MICROTUNE INC
Form 10-Q
November 04, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 SEPTEMBER 30, 2004

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 000-31029-40

MICROTUNE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**75-2883117**
(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or organization)	**Identification Number)**

2201 10th Street

Plano, Texas 75074

(Address of principal executive office and zip code)

(972) 673-1600

(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, as amended, 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 ¨

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO ¨

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of October 22, 2004, approximately 51,470,118 shares of the Registrant s Common Stock, $0.001 par value per share, were outstanding.

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Microtune, Inc.

FORM 10-Q

SEPTEMBER 30, 2004

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Caution Regarding Forward-Looking Statements

Throughout this quarterly report on Form 10-Q, we make forward-looking statements that are based upon our current expectations, estimates and projections about our business and our industry, and that reflect our beliefs and assumptions based upon information available to us at the date of this report. In some cases, you can identify these statements by words such as if, may, might, will, should, expects, plans, anticipates estimates, predicts, potential, continue, and other similar terms. These forward-looking statements include, among other things, projections of our future financial performance and our anticipated growth, descriptions of our strategies, the trends we anticipate in our businesses and the markets in which we operate, and the competitive nature and anticipated growth of those markets.

We caution readers that forward-looking statements are only predictions, based on our current expectations about future events. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Our actual results, performance or achievements could differ materially from those expressed or implied by the forward-looking statements. In addition to the other information in this report, we encourage you to review the information regarding the risks and uncertainties associated with our business set forth under the caption *Factors Affecting Future Operating Results and Stock Price* below and in our other filings with the Securities and Exchange Commission (SEC). We caution readers not to rely on these forward-looking statements, which reflect management s analysis only as of the date of this report. We undertake no obligation to revise or update any forward-looking statement for any reason.

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PART I.

Financial Information

Item 1. Financial Statements

Microtune, Inc.

Consolidated Balance Sheets

(In thousands, except per share data)

(unaudited)

	September 30, 2004	December 31, 2003
Assets		
Current assets:		
Cash and cash equivalents	$ 74,145	$ 53,337
Short-term investments		6,045
Accounts receivable, net	7,500	4,260
Inventories	6,385	4,165
Other current assets	1,510	4,309
Total current assets	89,540	72,116
Property and equipment, net	5,981	7,504
Long-term investments	6,581	14,028
Intangible assets, net	3,004	6,564
Other assets and deferred charges	278	447
Total assets	$ 105,384	$ 100,659
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 6,610	$ 7,195
Accrued compensation	1,355	1,182
Accrued expenses	4,292	3,945
Deferred revenue	301	147
Total current liabilities	12,558	12,469
Other non-current liabilities	1,216	1,466
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value Authorized 25,000 shares; issued and outstanding shares none		
Common stock, $0.001 par value Authorized 150,000 shares; issued and outstanding shares 51,470 and 51,157 respectively	52	51
Additional paid-in capital	436,770	436,025
Unearned stock compensation	(377)	(1,124)
Loans receivable from stockholders		(30)

Accumulated other comprehensive loss	(1,027)	(960)
Accumulated deficit	(343,808)	(347,238)
Total stockholders equity	91,610	86,724
Total liabilities and stockholders equity	$ 105,384	$ 100,659

See accompanying notes.

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Consolidated Statements of Operations

(In thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net revenue	$ 16,268	$ 8,975	$ 40,777	$ 35,573
Cost of revenue	9,402	10,549	23,242	30,036
Gross margin	6,866	(1,574)	17,535	5,537
Operating expenses:				
Research and development:				
Stock option compensation	158	375	522	2,057
Other	3,682	5,014	10,863	17,243
	3,840	5,389	11,385	19,300
Selling, general and administrative:				
Stock option compensation	47	121	191	1,667
Other	6,716	9,510	22,777	23,687
	6,763	9,631	22,968	25,354
Restructuring	9	(478)	108	(378)
Amortization of intangible assets	1,047	1,047	3,182	3,183
Total operating expenses	11,659	15,589	37,643	47,459
Loss from operations	(4,793)	(17,163)	(20,108)	(41,922)
Other income (expense):				
Interest income	242	492	647	1,085
Foreign currency gains (losses), net	263	(218)	(387)	1,106
Settlement of patent and anti-trust litigation			22,500	
Other	(166)	(127)	411	88
Income (loss) before provision for income taxes	(4,454)	(17,016)	3,063	(39,643)
Income tax expense (benefit)	(568)	125	(367)	370
Net income (loss)	$ (3,886)	$ (17,141)	$ 3,430	$ (40,013)
Net income (loss) per common share:				
Basic	$ (0.08)	$ (0.34)	$ 0.07	$ (0.80)
Diluted	$ (0.08)	$ (0.34)	$ 0.06	$ (0.80)
Weighted-average common shares outstanding:				
Basic	51,264	50,505	51,334	50,149

Diluted	51,264	50,505	53,653	50,149

See accompanying notes.

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Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Nine Months Ended September 30,	
	2004	**2003**
Operating activities:		
Net income (loss)	$ 3,430	$ (40,013)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation	1,876	5,491
Amortization of intangible assets	3,182	3,183
Write-off of patent costs	492	
Non-cash restructuring costs	(35)	1,360
Foreign currency (gains) losses, net	387	(1,106)
Amortization of deferred stock option compensation	713	3,724
Gain on sale of property and equipment	(251)	(955)
Allowance for uncollectible accounts receivable	18	
Other non-cash charges		491
Changes in operating assets and liabilities:		
Accounts receivable, net	(3,258)	5,094
Inventories	(2,220)	888
Other assets	2,637	1,143
Accounts payable	(476)	(1,326)
Accrued expenses	376	(7,308)
Other liabilities	(250)	468
Accrued compensation	173	246
Net cash provided by (used in) operating activities	6,794	(28,620)
Investing activities:		
Purchases of property and equipment	(369)	(533)
Proceeds from sale of property and equipment	267	467
Proceeds from sale of Philippine manufacturing assets	51	2,697
Sale of Netherlands subsidiary		(934)
Proceeds from available-for-sale investments	9,000	9,000
Proceeds from held-to-maturity investments	6,045	
Purchase of available-for-sale investments	(1,620)	(18,000)
Loans receivable		(46)
Acquisition of intangible assets	(114)	(364)
Net cash provided by (used in) investing activities	13,260	(7,713)
Financing activities:		
Proceeds from issuance of common stock	1,116	1,106
Loans receivable from stockholders	30	105
Other, net	(5)	
Net cash provided by financing activities	1,141	1,211
Effect of foreign currency exchange rate changes on cash	(387)	1,106

Net increase (decrease) in cash and cash equivalents	20,808	(34,016)
Cash and cash equivalents at beginning of period	53,337	101,278
Cash and cash equivalents at end of period	$ 74,145	$ 67,262

See accompanying notes.

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Notes to Consolidated Financial Statements

September 30, 2004

(unaudited)

1. Summary of Significant Accounting Policies

Description of business

Microtune, Inc. began operations in August 1996. We operate in a single industry segment: designing and marketing radio frequency (RF) integrated circuits and subsystem module solutions for the worldwide broadband communications and transportation electronics markets.

General

The accompanying unaudited financial statements as of and for the third quarter and first three quarters of 2004 and 2003 have been prepared by us, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

In the opinion of management, all adjustments which are of a normal and recurring nature and are necessary for a fair presentation of the financial position, results of operations, and cash flows as of and for the third quarter and first three quarters of 2004 and 2003 have been made. Results of operations for the third quarter and first three quarters of 2004 and 2003 are not necessarily indicative of results of operations to be expected for the entire year or any other period.

Risk and Uncertainties

Our future results of operations and financial condition will be impacted by the following factors, among others: dependence on the broadband communications and transportation electronics markets, on a few significant customers, on third party manufacturers and subcontractors, on third party distributors in certain markets, and on the successful development of products and marketing of new products. Our future results also may be impacted by foreign currency fluctuations as a result of our international operations, intellectual property rights, litigation costs and product liability.

Consolidation

Our Consolidated Financial Statements include the financial statements of Microtune and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

We make estimates, judgments and assumptions that affect the amounts reported in the financial statements and the disclosures made in the accompanying notes, including inventory valuation allowances, warranty costs, determining the collectibility of accounts receivable, the valuation of deferred tax assets, contingent liabilities and other amounts. We also use estimates, judgments and assumptions to determine the remaining economic lives and carrying values of purchased intangible assets, property and equipment and other long-lived assets. We believe that the estimates, judgments and assumptions upon which we rely are appropriate and correct, based upon information available to us at the time that they are made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the financial statements, as well as the reported revenue and expense during the periods presented. If there are material differences between these estimates, judgments or assumptions and actual facts, our financial statements will be affected.

Cash and Cash Equivalents

We consider highly liquid investments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents consist of bank deposits, money market funds and asset-backed commercial paper. Our investments in asset-backed commercial paper are comprised of high-quality securities in accordance with our investment policy.

Investments

Investments in debt securities are classified as held-to-maturity when we intend to hold them to maturity. Held-to-maturity investments are carried at amortized cost with the amortization of the purchase discount recorded in interest income. Investments in debt securities not classified as held-to-maturity and equity securities are classified as available-for-sale and carried at fair value, with unrealized gains and losses, net of tax, recorded in stockholders equity. Realized gains and losses and other than temporary declines in value, if any, on available-for-sale securities are reported in other income and expense as incurred. Our long-term investments, which consist of mortgage-backed securities, are classified as available-for-sale and are due within 2 years from September 30, 2004. The carrying values of our investments approximate their fair values. Our investments are reviewed periodically for other-than-temporary impairment.

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Inventories

Our inventories are stated at the lower of standard cost, which approximates actual cost, or estimated realizable value. Adjustments to reduce our inventories to estimated realizable value, including allowances for excess and obsolete inventories, are determined quarterly by comparing inventory levels of individual materials and parts to current backlog and estimated future sales. Actual amounts realized upon the sale of inventories may differ from estimates used to determine inventory valuation allowances due to changes in customer demand, technology changes and other factors.

Property and Equipment

Our property and equipment is stated at cost, net of accumulated depreciation. We calculate depreciation using the straight-line method over the estimated useful lives of the assets, which generally range from 3 to 7 years. We depreciate leasehold improvements using the straight-line method over the lesser of their estimated useful lives or remaining lease terms.

Intangible Assets

Our intangible assets, which consist primarily of acquired patents and acquired customer base, have been recorded as the result of our business or asset acquisitions and are being amortized on the straight-line basis over 3 to 5 years.

Impairment of Long-lived Assets

We review long-lived assets, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We evaluate the recoverability of these assets by a comparison of the carrying amount of an asset to projected undiscounted cash flows expected to be generated by the assets or business center. If we determine our long-lived assets are impaired, we recognize the impairment in the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

Revenue Recognition

We recognize revenue when we receive a purchase order from our customer, our product has been shipped, title has transferred to our customer, the price that we will receive for our product is fixed or determinable, and collection from our customer is considered probable. Title to our product transfers to our customer either when it is shipped to or received by our customer, based on the customer s specific agreement.

Our revenue is recorded based on the facts currently known to us. If we do not meet all the criteria above, we do not recognize revenue. If we are unable to determine the amount that we will ultimately collect once our product has shipped and title has transferred to our customer, we defer recognition of revenue until we can determine the amount that ultimately will be collected. Items that are considered when determining the amounts we will ultimately collect are: a customer s overall credit worthiness and payment history, customer rights to return unsold product, customer rights to price protection, customer payment terms conditional on sale or use of product by the customer, or other extended payment terms granted to a customer. It is not our standard business practice to grant any of these terms to our customers.

For certain of our customers, we do not recognize revenue until receipt of payment because collection is not probable or the amount we will ultimately collect is not determinable at the date of the shipment. Upon shipment of product to these customers, title to the inventory transfers to the customer and the customer is invoiced. We account for these transactions by recording accounts receivable for the sales value of the shipments, as the shipments represent valid receivables, and reducing inventory for the cost of the inventory shipped. The difference, representing the gross margin on the transactions, is recorded as deferred revenue. For financial statement presentation purposes, this deferred revenue balance is offset against the corresponding accounts receivable balance from the customer. When payment is received for the transaction, revenue is recognized for the value of the cash payment, cost of sales is recorded for the cost of the inventory and the deferred revenue is relieved for the gross margin on the transaction. At September 30, 2004 and December 31, 2003, the sales value of products shipped for which revenue was deferred was approximately $0.2 million.

When we defer revenue, the timing and amount of revenue we ultimately recognize is determined upon our receipt of payment, which can result in significant fluctuations in revenues from period to period. In the third quarter of 2004 and 2003, we recognized 3% and 17% of our net revenue upon receipt of payment, respectively. In the first three quarters of 2004 and 2003, we recognized 6% and 30% of our net revenue upon receipt of payment, respectively.

We also defer revenue when customers have made payments and we have not completed the earnings process. These payments are reflected as liabilities in our financial statements as deferred revenue. In these instances, once the product is shipped and title has transferred to our customer, we recognize revenue. As of September 30, 2004 and December 31, 2003, we had deferred revenue as a result of customer prepayments of $0.3 million and $0.1 million, respectively.

We grant limited stock rotation rights for conforming product to certain distributors for up to 5% of their aggregate net purchases for the previous six months. In these circumstances, we require the distributor to submit an offsetting purchase order that is, at a minimum, equivalent to the aggregate dollar amount of the product to be returned. We account for the return as a reduction to revenue and a reduction to accounts receivable for the price of the items returned. Correspondingly, cost of sales is reduced by the cost of returned inventory offset by an increase in inventory. Any returned inventory items are included in gross inventories, are reviewed along with our other inventory items and are recorded at the lower of cost or market. Historically, distributor returns under stock rotation rights have been insignificant due to our requirement that returns be offset by new purchase orders and the incremental shipping, handling and customs costs distributors would incur as a result of such returns. We account for the shipment of replacement product as a sales transaction.

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Research and Development Costs

Our research and development expenses consist primarily of personnel-related expenses, lab supplies, training and prototype materials. We expense all of our research and development costs in the period incurred as our current process for developing our products is essentially completed concurrently with the establishment of technological feasibility. Research and development efforts currently are focused primarily on development of our next generation of RF products.

Shipping and Handling Costs

Shipping and handling costs related to product shipments to customers are included in selling, general and administrative expenses.

Warranty Costs

We generally provide a minimum of a one-year warranty on all products and record a related provision for estimated warranty costs at the date of sale. Estimated warranty costs are recorded at the date of sale based on a percentage of revenues derived from our historical warranty costs. In addition, we record specific warranty provisions for any identified individual product issues.

Foreign Currency Gains and Losses

Our functional currency is the U.S. dollar. The impact from the re-measurement of accounts not denominated in U.S. dollars is recognized currently in our results of operations as a component of foreign currency gains and losses. Foreign currency gains (losses), net, were $0.3 million and $(0.2) million for the third quarter of 2004 and 2003, respectively. Foreign currency gains (losses), net, were $(0.4) million and $1.1 million for the first three quarters of 2004 and 2003, respectively.

Income Taxes

Our income taxes are computed using the asset and liability method of accounting. Under the asset and liability method, a deferred tax asset or liability is recognized for estimated future tax effects attributable to temporary differences and loss carryforwards. The measurement of deferred income tax assets is adjusted by a valuation allowance, if necessary, to recognize future tax benefits only to the extent, based on available evidence, it is more likely than not that such benefits will be realized. Our deferred tax assets were fully reserved as of September 30, 2004 and December 31, 2003.

Earnings Per Share

Basic earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period. Diluted earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period and dilutive common equivalent shares consisting of stock options, restricted stock subject to repurchase rights and employee stock purchase plan options.

Our computation of earnings (loss) per common share is as follows (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income (loss)	$ (3,886)	$ (17,141)	$ 3,430	$ (40,013)
Diluted earnings (loss) per common and dilutive potential common share:				
Weighted average common shares outstanding	51,264	50,505	51,334	50,149
Weighted average dilutive potential common shares:				
Stock options			2,267	
Restricted common stock			4	
Employee stock purchase plan			48	
Weighted average common and dilutive potential common shares	51,264	50,505	53,653	50,149
Diluted earnings (loss) per common share:				
Net income (loss)	$ (0.08)	$ (0.34)	$ 0.06	$ (0.80)
Basic earnings (loss) per common share:				
Net income (loss)	$ (0.08)	$ (0.34)	$ 0.07	$ (0.80)

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The following table sets forth anti-dilutive securities that have been excluded from diluted earnings per share (in thousands):

	September 30, 2004	September 30, 2003
Stock options	451	7,046
Restricted common stock		29
Employee stock purchase plan		99
Total anti-dilutive securities excluded	451	7,174

Stock-Based Compensation

At September 30, 2004, we have four stock-based compensation plans covering employees and directors. We have elected to follow Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for our employee stock options. We account for stock-based compensation for non-employees under the fair value method prescribed by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). Through September 30, 2004, there have been no significant grants to non-employees.

Stock option compensation expense results from grants of stock options with deemed exercise prices below the estimated fair value per share of our common stock at the date of grant under the provisions of APB No. 25. Deferred stock option compensation is being amortized and charged to operations over the vesting period of the related options. As of September 30, 2004 and December 31, 2003, unearned deferred stock compensation was $0.4 million and $1.1 million, respectively. The weighted average remaining vesting period of outstanding compensatory stock options was less than one year at September 30, 2004.

During the quarter ended September 30, 2004, we granted our employees approximately 1,069,000 stock options with exercise prices ranging from $4.47 to $5.48 per share. The stock options generally vest over the next three years.

Although SFAS No. 123 allows us to continue to follow the present APB No. 25 guidelines, we are required to disclose pro forma net income (loss) and net income (loss) per share as if we had adopted SFAS No. 123. The pro forma impact of applying SFAS No. 123 will not necessarily be representative of the pro forma impact in future periods. Our pro forma information is as follows (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income (loss), as reported	$ (3,886)	$ (17,141)	$ 3,430	$ (40,013)
Add stock compensation expense recorded under the intrinsic value method	205	496	713	3,724

Less pro forma stock compensation expense computed under the fair value method	(1,236)	(1,692)	(5,130)	(5,811)
Pro forma net income (loss)	$ (4,917)	$ (18,337)	$ (987)	$ (42,100)
Pro forma income (loss) per common share:				
Basic	$ (0.10)	$ (0.36)	$ (0.02)	$ (0.84)
Diluted	$ (0.10)	$ (0.36)	$ (0.02)	$ (0.84)

On March 31, 2004, the FASB issued its Exposure Draft, Share-Based Payment , which is a proposed amendment to SFAS No**.** 123, Accounting for Stock-Based Compensation. The amendment would require all share-based payments to employees, including grants of employee stock options and purchases under employee stock purchase plans, to be recognized in the statement of operations based on their fair values. On October 13, 2004, the FASB decided that the final amendment would be effective for public companies for any interim or annual period beginning after June 15, 2005, though early adoption would be encouraged, provided that financial statements for periods prior to the effective date have not been issued. We believe adopting this amendment will have a material impact on our consolidated results of operations.

Risk Concentrations

Financial instruments that potentially expose Microtune to concentrations of credit risk consist primarily of trade accounts receivable. Products are sold to customers internationally, principally in Asia Pacific and Europe. Management continually evaluates the creditworthiness of its customers financial condition and generally does not require collateral. At September 30, 2004, approximately

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54% of our net accounts receivable were due from five of our customers. We evaluate the collectibility of our accounts receivable based on a combination of factors. In circumstances when we are aware of a specific customer s inability to meet its financial obligations to us, we record a specific reserve for bad debts against amounts due to us and reduce the net realizable receivable to the amount we reasonably believe will be collected. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are outstanding, industry and geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers deteriorates or if economic conditions worsen, additional allowances may be required in the future. Historically, our reserves have been generally adequate to cover our actual credit losses.

We depend on third party foundries to manufacture all of our integrated circuit products. We do not have long-term supply agreements with our foundries and obtain integrated circuit products on a purchase order basis. The inability of a third party foundry to continue manufacturing our integrated circuits could have a material adverse effect on our operations. We are also dependent upon third parties, some of whom are competitors, for the supply of components used in subsystem module manufacturing. Our failure to obtain components for module manufacturing would significantly impact our ability to ship modules to customers in a timely manner.

We sold assets related to our Manila operations to Three-Five Systems (TFS) on March 27, 2003, and we use TFS for nearly all assembly and calibration functions for our subsystem module solutions. If TFS were unable to continue manufacturing our subsystem modules, there could be a material adverse effect on our operations.

2. Accounts Receivable, net

Accounts receivable, net consists of the following (in thousands):

	September 30, 2004	December 31, 2003
Gross accounts receivable	$ 7,811	$ 4,522
Allowance for doubtful accounts	(150)	(132)
Deferred revenue	(161)	(130)
Accounts receivable, net	$ 7,500	$ 4,260

3. Inventories

Inventories consist of the following (in thousands):

	September 30, 2004	December 31, 2003

Finished goods	$ 3,968	$ 2,905
Work-in-process	2,417	1,260
Total inventory	$ 6,385	$ 4,165

4. Intangible Assets

Amortization expense for intangible assets was $1.0 million for the third quarter of 2004 and 2003 and $3.2 million for the first three quarters of 2004 and 2003, respectively.

During the third quarter of 2004, we recorded charges to legal expense for previously capitalized patents costs of $0.3 million related to abandoned patent applications and non-patent costs and $0.2 million due to the uncertain timing of the related patent issuances.

The gross carrying amounts and related accumulated amortization of intangible assets consist of the following (in thousands):

	Remaining Weighted Average Useful Life in Years	September 30, 2004		December 31, 2003	
		Gross Carrying Amount	Accum. Amort.	Gross Carrying Amount	Accum. Amort.
Patents	0.84	10,297	7,498	11,467	5,723
Other	0.25	4,308	4,103	4,308	3,488
Total		$ 14,605	$ 11,601	$ 15,775	$ 9,211

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The following table sets forth the remaining estimated future amortization of intangible assets as of September 30, 2004 (in thousands):

Year Ending December 31,	
2004	$ 981
2005	2,014
2006	9

5. Accrued Expenses

Accrued expenses consist of the following (in thousands):

	September 30, 2004	December 31, 2003
Accrued warranty obligation	$ 200	$ 245
Accrued restructuring costs (Note 9)	13	202
Accrued legal fees	638	1,795
Accrued loss for excess subcontractor inventory	1,468	
Accrued payment for potential litigation settlement	957	
Other	1,016	1,703
Total accrued expenses	$ 4,292	$ 3,945

6. Income Taxes

We have established a valuation allowance to fully reserve our deferred tax assets at September 30, 2004 and December 31, 2003 due to the uncertainty of the timing and amount of future taxable income. For U.S. federal income tax purposes, at December 31, 2003, we had a net operating loss carryforward of approximately $173.9 million, including operating loss carryforwards of Transilica and an unused research and development credit carryforward of approximately $4.1 million, that will begin to expire in 2011. A change in ownership, as defined in Section 382 of the Internal Revenue Code, may limit utilization of the U.S. federal net operating loss and research and development credit carryforwards.

The provision for the third quarter of 2004 includes a benefit of $0.6 million as a result of our decision to re-structure our foreign operations to improve our foreign tax exposure. The provision for taxes during the first three quarters of 2004 and 2003 includes the utilization of previously reserved net operating loss carryforwards and consists of foreign income taxes.

Our income tax returns and those of our subsidiaries are subject to review and examination in the various jurisdictions in which we operate. We believe that all income tax issues that have been or may be raised as a result of such reviews and examinations will be resolved with no material impact on our financial position or future results of operations.

7. Commitments and Contingencies

Lease Commitments

In March 2000, we entered into a five-year operating lease for office space in Plano, Texas to be used as our headquarters, as well as for certain administrative, sales and marketing and research and development activities. We lease an administrative, sales and marketing, and research and development facility in Germany under an operating lease with a twenty-two year term, which began in December 1999. We also lease certain other facilities, equipment and computer software under operating leases. Future minimum lease payments required under operating leases as of September 30, 2004 are as follows (in thousands):

Year Ending December 31,	
2004	$ 381
2005	1,263
2006	651
2007	458
2008	453
Thereafter	5,771
	$ 8,977

Rent expense for the third quarter of 2004 and 2003 was $0.4 million and $0.5 million, respectively. Rent expense for the first three quarters of 2004 and 2003 was $1.4 million and $1.9 million, respectively.

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Purchase Commitments

As of October 22, 2004, we had approximately $15 million of cancelable and non-cancelable purchase commitments outstanding with our vendors. These commitments were entered into in the normal course of business.

Legal Proceedings

From time to time, we may be involved in routine legal proceedings, as well as demands, claims and threatened litigation that arise in the normal course of our business. The ultimate amount of liability, if any, for any pending claims of any type (either alone or combined) may materially and adversely affect our financial position, results of operations and liquidity. Moreover, the ultimate outcome of any pending litigation is uncertain. Any outcome, whether favorable or unfavorable, may materially and adversely affect us due to legal costs and expenses, diversion of management resources and other factors. There can be no assurance that additional contingencies of a legal nature or contingencies having legal aspects will not be asserted in the future. Such matters could relate to prior transactions or events or future transactions or events. Except as described below, we are not currently a party to any material litigation.

Intellectual Property and Anti-Trust Litigation

On January 24, 2001, we filed a lawsuit alleging patent infringement in the United States District Court for the Eastern District of Texas, Sherman Division, against Broadcom Corporation. The lawsuit alleged that Broadcom s BCM3415 microchip and related products infringe our U.S. Patent No. 5,737,035 (035 patent). In our complaint, we sought monetary damages resulting from the alleged infringement as well as injunctive relief precluding Broadcom from taking any further action that infringes our patent. On March 20, 2003, a jury found in favor of Microtune. The jury found that certain Broadcom products do infringe Microtune s valid and enforceable patent and that the infringement was willful. Subsequent to the jury verdict, Microtune was awarded $1,529,586 in damages. The Court then doubled this $1,529,586 damage award based on Broadcom s willful infringement. The Court also awarded Microtune $5,157,658.25 in reasonable attorneys fees, $500,168.31 in litigation expenses and $55,722.74 in costs of suit and pre-judgment and post-judgment interest. The Court entered a permanent injunction in this case that prohibited Broadcom from making, using, marketing, selling or distributing in the United States any technology found by the jury to infringe our patent. Broadcom appealed the infringement issues and the award of attorneys fees and litigation expenses to the Court of Appeals for the Federal Circuit and the Court heard oral arguments of the parties related to this appeal on May 3, 2004. This appeal was dismissed under the terms of the settlement described below.

On July 15, 2002, Broadcom filed a lawsuit alleging patent infringement in the United States District Court for the Eastern District of Texas, Sherman Division, against Microtune. The lawsuit alleged that various Microtune products infringed