MoSys, Inc.
Form 10-Q
May 10, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2011

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.

(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)

3301 Olcott Street

Santa Clara, California, 95054

(Address of principal executive office and zip code)

(408) 418-7500

(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 filing requirements for the past 90 days. YES x NO o

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 o NO o

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 o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of May 1, 2011, 37,808,627 shares of the Registrant s common stock, $0.01 par value, were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

MOSYS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par value)

	March 31, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	$ 5,899	$ 14,340
Short-term investments	22,157	15,011
Accounts receivable, net	1,245	1,079
Unbilled contracts receivable	184	202
Prepaid expenses and other current assets	3,013	3,377
Total current assets	32,498	34,009
Long-term investments	6,539	8,193
Property and equipment, net	2,113	2,160
Goodwill	23,134	23,134
Intangible assets, net	5,583	6,238
Other assets	196	232
Total assets	$ 70,063	$ 73,966
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 475	$ 839
Accrued expenses and other liabilities	2,597	2,604
Accrued acquisition-related liabilities	1,500	1,500
Accrued restructuring liabilities	19	19
Deferred revenue	2,186	1,801
Total current liabilities	6,777	6,763
Long-term liabilities	101	146
Commitments and contingencies (Note 4)		
Stockholders equity		
Preferred stock, $0.01 par value; 20,000 shares authorized; none issued and outstanding		
Common stock, $0.01 par value; 120,000 shares authorized; 37,622 shares and 37,225 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	376	372
Additional paid-in capital	145,497	143,336
Accumulated other comprehensive income (loss)	(4)	4

Accumulated deficit		(82,684)		(76,655)
Total stockholders equity		63,185		67,057
Total liabilities and stockholders equity	$	70,063	$	73,966

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

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MOSYS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)
(In thousands, except per share data)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Net revenue		
Licensing	$ 1,347	$ 1,547
Royalty	2,192	2,003
Total net revenue	3,539	3,550
Cost of net revenue		
Licensing	690	782
Total cost of net revenue	690	782
Gross profit	2,849	2,768
Operating expenses		
Research and development	6,155	5,973
Selling, general and administrative	2,714	2,598
Total operating expenses	8,869	8,571
Loss from operations	(6,020)	(5,803)
Other income and expense, net	9	109
Loss before income taxes	(6,011)	(5,694)
Income tax provision	18	32
Net loss	$ (6,029)	$ (5,726)
Net loss per share		
Basic and diluted	$ (0.16)	$ (0.18)
Shares used in computing net loss per share		
Basic and diluted	37,264	31,262

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)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cash flows from operating activities:		
Net loss	$ (6,029)	$ (5,726)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	281	272
Stock-based compensation	709	705
Amortization of intangible assets	655	643
Provision for doubtful accounts	106	
Other non-cash items	16	22
Changes in assets and liabilities, net of business acquired:		
Accounts receivable	(272)	(836)
Unbilled contracts receivable	18	627
Prepaid expenses and other assets	847	255
Deferred revenue	385	(516)
Accounts payable	(634)	(249)
Accrued expenses and other liabilities	(5)	635
Accrued restructuring liabilities		(39)
Net cash used in operating activities	(3,923)	(4,207)
Cash flows from investing activities:		
Purchases of property and equipment	(240)	(164)
Net cash paid for purchase of MagnaLynx, Inc.		(2,204)
Proceeds from sales and maturities of marketable securities	10,353	13,743
Purchase of marketable securities	(15,853)	(11,482)
Net cash used in investing activities	(5,740)	(107)
Cash flows from financing activities:		
Proceeds from issuance of common stock	1,269	114
Payments on capital lease obligations	(47)	(20)
Net cash provided by financing activities	1,222	94
Net decrease in cash and cash equivalents	(8,441)	(4,220)
Cash and cash equivalents at beginning of period	14,340	7,123
Cash and cash equivalents at end of period	$ 5,899	$ 2,903

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., (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. In February 2010, the Company announced the commencement of a new product initiative to develop a family of integrated circuit (IC) products under the Bandwidth Engine product name. Bandwidth Engine ICs combine the Company s high-density embedded memory with its high-speed 10 Gigabits per second interface (I/O) technology and are initially being marketed to networking systems companies.

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, 2010 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 (GAAP) 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 months ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 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 is the calendar year.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States 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, certificates of deposit, commercial paper, 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 are classified as available-for-sale. The Company s available-for-sale short-term and long-term investments are carried at fair value, with the unrealized holding gains and losses reported in accumulated other comprehensive income (loss). Realized gains and losses and declines in the value judged to be other than temporary are included in the other income and expense, net line item in the condensed consolidated statements of operations. The cost of securities sold is based on the specific identification method.

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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 certificates of deposit, 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.

Allowance for Doubtful Accounts

The Company establishes an allowance for doubtful accounts to ensure that its trade receivables balances are not overstated due to uncollectibility. The Company performs ongoing customer credit evaluations within the context of the industry in which it operates. A specific allowance of up to 100% of the invoice value is provided for any problematic customer balances. Delinquent account balances are written off after management has determined that the likelihood of collection is remote. The Company performs ongoing credit evaluations of its customers financial condition and generally does not require collateral from its customers. The Company grants credit only to customers deemed creditworthy in the judgment of management. The Company maintains an allowance for doubtful accounts receivable based upon the expected collectibility of all accounts receivable. The allowance for doubtful accounts receivable was $319,000 and $125,000 at March 31, 2011 and December 31, 2010, respectively.

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 deliverables (e.g., license and services), the Company reviews each deliverable 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 the relative 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

Licensing revenue consists of fees earned from license agreements, development services and support and maintenance. For stand-alone license agreements or license deliverables in multi-deliverable arrangements that do not require significant development, modification or customization, revenues are recognized when all revenue recognition criteria have been met. Delivery of the licensed technology is typically the final revenue recognition criterion met, at which time revenue is recognized. If any of the criteria are not met, revenue recognition is deferred until such time as all criteria have been met.

Beginning in the first quarter of 2011, the Company allocates revenue among the deliverables using the relative selling price method. Revenue allocated to each element is recognized when the basic revenue recognition criteria is met for each element. Under GAAP, the Company is required to apply a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value (VSOE), (ii) third-party evidence of selling price (TPE) and (iii) best estimate of the selling price (ESP). In general, the Company is unable to establish VSOE or TPE for license fees and development services. Therefore revenue is allocated to these elements based on the Company s ESP, which the Company determines after considering multiple factors such as management approved pricing guidelines, geographic differences, market conditions, competitor pricing strategies, internal costs and gross margin objectives. These factors may vary over time depending upon the unique facts and circumstances related to each deliverable. If the facts and circumstances underlying the factors considered change or should future

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facts and circumstances lead the Company to consider additional factors, the Company s ESP for license fee and development services could change. If the Company s arrangements entered into or materially modified on or after January 1, 2011 were subject to the previous accounting guidance, the reported net revenue amount during the three months ended March 31, 2011, would decrease by approximately $0.2 million or 5% of total net revenue for that period.

For license agreements involving deliverables that do require significant production, modification or customization, and where the Company has significant experience in meeting the design specifications 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. Under this method, revenue recognized in any period depends 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 to perform the contract services, based on experience in developing prior licensees designs. The direct labor hours for the development of the licensee s design are estimated at the beginning of the contract. As the direct labor hours are incurred, they are used as a measure of progress towards completion. . During the contract performance period, the Company reviews estimates of direct labor hours to complete the contracts and will revise its estimates of revenue and gross profit under the contract if it 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 or loss 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. If the amount of revenue recognized under the percentage of completion accounting method exceeds the amount of billings to a customer, the excess amount is recorded as an unbilled contracts receivable.

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. Under this method, the Company defers the recognition of all revenue until the design meets the contractual design specifications, and the cost of revenue is expensed as incurred. When the Company has experience in meeting design specifications but the lack of significant experience or inherent risks prevent the Company from reasonably estimating the direct labor hours related to services to meet a design specification, the Company defers the recognition of revenue.

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 VSOE, ratably over the period during which the obligation exists, typically 12 months. These arrangements are generally renewable annually by the customer.

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.

Royalty

The Company s licensing contracts typically also provide for royalties based on licensees use of the Company s memory technology in their currently shipping commercial products. The Company 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.

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Cost of Net 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 IC 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. If revenue is deferred, the corresponding costs are deferred. Deferred costs are charged to cost of licensing revenues when the related revenue is recognized.

- 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 capitalized in other current assets and charged to cost of licensing revenue when the related revenue is recognized.

Goodwill

The Company reviews goodwill for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. The Company uses a two-step impairment test. In the first step, the Company compares the fair value of the reporting unit to its carrying value. The fair value of the reporting unit is determined using the market approach. If the fair value of the reporting unit exceeds the carrying value of net assets of the reporting unit, goodwill is not impaired, and the Company is not required to perform further testing. If the carrying value of the net assets of the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step in order to determine the implied fair value of the reporting unit s goodwill and compare it to the carrying value of the reporting unit s goodwill. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, then the Company must record an impairment charge equal to the difference. The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. The Company performed the annual impairment test in September 2010, and the test did not indicate impairment of goodwill, as the fair value exceeded the carrying value of the reporting unit by approximately 63%. As the Company used the market approach to assess impairment, the price of its common stock is an important component of the fair value calculation. If the Company s stock price continues to experience significant price and volume fluctuations, this will impact the fair value of the reporting unit, which can lead to potential impairment in future periods. As of March 31, 2011, the Company had not identified any factors to indicate there was an impairment of our goodwill and determined that no additional impairment analysis was required.

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 business combinations were as follows

(dollar amounts in thousands):

	March 31, 2011			
	Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Developed technology	3-5	$ 9,240	$ 3,810	$ 5,430
Customer relationships	3	390	237	153
Contract backlog	1	750	750	
Non-compete agreements	1.5	140	140	
Total		$ 10,520	$ 4,937	$ 5,583

	December 31, 2010			
	Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Developed technology	3-5	$ 9,240	$ 3,188	$ 6,052
Customer relationships	3	390	204	186
Contract backlog	1	750	750	
Non-compete agreements	1.5	140	140	
Total		$ 10,520	$ 4,282	$ 6,238

The related amortization expense was $0.7 million and $0.6 million for the three months ended March 31, 2011 and 2010, respectively. Amortization expense has been included in research and development expense in the condensed consolidated statements of operations. The estimated aggregate amortization expense to be recognized in future years is approximately $2.0 million for the remainder of 2011, $1.6 million for 2012, $0.9 million for 2013, $0.9 million for 2014 and $0.2 million for 2015.

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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 potentially dilutive common shares outstanding during the period. Potentially dilutive common shares are composed of incremental shares of common stock issuable upon the exercise of stock options or restricted stock awards. For the three months ended March 31, 2011 and 2010, stock awards to purchase approximately 10,110,000 and 10,767,000 shares, respectively, were excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive.

Comprehensive Loss

Comprehensive loss, as defined, includes all changes in equity (net assets) during a period from non-owner sources. The components of other comprehensive loss for the three months ended March 31, 2011 and 2010, were as follows (in thousands):

	Three Months Ended March 31,			
		2011		2010
Net loss	$	(6,029)	$	(5,726)
Change in net unrealized loss on available-for-sale securities		(8)		(25)
Comprehensive loss	$	(6,037)	$	(5,751)

Note 2: Fair Value of Financial Instruments

The estimated fair values of financial instruments outstanding were as follows (in thousands):

	March 31, 2011							
		Cost		Unrealized Gains		Unrealized Losses		Fair Value
Cash and cash equivalents	$	5,899	$		$		$	5,899
Short-term investments:								
U.S. government debt securities	$	8,779	$	5	$	(1)	$	8,783
Corporate notes and commercial paper		11,682		12		(4)		11,690
Certificates of deposit		1,685				(1)		1,684
Total short-term investments	$	22,146	$	17	$	(6)	$	22,157
Long-term investments:								
U.S. government debt securities	$	4,501	$		$	(12)	$	4,489
Corporate notes		1,573				(3)		1,570
Certificates of deposit		480						480
Total long-term investments	$	6,554	$		$	(15)	$	6,539

December 31, 2010

	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 14,340	$	$	$ 14,340
Short-term investments:				
U.S. government debt securities	$ 8,711	$ 1	$ (2)	$ 8,710
Corporate notes	5,115	6	(5)	5,116
Certificates of deposit	1,185			1,185
Total short-term investments	$ 15,011	$ 7	$ (7)	$ 15,011
Long-term investments:				
U.S. government debt securities	$ 6,204	$	$ (2)	$ 6,202
Corporate notes	1,507	6		1,513
Certificates of deposit	480		(2)	478
Total long-term investments	$ 8,191	$ 6	$ (4)	$ 8,193

As of March 31, 2011 and 2010, all of the available-for-sale securities with unrealized losses were in a loss position for less than 12 months. Total fair value of available-for-sale securities with unrealized losses was $14.9 million at March 31, 2011.

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Cost and fair value of investments based on two maturity groups were as follows (in thousands):

	March 31, 2011			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Due within 1 year	$ 22,146	$ 17	$ (6)	$ 22,157
Due in 1-2 years	6,554		(15)	6,539
Total	$ 28,700	$ 17	$ (21)	$ 28,696

	December 31, 2010		
	Cost	Unrealized Gains	Unrealized Losses