

MoSys, Inc.
Form 10-Q
November 09, 2009
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from to

Commission file number 000-32929

MOSYS, INC.

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(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of Incorporation or organization)

77-0291941

(I.R.S. Employer
Identification Number)

755 N. Mathilda Avenue

Sunnyvale, California, 94085

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(Address of principal executive office and zip code)

(408) 731-1800

(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 filing requirements for the past 90 days. YES ☒ NO ☐

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

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐
(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

As of November 1, 2009, 31,216,298 shares of the Registrant's common stock, \$0.01 par value, were outstanding.

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MOSYS, INC.

FORM 10-Q
September 30, 2009

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	September 30, 2009	December 31, 2008
ASSETS		
Current assets		
Cash and cash equivalents	\$ 7,797	\$ 17,515
Short-term investments	24,201	26,560
Accounts receivable, net	1,298	688
Unbilled contracts receivable	1,083	428
Prepaid expenses and other assets	3,221	2,158
Total current assets	37,600	47,349
Long-term investments	10,671	23,395
Property and equipment, net	1,392	958
Goodwill	23,017	12,326
Intangible assets, net	5,260	
Other assets	238	1,905
Total assets	\$ 78,178	\$ 85,933
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 501	\$ 167
Accrued expenses and other liabilities	1,877	2,235
Accrued acquisition-related earn-out costs	5,171	
Accrued restructuring liabilities	165	1,004
Deferred revenue	1,587	639
Total current liabilities	9,301	4,045
Long-term liabilities	156	
Commitments and contingencies (Note 3)		
Stockholders' equity		
Preferred stock, \$0.01 par value; 20,000 shares authorized; none issued and outstanding at September 30, 2009 and December 31, 2008		
Common stock, \$0.01 par value; 120,000 shares authorized; 31,216 shares and 31,630 shares issued and outstanding at September 30, 2009 and December 31, 2008	312	317

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Additional paid-in capital	115,659	114,403
Accumulated other comprehensive income	123	280
Accumulated deficit	(47,373)	(33,112)
Total stockholders' equity	68,721	81,888
Total liabilities and stockholders' equity	\$ 78,178	\$ 85,933

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

Table of Contents**MOSYS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(In thousands, except per share data)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net revenue				
Licensing	\$ 1,332	\$ 1,198	\$ 2,162	\$ 2,297
Royalty	2,036	2,856	5,753	7,769
Total net revenue	3,368	4,054	7,915	10,066
Cost of net revenue				
Licensing	682	845	1,278	2,158
Total cost of net revenue	682	845	1,278	2,158
Gross profit	2,686	3,209	6,637	7,908
Operating expenses				
Research and development	5,668	4,175	13,569	13,012
Selling, general and administrative	2,202	2,641	7,080	8,923
Restructuring charges			706	
Total operating expenses	7,870	6,816	21,355	21,935
Loss from operations	(5,184)	(3,607)	(14,718)	(14,027)
Other income, net	139	391	493	2,026
Loss before income taxes	(5,045)	(3,216)	(14,225)	(12,001)
Income tax provision	(3)	(22)	(36)	(111)
Net loss	\$ (5,048)	\$ (3,238)	\$ (14,261)	\$ (12,112)
Net loss per share				
Basic and diluted	\$ (0.16)	\$ (0.10)	\$ (0.46)	\$ (0.38)
Shares used in computing net loss per share				
Basic and diluted	31,205	31,777	31,239	31,719
Allocation of stock-based compensation to cost of net revenue and operating expenses included above:				
Cost of net revenue	\$ 90	\$ 111	\$ 162	\$ 342
Research and development	332	207	785	936
Selling, general and administrative	503	660	1,213	2,299

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

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MOSYS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2009	2008
Cash flows from operating activities:		
Net loss	\$ (14,261)	\$ (12,112)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	581	541
Stock-based compensation	2,160	3,577
Amortization of intangible assets	820	591
Non-cash restructuring charges	122	
Provision for doubtful accounts	47	
Net realized gain on auction-rate securities	(22)	
Changes in assets and liabilities, net of business acquired:		
Accounts receivable	183	345
Unbilled contracts receivable	1,860	231
Prepaid expenses and other assets	555	676
Deferred revenue	(1,353)	481
Accounts payable	101	3
Accrued expenses and other liabilities	232	310
Accrued restructuring liabilities	(805)	
Net cash used in operating activities	(9,780)	(5,357)
Cash flows from investing activities:		
Purchases of property and equipment	(850)	(364)
Net cash paid for purchase of Prism Circuits, Inc.	(13,563)	
Proceeds from sales and maturities of marketable securities	38,101	54,503
Purchases of marketable securities	(22,717)	(44,280)
Net cash provided by investing activities	971	9,859
Cash flows from financing activities:		
Proceeds from issuance of common stock	28	184
Repurchase of common stock	(937)	
Net cash provided by (used in) financing activities	(909)	184
Net increase (decrease) in cash and cash equivalents	(9,718)	4,686
Cash and cash equivalents at beginning of period	17,515	37,673
Cash and cash equivalents at end of period	\$ 7,797	\$ 42,359

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

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MOSYS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. The Company and Summary of Significant Accounting Policies

The Company

MoSys, Inc., or the Company, was incorporated in California in September 1991, and reincorporated in September 2000 in Delaware. The Company designs, develops, markets and licenses high performance semiconductor memory and high speed parallel and serial interface intellectual property (IP) used by the semiconductor industry and communications, networking and storage equipment manufacturers.

The accompanying condensed consolidated financial statements of the Company have been prepared without audit in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). The condensed consolidated balance sheet at December 31, 2008 has been derived from the audited consolidated financial statements at that date. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted in accordance with these rules and regulations. The information in this report should be read in conjunction with the Company's consolidated financial statements and notes thereto included in its most recent annual report on Form 10-K filed with the SEC.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly the Company's financial position, results of operations and cash flows for the interim periods presented. The operating results for the three and nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009 or for any other future period.

Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The Company's fiscal year ends on December 31 of each calendar year.

Use of Estimates

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The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues recognized under the percentage of completion method and expenses recognized during the reported period. Actual results could differ from those estimates.

Cash Equivalents and Investments

The Company has invested its excess cash in money market accounts, auction-rate securities, corporate debt, government agency and municipal debt securities and considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Investments with original maturities greater than three months and remaining maturities less than one year are classified as short-term investments. Investments with remaining maturities greater than one year are classified as long-term investments. Management generally determines the appropriate classification of securities at the time of purchase. All securities, excluding auction-rate securities, are classified as available-for-sale. The Company's short-term and long-term investments are carried at fair value, with the unrealized holding gains and losses reported in accumulated other comprehensive income. Realized gains and losses and declines in the value judged to be other than temporary are included in the other income, net line item in the condensed consolidated statements of operations. The cost of securities sold is based on the specific identification method.

During the fourth quarter of fiscal 2008, the Company reclassified its auction-rate securities from available-for-sale to trading securities. Investments that the Company designates as trading securities are reported at fair value, with gains or losses which result from changes in fair value, recognized in earnings (see Note 2).

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Fair Value Measurements

The Company measures the fair value of financial instruments using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as follows:

Level 1 Inputs used to measure fair value are unadjusted quoted prices that are available in active markets for the identical assets or liabilities as of the reporting date.

Level 2 Pricing is provided by third party sources of market information obtained through the Company's investment advisors rather than models. The Company does not adjust for or apply any additional assumptions or estimates to the pricing information it receives from advisors. The Company's Level 2 securities include cash equivalents and available-for-sale securities, which consisted primarily of commercial paper, corporate debt, and government agency and municipal debt securities from issuers with high quality credit ratings. The Company's investment advisors obtain pricing data from independent sources, such as Standard & Poor's, Bloomberg and Interactive Data Corporation, and rely on comparable pricing of other securities because the Level 2 securities it holds are not actively traded and have fewer observable transactions. The Company considers this the most reliable information available for the valuation of the securities.

Level 3 Unobservable inputs that are supported by little or no market activity and reflect the use of significant management judgment are used to measure fair value. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions. The determination of fair value for Level 3 investments and other financial instruments involves the most management judgment and subjectivity.

Revenue Recognition

General

The Company generates revenue from the licensing of its IP, and customers pay fees for licensing, development services, royalties and maintenance and support. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery or performance has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Evidence of an arrangement generally consists of signed agreements. When sales arrangements contain multiple elements (e.g., license and services), the Company reviews each element to determine the separate units of accounting that exist within the agreement. If more than one unit of accounting exists, the consideration payable to the Company under the agreement is allocated to each unit of accounting using either the relative fair value method or the residual fair value method. Revenue is recognized for each unit of accounting when the revenue recognition criteria have been met for that unit of accounting.

Licensing

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Licensing revenue consists of fees earned from license agreements, development services and support and maintenance. For license agreements that do not require significant development, modification or customization, revenues are generally recognized when the revenue recognition criteria have been met. If any of these criteria are not met, revenue recognition is deferred until such time as all criteria have been met.

For license agreements that include deliverables requiring significant production, modification or customization, and where the Company has significant experience in meeting the design specifications involved in the contract and the direct labor hours related to services under the contract can be reasonably estimated, the Company recognizes revenue over the period in which the contract services are performed. For these arrangements, the Company recognizes revenue using the percentage of completion method. Revenue recognized in any period is dependent on the Company's progress toward completion of projects in progress. Significant management judgment and discretion are used to estimate total direct labor hours. These judgmental elements include determining that the Company has the experience to meet the design specifications and estimating the total direct labor hours. The Company follows this method because it can obtain reasonably dependable estimates of the direct labor hours to perform the contract services. The direct labor hours for the development of the licensee's design are estimated at the beginning of the contract. As these direct labor hours are incurred, they are used as a measure of progress towards completion. The Company has the ability to reasonably estimate the direct labor hours on a contract-by-contract basis based on its experience in developing prior licensees' designs. During the contract performance period, the Company reviews estimates of direct labor hours to complete the contracts as the contract progresses to completion and will revise its estimates of revenue and gross profit under the contract if the Company revises the estimations of the direct labor hours to complete. The Company's policy is to reflect any revision in the contract gross profit estimate in reported income in the period in which the facts giving rise to the revision become known. Under the percentage of completion method, provisions for estimated losses on uncompleted contracts are recorded in the period in which such losses are determined to be likely. No loss accruals were recorded for the three and nine months ended September 30, 2009. In the nine months ended September 30, 2008, the Company recorded a loss accrual of \$211,000. If the amount of revenue recognized under the percentage of completion accounting method exceeds the amount of billings to a customer, then the excess amount is recorded as an unbilled contracts receivable.

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For contracts involving design specifications that the Company has not previously met or if inherent risks make estimates doubtful, the contract is accounted for under the completed contract method, and the Company defers the recognition of all revenue until the design meets the contractual design specifications. In this event, the cost of revenue is expensed as incurred. When the Company has experience in meeting design specifications but does not have significant experience to reasonably estimate the direct labor hours related to services to meet a design specification, the Company defers both the recognition of revenue and the cost. No revenue was recognized under the completed contract method for the three and nine months ended September 30, 2009 or 2008.

The Company provides support and maintenance under many of its license agreements. Under these arrangements, the Company provides unspecified upgrades, design rule changes and technical support. No other upgrades, products or other post-contract support are provided. Support and maintenance revenue is recognized at its fair value established by objective evidence, ratably over the period during which the obligation exists, typically 12 months. These arrangements are generally renewable annually by the customer.

From time to time, a licensee may cancel a project during the development phase. Such a cancellation is not within the Company's control and is often caused by changes in market conditions or the licensee's business. Cancellations of this nature are an aspect of the Company's licensing business, and, in general, its license contracts allow the Company to retain all payments that the Company has received or is entitled to collect for items and services provided before the cancellation occurs. Typically under the Company's license agreements, the licensee is obligated to complete the project within a stated timeframe, including assisting the Company in completing the final milestone. If the Company performs the contracted services, the licensee is obligated to pay the license fees even if the licensee fails to complete verification or cancels the project prior to completion. For accounting purposes the Company will consider a project to have been canceled even in the absence of specific notice from its licensee if there has been no activity under the contract for six months or longer and the Company believes that completion of the contract is unlikely. In this event, the Company recognizes revenue in the amount of cash received, if the Company has performed a sufficient portion of the development services. If a cancelled contract had been entered into before the establishment of technological feasibility, the costs associated with the contract would have been expensed prior to the recognition of revenue under the completed contract method. In that case, there would be no costs associated with that revenue recognition, and gross margin would increase for the corresponding period. No license revenue was recognized from cancelled contracts for the three and nine months ended September 30, 2009 and 2008.

Under limited circumstances, the Company also recognizes prepaid pre-production royalties as license revenues. These are lump sum payments made when the Company enters into licensing agreements that cover future shipments of a product that is not commercially available from the licensee. The Company characterizes such payments as license revenues because they are paid as part of the initial license fee and not with respect to products being produced by the licensee. These payments are non-cancelable and non-refundable. No revenue from prepaid production royalties was recognized for the three and nine months ended September 30, 2009 and 2008.

Royalty

The Company's licensing contracts typically also provide for royalties based on licensees' use of our technology in their currently shipping commercial products. The Company generally recognizes royalties in the quarter in which it receives the licensee's report. Under limited circumstances, the Company may also recognize prepaid post-production royalties as revenue upon execution of the contract, which are paid in a lump sum after the licensee commences production of the royalty-bearing product and applied against future unit shipments regardless of the actual level of shipments by the licensee. The criteria for revenue recognition of prepaid royalties are that a formal agreement with the licensee is executed, no deliverables, development or support services related to prepaid royalties are required, the fees are non-refundable and not contingent upon future product shipments by the licensee, and the fees are payable by the licensee in a time period consistent with the Company's normal billing terms. If any of these criteria are not met, the Company defers revenue recognition until such time as all criteria have been met.

Cost of revenue

Cost of licensing revenue consists primarily of engineering personnel and overhead allocation costs directly related to development services specified in agreements. These services typically include customization of the Company's technologies for the licensee's particular integrated circuit design and may include engineering support to assist in the commencement of production of a licensee's products. The Company recognizes cost of licensing revenue in the following manner:

- If licensing revenue is recognized using the percentage of completion method, the associated cost of licensing revenue is recognized in the period in which the Company incurs the engineering costs.

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- If licensing revenue is recognized using the completed contract method, to the extent that the amount of engineering cost does not exceed the amount of the related licensing revenue, the cost of licensing revenue is deferred on a contract-by-contract basis from the time the Company has established technological feasibility of the product to be developed under the license contract. Technological feasibility is established when the Company has completed all activities necessary to demonstrate that the licensee's product can be produced to meet the performance specifications when incorporating its technology. Deferred costs are charged to cost of licensing revenue when the related revenue is recognized.

Goodwill

The following table summarizes the activity related to the carrying value of our goodwill during the nine months ended September 30, 2009 (in thousands):

	Nine Months Ended September 30, 2009
Beginning balance	\$ 12,326
Goodwill recorded in connection with the acquisition of Prism Circuits, Inc.	10,258
Purchase price adjustment Prism Circuits, Inc.	433
Ending balance	\$ 23,017

The above purchase price adjustment to the acquisition of Prism Circuits, Inc. reflects a revision to the fair value contractual obligations assumed due to new information that existed at the date of acquisition (see Note 5).

Purchased Intangible Assets

Intangible assets acquired in business combinations are accounted for based on the fair value of assets purchased and are amortized over the period in which economic benefit is estimated to be received. Identifiable intangible assets relating to the acquisition of Prism Circuits, Inc. (see Note 5) were as follows as of September 30, 2009 (dollar amounts in thousands):

	Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Developed technology	3	\$ 4,800	\$ 510	\$ 4,290
Customer relationships	3	390	41	349
Contract backlog	1	750	239	511
Non-compete agreements	1.5	140	30	110
Total		\$ 6,080	\$ 820	\$ 5,260

The related amortization expense was \$0.6 million and \$0.8 million for the three and nine months ended September 30, 2009. Amortization expense was \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2008, respectively. Amortization expense has

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been included in research and development expense. The estimated aggregate amortization expense to be recognized in future years is approximately \$0.6 million for the remainder of 2009, \$2.1 million for 2010, \$1.8 million for 2011 and \$0.8 million for 2012.

Per Share Amounts

Basic net loss per share is computed by dividing net loss for the period by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share gives effect to all dilutive potential common shares outstanding during the period. Potential common shares are composed of incremental shares of common stock issuable upon the exercise of stock options or restricted stock awards. As of September 30, 2009 and 2008, outstanding stock awards to purchase 10.3 million and 7.2 million shares, respectively, were excluded from computation of diluted net loss per share as their inclusion would be anti-dilutive.

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Comprehensive loss, as defined, includes all changes in equity (net assets) during a period from non-owner sources. The components of comprehensive loss for the three and nine months ended September 30, 2009 and 2008, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net loss	\$ (5,048)	\$ (3,238)	\$ (14,261)	\$ (12,112)
Change in net unrealized gains on available-for-sale securities	(87)	(335)	(157)	(1,006)
Comprehensive loss	\$ (5,135)	\$ (3,573)	\$ (14,418)	\$ (13,118)

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued revised guidance for addressing the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. The guidance eliminates the distinction between contractual and non-contractual contingencies, including the initial recognition and measurement criteria, and instead requires assumed assets and liabilities to be recognized at fair value at the acquisition date. The guidance is effective for contingent assets and contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company applied the guidance to its acquisition of Prism Circuits, Inc. completed in June 2009 (see Note 5).

In April 2009, the FASB issued guidance on the recognition and presentation of other-than-temporary impairments for debt securities. The Company adopted the guidance on a prospective basis beginning April 1, 2009, which did not have a material impact on the Company's financial condition or operating results.

In May 2009, the FASB issued guidance establishing general standards of accounting and disclosure for events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The guidance requires entities to disclose the date through which subsequent events were evaluated and the basis for that date. The Company adopted this guidance during the second quarter of 2009, and adoption did not have a material impact on the Company's financial condition or operating results.

In June 2009, the FASB issued guidance establishing the FASB Accounting Standards Codification (the Codification) as the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification supersedes all existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. The Company adopted the Codification for the quarter ended September 30, 2009, which did not have a material impact on the Company's financial condition or operating results.

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In October 2009, the FASB issued guidance for revenue arrangements with multiple deliverables that are outside the scope of software revenue recognition guidance. Under this guidance, when vendor-specific objective evidence or third-party evidence for deliverables in such an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. Additionally in October 2009, the FASB issued guidance modifying its earlier software revenue recognition guidance to exclude from its scope tangible products that contain both software and non-software components that function together to deliver a product's essential functionality. The guidance for both topics will apply to revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of the guidance will have on its consolidated financial statements.

Note 2: Fair Value of Financial Instruments

The estimated fair values of financial instruments outstanding, excluding auction-rate securities and a related right from UBS Financial Services, Inc. (UBS) (see below in this Note 2), were as follows (in thousands):

		September 30, 2009		
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	\$ 7,797	\$	\$	\$ 7,797
Short-term investments:				
Corporate notes	\$ 2,781	\$ 19	\$	\$ 2,800
U.S. government agency and municipal bonds	13,401	73		13,474
Total short-term investments	\$ 16,182	\$ 92	\$	\$ 16,274
Long-term investments:				
Corporate notes				