. The guidance requires fair value measurement to be classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets and liabilities. The fair value of available-for-sale securities included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. As of December 31, 2018, the Level 1 category included money market funds of $5.5 million, which were included in cash and cash equivalents on the Condensed Consolidated Balance Sheets.

Level 2: Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of available-for-sale securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well-established independent pricing vendors and broker-dealers. As of December 31, 2018, the Level 2 category included short-term investments $16.6 million and long-term investments of $10.2 million, which were comprised of certificates of deposit, government and agency securities.

Level 3: Valuations based on inputs that are unobservable and involve management judgment and the reporting entity's own assumptions about market participants and pricing. As of December 31, 2018, the Company's Level 3 financial instruments measured at fair value on the Condensed Consolidated Balance Sheets consisted of the contingent consideration liability related to the acquisition of MikaMonu. The fair value of the contingent consideration liability was initially determined as of the acquisition date using unobservable inputs. These inputs include the estimated amount and timing of future cash flows, the probability of success (achievement of the various contingent events) and a risk-adjusted discount rate of approximately 14.8% used to adjust the probability-weighted cash flows to their present value. Subsequent to the acquisition date, at each reporting period, the contingent consideration liability is re-measured to fair value with changes recorded in selling, general and administrative expenses in the Consolidated Statements of Operations.

The fair value of financial assets measured on a recurring basis is as follows (in thousands):

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active Markets for Identical Assets and Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs

	December 31, 2018	(Level 1)	(Level 2)	(Level 3)
Assets:				
Money market funds	$ 5,468	$ 5,468	$ —	$ —
Marketable securities	26,740	—	26,740	—
Total	$ 32,208	$ 5,468	$ 26,740	$ —
Liabilities:				
Contingent consideration	$ 4,496	$ —	$ —	$ 4,496

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		Fair Value Measurements at Reporting Date Using		
	March 31, 2018	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$ 6,788	$ 6,788	$ —	$ —
Marketable securities	26,047	—	26,047	—
Total	$ 32,835	$ 6,788	$ 26,047	$ —
Liabilities:				
Contingent consideration	$ 5,514	$ —	$ —	$ 5,514

The following table sets forth the changes in fair value of contingent consideration for the nine months ended December 31, 2018 and December 31, 2017:

	Nine Months Ended December 31,	
	2018	2017
Contingent consideration, beginning of period	$ 5,514	$ 6,200
Change due to accretion	111	120
Payment of contingent consideration	(1,129)	(371)
Contingent consideration, end of period	$ 4,496	$ 5,949

Short-term and long-term investments

All of the Company's short-term and long-term investments are classified as available-for-sale. Available-for-sale debt securities with maturities greater than twelve months are classified as long-term investments when they are not intended for use in current operations. Investments in available-for-sale securities are reported at fair value with unrecognized gains (losses), net of tax, as a component of accumulated other comprehensive income (loss) in the Condensed Consolidated Balance Sheets. The Company had money market funds of $5.5 million and $6.8 million at December 31, 2018 and March 31, 2018, respectively, included in cash and cash equivalents on the Condensed Consolidated Balance Sheets. The Company monitors its investments for impairment periodically and records appropriate reductions in carrying values when declines are determined to be other-than-temporary.

The following table summarizes the Company's available-for-sale investments:

	December 31, 2018			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Short-term investments:				
Certificates of deposit	$ 13,750	$ —	$ (48)	$ 13,702
Foreign government obligations	2,861	—	(6)	2,855
Total short-term investments	$ 16,611	$ —	$ (54)	$ 16,557
Long-term investments:				
Certificates of deposit	$ 7,250	$ —	$ (35)	$ 7,215
Agency bonds	2,963	8	(3)	2,968
Total long-term investments	$ 10,213	$ 8	$ (38)	$ 10,183

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	March 31, 2018			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Short-term investments:				
Agency bonds	$ 3,996	$ —	$ (1)	$ 3,995
Foreign government obligations	5,428	—	(21)	5,407
Certificates of deposit	8,750	—	(28)	8,722
Total short-term investments	$ 18,174	$ —	$ (50)	$ 18,124
Long-term investments:				
Certificates of deposit	$ 8,000	$ —	$ (77)	$ 7,923
Total long-term investments	$ 8,000	$ —	$ (77)	$ 7,923

The Company's investment portfolio consists of both corporate and governmental securities that have a maximum maturity of three years. All unrealized gains and losses are due to changes in interest rates and bond yields. Subject to normal credit risks, the Company has the ability to realize the full value of all these investments upon maturity.

The deferred tax asset related to unrecognized gains and losses on short-term and long-term investments was $19,000 and $29,000 at December 31, 2018 and March 31, 2018, respectively.

As of December 31, 2018, contractual maturities of the Company's available-for-sale investments were as follows:

	Cost	Fair Value
	(In thousands)	
Maturing within one year	$ 16,611	$ 16,557
Maturing in one to three years	10,213	10,183
	$ 26,824	$ 26,740

The Company classifies its short-term investments as "available-for-sale" as they are intended to be available for use in current operations.

NOTE 7—COMMITMENTS AND CONTINGENCIES

Indemnification obligations

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the Company, under which the Company agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to such matters as title to assets sold and certain intellectual property rights. In each of these circumstances, payment by the Company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party's claims. Further, the Company's obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by it under these agreements.

It is not possible to predict the maximum potential amount of future payments that may be required under these or similar agreements due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on its business, financial condition, cash flows or results of operations.

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Product warranties

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs and the accrued warranty liability were not material as of December 31, 2018 and March 31, 2018 and for the three months and nine months ended December 31, 2018 or 2017.

NOTE 8—STOCK-BASED COMPENSATION

As of December 31, 2018, 3,532,483 shares of common stock were available for grant under the Company's 2016 Equity Incentive Plan.

The following table summarizes the Company's stock option activities for the nine months ended December 31, 2018:

	Shares Available for Grant	Number of Shares Underlying Options Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Intrinsic Value
Balance at March 31, 2018	4,444,301	7,874,267		$ 5.45	
Granted	(977,783)	977,783		$ 6.60	
Exercised	—	(495,183)		$ 3.83	$ 1,614,452
Forfeited	65,965	(108,550)		$ 5.61	
Balance at December 31, 2018	3,532,483	8,248,317	5.60	$ 5.68	
Options vested and exercisable		5,188,755	3.95	$ 5.42	$ 2,004,633
Options vested and expected to vest		8,172,262	5.57	$ 5.67	$ 2,339,743

The weighted average fair value per underlying share of options granted during the three months ended December 31, 2018 and 2017 was $2.16 and $2.35, respectively, $2.39 and $2.49 for the nine months ended December 31, 2018 and 2017, respectively.

Options outstanding by exercise price at December 31, 2018 were as follows:

Exercise Price	Number of Shares Underlying Options Outstanding	Options Outstanding Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Options Exercisable Number Vested and Exercisable	Weighted Average Exercise Price
$ 2.43 - 4.00	1,096,070	$ 3.62	2.76	985,884	$ 3.64
$ 4.17 - 4.90	831,085	$ 4.55	3.77	813,760	$ 4.55
$ 4.92 - 4.99	1,188,036	$ 4.98	6.87	277,710	$ 4.97
$ 5.13 - 5.59	1,000,124	$ 5.31	5.80	904,395	$ 5.32
$ 5.69 - 6.16	911,769	$ 5.93	5.95	572,413	$ 5.90
$ 6.24 - 6.70	1,460,264	$ 6.57	6.27	770,371	$ 6.47
$ 6.82 - 7.26	1,373,359	$ 7.04	6.38	703,939	$ 6.91
$ 7.40 - 7.70	151,620	$ 7.54	8.83	19,626	$ 7.40
$ 8.09	127,410	$ 8.09	9.06	32,077	$ 8.09
$ 9.20	108,580	$ 9.20	2.08	108,580	$ 9.20
	8,248,317	$ 5.68	5.60	5,188,755	$ 5.42

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The following table summarizes stock-based compensation expense by line item in the Condensed Consolidated Statements of Operations, all relating to employee stock plans:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
	(In thousands)			
Cost of revenues	$ 71	$ 73	$ 185	$ 186
Research and development	330	292	974	843
Selling, general and administrative	191	170	527	492
Total	$ 592	$ 535	$ 1,686	$ 1,521

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures in accordance with authoritative guidance. The Company estimates forfeitures at the time of grant and revises the original estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

No tax benefit related to stock-based compensation was recognized in the nine months ended December 31, 2018 due to a full valuation allowance. There were no windfall tax benefits realized from exercised stock options in either of these periods. Compensation cost capitalized within inventory at December 31, 2018 was immaterial. As of December 31, 2018, the Company's total unrecognized compensation cost was $4.8 million, which will be recognized over a weighted average period of 2.11 years. The Company calculated the fair value of stock-based awards in the periods presented using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Stock Option Plans:				
Risk-free interest rate	2.91%	2.00%	2.78- 2.91%	1.84- 2.00%
Expected life (in years)	5.00	5.00	5.00	5.00
Volatility	36.4%	35.5%	35.6- 36.4%	35.5- 36.5%
Dividend yield	— %	— %	— %	— %
Employee Stock Purchase Plan:				
Risk-free interest rate	2.50%	1.42%	2.09- 2.50%	1.04- 1.42%
Expected life (in years)	0.50	0.50	0.50	0.50

Volatility	32.6%	38.8%	32.6- 37.7%	38.8- 51.1%
Dividend yield	— %	— %	— %	— %

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NOTE 9—SEGMENT AND GEOGRAPHIC INFORMATION

Based on its operating management and financial reporting structure, the Company has determined that it has one reportable business segment: the design, development and sale of integrated circuits.

The following is a summary of net revenues by geographic area based on the location to which product is shipped:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
	(In thousands)			
United States	$ 4,442	$ 6,404	$ 13,261	$ 15,820
China	1,374	1,372	3,391	4,319
Singapore	1,186	1,068	6,207	4,768
Netherlands	4,214	1,145	8,756	3,128
Germany	3,126	793	6,070	2,349
Rest of the world	360	336	1,115	1,068
	$ 14,702	$ 11,118	$ 38,800	$ 31,452

All sales are denominated in United States dollars.

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

This Quarterly Report on Form 10-Q, and in particular the following Management’s Discussion and Analysis of Financial Condition and Results of Operations, includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as “anticipates,” “believes,” “expects,” “intends,” “may,” “will,” and other similar expressions. In addition, any statements which refer to expectations, projections, or other characterizations of future events or circumstances are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth in this report under “Risk

Factors," those described elsewhere in this report, and those described in our other reports filed with the Securities and Exchange Commission ("SEC"). We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

Overview

We are a fabless semiconductor company that designs, develops and markets static random access memories, or SRAMs, that operate at speeds of less than 10 nanoseconds, which we refer to as Very Fast SRAMs, and low latency dynamic random access memories, or LLDRAMs, primarily for the networking and telecommunications markets. We are subject to the highly cyclical nature of the semiconductor industry, which has experienced significant fluctuations, often in connection with fluctuations in demand for the products in which semiconductor devices are used. Our revenues have been substantially impacted by significant fluctuations in sales to our largest customer, Nokia. We expect that future direct and indirect sales to Nokia will continue to fluctuate significantly on a quarterly basis. The networking and telecommunications market has accounted for a significant portion of our net revenues in the past and has declined during the past several years and is expected to continue to decline. However, with no debt, substantial liquidity and a history of positive cash flows from operations, we believe we are in a better financial position than many other companies of our size.

Revenues. Our revenues are derived primarily from sales of our Very Fast SRAM products. Sales to networking and telecommunications OEMs accounted for 55% to 66% of our net revenues during our last three fiscal years. We also sell our products to OEMs that manufacture products for military and aerospace applications such as radar and guidance systems, missiles and satellites, for professional audio applications such as sound mixing systems, for test and measurement applications such as high-speed testers, for automotive applications such as smart cruise control and voice recognition systems, and for medical applications such as ultrasound and CAT scan equipment.

As is typical in the semiconductor industry, the selling prices of our products generally decline over the life of the product. Our ability to increase net revenues, therefore, is dependent upon our ability to increase unit sales volumes of existing products and to introduce and sell new products with higher average selling prices in quantities sufficient to compensate for the anticipated declines in selling prices of our more mature products. Although we expect the average selling prices of individual products to decline over time, we believe that, over the next several quarters, our overall average selling prices will increase due to a continuing shift in product mix to a higher percentage of higher price, higher density products. Our ability to increase unit sales volumes is dependent primarily upon increases in customer demand but, particularly in periods of increasing demand, can also be affected by our ability to increase production through the availability of increased wafer fabrication capacity from Taiwan Semiconductor Manufacturing Company, or TSMC, and Powerchip, our wafer suppliers, and our ability to increase the number of good integrated circuit die produced from each wafer through die size reductions and yield enhancement activities.

We may experience fluctuations in quarterly net revenues for a number of reasons. Historically, orders on hand at the beginning of each quarter are insufficient to meet our revenue objectives for that quarter and are generally cancelable up to 30 days prior to scheduled delivery. Accordingly, we depend on obtaining and shipping orders in the same quarter to achieve our revenue objectives. In addition, the timing of product releases, purchase orders and product availability could result in significant product shipments at the end of a quarter. Failure to ship these products by the end of the quarter may adversely affect our operating results. Furthermore, our customers may delay scheduled delivery dates and/or cancel orders within specified timeframes without significant penalty.

We sell our products through our direct sales force, international and domestic sales representatives and distributors. Sales to consignment warehouses, who purchase products from us for use by contract manufacturers, are recorded upon delivery to the contract manufacturer. Sales to certain distributors were previously made under agreements allowing for returns or credits under certain circumstances. We therefore deferred recognition of revenue on sales to those distributors under these terms until products were resold by the distributor. During fiscal 2018, prior to the implementation of ASC 606, we revised our distribution agreements to these distributors to eliminate ship from stock and debits and price protection. Under these revised distribution agreements, selling prices were fixed and determinable on the date of shipment and revenue was recognized upon shipment.

Nokia was our largest customer in fiscal 2018, 2017 and 2016. Nokia purchases products directly from us and through contract manufacturers and distributors. Based on information provided to us by its contract manufacturers and our distributors, purchases by Nokia represented approximately 46%, 36%, 41% and 32% of our net revenues in the nine months ended December 31, 2018 and in fiscal 2018, 2017 and 2016, respectively. Our revenues have been substantially impacted by significant fluctuations in sales to Nokia, and we expect that future direct and indirect sales to Nokia will continue to fluctuate substantially on a quarterly basis and that such fluctuations may significantly affect our operating results in future periods. To our knowledge, none of our other OEM customers accounted for more than 10% of our net revenues in the nine months ended December 31, 2018 and in fiscal 2018, 2017 or 2016.

Cost of Revenues. Our cost of revenues consists primarily of wafer fabrication costs, wafer sort, assembly, test and burn-in expenses, the amortized cost of production mask sets, stock-based compensation and the cost of materials and overhead from operations. All of our wafer manufacturing and assembly operations, and a significant portion of our wafer sort testing operations, are outsourced. Accordingly, most of our cost of revenues consists of payments to TSMC, Powerchip and independent assembly and test houses. Because we do not have long-term, fixed-price supply contracts, our wafer fabrication and other outsourced manufacturing costs are subject to the cyclical fluctuations in demand for semiconductors. Cost of revenues also includes expenses related to supply chain management, quality assurance, and final product testing and documentation control activities conducted at our headquarters in Sunnyvale, California and our branch operations in Taiwan.

Gross Profit. Our gross profit margins vary among our products and are generally greater on our higher density products and, within a particular density, greater on our higher speed and industrial temperature products.

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We expect that our overall gross margins will fluctuate from period to period as a result of shifts in product mix, changes in average selling prices and our ability to control our cost of revenues, including costs associated with outsourced wafer fabrication and product assembly and testing.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related expenses for design engineers and other technical personnel, the cost of developing prototypes, stock-based compensation and fees paid to consultants. We charge all research and development expenses to operations as incurred. We charge mask costs used in production to cost of revenues over a 12-month period. However, we charge costs related to pre-production mask sets, which are not used in production, to research and development expenses at the time they are incurred. These charges often arise as we transition to new process technologies and, accordingly, can cause research and development expenses to fluctuate on a quarterly basis. We believe that continued investment in research and development is critical to our long-term success, and we expect to continue to devote significant resources to product development activities. In particular, we are devoting substantial resources to the development of a new category of in-place associative computing products. Accordingly, we expect that our research and development expenses will continue to be substantial in future periods and may lead to operating losses in some periods. Such expenses as a percentage of net revenues may fluctuate from period to period.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of commissions paid to independent sales representatives, salaries, stock-based compensation and related expenses for personnel engaged in sales, marketing, administrative, finance and human resources activities, professional fees, costs associated with the promotion of our products and other corporate expenses. We expect that our sales and marketing expenses will increase in absolute dollars in future periods if we are able to grow and expand our sales force but that, to the extent our revenues increase in future periods, these expenses will generally decline as a percentage of net revenues. We also expect that, in support of any future growth that we are able to achieve, general and administrative expenses will generally increase in absolute dollars.

Results of Operations

The following table sets forth statement of operations data as a percentage of net revenues for the periods indicated:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Net revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	31.7	49.0	38.5	48.7

Gross profit	68.3	51.0	61.5	51.3
Operating expenses:				
Research and development	35.2	38.1	40.7	40.5
Selling, general and administrative	17.9	22.3	20.3	24.7
Total operating expenses	53.1	60.4	61.0	65.2
Income (loss) from operations	15.2	(9.4)	0.5	(13.9)
Interest and other income, net	0.1	1.0	0.1	1.0
Income (loss) before income taxes	15.3	(8.4)	0.6	(12.9)
Provision for income taxes	0.0	5.3	0.0	2.3
Net income (loss)	15.3	(13.7)	0.6	(15.2)

Net Revenues. Net revenues increased by 32.2% from $11.1 million in the three months ended December 31, 2017 to $14.7 million in the three months ended December 31, 2018 and by 23.4% from $31.5 million in the nine months ended December 31, 2017 to $38.8 million in the nine months ended December 31, 2018. The overall average selling price of all units shipped in the quarter ended December 31, 2018 increased by 61.3% compared to the quarter ended December 31, 2017 and by 23.9% in the nine months ended December 31, 2018 compared to the nine months ended December 31, 2017. The increase in the average selling price in each fiscal 2019 period was due to a change in product mix, as we sold more higher density, higher average selling price products in the fiscal 2019 periods compared to the prior fiscal year periods. Units shipped declined 4.8% and 2.1% in the three months ended December 31, 2018 compared to the three months ended December 31, 2017 and in the nine months ended

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December 31, 2018 compared to the nine months ended December 31, 2017, respectively. Direct and indirect sales to Nokia, currently our largest customer, increased from $3.9 million in the three months ended December 31, 2017 to $6.6 million in the three months ended December 31, 2018 and from $11.2 million in the nine months ended December 31, 2017 to $17.9 million in the nine months ended December 31, 2018. Shipments of our SigmaQuad product line accounted for 69.7% of total shipments in the three months ended December 31, 2018 compared to 54.5% of total shipments in the three months ended December 31, 2017 and 65.7% of total shipments in the nine months ended December 31, 2018 compared to 48.2% of total shipments in the nine months ended December 31, 2017. The increase in SigmaQuad shipments was primarily due to the increase in sales to Nokia discussed above.

Cost of Revenues. Cost of revenues decreased by 14.3% from $5.4 million in the three months ended December 31, 2017 to $4.7 million in the three months ended December 31, 2018 and by 2.4% from $15.3 million in the nine months ended December 31, 2017 to $14.9 million in the nine months ended December 31, 2018. Cost of revenues included stock-based compensation expense of $71,000 and $73,000 for the three months ended December 31, 2018 and 2017, respectively and $185,000 and $186,000 for the nine months ended December 31, 2018 and 2017, respectively.

Gross Profit. Gross profit increased by 76.9% from $5.7 million in the three months ended December 31, 2017 to $10.0 million in the three months ended December 31, 2018 and by 47.8% from $16.1 million in the nine months ended December 31, 2017 to $23.9 million in the nine months ended December 31, 2018.

Gross margin increased from 51.0% in the three months ended December 31, 2017 to 68.3% in the three months ended December 31, 2018 and from 51.3% in the nine months ended December 31, 2017 to 61.5% in the nine months ended December 31, 2018. The increase in gross profit in each period is primarily related to the increases in net revenues discussed above. The increases in gross margin are primarily related to changes in the mix of products and customers and changes in the level of charges for inventory reserves booked in each period.

Research and Development Expenses. Research and development expenses increased by 22.2% from $4.2 million in the three months ended December 31, 2017 to $5.2 million in the three months ended December 31, 2018. This increase was primarily due to increases of $407,000 in payroll related expenses, $372,000 in outside consultant expenses and $70,000 in depreciation expense, all related to our associative processor development activities. Research and development expenses included stock-based compensation expense of $330,000 and $292,000 for the three months ended December 31, 2018 and 2017, respectively. Research and development expenses increased 23.9% from $12.7 million in the nine months ended December 31, 2017 to $15.8 million in the nine months ended December 31, 2018. The increase was primarily due to increases of $986,000 in non-production mask sets, $942,000 in outside consultant expenses, $801,000 in payroll related expenses and $135,000 in depreciation expense, all related to our associative processor development activities. Research and development expenses included stock-based compensation expense of $974,000 and $843,000 for the nine months ended December 31, 2018 and 2017, respectively.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by 6.1% from $2.5 million in the three months ended December 31, 2017 to $2.6 million in the three months ended December 31, 2018. This increase was primarily related to increases of $265,000 for payroll related expenses and $100,000 for independent sales representatives commissions. The increased commissions were due to the increased net revenues discussed above. Selling, general and administrative expenses included stock-based compensation expense of $191,000 and $170,000 for the three months ended December 31, 2018 and 2017, respectively. Selling, general and administrative expenses increased by 1.7% from $7.8 million in the nine months ended December 31, 2017 to $7.9 million in the nine months ended December 31, 2018. A decrease in professional fees of $534,000 was more than offset by increases in payroll related expenses, independent sales representatives commissions and facility related expenses. Selling, general and administrative expenses included stock-based compensation expense of $527,000 and $492,000 for the nine months ended December 31, 2018 and 2017, respectively.

Interest and Other Income (Expense), Net. Interest and other income (expense), net decreased 3.0% from income of $99,000 in the three months ended December 31, 2017 to $96,000 in the three months ended December 31, 2018. Interest income increased by $82,000 due to higher interest rates received on our cash and short-term and long-term investments. Foreign exchange losses were $14,000 for the three months ended December 31, 2017 compared to $99,000 for the three months ended December 31, 2018. The exchange losses in each period were related to our Taiwan branch operations and our operations in Israel. Interest and other income (expense), net decreased 12.0% from income of $300,000 in the nine months ended December 31, 2017 to $264,000 in the nine months ended December 31, 2018. Interest income increased by $179,000 due to higher interest rates received on our cash and short-term and long-term investments. We had a foreign exchange loss of $9,000 for the nine months ended December 31, 2017 compared to $224,000 for the nine months ended December 31, 2018. The exchange losses in each period were related to our Taiwan branch operations and our operations in Israel.

Provision for Income Taxes. The provision for income taxes decreased 88.1% from $590,000 in the three months ended December 31, 2017 to $70,000 in the three months ended December 31, 2018 and the provision decreased 74.7% from $720,000 in the nine months ended December 31, 2017 to $182,000 in the nine months ended December 31, 2018. These changes were primarily due to a tax provision of $639,000 related to the transition tax associated with deemed repatriation of foreign earnings and the re-measurement of deferred tax assets and liabilities based on the provisions of H.R. 1 recorded in the quarter ended December 31, 2017 as well as from fluctuations in the relative mix of income among our operating jurisdictions.

Net Income (Loss). Net loss was $1.5 million in the three months ended December 31, 2017 compared net income of $2.3 million in the three months ended December 31, 2018 and net loss was $4.8 million in the nine months ended December 31, 2017 compared to net income of $265,000 in the nine months ended December 31, 2018. These fluctuations were primarily due to the changes in net revenues, gross profit and operating expenses discussed above.

Liquidity and Capital Resources

As of December 31, 2018, our principal sources of liquidity were cash, cash equivalents and short-term investments of $57.1 million compared to $58.4 million as of March 31, 2018.

Net cash provided by operating activities was $797,000 for the nine months ended December 31, 2018 compared to net cash used in operating activities of $605,000 for the nine months ended December 31, 2017. Primary sources of cash in the nine months ended December 31, 2018 were net income and non-cash items including stock-based compensation of $1.7 million, depreciation and amortization expenses of $1.1 million and a provision for excess and obsolete inventories of $874,000. Additional sources of cash in the nine months ended December 31, 2018 were lesser increases in accrued expenses and other liabilities and accounts payable. The primary uses of cash in the current nine month period were increases in accounts receivable of $2.9 million and inventory of $1.3 million. Accounts receivable increased primarily due to the timing of payments received from customers and the increased level of shipments during the current nine month period compared to the prior year, primarily related to shipments to Nokia, our largest customer. The primary uses of cash in the nine month period ended December 31, 2017 were a net loss of $4.8 million and the reduction of accrued expenses and other liabilities of $1.6 million. The primary sources of cash in the nine month period ended December 31, 2017 were a decrease in inventory of $1.3 million and non-cash items including stock-based compensation of $1.5 million, a provision for excess and obsolete inventories of $1.2 million and depreciation and amortization expenses of $948,000.

Net cash used in investing activities was $1.8 million in the nine months ended December 31, 2018 compared to net cash provided by investing activities of $4.5 million in the nine months ended December 31, 2017. Investment activities in the nine months ended December 31, 2018 primarily consisted of the purchase of agency bonds and certificates of deposit of $16.1 million, partially offset by the maturity of agency bonds and certificates of deposit of $15.4 million and the purchase of property and equipment of $1.9 million. Investment activities in the nine months ended December 31, 2017 consisted primarily of the maturity of certificates of deposit of $10.5 million, partially offset by the purchase of agency bonds and certificates of deposit of $6.7 million and the purchase of property and equipment of $436,000.

Net cash provided by financing activities in the nine months ended December 31, 2018 consisted of the net proceeds from the sale of common stock pursuant to our employee stock plans of $2.5 million partially offset by a payment of contingent consideration related to our acquisition of MikaMonu in November 2015 in the amount of $720,000 and the release of an escrow deposit related to our acquisition of MikaMonu in the amount of $364,000. Net cash provided by financing activities in the nine months ended December 31, 2017 primarily consisted of the net

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proceeds from the sale of common stock pursuant to our employee stock plans of $2.9 million, partially offset the by release of an escrow deposit related to our acquisition of MikaMonu in November 2015 in the amount of $850,000.

The Company's estimated annual effective income tax rate was approximately (22.6%) as of December 31, 2018. The statutory Federal tax rate for the year ending March 31, 2019 will be 21% compared to 31.5% for the fiscal year ended March 31, 2018. See Note 5, Income Taxes, for further information.

We believe that our existing balances of cash, cash equivalents and short-term investments, and cash flow expected to be generated from our future operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months, although we could be required, or could elect, to seek additional funding prior to that time. Our future capital requirements will depend on many factors, including revenue growth, if any, that we experience, the extent to which we utilize subcontractors, the levels of inventory and accounts receivable that we maintain, the timing and extent of spending to support our product development efforts and the expansion of our sales and marketing. Additional capital may also be required for the consummation of any acquisition of businesses, products or technologies that we may undertake. We cannot assure that additional equity or debt financing, if required, will be available on terms that are acceptable or at all.

Contractual Obligations

The following table describes our contractual obligations as of December 31, 2018:

	Payments due by period				
	Up to 1 year	1 - 3 years	3 - 5 years	More than 5 years	Total
Facilities leases	$ 114,000	$ 808,000	$ 90,000		