MoSys, Inc.
Form 10-Q
May 11, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

OR

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

For the transition period from to

Commission file number 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)

2309 Bering Drive

San Jose, California, 95131

(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 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, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth 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
Emerging Growth Company		

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

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

As of April 30, 2018, 8,170,910 shares of the Registrant's common stock, $0.001 par value, were outstanding.

MOSYS, INC.

FORM 10-Q

March 31, 2018

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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, 2018	December 31, 2017
ASSETS		
Current assets		
Cash and cash equivalents	$3,501	$ 3,868
Accounts receivable	1,505	1,681
Inventories	1,900	1,766
Prepaid expenses and other	1,255	1,347
Total current assets	8,161	8,662
Property and equipment, net	658	827
Goodwill	13,276	13,276
Intangible assets, net	84	111
Other	262	263
Total assets	$22,441	$ 23,139
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$233	$ 170
Deferred revenue	2,702	3,938
Accrued expenses and other	1,886	2,507
Total current liabilities	4,821	6,615
Long-term liabilities	18	18
Convertible notes payable	9,635	9,160
Total liabilities	14,474	15,793
Commitments and contingencies (Note 4)		
Stockholders' equity		
Preferred stock, $0.01 par value; 20,000 shares authorized; none issued and outstanding	—	—
Common stock, $0.001 par value; 120,000 shares authorized; 8,171 shares and 8,068 shares issued and outstanding at March 31, 2018 and	8	8

December 31, 2017, respectively		
Additional paid-in capital	232,069	232,026
Accumulated deficit	(224,110)	(224,688)
Total stockholders’ equity	7,967	7,346
Total liabilities and stockholders’ equity	$22,441	$ 23,139

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

MOSYS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands, except per share data)

	Three Months Ended March 31, 2018	2017
Net revenue		
Product	$3,704	$955
Royalty and other	504	257
Total net revenue	4,208	1,212
Cost of net revenue	1,601	602
Gross profit	2,607	610
Operating expenses		
Research and development	1,051	3,485
Selling, general and administrative	989	1,314
Total operating expenses	2,040	4,799
Income (loss) from operations	567	(4,189)
Interest expense	(221)	(224)
Other income, net	3	13
Income (loss) before income taxes	349	(4,400)
Income tax provision	1	5
Net and comprehensive income (loss)	$348	$(4,405)
Net income (loss) per share		
Basic	$0.04	$(0.66)
Diluted	$0.04	$(0.66)
Shares used in computing net income (loss) per share		
Basic	8,130	6,647
Diluted	8,347	6,647

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

MOSYS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three Months Ended March 31, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$348	$(4,405)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	169	196
Stock-based compensation	94	185
Amortization of intangible assets	27	28
Amortization of debt issuance costs	12	11
Accrued interest	209	210
Changes in assets and liabilities:		
Accounts receivable	406	(151)
Inventories	(134)	396
Prepaid expenses and other assets	93	173
Accounts payable	63	(219)
Deferred revenue and other liabilities	(1,604)	(602)
Net cash used in operating activities	(317)	(4,178)
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	—	2,364
Purchases of marketable securities	—	(1,602)
Net cash provided by investing activities	—	762
Cash flows from financing activities:		
Issuance costs for sale of common stock	(12)	(20)
Taxes paid to net share settle equity awards	(38)	—
Net cash used in financing activities	(50)	(20)
Net decrease in cash and cash equivalents	(367)	(3,436)
Cash and cash equivalents at beginning of period	3,868	8,766
Cash and cash equivalents at end of period	$3,501	$5,330
Supplemental disclosure:		
Issuance of convertible notes in settlement of accrued interest	$463	$420

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

MOSYS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. The Company and Summary of Significant Accounting Policies

MoSys, Inc. (the Company) was incorporated in California in September 1991 and reincorporated in September 2000 in Delaware. The Company’s strategy and primary business objective is to be an IP-rich fabless semiconductor company focused on the development and sale of integrated circuit (IC) products. Its Bandwidth Engine ICs combine the Company’s proprietary high-density embedded memory with its high-speed 10 gigabits per second and higher interface technology. The Company’s future success and ability to maintain profitability depends on its success in developing a market for its ICs.

The accompanying condensed consolidated financial statements of the Company have been prepared on a basis that assumes that the Company will continue as a going concern and contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business and have been prepared without audit in accordance with the rules and regulations of the Securities and Exchange Commission (SEC).

The condensed consolidated balance sheet as of December 31, 2017 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, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 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

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 and expenses recognized during the reported period. Actual results could differ from those estimates.

Cash Equivalents and Investments

The Company invests its excess cash in money market accounts, certificates of deposit, commercial paper, corporate debt, government-sponsored enterprise bonds and municipal bonds 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 investments are carried at fair value, with the unrealized holding gains and losses reported in accumulated other comprehensive loss. 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 and comprehensive loss. The cost of securities sold is based on the specific identification method.

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:

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 may include cash equivalents and available-for-sale securities, which consist primarily of certificates of deposit, 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 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 and generally does not require collateral from its customers. 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 grants credit only to customers deemed creditworthy in the judgment of management. There was no allowance for doubtful accounts receivable at either March 31, 2018 or December 31, 2017.

Inventories

The Company values its inventories at the lower of cost, which approximates actual cost on a first-in, first-out basis, or net realizable value. The Company records inventory reserves for estimated obsolescence or unmarketable inventories based upon assumptions about future demand and market conditions. Once a reserve is established, it is maintained until the product to which it relates is sold or otherwise disposed of. If actual market conditions are less favorable than those expected by management, additional adjustment to inventory valuation may be required. Charges for obsolete and slow-moving inventories are recorded based upon an analysis of specific identification of obsolete inventory items and quantification of slow moving inventory items. The Company recorded no inventory write-downs during the three months ended March 31, 2018 or 2017.

Revenue Recognition

On January 1, 2018, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 606, Revenue from Contracts with Customers (ASC 606) using the modified retrospective (cumulative effect) transition method. Under this transition method, results for reporting periods beginning January 1, 2018 or later are presented under ASC 606, while prior period results continue to be reported in accordance with previous guidance. The cumulative effect of the initial application of ASC 606 was recognized as an adjustment to accumulated deficit as of January 1, 2018 of $230,000. Overall, the adoption of ASC 606 did not have a material impact on the Company’s condensed consolidated balance sheet, statement of operations and comprehensive income and statement of cash flows for the three months ended March 31, 2018. ASC 606 also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. As described below, the analysis of contracts under ASC 606 supports the recognition of revenue at a point in time, resulting in revenue recognition timing that is materially consistent with the Company’s historical practice of recognizing product revenue when title and risk of loss pass to the customer.

Revenue is recognized when control over a product or service is transferred to a customer. Revenue is measured at the transaction price which is based on the amount of consideration that the Company expects to receive in exchange for transferring the promised goods or services to the customer and excludes any amounts collected on behalf of third parties. The Company enters into contracts that may include both products and services, which are generally capable of being distinct and accounted for as separate performance obligations.

The Company does not have significant financing components, as payments from customers are typically due within 60 days of invoicing and the Company has elected the practical expedient to net value financing components that are less than one year. Shipping and handling costs are incurred by the customer, and, therefore, are not recorded as revenue.

The following table summarizes the cumulative effect of the changes to the Company’s unaudited condensed consolidated balance sheet as of January 1, 2018 due to the adoption of ASC 606 (in thousands):

	Balance as of December 31, 2017	Adjustments due to ASC 606	Balance as of January 1, 2018
Assets			
Accounts receivable, net	$1,681	$ 230	$1,911

Equity			
Accumulated deficit	$(224,688)	$ 230	$(224,458)

The following tables summarize the current-period impacts of adopting ASC 606 on the Company's unaudited condensed consolidated balance sheet and statement of operations and comprehensive income:

	March 31, 2018		
	As Reported	Effect of adoption	Balances without adoption of ASC 606
Assets			
Accounts receivable, net	$1,505	$ (220)	$ 1,285
Equity			
Accumulated deficit	$(224,110)	$ (220)	$ (224,330)

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	For the Three Months Ended March 31, 2018		
	As Reported	Effect of adoption	Balances without adoption of ASC 606
Product sales	$3,704	$ —	$ 3,704
Royalty and other	504	10	514
Cost of net revenue	1,601	—	1,601
Operating expenses	2,040	—	2,040
Interest expense	221	—	221
Other income, net	3	—	3
Income tax provision	1	—	1
Net income	348	10	358
Net income per share:			
Basic	$0.04	$ —	$ 0.04
Diluted	$0.04	$ —	$ 0.04

Additionally, as a result of the adoption of ASC 606, the Company changed its accounting policy for revenue recognition.

Critical Accounting Policy – Revenue Recognition

The Company generates revenue primarily from sales of IC products and licensing of its IP. Revenues are recognized when control is transferred to customers in amounts that reflect the consideration the Company expects to be entitled to receive in exchange for those goods. Revenue recognition is evaluated through the following five steps: (i) identification of the contract, or contracts, with a customer; (ii) identification of the performance obligations in the contract; (iii) determination of the transaction price; (iv) allocation of the transaction price to the performance obligations in the contract; and (v) recognition of revenue when or as a performance obligation is satisfied.

IC products

Revenue is recognized when performance obligations under the terms of a contract with a customer are satisfied.

The majority of the Company's contracts have a single performance obligation to transfer products. Accordingly, the Company recognizes revenue when title and risk of loss have been transferred to the customer, generally at the time of shipment of products. Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring products and is generally based upon a negotiated, formula, list or fixed price. The Company sells its products both directly to customers and through distributors generally under agreements with payment terms typically less than 60 days.

The Company may record an estimated allowance, at the time of shipment, for future returns and other charges against revenue consistent with the terms of sale.

Royalty and other

The Company's licensing contracts typically provide for royalties based on the licensee's use of the Company's memory technology in its currently shipping commercial products. With the adoption of ASC 606 in January 2018, the Company estimates its royalty revenue in the calendar quarter in which the licensee uses the licensed technology. Payments are generally received in the subsequent quarter.

Contract liabilities – deferred revenue

The Company's contract liabilities consist of advance customer payments and deferred revenue. The Company classifies advance customer payments and deferred revenue as current or non-current based on the timing of when the Company expects to recognize revenue. For the three months ended March 31, 2018 contract liabilities were in a current position and included in deferred revenue.

During the three months ended March 31, 2018, the Company recognized revenue of $1.4 million that had been included in deferred revenue at December 31, 2017.

See Note 5 for disaggregation of revenue by geography.

Cost of Net Revenue

Cost of net revenue consists primarily of direct and indirect costs of IC product sales and engineering personnel costs directly related to maintenance and support services specified in licensing agreements. Maintenance and support typically include engineering support to assist in the commencement of production of a licensee’s products.

Goodwill

In January 2017, the FASB issued Accounting Standards Update (ASU) No. 2017-04, Simplifying the Test for Goodwill Impairment (ASU No. 2017-04), which eliminated step 2, the computation of the implied fair value of goodwill to determine the amount of impairment, from the goodwill impairment test. Under ASU No. 2017-04, the Company determines the amount of goodwill impairment by comparing the fair value of the reporting unit with its carrying amount. To the extent the carrying value of a reporting unit exceeds its fair value, a goodwill impairment charge is recognized. The Company early-adopted ASU No. 2017-04 effective January 1, 2017, because the ASU significantly simplifies the evaluation of goodwill for impairment.

The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. As the Company uses the market approach to determine the step one fair value, 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. 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 first assesses qualitative factors to determine whether it is more-likely-than-not that the fair value of the reporting unit is less than the carrying amount. If the qualitative assessment warrants further analysis, 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. If the carrying value of the reporting unit’s goodwill exceeds its fair value, then the Company must record an impairment charge equal to the difference. The Company performed its annual test for goodwill impairment as of September 1, 2017, and performed a subsequent test on March 31, 2018. In both tests, the Company’s fair value exceeded its carrying value of net assets and, as such, there was no additional impairment of goodwill.

Per Share Amounts

Basic net income (loss) per share is computed by dividing net income (loss) for the period by the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share gives effect to all potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of incremental shares of common stock issuable upon the exercise of stock options, vesting of stock awards and shares issuable in conjunction with our convertible debt.

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated (in thousands, except per share amounts):

	Three months ended March 31,	
	2018	2017
Numerator:		
Net income (loss)	$348	$(4,405)
Denominator:		
Add: weighted-average common shares outstanding	8,130	6,647
Total shares: basic	8,130	6,647
Add: weighted-average stock options outstanding	63	—
Add: weighted-average unvested restricted stock units	154	—
Total shares: diluted	8,347	6,647
Net income (loss) per share:		
Basic	$0.04	$(0.66)
Diluted	$0.04	$(0.66)

The following table sets forth securities outstanding which were excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive (in thousands):

	Three months ended	
	March 31, 2018	March 31, 2017
Options outstanding to purchase common stock	186	508
Unvested restricted common stock units	-	89
Convertible debt	2,272	973
Total	2,458	1,570

Debt Issuance Costs

Debt issuance costs are capitalized and amortized to interest expense using the effective interest method. Unamortized debt issuance costs are presented in the condensed consolidated balance sheets as a direct deduction from the carrying amount of the related debt liability and accounted for as debt discounts.

Note 2: Fair Value of Financial Instruments

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

	March 31, 2018			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$3,501	$ —	$ —	$3,501

	December 31, 2017			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$3,868	$ —	$ —	$3,868

The following table represents the Company’s fair value hierarchy for its financial assets (cash equivalents and investments) (in thousands):

	March 31, 2018			
	Fair Value	Level 1	Level 2	Level 3
Money market funds	$622	$ 622	$ —	$ —

	December 31, 2017			
	Fair Value	Level 1	Level 2	Level 3
Money market funds	$621	$621	$ —	$ —

There were no transfers in or out of Level 1 and Level 2 securities during the three months ended March 31, 2018 or 2017.

Note 3. Balance Sheet Detail

	March 31, 2018	December 31, 2017
	(in thousands)	
Inventories:		
Work-in-process	$1,746	$ 1,612
Finished goods	154	