CAVIUM, INC.
Form 10-Q
August 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-33435

CAVIUM, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	77-0558625
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2315 N. First Street	
San Jose, California	95131
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (408) 943-7100

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No ¨

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

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

The number of shares of the Registrant’s Common Stock, $0.001 par value, outstanding as of August 2, 2016 was: 57,898,237

CAVIUM, INC.

QUARTERLY REPORT ON FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CAVIUM, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(unaudited)

	As of June 30, 2016	As of December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$140,419	$134,646
Accounts receivable, net of allowances of $1,632 and $1,468, respectively	82,137	68,742
Inventories	52,702	47,009
Prepaid expenses and other current assets	10,109	10,231
Total current assets	285,367	260,628
Property and equipment, net	64,917	64,677
Intangible assets, net	36,698	35,492
Goodwill	71,478	71,478
Other assets	1,822	1,718
Total assets	$460,282	$433,993
Liabilities and Stockholders' equity		
Current liabilities:		
Accounts payable	$30,024	$27,489
Accrued expenses and other current liabilities	16,447	9,443
Deferred revenue	7,856	6,316
Capital lease and technology license obligations	17,380	20,608
Total current liabilities	71,707	63,856
Capital lease and technology license obligations, net of current portion	4,182	9,858
Deferred tax liability	3,923	3,417
Other non-current liabilities	4,140	2,962
Total liabilities	83,952	80,093
Commitments and contingencies (Note 10)		
Stockholders' equity		
Common stock, par value $0.001:		

200,000,000 shares authorized; 57,661,961 and 56,259,252 shares issued and outstanding, respectively	58	56
Additional paid-in capital	576,927	543,256
Accumulated deficit	(200,655)	(189,412)
Total stockholders' equity	376,330	353,900
Total liabilities and stockholders' equity	$460,282	$433,993

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

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CAVIUM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net revenue	$107,158	$104,961	$209,040	$206,739
Cost of revenue	35,499	37,673	69,365	73,472
Gross profit	71,659	67,288	139,675	133,267
Operating expenses:				
Research and development	52,578	52,225	103,033	110,647
Sales, general and administrative	25,882	20,336	46,807	41,007
Total operating expenses	78,460	72,561	149,840	151,654
Loss from operations	(6,801)	(5,273)	(10,165)	(18,387)
Other income (expense), net:				
Interest expense	(185)	(388)	(393)	(798)
Other, net	(151)	(33)	(137)	(99)
Total other expense, net	(336)	(421)	(530)	(897)
Loss before income taxes	(7,137)	(5,694)	(10,695)	(19,284)
Provision for income taxes	273	661	548	962
Net loss	$(7,410)	$(6,355)	$(11,243)	$(20,246)
Earnings per share:				
Net loss per common share, basic	$(0.13)	$(0.11)	$(0.20)	$(0.37)
Shares used in computing basic net loss per common share	57,527	55,507	57,229	55,196
Net loss per common share, diluted	$(0.13)	$(0.11)	$(0.20)	$(0.37)
Shares used in computing diluted net loss per common share	57,527	55,507	57,229	55,196

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

CAVIUM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30, 2016			2015		
Cash flows from operating activities:						
Net loss	$	(11,243	)	$	(20,246	)
Adjustments to reconcile net loss to net cash provided by operating activities:						
Stock-based compensation expense		27,317			23,475	
Depreciation and amortization		23,086			21,948	
Deferred income taxes		505			323	
Gain on disposition of certain consumer product assets		-			(400	)
Changes in assets and liabilities:						
Accounts receivable, net		(13,395	)		(18,966	)
Inventories		(5,613	)		1,519	
Prepaid expenses and other current assets		122			(1,182	)
Other assets		(101	)		(146	)
Accounts payable		3,141			1,426	
Deferred revenue		1,539			988	
Accrued expenses and other current and non-current liabilities		8,182			7,205	
Net cash provided by operating activities		33,540			15,944	
Cash flows from investing activities:						
Purchases of property and equipment		(18,665	)		(15,385	)
Purchases of intangible assets		(6,474	)		(3,783	)
Cash payment to common shareholders		-			(3,630	)

of Xpliant						
Proceeds received from disposition of certain consumer product assets		-			400	
Sale of short-term investment		-			1,000	
Net cash used in investing activities		(25,139	)		(21,398	)
Cash flows from financing activities:						
Proceeds from issuance of common stock upon exercise of options		6,276			7,851	
Principal payment of capital lease and technology license obligations		(8,904	)		(12,131	)
Net cash used in financing activities		(2,628	)		(4,280	)
Net increase (decrease) in cash and cash equivalents		5,773			(9,734	)
Cash and cash equivalents, beginning of period		134,646			131,718	
Cash and cash equivalents, end of period	$	140,419		$	121,984	
Supplemental disclosures of cash flows from investing and financing activities:						
Property and equipment and intangible assets acquired included in accounts payable, other accrued expense and other current liabilities	$	1,657		$	6,019	
Property and equipment and intangible assets		-			400	

acquired included in capital lease and technology license obligations

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

CAVIUM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Organization and Basis of Presentation

Organization

Cavium, Inc., (the "Company"), was incorporated in the state of California on November 21, 2000 and was reincorporated in the state of Delaware effective February 6, 2007. The Company designs, develops and markets semiconductor processors for intelligent and secure networks.

Basis of Presentation

The condensed consolidated financial statements include the accounts of Cavium, Inc. and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. Prior to the closing of the acquisition of Xpliant, Inc. ("Xpliant") in April 2015 as discussed in Note 5 of Notes to Condensed Consolidated Financial Statements, the Company accounted for Xpliant as a variable interest entity, or VIE. Under the accounting principles generally accepted in the United States of America, or US GAAP, a VIE is required to be consolidated by its primary beneficiary. The primary beneficiary is the party that absorbs a majority of the VIE's anticipated losses and/or a majority of the expected returns.

The condensed consolidated financial statements have been prepared in accordance with US GAAP, and pursuant to the rules and regulations of the Securities and Exchange Commission, or SEC. Accordingly, they do not include all of the information and footnotes required by US GAAP for annual financial statements. For further information, these financial statements should be read in conjunction with the Company's Annual Report on Form 10-K (File No. 001-33435) on file with the SEC for the year ended December 31, 2015.

The condensed consolidated financial statements contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to state fairly the Company's condensed consolidated financial position at June 30, 2016, and the condensed consolidated results of its operations for the three and six months ended June 30, 2016 and 2015, and condensed consolidated statements of cash flows for the six months ended June 30, 2016 and 2015. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the full year.

The condensed consolidated balance sheet at December 31, 2015 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by US GAAP.

Significant Accounting Policies

The Company's significant accounting policies are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. There had been no material changes to these accounting policies other than the accounting for stock-based compensation. For options granted beginning 2016, the Company used historical exercise patterns to estimate the expected life. Prior to 2016, the Company used the simplified method as permitted by the guidance on stock-based compensation to estimate the expected life.

Recent Accounting Pronouncements

In May 2014, the FASB issued a new guidance on the recognition of revenue from contracts with customers, which includes a single set of rules and criteria for revenue recognition to be used across all industries. The new revenue guidance's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the guidance requires five basic steps: identify the contract with the customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when or as the entity satisfies a performance obligation. In August 2015, the FASB issued an update to defer the effective date by one year. In March 2016, the FASB issued amendments intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations and revenue from contracts with customers. In April 2016, the FASB issued an update on identifying performance obligations and licensing. The updated guidance provides guidance on accounting for licenses of intellectual property and identifying performance obligations. The amendments clarify how an entity should evaluate its promise when granting a license of intellectual property. The FASB also clarified when a promised good or service is separately identifiable and allows entities to disregard items that are immaterial in the context of the contract. In May 2016, the FASB issued an update to clarify certain issues related to transitioning to the new revenue guidance, as well as, assessing collectability, recognition of noncash consideration and presentation of sales and other similar taxes in revenue transactions. This new guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods during the

annual period. Early adoption is allowed for annual reporting periods beginning after December 15, 2016. This new guidance may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company has not selected the transition method and is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

In March 2016, the Financial Accounting Standards Board, or FASB, issued an update to the guidance on stock-based compensation. Under the new guidance, all excess tax benefits and tax deficiencies will be recognized in the income statement as they occur. This will replace the current guidance, which requires tax benefits that exceed compensation cost (windfalls) to be recognized in equity. It will also eliminate the need to maintain a "windfall pool," and will remove the requirement to delay recognizing a windfall until it reduces current taxes payable. The new guidance will also change the cash flow presentation of excess tax benefits, classifying them as operating inflows, consistent with other cash flows related to income taxes. Today, windfalls are classified as financing activities. Also, most companies with stock-based compensation will show additional dilutive effects in earnings per share, or EPS, calculations. This is because there will no longer be excess tax benefits recognized in additional paid in capital. Today those excess tax benefits are included in assumed proceeds from applying the treasury stock method when computing diluted EPS. Under the amended guidance, companies will be able to make an accounting policy election to either (1) continue to estimate forfeitures or (2) account for forfeitures as they occur. This updated guidance is effective for annual and interim periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the impact this updated guidance on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued an updated guidance on leases. The core principle of this updated guidance is that a lessee should recognize the assets and lease liabilities on the balance sheet for certain leases classified as operating leases under previous GAAP. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. This updated guidance is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. The Company is currently evaluating the impact this updated guidance on its consolidated financial statements and related disclosures.

In January 2016, the FASB issued an updated guidance on Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this updated guidance, among other things, requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. It requires entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Further, it requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). It also eliminates the requirement for entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this updated guidance are effective for annual and interim periods beginning after December 15, 2017. Early adoption is not permitted. The adoption of this updated guidance is not expected to have a material effect on the Company's consolidated financial statements and related disclosures.

2. Net Loss Per Common Share

The following table sets forth the computation of net loss per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands, except per share data)			
Net loss	$(7,410)	$(6,355)	$(11,243)	$(20,246)
Weighted average common shares outstanding - basic	57,527	55,507	57,229	55,196
Dilutive effect of employee stock plans	-	-	-	-
Weighted average common shares outstanding - diluted	57,527	55,507	57,229	55,196
Net loss per common share, basic	$(0.13)	$(0.11)	$(0.20)	$(0.37)
Net loss per common share, diluted	$(0.13)	$(0.11)	$(0.20)	$(0.37)

The following outstanding options and restricted stock units were excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an anti-dilutive effect:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Options to purchase common stock	1,412	2,186	1,412	2,186
Restricted stock units	2,713	2,627	2,713	2,627

3. Fair Value Measurements

At June 30, 2016 and December 31, 2015, the Company's cash equivalents comprised of an investment in a money market fund. In accordance with the guidance for fair value measurements and disclosures, the Company determined the fair value hierarchy of its money market fund as Level 1, which approximated $91.2 million and $102.2 million as of June 30, 2016 and December 31, 2015, respectively. The carrying amount of the Company's accounts receivable, accounts payable and accrued expenses approximate fair value due to their short term maturities.

There are no other financial assets and liabilities that require Level 2 or Level 3 fair value hierarchy measurements and disclosures.

4. Balance Sheet Components

Inventories

	As of June 30, 2016	As of December 31, 2015
	(in thousands)	
Work-in-process	$38,293	$ 33,701
Finished goods	14,409	13,308
	$52,702	$ 47,009

Property and equipment, net

	As of June 30, 2016	As of December 31, 2015
	(in thousands)	
Test equipment and mask costs	$84,790	$71,021
Software, design tools, computer and other equipment	66,093	62,331
Furniture, office equipment and leasehold improvements	6,621	5,755

	157,504	139,107
Less: accumulated depreciation and amortization	(92,587)	(74,430)
	$64,917	$64,677

Depreciation and amortization expense was $9.2 million and $9.3 million for the three months ended June 30, 2016 and 2015, respectively, and $18.2 million and $16.8 million for the six months ended June 30, 2016 and 2015, respectively.

The Company leases certain design tools under capital lease and certain financing arrangements which are included in property and equipment, which total cost, net of accumulated amortization amounted to $17.8 million and $25.3 million at June 30, 2016 and December 31, 2015, respectively. Amortization expense related to assets recorded under capital lease and certain financing arrangements was $3.7 million and $3.7 million for the three months ended June 30, 2016 and 2015, respectively, and $7.5 million and $7.4 million for the six months ended June 30, 2016 and 2015, respectively.

Accrued expenses and other current liabilities

	As of June 30, 2016	As of December 31, 2015
	(in thousands)	
Accrued compensation and related benefits	$5,862	$ 4,485
Professional fees	6,215	1,018
Accrued royalties	1,181	761
Manufacturing rights payable (Note 10)	-	1,875
Income tax payable	430	541
Other	2,759	763
	$16,447	$ 9,443

Accrued Rebates

In 2016, the Company started its rebate programs with certain customers. The Company records reductions of revenue for pricing adjustments, such as competitive pricing programs and rebates, in the same period that the related revenue is recorded. The Company accrues the full potential rebates at the time of sale and does not apply a breakage factor. The reversal of the accrual of unclaimed rebate will be made if the specific rebate programs contractually end and when the Company believes that the unclaimed rebates are no longer subject to payment and will not be paid. Thus the reversal of unclaimed rebates may have a positive impact on the Company's net revenue and net income in subsequent periods. Additional reductions of revenue would result if actual pricing adjustments exceed the estimates. Accrued rebates will vary in future periods based upon the level of overall sales to customers that participate in our rebate programs. Establishing accruals for rebates requires the use of judgment and estimates that impact the amount and timing of revenue recognition.

For the three and six months ended June 30, 2016, the Company recorded estimated rebates amounting to $0.3 million and $0.3 million, respectively. There were no significant reversal or settlements during the three and six months ended June 30, 2016. As of June 30, 2016, total accrued rebates included within other accrued expenses and other current liabilities was $0.3 million.

Warranty Accrual

The following table presents a rollforward of the warranty liability, which is included within other accrued expenses and other current liabilities above:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Beginning balance	$389	$442	$336	$227
Accruals and adjustments	179	(23)	379	256
Settlements	(113)	(55)	(260)	(119)
Ending balance	$455	$364	$455	$364

Deferred revenue

	As of June 30, 2016	As of December 31, 2015

	(in thousands)	
Services/support and maintenance	$6,790	$ 5,531
Software license/subscription	1,066	785
	$7,856	$ 6,316

5. Business Combination

Pending Merger with QLogic Corporation

On June 15, 2016, the Company entered into an Agreement and Plan of Merger with QLogic Corporation (“QLogic”), a supplier of high performance networking infrastructure solutions, (the “QLogic merger agreement”). Subject to the terms and conditions of the QLogic merger agreement, the Company is seeking to acquire all of the outstanding QLogic common stock for approximately $15.50 per share, comprised of $11.00 per share in cash and 0.098 of a share (valued based on the Company’s volume weighted trading price for the three trading days beginning June 10, 2016) of the Company’s common stock for each share of QLogic common stock through an exchange offer. Upon completion of the merger, QLogic will survive as a wholly owned subsidiary of the Company, and each issued and outstanding share of QLogic common stock, other than shares held in treasury, will be converted into the right to receive the merger consideration. The Company intends to fund the merger consideration with a combination of cash on hand, committed debt financing as discussed in detail below and issuance of new equity. This merger is primarily intended to provide an opportunity to the Company to drive significant growth at scale in data center and storage markets.

As a result of the merger, subject to the terms and conditions of the QLogic merger agreement, at the effective time of the merger: (i) each outstanding and unvested QLogic stock option (other than any such unvested option which has an exercise price greater than merger consideration per share, an “underwater option”), shall be assumed by the Company and converted into an option to purchase, on the same terms and conditions as were applicable under such QLogic stock option, that number of shares of the Company’s common stock; (ii) each outstanding and vested QLogic stock option with an exercise price less than the sum of (a) the

cash consideration and (b) the share consideration value, shall be cancelled and the holder thereof shall be entitled to receive vested option consideration; (iii) each outstanding QLogic stock option that is an Underwater Option shall be cancelled, and the holder thereof shall receive no payment on account thereof; (iv) the unvested QLogic restricted stock units, or RSU's, outstanding immediately prior to the effective time shall be assumed and converted into RSUs of the Company's common stock; (v) each outstanding and vested QLogic RSU unit shall be cancelled and extinguished and the holder thereof shall be entitled to receive an amount equal to the merger consideration that would be payable in respect of the total number of shares of QLogic Common Stock subject to such QLogic RSU; and (vi) the unvested QLogic performance based RSUs outstanding immediately prior to the effective time shall be assumed by the Company and converted into RSUs of the Company's common stock.

On June 15, 2016, the Company entered into a commitment letter (the "commitment letter") with JPMorgan Chase Bank, N.A. ("JPMCB ") pursuant to which JPMCB has committed to provide (i) a $650.0 million senior secured term loan facility and (ii) a $100.0 million senior secured interim term loan facility ((i) and (ii) together, the "facilities" and the provision of such funds as set forth in the commitment letter, the "financing"), subject to the execution of definitive documentation and satisfaction of customary closing conditions. The facilities are available to finance the exchange offer and the merger and pay fees and expenses related to the exchange offer, the merger and the financing. The interest rates per annum applicable to each term loan facility will be either (i) LIBOR plus the applicable margin or (ii) the base rate plus the applicable margin. The senior term loan facility will mature on the date that is 6 years after the closing date and the interim term loan facility will mature on February 15, 2017. Under the terms of the commitment letter, JPMCB will act as a joint lead arranger and a joint book running manager. The actual documentation governing the facilities has not been finalized, and accordingly, the actual terms may differ from the description of such terms in the commitment letter. The Company may increase the amount of borrowings under the senior secured term loan facility up to $700.0 million, and make a corresponding reduction up to $50.0 million of its borrowings under the senior secured interim loan facility.

In May 2016, the Company engaged JPCMB as its financial advisor in connection with the pending merger with QLogic. The Company agreed to pay a transaction fee to JPCMB of $11.0 million, payable in installment, for the financial advisory services and rendering of an opinion as to the fairness, from the financial point of view, of the consideration to be paid by the Company in connection with the merger. The initial installment of $3.0 million is payable upon delivery of the fairness opinion and the balance shall be payable upon closing of the merger. The Company recorded the initial installment due in sales, general and administrative expense in the condensed consolidated statement of operations for the three months ended June 30, 2016 and the corresponding liability in the accrued expense and other current liabilities on the condensed consolidated balance sheet as of June 30, 2016.

The QLogic merger agreement contains certain termination rights for the Company and QLogic, including, among others, if the transactions contemplated by the merger agreement are not consummated at or prior to November 12, 2016. Upon termination of the QLogic merger agreement under specified circumstances, including a termination by QLogic to enter into an agreement for an alternative transaction pursuant to the QLogic merger agreement, QLogic has agreed to pay the Company a termination fee of $47.8 million.

The Company and QLogic have each made customary covenants in the QLogic merger agreement, including, without limitation, covenants not to solicit alternative transactions or, subject to certain exceptions, not to enter into discussions concerning, or provide confidential information in connection with, an alternative transaction, as more fully described in the merger agreement.

The QLogic merger agreement has been unanimously approved by the boards of directors of the Company and QLogic. The merger is expected to close in the third quarter of calendar year 2016 pending customary closing conditions, including the tender into the exchange offer by QLogic stockholders of shares representing at least a majority of the outstanding shares of QLogic common stock, and the receipt of relevant regulatory approvals.

Xpliant, Inc.

Pursuant to the Agreement and Plan of Merger and Reorganization ("the Xpliant merger agreement") between the Company and Xpliant, a final closing occurred on April 29, 2015 as discussed in detail below. Between May 2012 and March 2015, the Company entered into several note purchase agreements and promissory notes with Xpliant to provide cash advances. Xpliant was a Delaware incorporated and privately held company, engaged in the design and development of next generation software defined network switch chips. Prior to the closing of the merger pursuant to the Xpliant merger agreement, the Company concluded that Xpliant was a VIE as the Company was Xpliant's primary beneficiary due to the Company's involvement with Xpliant and the Company's purchase option to acquire Xpliant. As such, the Company has included the accounts of Xpliant in the condensed consolidated financial statements. The Company had made total cash advances of $85.8 million, consisting of $10.0 million under nine convertible notes which, as amended, matured on August 31, 2014 and $75.8 million under several promissory notes which originally matured between April 2015 and March 2016. All promissory notes were cancelled as of July 31, 2015.

On July 30, 2014, the Company entered into the Xpliant merger agreement, which was amended on October 8, 2014 and March 31, 2015 with Xpliant. Under the terms of the Xpliant merger agreement, as amended, the Company paid approximately $3.6 million in total cash consideration in exchange for all outstanding securities held by Xpliant's stockholders. Pursuant to the Xpliant merger agreement, as amended, a first closing occurred on March 31, 2015 and the Company paid $2.5 million to Xpliant's stockholders with respect to approximately 70% of the Xpliant stock outstanding and a second and final closing occurred on April 29, 2015 and the Company paid $1.1 million to Xpliant's stockholders with respect to the then remaining approximately 30% of the Xpliant stock outstanding. Based on the substance of the transaction, the Company recorded the payments of cash consideration to Xpliant stockholders as a decrease to the Company's additional paid-in capital within stockholders' equity.

6. Goodwill and Intangible Assets, Net

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. The carrying value of goodwill as of June 30, 2016 was $71.5 million, unchanged from the balance at December 31, 2015.

Intangible assets, net

	As of June 30, 2016			
	Gross	Accumulated Amortization	Net	Weighted average remaining amortization period (years)
	(in thousands)			
Technology licenses	$76,621	$ (40,204)	$36,417	5.54
Existing and core technology - product	41,711	(41,430)	281	0.49
Customer contracts and relationships	2,215	(2,215)	-	-
Trade name	2,296	(2,296)	-	-
Total amortizable intangible assets	$122,843	$ (86,145)	$36,698	5.50

	As of December 31, 2015			
	Gross	Accumulated Amortization	Net	Weighted average remaining amortization

				period (years)
	(in thousands)			
Technology licenses	$70,521	$ (35,625)	$34,896	6.10
Existing and core technology - product	41,711	(41,115)	596	0.99
Customer contracts and relationships	2,215	(2,215)	-	-
Trade name	2,296	(2,296)	-	-
Total amortizable intangible assets	$116,743	$ (81,251)	$35,492	6.01

Amortization expense was $2.5 million and $2.3 million for the three months ended June 30, 2016 and 2015, respectively, and $4.9 million and $5.2 million for the six months ended June 30, 2016 and 2015, respectively. The estimated future amortization expense of amortizable intangible assets is as follows (in thousands):

Remainder of 2016	$4,925
2017	8,235
2018	6,610
2019	4,889
2020	4,340
2021 and thereafter	7,699
	$36,698

7. Stockholders' Equity

Equity Incentive Plans

On June15, 2016, the Company adopted the 2016 Equity Incentive Plan (the "2016 EIP"), which reserved 3,600,000 shares of the Company's common stock. The 2016 EIP is intended as the successor to and continuation of the Company's 2007 Equity Incentive Plan (the "2007 EIP"). The 2016 EIP provides for the grant of incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance stock awards, performance cash awards and other stock awards, which may be granted to employees, directors and consultants. Following the effective date, no additional awards may be granted under the 2007 EIP. All outstanding awards granted under the 2007 EIP will remain subject to the terms of such plan, provided however, that the following shares of common stock subject to any outstanding stock award granted under the 2007 EIP (collectively, the "2007 EIP Returning Shares") will immediately be added to the share reserve as and when such shares become 2007 EIP Returning Shares and become available for issuance pursuant to awards granted under the 2016 EIP: (i) any shares subject to such stock award that are not issued because such stock award or any portion thereof expires or otherwise terminates without all of the shares covered by such stock award having been issued; (ii) any shares subject to such stock award that are not issued because such stock award or any portion thereof is settled in cash; and (iii) any shares issued pursuant to such stock award that are forfeited back to or repurchased by the Company because of the failure to meet a contingency or condition required for the vesting of such shares. All awards granted on or after June 15, 2016 will be subject to the terms of the 2016 EIP.

The following table summarizes the details related to stock options granted and outstanding under the Company's equity and stock incentive plans for the six months ended June 30, 2016:

	Number of Options Outstanding	Weighted Average Exercise Price
Balance as of December 31, 2015	2,027,999	$ 24.75
Options granted	175,776	48.88
Options exercised	(792,228)	7.92
Options cancelled and forfeited	-	-
Balance as of June 30, 2016	1,411,547	37.20

The fair value of each option grant for the three and six months ended June 30, 2016 and 2015 were estimated on the date of grant using the Black-Scholes option-pricing model using the assumptions below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Risk-free interest rate	-	1.34%	1.11%	1.34% to 1.41%
Expected life	-			

		3.77 years	4.96 years	3.77 to 4.58 years
Dividend yield	-	0%	0%	0%
Volatility	-	40.96%	42.51%	40.96% to 43.03%

No stock options were granted during the three months ended June 30, 2016. The estimated weighted-average grant date fair value of options granted for the three months ended June 30, 2015 was $24.95 per share, and for the six months ended June 30, 2016 and 2015 was $18.65 per share and $23.79 per share, respectively.

As of June 30, 2016, there was $5.0 million of unrecognized compensation costs, net of estimated forfeitures, related to stock options granted under the Company’s 2007 Equity Incentive Plan and 2001 Stock Incentive Plan. The unrecognized compensation cost is expected to be recognized over a weighted average period of 2.74 years.

The following table summarizes the details related to restricted stock units, or RSUs, granted and outstanding under the 2007 Equity Incentive Plan for the six months ended June 30, 2016:

	Number of Shares	Weighted-Average Grant Date Fair Value Per Share
Balance as of December 31, 2015	2,194,068	$ 47.85
Granted	1,211,008	49.41
Issued and released	(610,480)	45.11
Cancelled and forfeited	(81,457)	55.12
Balance as of June 30, 2016	2,713,139	48.95

Included in the RSU grants in the table above was one-year performance-based RSUs granted in February 2016 for which the Company determined that the fair value of these performance RSU's was $2.9 million. The Company recorded the related stock-based compensation expense based on its evaluation of the probability of achieving the milestones of all of the outstanding performance-based RSU's as of June 30, 2016. At each reporting period, the Company evaluates the probability of achieving the milestone of each of the outstanding performance-based RSU's and updates the recognition of related stock-based compensation expense.

Also included in the RSU grants in the table above was a three-year vesting market-based RSU granted in February 2016. This market-based RSU will vest if: (i) during the performance period, the Company's total stockholder return over a period of 30 consecutive trading days is equal to or greater than that of the industry index set by the compensation committee of the board of directors; and (ii) the recipient remains in continuous service with the Company through such vesting period. The fair value of the market-based RSU was determined by management using the Monte Carlo simulation method which takes into account multiple input variables that determine the probability of satisfying the market conditions stipulated in the award. This method requires the input of assumptions, including the expected volatility of the Company's common stock, and a risk-free interest rate, similar to assumptions used in determining the fair value of the stock option grants discussed above. As such, the Company determined that the fair value of this market-based RSU was $3.3 million at the date of grant. The Company recorded the related stock-based compensation expense for the three and six months ended June 30, 2016 related to this grant.

As of June 30, 2016, there was $105.7 million of unrecognized compensation costs, net of estimated forfeitures related to RSUs granted under the Company's 2007 Equity Incentive Plan. The unrecognized compensation cost is expected to be recognized over a weighted average period of 2.57 years.

Stock-Based Compensation

The following table presents the detail of stock-based compensation expense amounts included in the condensed consolidated statement of operations for each of the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Cost of revenue	$242	$185	$425	$382
Research and development	8,564	7,301	16,578	14,096
Sales, general and administrative	5,118	4,290	10,314	8,997
	$13,924	$11,776	$27,317	$23,475

The total stock-based compensation cost capitalized as part of inventory as of June 30, 2016 and December 31, 2015 was not material.

8. Income Taxes

The quarterly provision for income taxes is based on the estimated annual effective tax rate, plus any discrete items. The Company updates its estimate of its annual effective tax rate at the end of each quarterly period. The estimate takes into account estimations of annual pre-tax income (loss), the geographic mix of pre-tax income (loss) and interpretations of tax laws and the possible outcomes of current and future audits.

The following table presents the provision for income taxes and the effective tax rates for the three and six months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Loss before income taxes	$(7,137)	$(5,694)	$(10,695)	$(19,284)
Provision for income taxes	273	661	548	962
Effective tax rate	(3.8)%	(11.6)%	(5.1)%	(5.0)%

The provision for income taxes for the three and six months ended June 30, 2016 and 2015 were primarily related to earnings in foreign jurisdictions. The difference between the provision for income taxes that would be derived by applying the statutory rate to the Company’s loss before income taxes and the provision for income taxes recorded for the three and six months ended June 30, 2016 and 2015 were primarily attributable to the difference in foreign tax rates and an increase in deferred tax liability related to the indefinite lived intangible assets.

The Company’s net deferred tax assets relate predominantly to its U.S. tax jurisdiction. A full valuation allowance against the Company federal and state net deferred tax assets has been in place since 2012. The Company periodically evaluates the realizability of its net deferred tax assets based on all available evidence, both positive and negative. The realization of net deferred tax assets is dependent on the Company's ability to generate sufficient future taxable income during periods prior to the expiration of tax attributes to fully utilize these assets. The Company weighed both positive and negative evidence and determined that there is a continued need for a valuation allowance as the Company is in a cumulative loss position over the previous three years, which is considered significant negative evidence. As such, the Company has not changed its judgment regarding the need for a full valuation allowance on its federal and state deferred tax assets as of December 31, 2015 and June 30, 2016. Until such time, consumption of tax attributes to offset profits will reduce the overall level of deferred tax assets subject to valuation allowance. Should the Company determine that it would be able to realize its remaining deferred tax assets in the foreseeable future, an adjustment to its remaining deferred tax assets would cause a material increase to net income in the period such determination is made.

On July 27, 2015, the U.S. Tax Court in Altera Corp. v. Commissioner, 145 T.C. No. 3 (2015) issued an opinion with respect to Altera’s litigation with the Internal Revenue Service, concerning the treatment of stock-based compensation expense in an inter-company cost sharing arrangement. In ruling in favor of Altera, the Tax Court invalidated the portion of the Treasury regulations requiring the inclusion of stock-based compensation expense in such inter-company cost-sharing arrangements. Accordingly, the Company adjusted its inter-company arrangement to reflect the recent ruling; however, due to the valuation allowance against the Company’s federal and state net deferred tax assets, there was no material impact. On an ongoing basis, stock-based compensation will be excluded from intercompany charges.

9. Segment and Geographic Information

The Company manages and operates as one reportable segment. The Company’s revenue consists primarily of sale of semiconductor products and the Company also derives revenue from licensing software and related maintenance and support. The revenue from these sources is classified by the Company as product revenue. The Company also generates revenue from professional service arrangements which is categorized as service revenue. The total service revenue is less than 10% of the Company’s total net revenue for the three and six months ended June 30, 2016 and 2015. The Company categorizes its net revenue in two different markets, (i) the enterprise network, data center and access and service provider markets; and (ii) broadband and consumer markets. The net revenue by markets for the periods indicated was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Enterprise network, data center and access and service provider markets	$98,799	$95,023	$192,809	$187,420
Broadband and consumer markets	8,359	9,938	16,231	19,319
	$107,158	$104,961	$209,040	$206,739

The following table is based on the geographic location of the original equipment manufacturers, the contract manufacturers or the distributors who purchased the Company's products. For sales to the distributors, their geographic location may be different from the geographic locations of the ultimate end customers.

Sales by geography for the periods indicated were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
United States	$37,144	$37,211	$70,610	$69,216
China	26,816	25,218	50,549	51,336
Finland	11,815	8,537	28,378	16,452
Taiwan	10,760	8,184	20,093	16,554
Mexico	5,518	8,468	11,309	18,004
Korea	4,783	4,805	8,153	12,720
Other countries	10,322	12,538	19,948	22,457
Total	$107,158	$104,961	$209,040	$206,739

The following table sets forth tangible long lived assets, which consist of property and equipment, net by geographic regions:

	As of June 30, 2016	As of December 31, 2015
	(in thousands)	
United States	$48,085	$ 52,547
All other countries	16,832	12,130
Total	$64,917	$ 64,677

10. Commitments and Contingencies

The Company is not currently a party to any legal proceedings, the outcome of which, if determined adversely to the Company, would have a material adverse effect on the condensed consolidated financial position, condensed results of operations or condensed cash flows of the Company.

The Company leases its facilities under non-cancelable operating leases, which contain renewal options and escalation clauses, and expire on various dates ending in October 2022. The Company also acquires certain assets under capital leases. Rent expense incurred under operating leases was $2.4 million and $1.9 million for the three months ended June 30, 2016 and 2015, respectively, and $4.9 million and $3.7 million for the six months ended June 30, 2016 and 2015, respectively.

The capital lease and technology license obligations include future cash payments payable primarily for license agreements with various outside vendors. For license agreements which qualify under capital lease and where installment payments extend beyond one year, the present value of the future installment payments are capitalized and included as part of intangible assets or property and equipment which is amortized over the estimated useful lives of the related licenses.

Minimum commitments under non-cancelable operating and capital lease agreements as of June 30, 2016 are as follows:

	Capital lease and technology license	Operating leases	Total

	obligations (in thousands)		
Remainder of 2016	$12,324	$4,497	$16,821
2017	8,791	8,847	17,638
2018	1,075	8,969	10,044
2019	-	8,847	8,847
2020	-	8,966	8,966
2021 thereafter	-	14,169	14,169
	$22,190	$54,295	$76,485
Less: Interest component (3.75% annual rate)	628		
Present value of minimum lease payment	21,562		
Current portion of the obligations	$17,380		
Long-term portion of obligations	$4,182		

On March 30, 2015, Xpliant exercised its option to purchase the manufacturing rights to accelerate the takeover of manufacturing, and to relieve Xpliant from any further obligation to purchase product quantities from Xpliant's application specific integrated circuit, or ASIC, vendor. In consideration for this, Xpliant agreed to pay a $7.5 million manufacturing rights licensing fee and a per-unit royalty fee for certain ASIC products sold to certain customers for a limited time. The manufacturing rights licensing fee was payable in four equal quarterly payments, with the first installment payment was due on April 29, 2015 and each of the subsequent three installment payments were due on the first day of the following calendar quarter. The royalty shall be payable within 30 days after the end of each calendar quarter following the sale. Considering the terms of the purchase of the manufacturing rights, the Company recorded the full amount of the manufacturing rights licensing fee within research and development expense on the condensed consolidated statement of operations in the first quarter of 2015 and the related liability was recorded within other accrued expenses and other current liabilities on the condensed consolidated balance sheets. In 2015, the Company settled three installments due. The final installment payment was made in the first quarter of 2016.

In July 2016, the Company signed the design kit license agreements with a third party vendor for an aggregate consideration of $9.0 million, payable in four equal installments. The first installment is due on the effective date of the agreement and the remaining installment payments are due in the succeeding quarters following the effective date.

The Company has funding commitments related to the merger with QLogic. See Note 5 of Notes to Condensed Consolidated Financial Statements for related discussions.

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

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and the related notes that appear elsewhere in this document.

The information in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (“Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (“Exchange Act”), which are subject to the “safe harbor” created by those sections. Forward-looking statements are based on our management’s beliefs and assumptions and on information currently available to our management. In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “could,” “would,” “estimate,” “project,” “predict,” “potential,” “continue,” “strategy,” “believe,” “anticipate,” “plan, and similar expression intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance, time frames or achievements to be materially different from any future results, performance, time frames or achievements expressed or implied by the forward-looking statements. We discuss many of these risks, uncertainties and other factors in this Quarterly Report on Form 10-Q in greater detail under the heading “Risk Factors.” Given these risks, uncertainties and other factors, you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this filing. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect. We hereby qualify our forward-looking statements by these cautionary statements. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

OCTEON®, OCTEON Fusion-M™, OCTEON XL®, LiquidIO®, LiquidSecurity ®, NITROX®, NEURON Search®, ThunderX®, Xpliant® and XPA™ are trademarks or registered trademarks of Cavium, Inc.

Overview

We are a provider of highly integrated semiconductor processors that enable intelligent processing for wired and wireless networking, communications, storage, cloud, wireless, security, video and connected home and office applications. A range of our products also include a rich suite of embedded security protocols that enable unified threat management, or UTM, secure connectivity, network perimeter protection, and deep packet inspection, or DPI. We sell our products to providers of networking equipment that sell into the enterprise, datacenter, service provider, and broadband and consumer markets. In the enterprise market, our products are used in routers, switches, wireless local area networks, or WLAN, and UTM. In the datacenter market, our products are used in servers and server load balancers. In the service provider market in wired infrastructure our products are used in edge routers, cable modem termination system head-ends, and media gateways, and in wireless infrastructure in 3G/4G/5G base stations, radio network controllers, small cell, and evolved packet core nodes. In the broadband and consumer market our products are used in home gateways, wireless high-definition multimedia interface, or HDMI, WLAN, small office/home

office, and UTM. Our products are systems on a chip, or SoCs, which incorporate single or multiple processor cores, a highly integrated architecture and customizable software that is based on a broad range of standard operating systems. We focus our resources on the design, sales and marketing of our products, and outsource the manufacturing of our products.

We have a broad portfolio of multi-core processors to deliver integrated and optimized hardware and software embedded solutions to the market. Our software and service revenue is primarily from the sale of software subscriptions of embedded Linux operating system, related development tools, application software stacks, support and professional services.

The following summarizes our product timeline introduction:

Timeline	History
2000 through 2003	· We were incorporated and commenced product development.
	· We began shipping NITROX security processors commercially.
2004	· We introduced and commenced commercial shipments of NITROX Soho.
2006	· We commenced our first commercial shipments of OCTEON multi-core processors.
2007	· We introduced our new line of OCTEON based storage services processors designed to address the specific needs in the storage market, as well as other new products in the OCTEON and NITROX families.
2008	· We expanded our OCTEON and NITROX product families with new products including wireless services processors to address the needs for wireless infrastructure equipment.
2009	· We announced the OCTEON II Internet Application Processor, or IAP, family multi-core MIPS64 processors.
	· We acquired MontaVista Software, Inc. in December 2009. This acquisition complemented our broad portfolio of multi-core processors to deliver integrated and optimized embedded solutions to the market.
2010	· We announced the next generation NITROX III, a processor family with 16 to 64-cores that delivers security and compression processors for application delivery, cloud computing and wide area network optimization.
2011	· We introduced NEURON, a new search processor product family that targets a wide range of high performance, L2-L4 network search applications in enterprise and service provider infrastructure equipment.
	· We also introduced another new product family, the OCTEON Fusion, a single chip SoCs with up to 6x MIPS64 cores and up to 8x LTE/3G baseband DSP cores which enable macro base station class features for small cell base stations.
2012	· We introduced OCTEON III, Cavium's 48-core 2.5GHz multi-core processor family that can deliver up to 100Gbps of application processing, up to 120GHz of 64-bit compute processing per chip and can be connected in multi-chip configurations.
	· We announced Project Thunder, the development of a new family of 64-bit ARMv8 scalable multi-core processors for cloud and datacenter applications.
2013	· We introduced the LiquidIO family of 10 Gigabit Server Adapters which provide high-performance, programmable adapter platform to enable software defined networks for cloud service providers and datacenters.
2014	· We introduced the ThunderX family of 64-bit ARMv8 processors incorporated into a highly differentiated SoC architecture optimized for cloud and datacenter applications.
2015	· We introduced OCTEON Fusion-M, a family of single chip solutions for next generation macrocell base stations and smart radio heads.
	· We introduced LiquidSecurity, a high performance hardware based transaction security solution for cloud data centers, enterprise, government organizations and ecommerce applications.
	· We introduced Nitrox V, a processor family with up to 288 cores for security in the enterprise and virtualized cloud data centers.
2016	· We introduced OCTEON TX, a 64-bit ARM-based SOC for a broad spectrum of open, services-centric applications in enterprise and service provider infrastructure.
	· We announced ThunderX2, our second generation workload optimized ARM server SoC.

Since inception, we have invested heavily in new product development and our net revenue has grown from $7.4 million in 2004 to $412.7 million in 2015. We expect sales of our products for use in the enterprise, data center and service provider markets to continue to represent a significant portion of our revenue in the foreseeable future, and

also expect some growth in the broadband market.

We primarily sell our products to original equipment manufacturers, or OEMs, either directly or through their contract manufacturers. Contract manufacturers purchase our products only when an OEM incorporates our product into the OEM's product, not as commercial off-the-shelf products. Our customers' products are complex and require significant time to define, design and ramp to volume production. Accordingly, our sales cycle is long. This cycle begins with our technical marketing, sales and field application engineers engaging with our customers' system designers and management, which is typically a multi-month process. If we are successful, a customer will decide to incorporate our product in its product, which we refer to as a design win. Because the sales cycles for our products are long, we incur expenses to develop and sell our products, regardless of whether we achieve the design win and well in advance of generating revenue, if any, from those expenditures. We do not have long-term purchase commitments from any of our customers, as sales of our products are generally made under individual purchase orders. However, once one of our products is incorporated into a customer's design, it is likely to remain designed in for the life cycle of the product. We believe this to be the case because a redesign would generally be time consuming and expensive. We have experienced revenue growth due to an increase in the number of our products, an expansion of our customer base, an increase in the number of average design wins within any one customer and an increase in the average revenue per design win.

We also earn revenue from the sale of software subscriptions of embedded Linux operating system, related development tools, support and professional services. The net revenue for our software and services operations is primarily derived from the sale of time-based software licenses, software maintenance and support, and from professional services arrangements and training.

Business Combinations

Pending Merger with QLogic Corporation

On June 15, 2016, the Company entered into an Agreement and Plan of Merger with QLogic Corporation ("QLogic"), a supplier of high performance networking infrastructure solutions, (the "QLogic merger agreement"). Subject to the terms and conditions of the QLogic merger agreement, we are seeking to acquire all of the outstanding QLogic common stock for approximately $15.50 per share, comprised of $11.00 per share in cash and 0.098 of a share of our common stock for each share of QLogic common stock through an exchange offer. Upon completion of the merger, QLogic will survive as a wholly owned subsidiary of us, and each issued and outstanding share of QLogic common stock, other than shares held in treasury, will be converted into the right to receive the merger consideration. The merger will be funded with a combination of balance sheet cash, $750.0 million of committed financing, which includes $650.0 million of term loan, and $100.0 million of short-term bridge debt, and issuance of new equity. The merger is primarily intended to provide us the opportunity to drive significant growth at scale in data center and storage markets.

The QLogic merger agreement has been unanimously approved by our and QLogic's board of directors. The transaction is expected to close in the third quarter of calendar year 2016 pending customary closing conditions, including the tender into the exchange offer by QLogic stockholders of shares representing at least a majority of the outstanding shares of QLogic common stock, and the receipt of relevant regulatory approvals.

See detailed discussions on this pending merger in Note 5 of Notes to Condensed Consolidated Financial Statements.

Acquisitions

The following summarizes our acquisitions in the last five years:

- We completed the acquisition of substantially all of the assets and assumed certain liabilities of Wavesat Inc. in January 2011. This acquisition added multicore wireless digital system processing to our embedded processor product line.

- We completed the acquisition of substantially all of the assets and assumed certain liabilities of Celestial Semiconductor, Ltd. in March 2011. With the acquisition of Celestial Semiconductor, we added capabilities to enable a processor family targeted for the large and growing market of converged media, gateway and wireless display applications.
- We completed the acquisition of Xpliant in April 2015. This acquisition provides high performance, high density switch silicon under development and will target a broad range of switching applications for the data center, cloud service provider and enterprise markets.

Key Business Metrics

Design Wins. We closely monitor design wins by customer and end market on a periodic basis. We consider design wins to be a key ingredient in our future success, although the revenue generated by each design win can vary significantly. Our long-term sales expectations are based on internal forecasts from specific customer design wins based upon the expected time to market for end customer products deploying our products and associated revenue potential.

Pricing and Margins. Pricing and margins depend on the features of the products we provide to our customers. In general, products with more complex configurations and higher performance tend to be priced higher and have higher gross margins. These configurations tend to be used in high performance applications that are focused on the enterprise network, data center, and access and service provider markets. We tend to experience price decreases over the life cycle of our products, which can vary by market and application.

Sales Volume. A typical design win can generate a wide range of sales volumes for our products, depending on the end market demand for our customers' products. This can depend on several factors, including the reputation, market penetration, the size of the end market that the product addresses, and the marketing and sales effectiveness of our customer. In general, our customers with greater market penetration and better branding tend to develop products that generate larger volumes over the product life cycle. In addition, some markets generate large volumes if the end market product is adopted by the mass market.

Customer Product Life Cycle. We typically commence commercial shipments from six months to three years following a design win. Once our product is in production, revenue from a particular customer may continue for several years. We estimate our customers' product life cycles based on the customer, type of product and end market. In general, products that go into the enterprise network and data center take longer to reach volume production but tend to have longer lives. Products for other markets, such as broadband and consumer, tend to ramp relatively quickly, but generally have shorter life cycles. We estimate these life cycles based on our management's experience with network equipment providers and data centers as well as the semiconductor market as a whole.

Results of Operations

Our net revenue, cost of revenue, gross profit and gross margin for the periods presented were:

	Three Months Ended				Six Months Ended			
	June 30,				June 30,			
	2016	2015	Change	%	2016	2015	Change	%
	(in thousands)				(in thousands)			
Net revenue	$107,158	$104,961	$2,197	2.1 %	$209,040	$206,739	$2,301	1.1 %
Cost of revenue	35,499	37,673	(2,174)	-5.8%	69,365	73,472	(4,107)	-5.6%
Gross Profit	$71,659	$67,288	$4,371	6.5 %	$139,675	$133,267	$6,408	4.8 %
Gross Margin	66.9 %	64.1 %	2.8 %		66.8 %	64.5 %	2.3 %	

Net Revenue. Our net revenue consists primarily of sales of our semiconductor products to providers of networking equipment and their contract manufacturers and distributors. Initial sales of our products for a new design are usually made directly to providers of networking equipment as they design and develop their product. Once their design enters production, they often outsource their manufacturing to contract manufacturers that purchase our products directly from us or from our distributors. We price our products based on market and competitive conditions and periodically reduce the price of our products, as market and competitive conditions change, and as manufacturing costs are reduced. We do not experience different margins on direct sales to providers of networking equipment and indirect sales through contract manufacturers because in all cases we negotiate product pricing directly with the providers of networking equipment. To date, substantially all of our revenue has been denominated in U.S. dollars.

Two customers together accounted for 37.3% and 38.8% of our net revenue in the three and six months ended June 30, 2016, respectively. Three customers together accounted for 42.6% and two customers together accounted for 27.8% of our net revenue in the three and six months ended June 30, 2015, respectively. No other customer accounted

for more than 10.0% of our revenues in the three and six months ended June 30, 2016 and 2015.

We use distributors to support some of our sales logistics including importation and credit management. Total net revenue through distributors accounted for 43.7% and 29.3% in the three months ended June 30, 2016 and 2015, respectively, and 40.2% and 30.8% in the six months ended June 30, 2016 and 2015, respectively. While we have purchase agreements with our distributors, the distributors do not have long-term contracts with any of the equipment providers. Our distributor agreements limit the distributor’s ability to return product up to a portion of purchases in the preceding quarter. Given our experience, along with our distributors’ limited contractual return rights, we believe we can reasonably estimate expected returns from our distributors. Accordingly, we recognize sales through distributors at the time of shipment, reduced by our estimate of expected returns. The inventory at these distributors at the end of the period may fluctuate from time to time mainly due to the OEM production ramps or new customer demands.

The increase in net revenue in the three and six months ended June 30, 2016 compared to the same periods in 2015 was attributable mainly to the increases in sales in our enterprise network; data center and access and service provider markets, combined of $3.8 million and $5.4 million, respectively. Sales in our broadband and consumer market decreased by $1.6 million and $3.1 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015. The overall increase in sales in our enterprise networks; data center; and access and service provider markets and the decrease and increase in our broadband and consumer market was mainly due to the fluctuation in demand for our products in those respective markets as a result of the timing of our customers' volume production of our design wins.

Our net revenue by markets for periods indicated was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Enterprise network, data center and access and service provider markets	$98,799	$95,023	$192,809	$187,420
Broadband and consumer markets	8,359	9,938	16,231	19,319
	$107,158	$104,961	$209,040	$206,739

The following table is based on the geographic location of our customers including the original equipment manufacturers, contract manufacturers or the distributors who purchased our products and services. For sales to our distributors, their geographic location may be different from the geographic locations of the ultimate end customers. Sales by geography for the periods presented were:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
United States	$37,144	$37,211	$70,610	$69,216
China	26,816	25,218	50,549	51,336
Finland	11,815	8,537	28,378	16,452
Taiwan	10,760	8,184	20,093	16,554
Mexico	5,518	8,468	11,309	18,004
Korea	4,783	4,805	8,153	12,720
Other countries	10,322	12,538	19,948	22,457
Total	$107,158	$104,961	$209,040	$206,739

Cost of Revenue and Gross Margin. We outsource wafer fabrication, assembly and test functions of our products. A significant portion of our cost of revenue consists of payments for the purchase of wafers and for assembly and test services, amortization related to capitalized mask costs and amortization of acquired intangibles. To a lesser extent, cost of revenue includes expenses relating to our internal operations that manage our contractors, stock-based compensation, the cost of shipping and logistics, royalties, inventory valuation expenses for excess and obsolete inventories, warranty costs and changes in product cost due to changes in sort, assembly and test yields. In general,

our cost of revenue associated with a particular product declines over time as a result of yield improvements, primarily associated with design and test enhancements.

We use third-party foundries and assembly and test contractors, which are primarily located in Asia, to manufacture, assemble and test our semiconductor products. We currently outsource a substantial percentage of our integrated circuit manufacturing to Samsung, with the remaining manufacturing outsourced to TSMC and GlobalFoundries. We also outsource the sort, assembly, final testing and other processing of our product to third-party contractors, primarily ASE Electronics in Taiwan, Malaysia and Singapore, as well as ISE Labs, Inc., in the United States. We negotiate wafer fabrication on a purchase order basis. There are no long-term agreements with any of these third-party contractors. A significant disruption in the operations of one or more of these third-party contractors would impact the production of our products for a substantial period of time, which could have a material adverse effect on our business, financial condition and results of operations.

Our gross margin has been and will continue to be affected by a variety of factors, including the product mix, average sales prices of our products, the amortization expense associated with the acquired intangible assets, the timing of cost reductions for fabricated wafers and assembly and test service costs, inventory valuation charges, the cost of fabrication masks that are capitalized and amortized, and the timing and changes in sort, assembly and test yields. Overall gross margin is impacted by the mix between higher performance, higher margin products and services and lower performance, lower margin products and services. In addition, we typically experience lower yields and higher associated costs on new products, which improve as production volumes increase.

Gross margin increased by 2.8 percentage points from 64.1% in the three months ended June 30, 2015 to 66.9% in the three months ended June 30, 2016 and increased by 2.3 percentage points from 64.5% in the six months ended June 30, 2015 to 66.8% in the six months ended June 30, 2016. The increase in gross margin was mainly due to a small shift of product sales mix. Higher performance products yield higher gross margins compared to our lower performance products. Also partly contributing to the increase in gross margin for the three and six months ended June 30, 2016 compared to the same periods in 2015 was the write-off during the second quarter of 2015 of a certain mask that is no longer used.

Research and Development Expenses. Research and development expenses primarily include personnel costs, engineering design development software and hardware tools, allocated facilities expenses and depreciation of equipment used in research and development and stock-based compensation. We expect research and development expenses to continue to increase in total dollars to support the development of new products and improvement of existing products. Additionally, as a percentage of revenue, these costs fluctuate from one period to another. Total research and development expenses for the periods presented were:

	Three Months Ended				Six Months Ended			
	June 30, 2016	2015	Change	%	June 30, 2016	2015	Change	%
	(in thousands)				(in thousands)			
Research and development expenses	$52,578	$52,225	$ 353	0.7%	$103,033	$110,647	$(7,614)	-6.9%
Percent of total net revenue	49.1 %	49.8 %	-0.7 %		49.3 %	53.5 %	-4.2 %	

Research and development expenses increased by $0.4 million and decreased by $7.6 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015. Salaries and employee benefits increased by $1.6 million and $4.1 million and stock-based compensation expense and related taxes increased by $1.1 million and $2.1 million for the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015 mainly as a result of the increase in headcount. Depreciation and amortization expense also increased by $0.5 million and $1.7 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015 due to additional property and equipment and intangible assets acquired for research and development. These increases were offset or partly offset by the decrease in outsourced engineering services and other miscellaneous research and development of $2.8 million and $8.0 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015, due to the timing of our research and development work for Xpliant and for our other new product families. The decrease in research and development expenses for the six months ended June 30, 2016 compared to the same period in 2015 was mainly due to a manufacturing right acquired from a third party vendor amounting to $7.5 million which was recorded as research and development expense in the first quarter of 2015. Research and development headcount was 790 at June 30, 2016 compared to 754 at June 30, 2015.

Sales, General and Administrative Expenses. Sales, general and administrative expenses primarily include personnel costs, accounting and legal fees, information systems, sales commissions, trade shows, marketing programs, depreciation, allocated facilities expenses and stock-based compensation. We expect sales, general and administrative expenses to increase in absolute dollars to support our growing sales and marketing activities resulting from our expanded product portfolio. Total sales, general and administrative costs for the periods presented were:

	Three Months Ended				Six Months Ended			
	June 30,				June 30,			
	2016	2015	Change	%	2016	2015	Change	%
	(in thousands)				(in thousands)			
Sales, general and administrative expenses	$25,882	$20,336	$5,546	27.3%	$46,807	$41,007	$5,800	14.1%
Percent of total net revenue	24.2 %	19.4 %	4.8 %		22.4 %	19.8 %	2.6 %	

Sales, general and administrative expenses increased by $5.5 million and $5.8 million in the three and six months ended June 30, 2016 compared to the same periods in 2015. Salaries and employee benefits increased by $0.9 million and $1.8 million and stock-based compensation expense increased by $0.8 million and $1.7 million for the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015 mainly as a result of the increase in headcount. Outside services increased by $3.6 million and $1.8 million for the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015 mainly due to the transaction costs incurred related to the pending merger with QLogic, partly offset by lower legal fees due to the timing of legal services for intellectual property related matters. Facilities, marketing and other miscellaneous sales, general and administrative expenses, combined increased by $0.2 million and $0.5 million in the three and six months ended June 30, 2016 compared to the same periods in 2015, respectively, as a result of an increase in headcount and increase in marketing related activities. Sales, general and administrative headcount was 201 at June 30, 2016 compared to 187 at June 30, 2015.

Other income (expense), net. Other income (expense), net primarily includes interest expense associated with capital lease and technology license obligations, interest income on cash and cash equivalents and foreign currency gains and losses. Total other expense, net for the periods presented were:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016	2015	Change	%	2016	2015	Change	%
	(in thousands)				(in thousands)			
Interest expense	$(185)	$(388)	$ 203	-52.3 %	$(393)	$(798)	$ 405	-50.8%
Other, net	(151)	(33)	(118)	357.6%	(137)	(99)	(38)	38.4 %
Total other expense, net	$(336)	$(421)	$ 85	-20.2 %	$(530)	$(897)	$ 367	-40.9%

The decrease in other expense, net in the three and six months ended June 30, 2016 compared to the same periods in 2015 were mainly due to the decrease in interest expense associated with capital lease and technology license obligations, partly offset by the increase in other expense, net due to higher foreign exchange losses.

Provision for Income Taxes. The quarterly provision for income taxes were based on our estimated annual effective tax rate, plus any discrete items, and taking into account valuation allowance, as necessary, in compliance with applicable guidance. We update our estimate of our annual effective tax rate at the end of each quarterly period. Our estimate takes into account estimations of annual pre-tax income, the geographic mix of pre-tax income, our interpretations of tax laws and the possible outcomes of current and future audits. The following table presents the provision for income taxes and the effective tax rates for the respective periods presented:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016	2015	Change	%	2016	2015	Change	%
	(in thousands)				(in thousands)			
Loss before income taxes	$(7,137)	$(5,694)	$(1,443)	25.3 %	$(10,695)	$(19,284)	$8,589	-44.5%
Provision for income taxes	273	661	(388)	-58.7%	548	962	(414)	-43.0%
Effective tax rate	(3.8)%	(11.6)%	7.8 %		(5.1)%	(5.0)%	(0.1)%	

The provision for income taxes for the three and six months ended June 30, 2016 and 2015 were primarily related to earnings in foreign jurisdictions. The difference between the provision for income taxes that would be derived by applying the statutory rate to our loss before income taxes and the provision for income taxes recorded in the three and six months ended June 30, 2016 and 2015 were primarily attributable to the difference in foreign tax rates and an increase in deferred tax liability related to the indefinite lived intangible assets.

Liquidity and Capital Resources

Following is a summary of our working capital and cash and cash equivalents as of the periods presented:

	As of June 30, 2016	As of December 31, 2015
	(in thousands)	
Working capital	$213,660	$196,772
Cash and cash equivalents	140,419	134,646

Following is a summary of our cash flows from operating activities, investing activities and financing activities for the periods presented:

	Six Months Ended June 30,	
	2016	2015
	(in thousands)	
Net cash provided by operating activities	$33,540	$15,944
Net cash used in investing activities	(25,139)	(21,398)
Net cash used in financing activities	(2,628)	(4,280)

Cash Flows from Operating Activities

Net cash flows from operating activities increased by $17.6 million from net cash provided by operating activities of $15.9 million in the six months ended June 30, 2015 compared to $33.5 million in the six months ended June 30, 2016. Total cash inflow from operations after adjustments of non-cash items in the six months ended June 30, 2016 and 2015 were $39.7 million and $25.1 million, respectively. The increase was mainly due to a smaller loss from operations in the six months ended June 30, 2016 compared to the six months ended June 30, 2015 resulting from higher gross margin and the decrease in expenses of Xpliant. Changes in assets and liabilities resulted in net cash outflow of $6.1 million in the six months ended June 30, 2016 compared to $9.2 million in the six months ended June 30, 2015. The significant changes in assets and liabilities in the six months ended June 30, 2016 were higher accounts receivable resulting from the timing of shipments to customers, higher inventories due to timing of inventory build-up and higher accrued expenses and other current liabilities mainly related to the accrual of transaction costs due to the timing of payments to vendors. The significant changes in assets and liabilities in the six months ended June 30, 2015 were higher accounts receivable resulting from the timing of shipments to customers and higher accrued expenses and other current liabilities mainly from the accrual of manufacturing rights payable due to the timing of payments to vendors.

Cash Flows from Investing Activities

Net cash used in investing activities in the six months ended June 30, 2016 was $25.1 million compared to $21.4 million in the six months ended June 30, 2015. Net cash used in investing activities in the six months ended June 30, 2016 resulted from the cash payments made to purchase property and equipment of $18.7 million and intangible assets of $6.5 million. Net cash used in investing activities in the six months ended June 30, 2015 partly resulted from the cash payments made to purchase property and equipment of $15.4 million, cash payments made to purchase intangible assets of $3.8 million and cash payment to common shareholders of Xpliant of $3.6 million pursuant to the first and final closing of the merger. These cash outflows were partially offset by the proceeds from sale of a short-term investment of $1.0 million and the proceeds received from the disposition of certain consumer product assets of $0.4 million.

Cash Flows from Financing Activities

Net cash used in financing activities in the six months ended June 30, 2016 was $2.6 million compared to $4.3 million in the six months ended June 30, 2015. Net cash used in financing activities in the six months ended June 30, 2016 resulted from the principal payments of capital lease and technology license obligations of $8.9 million, which was partially offset by the proceeds received from issuance of common stock upon the exercise of options of $6.3 million. Net cash provided by financing activities in the six months ended June 30, 2015 resulted mainly from the principal payments of capital lease and technology license obligations of $12.1 million which was partially offset by the proceeds received from issuance of common stock upon the exercise of options of $7.9 million.

Capital Resources

Cash equivalents consist of an investment in a money market fund. We believe that our $140.4 million of cash and cash equivalents at June 30, 2016, and expected cash flow from operations, if any, will be sufficient to fund our projected operating requirements for at least 12 months.

In connection with the pending merger with QLogic, on June 15, 2016, we entered into a commitment letter with JPMCB pursuant to which JPMCB has committed to provide (i) a $650.0 million senior secured term loan facility and (ii) a $100.0 million senior secured interim term loan facility ((i) and (ii) together, the “facilities” and the provision of such funds as set forth in the commitment letter, the “financing”), subject to the execution of definitive documentation and satisfaction of customary closing conditions. We may increase the amount of borrowings under the senior secured term loan facility up to $700.0 million, and make a corresponding reduction up to $50.0 million of our borrowings

under the senior secured interim term loan facility. The facilities are available to finance the exchange offer and the merger and pay fees and expenses related to the exchange offer, the merger and the financing.

Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our engineering, sales and marketing activities, the timing and extent of our expansion into new territories, the timing of introductions of new products and enhancements to existing products and the continuing market acceptance of our products. Although we currently are not a party to any agreement with respect to potential material investments (other than QLogic) in, or acquisitions of, complementary businesses, services or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

Indemnities

In the ordinary course of business, we have entered into agreements with customers that include indemnity provisions. Based on historical experience and information known through the filing of this report, we believe our exposure related to the above indemnities as of June 30, 2016, was not material. We also enter into indemnification agreements with our officers and directors and our certificate

of incorporation and bylaws include similar indemnification obligations to our officers and directors. It is not possible to determine the amount of our liability related to these indemnification agreements and obligations to our officers and directors due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement.

Off-Balance Sheet Arrangements

During the periods presented, we did not have, nor do we currently have, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Contractual Obligations

The table below describes our commitments to settle contractual obligations in cash as of June 30, 2016:

	Payments Due By Period				
	Total	Remainder of 2016	1 to 3 Years	3 to 5 Years	More Than 5 Years
	(in thousands)				
Operating lease obligations	$54,295	$ 4,497	$17,816	$17,813	$ 14,169
Capital lease and technology license obligations	22,190	12,324	9,866	-	-
Total	$76,485	$ 16,821	$27,682	$17,813	$ 14,169

As of June 30, 2016, the liability for uncertain tax positions was $0.7 million. The timing of any payments which could result from these unrecognized tax benefits will depend upon a number of factors. Accordingly, the timing of payment cannot be estimated.

In July 2016, we signed the design kit license agreements with a third party vendor for an aggregate consideration of $9.0 million, payable in four equal installments. The first installment is due on the effective date of the agreement and the remaining installment payments are due in the succeeding quarters following the effective date.

We have funding commitments in relation to the merger with QLogic. See Note 5 of Notes to Condensed Consolidated Financial Statements for related discussions.

In addition, we have other obligations for goods and services entered into in the normal course of business. These obligations, however, are either not enforceable or legally binding or are subject to change based on our business decisions.

Critical Accounting Policies and Estimates

The preparation of our financial statements and accompanying disclosures in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and the accompanying notes. The SEC has defined a company’s critical accounting policies as policies that are most important to the portrayal of a company’s financial condition and results of operations, and which require a company to make its most difficult and

subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified our most critical accounting policies and estimates to be as follows: (1) revenue recognition; (2) stock-based compensation; (3) inventory valuation; (4) accounting for income taxes; (5) mask costs; (6) business combinations and (7) valuation of goodwill and purchased intangible assets. Although we believe that our estimates, assumptions and judgments are reasonable, they are based upon information not presently available. Actual results may differ significantly from these estimates if the assumptions, judgments and conditions upon which they are based turn out to be inaccurate. Management believes that there have been no significant changes to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Annual Report on Form 10-K for the year ended December 31, 2015 filed on February 22, 2016.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

During the six months ended June 30, 2016, there were no material changes to our quantitative and qualitative disclosures about market risk related to our investment activities as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the SEC on February 22, 2016.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer evaluated, with the participation of our management, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of June 30, 2016. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to management as appropriate to allow for timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended June 30, 2016 that has materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

This information is included in Note 10 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report, and is incorporated herein by reference.

Item 1A. Risk Factors

The following risks and uncertainties may have a material adverse effect on our business, financial condition or results of operations. Investors should carefully consider the risks described below before making an investment decision. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently believe are immaterial may also significantly impair our business operations. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and investors may lose all or part of their investment.

We have marked with an asterisk (*) those risks described below that reflect substantive changes from the risks described under “Item 1A. Risk Factors” included in our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission on February 22, 2016.

Risks Related to Our Business and Industry

*We have a limited history of profitability, and we may not achieve or sustain profitability in the future, on a quarterly or annual basis.

We have a history of losses during certain quarterly or annual periods since our incorporation. As of June 30, 2016, our accumulated deficit was $200.7 million. We expect to make significant expenditures related to the development of

our products and expansion of our business, including research and development and sales and administrative expenses. Additionally, we may encounter unforeseen difficulties, complications, product delays and other unknown factors that may require additional expenditures. As a result of these expenditures, we may not generate sufficient revenue to achieve profitability. Our revenue growth trend in 2013, 2014 and 2015 may not be sustainable, and accordingly, we may incur losses in the future.

*We expect our operating results to fluctuate, which could adversely affect the price of our common stock.

We expect our revenues and expense levels to vary in the future, making it difficult to predict our future operating results. In particular, we experience variability in demand for our products as our customers manage their product introduction dates and their inventories. Given the current global economic uncertainty, the demand for our products may be more varied and difficult to ascertain in a timely and efficient manner.

Factors that could cause our results to fluctuate include, among other things:

- fluctuations in demand, sales cycles, product mix and prices for our products;
- the variability in lead time between the time when a customer begins to design in one of our products and the time when the customer’s end system goes into production and they begin purchasing our products;
- the forecasting, scheduling, rescheduling or cancellation of orders by our customers;

- the timing of our new product introductions;
- our dependence on a few significant customers, which may vary the size of their orders;
- our ability to retain, recruit and hire key executives, technical personnel and other employees in the positions and numbers, and with the experience and capabilities that we need;
- our ability to successfully define, design and release new products in a timely manner that meet our customers' needs;
- changes in manufacturing costs, including wafer, test and assembly costs, mask costs, manufacturing yields and product quality and reliability;
- the timing and availability of adequate manufacturing capacity from our manufacturing suppliers;
- the timing of announcements by our competitors or us;
- any mergers, acquisitions or divestitures of assets undertaken by us, including the pending merger with QLogic;
- future accounting pronouncements and changes in accounting policies;
- the timing of recognition of non-recurring engineering credits. From time to time, we enter into research and development collaboration agreements with certain customers. Subject to the terms of the agreements, the consideration is recognized as a credit to our research and development expenses. The timing of the recognition of such credit may be subject to certain milestones specified in the agreement.
- volatility in our stock price, which may lead to higher stock compensation expenses;
- general economic and political conditions in the countries in which we operate or our products are sold or used;
- costs associated with litigation, especially related to intellectual property; and
- productivity and growth of our sales and marketing force.

Unfavorable changes in any of the above factors, most of which are beyond our control, could significantly harm our business and results of operations, and therefore our stock price.

We may have difficulty accurately predicting our future revenues for the purpose of appropriately budgeting and adjusting our expenses, which could adversely affect our operating results.

The dynamic and rapidly evolving market in which we sell our products, our dependence on a limited number of customers, as well as numerous other factors beyond our control, including general market conditions, impede our ability to forecast quarterly and annual revenues accurately. As a result, we could experience budgeting and cash flow management problems, unexpected fluctuations in our results of operations and other difficulties, any of which could make it difficult for us to attain and maintain profitability and could increase the volatility of the market price of our common stock.

We face intense competition and expect competition to increase in the future, which could reduce our revenues, gross margin and/or customer base.

The market for our products is highly competitive and we expect competition to intensify in the future. This competition could make it more difficult for us to sell our products, and result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and failure to increase, or the loss of, market share or expected market share, any of which would likely seriously harm our business, operating results and financial condition. For instance, semiconductor products have a history of declining prices as the cost of production is reduced. However, if market prices decrease faster than product costs, gross and operating margins can be adversely affected. In the enterprise, datacenter, service provider, and broadband and consumer markets, we consider our primary competitors to be other companies that provide processor products to one or more of our markets, including Freescale Semiconductor, Inc., which was acquired by NXP Semiconductor, Intel Corporation, Broadcom Limited (formerly Broadcom Corporation, acquired by Avago Technologies Limited in February 2016 and renamed itself as Broadcom Limited), Marvell Technology Group Ltd., Applied Micro Circuits Corporation, Qualcomm Incorporated, and Advanced Micro Devices, Inc.

A few of our current competitors operate their own fabrication facilities and have, and some of our potential competitors could have, longer operating histories, greater name recognition, larger customer bases and significantly

greater financial, technical, sales, marketing and other resources than we have. Potential customers may prefer to purchase from their existing suppliers rather than a new supplier regardless of product performance or features.

In the embedded commercial Linux operating system and professional services markets, we consider the primary competitors for our software products to be Wind River Systems, Inc., a subsidiary of Intel Corporation, and, to a lesser extent, Canonical Ltd. and Mentor Graphics Corporation.

We expect increased competition from other established and emerging companies both domestically and internationally. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties. If so, new competitors or alliances that include our competitors may emerge that could acquire significant market share. In the future, further development by our competitors, and development by our potential competitors, could cause our products to become obsolete. Our ability to compete depends on a number of factors, including:

- our success in identifying new and emerging markets, applications and technologies and developing products for these markets;
- our products' performance and cost effectiveness relative to that of our competitors' products;
- our ability to deliver products in large volume on a timely basis at a competitive price;
- our success in utilizing new and proprietary technologies to offer products and features previously not available in the marketplace;
- our ability to recruit design and application engineers and sales and marketing personnel; and
- our ability to protect our intellectual property.

In addition, we cannot assure you that existing customers or potential customers will not develop their own products, purchase competitive products or acquire companies that use alternative methods to enable networking, communication or security applications to facilitate network-aware processing in their systems. Any of these competitive threats, alone or in combination with others, could seriously harm our business, operating results and financial condition.

Our customers may cancel their orders, change production quantities or delay production, and if we fail to forecast demand for our products accurately, we may incur product shortages, delays in product shipments or excess or insufficient product inventory.

We generally do not obtain firm, long-term purchase commitments from our customers. Because production lead times often exceed the amount of time required to fulfill orders, we often must build in advance of orders, relying on an imperfect demand forecast to project volumes and product mix.

Our demand forecast accuracy can be adversely affected by a number of factors, including inaccurate forecasting by our customers, changes in market conditions, adverse changes in our product order mix and demand for our customers' products. Even after an order is received, our customers may cancel these orders or request a decrease in production quantities. Any such cancellation or decrease subjects us to a number of risks, most notably that our projected sales will not materialize on schedule or at all, leading to unanticipated revenue shortfalls and excess or obsolete inventory which we may be unable to sell to other customers. Alternatively, if we project customer requirements to be less than the demand that materializes, we may not build enough products, which could lead to delays in product shipments and lost sales opportunities in the near term, as well as force our customers to identify alternative sources, which could affect our ongoing relationships with these customers. In the past, we have had customers dramatically increase their requested production quantities with little or no advance notice. Either underestimating or overestimating demand could lead to insufficient, excess or obsolete inventory, which could harm our operating results, cash flow and financial condition, as well as our relationships with our customers.

*We receive a substantial portion of our revenues from a limited number of customers, and the loss of, or a significant reduction in, orders from one or a few of our major customers would adversely affect our operations and financial condition.

We receive a substantial portion of our revenues from a limited number of customers. We received an aggregate of approximately 57.8% and 54.9% of our net revenue from our top five customers in the three months ended June 30, 2016 and 2015, respectively and $59.0% and 50.1% in the six months ended June 30, 2016 and 2015, respectively. Two customers together accounted for 37.3% and 38.8% of our net revenue in the three and six months ended June 30, 2016, respectively. Three customers together accounted for 42.6% and two customers together accounted for

27.8% of our net revenue in the three and six months ended June 30, 2015, respectively. No other customer accounted for more than 10.0% of our revenues in the three and six months ended June 30, 2016 and 2015. We anticipate that we will continue to be dependent on a limited number of customers for a significant portion of our revenues in the immediate future and that the portion of our revenues attributable to some of these customers may increase in the future. However, we may not be able to maintain or increase sales to some of our top customers for a variety of reasons, including the following:

- our agreements with our customers do not require them to purchase a minimum quantity of our products;
- some of our customers can stop incorporating our products into their own products with limited notice to us and suffer little or no penalty; and
- many of our customers have pre-existing or concurrent relationships with our current or potential competitors that may affect the customers' decisions to purchase our products.

In the past, we have relied in significant part on our relationships with customers that are technology leaders in our target markets. We intend to continue expanding these relationships and forming new relationships but we cannot assure you that we will be able to do so. These relationships often require us to develop new products that may involve significant technological challenges. Our customers frequently place considerable pressure on us to meet their tight development schedules. Accordingly, we may need to devote a substantial amount of our resources to our relationships, which could detract from or delay our completion of other important development projects. Delays in development could impair our relationships with our other large customers and negatively impact sales of the products under development. Moreover, it is possible that our customers may develop their own product or adopt a competitor’s solution for products that they currently buy from us. If that happens, our sales would decline and our business, financial condition and results of operations could be materially and adversely affected.

In addition, our relationships with some customers may also deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer some customers favorable prices on our products. In that event, our average selling prices and gross margins would decline. The loss of a key customer, a reduction in sales to any key customer or our inability to attract new significant customers could seriously impact our revenue and materially and adversely affect our business, financial condition, and results of operations.

We may be unsuccessful in developing and selling new products or in penetrating new markets.

We operate in a dynamic environment characterized by rapidly changing technologies and industry standards and technological obsolescence. Our competitiveness and future success depend on our ability to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost effective basis. A fundamental shift in technologies in any of our product markets could harm our competitive position within these markets. Our failure to anticipate these shifts, to develop new technologies or to react to changes in existing technologies could materially delay our development of new products, which could result in product obsolescence, decreased revenues and a loss of design wins to our competitors. The success of a new product depends on accurate forecasts of long-term market demand and future technological developments, as well as a variety of specific implementation factors, including:

- timely and efficient completion of process design and transfer to manufacturing, assembly and test processes;
- the quality, performance and reliability of the product; and
- effective marketing, sales and service.

If we fail to introduce new products that meet the demand of our customers or penetrate new markets in which we expend significant resources, our revenues will likely decrease over time and our financial condition could suffer. Additionally, if we concentrate resources on a new market that does not prove profitable or sustainable, our financial condition could decline.

The average selling prices of products in our markets have historically decreased over time and will likely do so in the future, which could harm our revenues and gross profits.

Average selling prices of semiconductor products in the markets we serve have historically decreased over time. Our gross profits and financial results will suffer if we are unable to offset any reductions in our average selling prices by reducing our costs, developing new or enhanced products on a timely basis with higher selling prices or gross profits, or increasing our sales volumes. Additionally, because we do not operate our own manufacturing, assembly or testing facilities, we may not be able to reduce our costs as rapidly as companies that operate their own facilities, and our costs may even increase, which could also reduce our margins.

Fluctuations in the mix of products sold may adversely affect our financial results.

Because of the wide price differences among our processors, the mix and types of performance capabilities of processors sold affect the average selling price of our products and have a substantial impact on our revenue. Generally, sales of higher performance products have higher gross margins than sales of lower performance products. We currently offer both higher and lower performance products in a number of our different product families. If the sales mix shifts towards lower performance, lower margin products, our overall gross margins will be negatively affected. Fluctuations in the mix and types of our products may also affect the extent to which we are able to recover our fixed costs and investments that are associated with a particular product, and as a result can negatively impact our financial results.

Adverse changes in general economic or political conditions in any of the major countries in which we do business could adversely affect our operating results.

As our business has grown to both customers located in the United States as well as customers located outside of the United States, we have become increasingly subject to the risks arising from adverse changes in both the domestic and global economic and political conditions. If economic growth in the United States and other countries' economies continues to slow, the demand for our customer's products could decline, which would then decrease demand for our products. Furthermore, if economic conditions in the countries into which our customers sell their products continue to deteriorate, some of our customers may decide to postpone or delay some of their development programs, which would then delay their need to purchase our products. This could result in a reduction in sales of our products or in a reduction in the growth of our product sales. Any of these events would likely harm investors' view of our business, financial condition, and results of operations.

The semiconductor and communications industries have historically experienced significant fluctuations with prolonged downturns, which could impact our operating results, financial condition and cash flows

The semiconductor industry has historically exhibited cyclical behavior, which at various times has included significant downturns in customer demand, including in late 2008 through 2009. Because a significant portion of our expenses is fixed in the near term or is incurred in advance of anticipated sales, we may not be able to decrease our expenses rapidly enough to offset any unanticipated shortfall in revenues. If this situation were to occur, it could adversely affect our operating results, cash flow and financial condition. Furthermore, the semiconductor industry has periodically experienced periods of increased demand and production constraints. If this happens in the future, we may not be able to produce sufficient quantities of our products to meet the increased demand. We may also have difficulty in obtaining sufficient wafer, assembly and test resources from our subcontract manufacturers. Any factor adversely affecting the semiconductor industry in general, or the particular segments of the industry that our products target, may adversely affect our ability to generate revenue and could negatively impact our operating results.

The communications industry has, in the past, experienced pronounced downturns, and these cycles may continue in the future. To respond to a downturn, many networking equipment providers may slow their research and development activities, cancel or delay new product development, reduce their inventories and take a cautious approach to acquiring our products, which would have a significant negative impact on our business. If this situation were to occur, it could adversely affect our operating results, cash flow and financial condition. In the future, any of these trends may also cause our operating results to fluctuate significantly from year to year, which may increase the volatility of the price of our stock.

Our products must meet exact specifications, and defects and failures may occur, which may cause customers to return or stop buying our products.

Our customers generally establish demanding specifications for quality, performance and reliability that our products must meet. However, our products are highly complex and may contain defects and failures when they are first introduced or as new versions are released. If defects and failures occur in our products during or after the design phase, we could experience lost revenues, increased costs, including warranty expense and costs associated with customer support, delays in or cancellations or rescheduling of orders or shipments, product returns or discounts, diversion of management resources or damage to our reputation and brand equity, and in some cases consequential damages, any of which would harm our operating results. In addition, delays in our ability to fill product orders as a result of quality control issues may negatively impact our relationship with our customers.

We rely on our customers to design our products into their systems, and the nature of the design process requires us to incur expenses prior to customer commitments to use our products or recognizing revenues associated with those expenses which may adversely affect our financial results.

One of our primary focuses is on winning competitive bid selection processes, known as “design wins,” to develop products for use in our customers’ products. We devote significant time and resources in working with our customers’ system designers to understand their future needs and to provide products that we believe will meet those needs and these bid selection processes can be lengthy. If a customer’s system designer initially chooses a competitor’s product, it becomes significantly more difficult for us to sell our products for use in that system because changing suppliers can involve significant cost, time, effort and risk for our customers. Thus, our failure to win a competitive bid can result in our foregoing revenues from a given customer’s product line for the life of that product. In addition, design opportunities may be infrequent or may be delayed. Our ability to compete in the future will depend, in large part, on our ability to design products to ensure compliance with our customers’ and potential customers’ specifications. We expect to invest significant time and resources and to incur significant expenses to design our products to ensure compliance with relevant specifications.

We often incur significant expenditures in the development of a new product without any assurance that our customers’ system designers will select our product for use in their applications. We often are required to anticipate which product designs will generate demand in advance of our customers expressly indicating a need for that particular design. Even if our customers’ system designers select our products, a substantial period of time will elapse before we generate revenues related to the significant expenses we have incurred.

The reasons for this delay generally include the following elements of our product sales and development cycle timeline and related influences:

- our customers usually require a comprehensive technical evaluation of our products before they incorporate them into their designs;
- it can take from six months to three years from the time our products are selected to commence commercial shipments; and
- our customers may experience changed market conditions or product development issues.

The resources devoted to product development and sales and marketing may not generate material revenue for us, and from time to time, we may need to write off excess and obsolete inventory if we have produced product in anticipation of expected demand. We may spend resources on the development of products that our customers may not adopt. If we incur significant expenses and investments in inventory in the future that we are not able to recover, and we are not able to compensate for those expenses, our operating results could be adversely affected. In addition, if we sell our products at reduced prices in anticipation of cost reductions but still hold higher cost products in inventory, our operating results would be harmed.

Additionally, even if system designers use our products in their systems, we cannot assure you that these systems will be commercially successful or that we will receive significant revenue from the sales of processors for those systems. As a result, we may be unable to accurately forecast the volume and timing of our orders and revenues associated with any new product introductions.

In the event one of our distributor arrangements terminates, it could lead to a loss of revenues and possible product returns.

A portion of our sales is made through third-party distribution agreements. Termination of a distributor relationship, either by us or by the distributor, could result in a temporary loss of revenues until a replacement distributor can be established to service the affected end-user customers, or a permanent loss of revenues if no replacement can be established. We may not be successful in finding suitable alternative distributors on satisfactory terms or at all and this could adversely affect our ability to sell in some locations or to some end-user customers. Additionally, if we terminate our relationship with a distributor, we may be obligated to repurchase unsold products. We record a reserve for estimated returns and price credits. If actual returns and credits exceed our estimates, our operating results could be harmed.

*The failure to complete our merger with QLogic Corporation may adversely affect our business and our share price.

Our and QLogic’s obligations to consummate the merger with QLogic are subject to the satisfaction or waiver of certain customary conditions including (i) at least a majority of the outstanding QLogic stock having been validly tendered into (and not withdrawn from) the exchange offer prior to the expiration date of the exchange offer, (ii) the exchange of shares of our common stock pursuant to the exchange offer and the merger having been registered pursuant to a registration statement filed by us with the SEC and declared effective by the SEC, (iii) shares of our common stock issuable pursuant to the exchange offer and the merger having been authorized for listing on NASDAQ, (iv) the expiration or termination of any applicable regulatory waiting periods and/or receipt of regulatory clearance, (v) the absence of any order or ruling prohibiting the consummation of the merger, and (vi) subject to certain exceptions, the accuracy of the other party’s representations and warranties and compliance with covenants. In addition, our obligation to consummate the merger is also subject to the satisfaction or waiver of the condition that no material adverse effect on QLogic shall have occurred since the date of the QLogic merger agreement. The Company and QLogic’s obligations are not subject to any financing condition.

If the merger is not completed, we may suffer consequences that could adversely affect our business, results of operations and share price, including the following:

- we would have incurred significant costs in connection with the merger that we would be unable to recover;
- we may be subject to legal proceedings related to the merger;
- the failure to consummate the merger may result in negative publicity and a negative impression of us in the investment community; and
- any disruptions to our business resulting from the announcement and pendency of the merger, including any adverse changes in our relationships with our customers, vendors and employees, may continue or intensify in the event the merger is not consummated.

In addition, we would not realize any of the expected benefits of having completed the merger. The benefits we expect to realize from the merger with QLogic are, necessarily, based on projections and assumptions about our combined businesses with QLogic. Furthermore, if the merger closes, our ability to realize these benefits will depend, in part, on our ability to integrate the business of QLogic successfully and efficiently with our business. Integration of the QLogic business will be complex and time-consuming, will involve additional expense and could disrupt our business and divert management attention from ongoing business concerns.

*We may fail to realize the benefits expected from the merger with Qlogic, which could adversely affect our stock price.

The anticipated benefits we expect from the merger with QLogic are, necessarily, based on projections and assumptions about our combined business with QLogic, which may not materialize as expected or which may prove to be inaccurate. The value of our common stock following the completion of the merger with QLogic could be adversely affected if we are unable to realize the anticipated benefits from the merger on a timely basis or at all. Achieving the benefits of the merger with QLogic will depend, in part, on our ability to integrate the business and operations of QLogic successfully and efficiently with our business. The challenges involved in this integration, which will be complex and time-consuming, include the following:

- difficulties entering new markets or manufacturing in new geographies where we have no or limited direct prior experience;
- successfully managing relationships with our combined supplier and customer base;
- coordinating and integrating independent research and development and engineering teams across technologies and product platforms to enhance product development while reducing costs;
- coordinating sales and marketing efforts to effectively position the combined company’s capabilities and the direction of product development;
- difficulties in integrating the systems and process of two companies with complex operations including multiple manufacturing sites;
- the increased scale and complexity of our operations resulting from the merger;
- retaining key employees;
- obligations that we will have to counterparties of QLogic that arise as a result of the change in control of QLogic; and
- the diversion of management attention from other important business objectives.

If we do not successfully manage these issues and the other challenges inherent in integrating QLogic, then we may not achieve the anticipated benefits of the merger with QLogic and our revenue, expenses, operating results and financial condition could be materially adversely affected.

*Any delay in completing the merger with QLogic may significantly reduce the benefits expected to be obtained from the merger.

The merger with QLogic is subject to a number of conditions that are beyond our control and that may prevent, delay or otherwise materially adversely affect completion of the merger. We cannot predict whether and when these conditions will be satisfied. Any delay in completing the merger may significantly reduce the benefits that we expect to achieve if we and QLogic successfully complete the merger within the expected timeframe and integrate the respective businesses.

*Failure to effectively retain, attract and motivate key employees could diminish the anticipated benefits of the merger with QLogic.

The success of the acquisition of QLogic will depend in part on the attraction, retention and motivation of personnel critical to the business and operations of the surviving company due to, for example, their technical skills or industry and management expertise. Employees and consultants may experience uncertainty about their future roles with the company and QLogic during the pendency of the offer and the merger or after their completion. The company and QLogic, while similar and sharing a number of core values, do not have identical corporate cultures, and some employees or consultants may not want to work for the surviving company. In addition, competitors may recruit employees during our integration of QLogic. If we are unable to attract, retain and motivate personnel that are critical to the successful integration and future operation of the company, we could face disruptions in its operations, loss of existing customers, key information, expertise or know-how and unanticipated additional recruiting and training costs. In addition, the loss of key personnel could diminish the anticipated benefits of the acquisition.

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*Our acquisition, disposition and investment strategies may result in unanticipated accounting charges or otherwise adversely affect our business, financial condition and results of operations.

Since May 2008, we have acquired three companies, acquired assets of, and assumed liabilities of, five other companies and we are currently seeking to acquire all of the outstanding common stock of QLogic in connection with the pending merger with QLogic. We expect that we will in the future continue to acquire companies or assets of companies or invest in third-party companies that we believe to be complementary to our business, including for the purpose of expanding our new product design capacity, introducing new design, market or application skills or enhancing and expanding our existing product lines. In connection with any such future acquisitions or investments, we may need to use a significant portion of our available cash, issue additional equity securities that would dilute current stockholders' percentage ownership and incur substantial debt or contingent liabilities. In addition, we may incur higher operating costs following an acquisition. These actions could adversely impact our operating results and the market price of our common stock. In addition, acquisitions of companies exposes us to risks, including:

- difficulties may occur in assimilating and integrating the operations, personnel, technologies, and products of acquired companies or businesses;
- key personnel of an acquired company may decide not to work for us;
- to the extent we acquire a company with existing products; those products may have lower gross margins than our customary products, which could adversely affect our gross margin and operating results;
- if an acquired company also has inventory that we assume, we will be required to write up the carrying value of that inventory to fair value, and when that inventory is sold, the gross margins for those products will be reduced and our gross margins for that period would be negatively affected; and
- the purchase price of any acquired businesses may exceed the current fair values of the net tangible assets of the acquired businesses, in which case we would be required to record material amounts of goodwill, and acquired in-process research and development charges and other intangible assets, which could result in significant impairment and acquired in-process research and development charges and amortization expense in future periods, which charges, in addition to the results of operations of the acquired businesses and potential restructuring costs associated with an acquisition, could have a material adverse effect on our business, financial condition and results of operations. We cannot forecast the number, timing or size of future acquisitions, or the effect that any acquisitions might have on our operating or financial results.

*Our future indebtedness resulting from the pending merger with QLogic could adversely affect our financial condition and our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent of our variable rate indebtedness.

On June 15, 2016, we entered into a commitment letter JPMCB, pursuant to which JPMCB has committed to provide (i) a $650.0 million senior secured term loan facility and (ii) a $100.0 million senior secured interim term loan facility. The Facilities are available to (i) finance the exchange offer and the merger with QLogic, (ii) repay existing indebtedness of QLogic under its existing credit facility, and (iii) pay fees and expenses related to the Offer, the Merger and the financing. We may increase the amount of borrowings under the senior secured term loan facility up to $700.0 million, and make a corresponding reduction in the amount of our borrowings under the interim term loan facility. The financing could have important consequences to us including:

- increasing our vulnerability to adverse general economic and industry conditions;
- requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, execution of our business strategy, acquisitions and other general corporate purposes;
- limiting our flexibility in planning for, or reacting to, changes in the economy and the semiconductor industry;
- placing us at a competitive disadvantage compared to our competitors with less indebtedness;
- exposing us to interest rate risk to the extent of our variable rate indebtedness; and
- making it more difficult to borrow additional funds in the future to fund growth, acquisitions, working capital, capital expenditures and other purposes.

We rely on our ecosystem partners to enhance our product offerings and our inability to continue to develop or maintain these relationships in the future would harm our ability to remain competitive.

We have developed relationships with third parties, which we refer to as ecosystem partners, which provide operating systems, tool support, reference designs and other services designed for specific uses with our SoCs. We believe that these relationships enhance our customers' ability to get their products to market quickly. If we are unable to continue to develop or maintain these relationships, we may not be able to enhance our customers' ability to commercialize their products in a timely fashion and our ability to remain competitive would be harmed, which would negatively impact our ability to generate revenue and our operating results.

The loss of any of our key personnel could seriously harm our business, and our failure to attract or retain specialized technical, management or sales and marketing talent could impair our ability to grow our business.

We believe our future success will depend in large part upon our ability to attract, retain and motivate highly skilled managerial, engineering, sales and marketing personnel. The loss of any key employees or the inability to attract, retain or motivate qualified personnel, including engineers and sales and marketing personnel could delay the development and introduction of, and harm our ability to sell our products which would materially and adversely affect our business, financial condition and results of operations. For instance, if any of these individuals were to leave our company unexpectedly, we could face substantial difficulty in hiring qualified successors and could experience a loss in productivity during the search for and while any successor is integrated into our business and operations.

There is currently a shortage of qualified technical personnel with significant experience in the design, development, manufacturing, marketing and sales of integrated circuits. In particular, there is a shortage of engineers who are familiar with the intricacies of the design and manufacture of multi-core networking processors, and competition for these engineers is intense. Our key technical personnel represent a significant asset and serve as the source of our technological and product innovations. We may not be successful in attracting, retaining and motivating sufficient numbers of technical personnel to support our anticipated growth.

To date, we have relied primarily on our direct marketing and sales force to drive new customer design wins and to sell our products. Because we are looking to expand our customer base and grow our sales to existing customers, we will need to hire additional qualified sales personnel in the near term and beyond if we are to achieve revenue growth. The competition for qualified marketing and sales personnel in our industry, and particularly in Silicon Valley, is very intense. If we are unable to hire, train, deploy and manage qualified sales personnel in a timely manner, our ability to grow our business will be impaired. In addition, if we are unable to retain our existing sales personnel, our ability to maintain or grow our current level of revenues will be adversely affected. Further, if we are unable to integrate and retain personnel acquired through our various acquisitions, we may not be able to fully capitalize on such acquisitions.

We rely on stock-based awards as one means for recruiting, motivating and retaining highly skilled talent. If the value of the stock awards does not appreciate as measured by the performance of the price of our common stock or if our share-based compensation otherwise ceases to be viewed as a valuable benefit, our ability to attract, retain, and motivate employees could be weakened, which could harm our business, financial condition and results of operations.

Some of our operations and a significant portion of our customers and contract manufacturers are located outside of the United States, which subjects us to additional risks, including increased complexity and costs of managing international operations and geopolitical instability.

We have international sales offices and research and development facilities and we conduct, and expect to continue to conduct, a significant amount of our business with companies located outside the United States, particularly in Asia and Europe. Even customers based in the United States often use contract manufacturers based in Asia to manufacture their systems, and it is the contract manufacturers that purchase products directly from us. As a result of our international focus, we face numerous challenges, including:

- increased complexity and costs of managing international operations;
- longer and more difficult collection of receivables;
- difficulties in enforcing contracts generally;
- geopolitical and economic instability and military conflicts;
- limited protection of our intellectual property and other assets;
- compliance with local laws and regulations and unanticipated changes in local laws and regulations, including tax laws and regulations;
- trade and foreign exchange restrictions and higher tariffs;
- travel restrictions;

- timing and availability of import and export licenses and other governmental approvals, permits and licenses, including export classification requirements;
- foreign currency exchange fluctuations relating to our international operating activities;
- transportation delays and limited local infrastructure and disruptions, such as large scale outages or interruptions of service from utilities or telecommunications providers;
- difficulties in staffing international operations;
- heightened risk of terrorism;
- local business and cultural factors that differ from our normal standards and practices;

- differing employment practices and labor issues;
- regional health issues and natural disasters; and
- work stoppages.

We are subject to governmental export and import controls that may adversely affect our business.

We and our customers are subject to various import and export laws and regulations. Government export regulations apply to the encryption or other features contained in some of our products. Although our processes and procedures are designed to maintain compliance, we cannot assure you that we have been or will be at all times in complete compliance with these laws and regulations. On January 30, 2015, we submitted an initial notification of a voluntary self-disclosure to the U.S. Department of Commerce, Bureau of Industry and Security, or BIS. The notification reported our discovery that hardware and software, with encryption functionality, may have been exported without the required BIS export license. With the assistance of outside counsel, we conducted a review of past export transactions during the past five years, and on July 17, 2015, we reported our findings in a full voluntary self-disclosure to BIS. The findings reported that we exported certain encryption hardware and software to fifteen government end-users in the People’s Republic of China, Taiwan, Hong Kong, Singapore, India and South Korea, as well as one party on BIS' entity list, without the required BIS export license. The aggregate billings for the reported exports were approximately $0.5 million. The disclosure also addressed our remedial and corrective actions. BIS is reviewing our voluntary self-disclosure and we are cooperating fully with BIS. Violations of the export control laws may result in civil, administrative or criminal fines or penalties, loss of export privileges, debarment or a combination of these penalties. At this time we are unable to determine the outcome of the government’s investigation or its possible effect on the Company.

If we fail to receive licenses or otherwise comply with import and export laws and regulations, we may be unable to manufacture the affected products at foreign foundries or ship these products to some customers, or we may incur penalties or fines and civil and criminal liabilities or other sanctions. In addition, changes in import or export laws and regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products or cause decreased use of our products by customers with international operations, each of which would adversely affect our business and results of operations.

New regulations related to “conflict minerals” may force us to incur additional expenses, may make our supply chain more complex and may result in damage to our reputation with customers.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, the Securities and Exchange Commission has adopted new requirements for companies that use certain minerals and metals, known as conflict minerals, in their products, whether or not these products are manufactured by third parties. These requirements will require companies to diligence, disclose and report whether or not such minerals originate from the Democratic Republic of Congo and adjoining countries. The implementation of these new requirements could adversely affect the sourcing, availability and pricing of minerals used in the manufacture of semiconductor devices, including our products. In addition, we will incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. Since our supply chain is complex, we may not be able to sufficiently verify the origins for these minerals and metals used in our products through the due diligence procedures that we implement, which may harm our reputation. In such event, we may also face difficulties in satisfying customers who require that all of the components of our products are certified as conflict mineral free.

We outsource our wafer fabrication, assembly, testing, warehousing and shipping operations to third parties, and rely on these parties to produce and deliver our products according to requested demands in specification, quantity, cost and time.

We rely on third parties for substantially all of our manufacturing operations, including wafer fabrication, assembly, testing, warehousing and shipping. We depend on these parties to supply us with material of a requested quantity in a

timely manner that meets our standards for yield, cost and manufacturing quality. We do not have any long-term supply agreements with our manufacturing suppliers. Any problems with our manufacturing supply chain could adversely impact our ability to ship our products to our customers on time and in the quantity required, which in turn could cause an unanticipated decline in our sales and possibly damage our customer relationships.

The fabrication of integrated circuits is a complex and technically demanding process. Our foundries could, from time to time, experience manufacturing defects and reduced manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundries could result in lower than anticipated manufacturing yields or unacceptable performance. Many of these problems are difficult to detect at an early stage of the manufacturing process and may be time consuming and expensive to correct. In addition, our manufacturing processes with our foundries are unique and not within the customary manufacturing processes of these foundries, which may lead to manufacturing defects, reduced manufacturing yields and/or increases in manufacturing costs.

Poor yields from our foundries, or defects, integration issues or other performance problems in our products could cause us significant customer relations and business reputation problems, harm our financial results and result in financial or other damages to our customers. Our customers could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

In addition, a significant portion of our sales are to customers that practice just-in-time order management from their suppliers, which gives us a very limited amount of time in which to process and complete these orders. As a result, delays in our production or shipping by the parties to whom we outsource these functions could reduce our sales, damage our customer relationships and damage our reputation in the marketplace, any of which could harm our business, financial condition and results of operations.

Our products are manufactured at a limited number of locations and if we experience manufacturing problems at a particular location, we could experience a delay in obtaining our manufactured products, which could harm our business and reputation.

Although we use several independent foundries to manufacture substantially all of our semiconductor products, most of our components are not manufactured at more than one foundry at any given time, and our products typically are designed to be manufactured in a specific process at only one of these foundries. Accordingly, if one of our foundries is unable to provide us with components as needed, we could experience significant delays in securing sufficient supplies of those components from other sources. Converting or transferring manufacturing from a primary location or supplier to a backup fabrication facility could be expensive and could take one to two quarters. During such a transition, we would be required to meet customer demand from our then-existing inventory, as well as any partially finished goods that can be modified to the required product specifications. We do not seek to maintain sufficient inventory to address a lengthy transition period because we believe it is uneconomical to keep more than minimal inventory on hand. As a result, we may not be able to meet customer needs during such a transition, which could delay shipments, cause a production delay or stoppage for our customers, result in a decline in our sales and damage our customer relationships. We cannot assure you that any of our existing or new foundries will be able to produce integrated circuits with acceptable manufacturing yields, or that our foundries will be able to deliver enough semiconductor devices to us on a timely basis, or at reasonable prices. These and other related factors could impair our ability to meet our customers' needs and have a material and adverse effect on our operating results.

If we experience delays or loss of manufacturing availability when demand is high, we would experience a delay in obtaining our manufactured products, which could harm our business and reputation.

We have no long-term supply contracts with the foundries with which we work. Availability of foundry capacity has in the recent past been reduced due to strong demand. The ability of each foundry to provide us with semiconductor devices is limited by its available capacity and existing obligations. Foundry capacity may not be available when we need it or at reasonable prices which could cause us to be unable to meet customer needs, delay shipments, because a production delay or stoppage for our customers, result in a decline in our sales and harm our financial results. Further, some of our competitors may be better financed than we are, may have long-term agreements with our main foundries and may induce our foundries to reallocate capacity to those customers. This reallocation could impair our ability to secure the supply of components that we need.

To secure sufficient foundry capacity when demand is high and mitigate the risks described in the foregoing paragraph, we may enter into various arrangements with suppliers that could be costly and harm our operating results, such as nonrefundable deposits with or loans to foundries in exchange for capacity commitments and contracts that commit us to purchase specified quantities of integrated circuits over extended periods. We may not be able to make any such arrangement in a timely fashion or at all, and any arrangements may be costly, reduce our financial flexibility, and not be on terms favorable to us. Moreover, if we are able to secure foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

Any increase in the manufacturing cost of our products could reduce our gross margins and operating profit.

The semiconductor business experiences ongoing competitive pricing pressure from customers and competitors. Accordingly, any increase in the cost of our products, whether by adverse purchase price variances or adverse manufacturing cost variances, may not be able to be passed on to our customers and we may experience reduced gross margins and operating profit. We do not have any long-term supply agreements with our manufacturing suppliers and we typically negotiate pricing on a purchase order by purchase order basis. Consequently, we may not be able to obtain price reductions or anticipate or prevent future price increases from our suppliers.

*Our failure to protect our intellectual property rights adequately could impair our ability to compete effectively or to defend ourselves from litigation, which could harm our business, financial condition and results of operations.

We rely primarily on patent, copyright, trademark and trade secret laws, as well as confidentiality and nondisclosure agreements and other methods, to protect our proprietary technologies and know-how.

The failure of our patents and other intellectual property protections to adequately protect our technology might make it easier for our competitors to offer similar products or technologies, which would harm our business. Including patents from our acquisitions, we have been issued 159 patents in the United States and 58 patents in foreign countries and have an additional 308 patent applications pending in the United States and 306 patent applications pending in foreign countries as of June 30, 2016. Even if the pending patent applications are granted, the rights granted to us may not be meaningful or provide us with any commercial advantage. For example, these patents could be opposed, contested, circumvented or designed around by our competitors or be declared invalid or unenforceable in judicial or administrative proceedings. Our foreign patent protection is generally not as comprehensive as our U.S. patent protection and may not protect our intellectual property in some countries where our products are shipped, sold or may be sold in the future. Many U.S.-based companies have encountered substantial intellectual property infringement in foreign countries, including countries where we sell products. Even if foreign patents are granted, effective enforcement in foreign countries may not be available.

We enter into confidentiality agreements with our employees, consultants and strategic partners. We also control access to and distribution of our technologies, documentation and other proprietary information. However, internal or external parties may copy, disclose, obtain or use our proprietary information without our authorization. Further, current or former employees or third parties may attempt to misappropriate our proprietary information.

Monitoring unauthorized use of our intellectual property and the intellectual property of our customers and strategic partners is difficult and costly. It is possible that unauthorized use of our intellectual property may have occurred or may occur without our knowledge. We cannot assure you that the steps we have taken will prevent unauthorized use of our intellectual property.

Our failure to effectively protect our intellectual property could reduce the value of our technology in licensing arrangements or in cross-licensing negotiations, and could harm our business, financial condition, and results of operations. We may in the future need to initiate infringement claims or litigation to defend or enforce our intellectual property rights. Litigation, whether we are a plaintiff or a defendant, can be expensive, time consuming and may divert the efforts of our technical staff and managerial personnel, which could harm our business, whether or not such litigation results in a determination favorable to us.

A breach of our security systems may have a material adverse effect on our business.

Our security systems are designed to maintain the physical security of our facilities and protect our customers', suppliers' and employees' confidential information. However, we are also dependent on a number of third-party "cloud-based" service providers of critical corporate infrastructure services relating to, among other things, human resources, electronic communication services and some finance functions, and we are, of necessity, dependent on the security systems of these providers. Accidental or willful security breaches or other unauthorized access by third parties to our facilities, our information systems or the systems of our cloud-based service providers or the existence of computer viruses in our or their data or software could expose us to a risk of information loss and misappropriation of proprietary and confidential information. Any theft or misuse of this information could result in, among other things, unfavorable publicity, damage to our reputation, disclosure of our intellectual property and/ or confidential customer, supplier or employee data, difficulty in marketing our products, allegations by our customers that we have not performed our contractual obligations, litigation by affected parties and possible financial obligations for liabilities and damages related to the theft or misuse of this information, any of which could have a material adverse effect on our business, profitability and financial condition. Since the techniques used to obtain unauthorized access or to

sabotage systems change frequently and are often not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures.

Assertions by third parties of infringement by us of their intellectual property rights could result in significant costs and cause our operating results to suffer.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights and positions, which has resulted in protracted and expensive litigation for many companies. From time to time we receive communications that allege we have infringed specified patents, trade secrets or other intellectual property rights owned by others. Any of these allegations, regardless of merit, could cause us to incur significant costs in responding to, defending and resolving these allegations. Any lawsuits resulting from these allegations could subject us to significant liability for damages and invalidate our proprietary rights. Any potential intellectual property litigation also could force us to do one or more of the following:

- stop selling products or using technology that contain the allegedly infringing intellectual property;
- lose the opportunity to license our technology to others or to collect royalty payments based upon successful protection and assertion of our intellectual property against others;

- incur significant legal expenses;
- pay substantial damages to a third-party if we are found to be infringing;
- redesign those products that contain the allegedly infringing intellectual property; or
- attempt to obtain a license to the relevant intellectual property from third parties, which may not be available on reasonable terms or at all.

Any significant impairment of our intellectual property rights from any litigation we face could harm our business and our ability to compete.

Our customers have in the past and may in the future also become the target of allegations of infringement or litigation relating to the patent and other intellectual property rights of others. This could trigger technical support and indemnification obligations in some of our licenses or customer agreements. These obligations could result in substantial expenses, including the payment by us of costs and damages relating to claims of intellectual property infringement. In addition to the time and expense required for us to provide support or indemnification to our customers, litigation could disrupt the businesses of our customers, which in turn could hurt our relationships with our customers and cause the sale of our products to decrease. We cannot assure you that claims for indemnification will not be made or that if made, the claims would not have a material adverse effect on our business, operating results or financial conditions.

If we do not manage the risks associated with our large professional service contracts properly, our revenue and customer base could be adversely affected.

The pricing and other terms of some of our larger professional services agreements require us to make estimates and assumptions at the time we enter into these contracts that could differ from actual results. Any increased or unexpected costs or unanticipated delays in connection with the performance of these engagements, including delays caused by factors outside our control, could make these agreements less profitable or unprofitable, which would have an adverse effect on the profit margin of our software and services business and adversely affect our operating results. In addition, changes in costs or a delay in connection with the performance of our large professional service agreements may harm our relationships with these customers.

Our software and licenses revenues are derived mainly from subscription-based software licenses and we are dependent upon the ability of our customers to develop and penetrate new markets successfully, and to develop new products for existing markets.

Our subscription-based license revenues depend both upon our ability to successfully negotiate license agreements with our customers and, in turn, upon our customers' successful commercialization of their underlying products. As our open source business grows, we may not be able to rely on receiving per unit fees from our customers. For our open source business, we may instead need to rely on other fees to compensate for the subscription-based license fees that we have traditionally received for our proprietary products. Also, we derive significant revenues from customers that develop products in highly competitive and technologically complex markets such as the internet infrastructure, server and storage, digital consumer, aerospace and defense, industrial control, medical equipment, gaming, and office automation. If these customers sell fewer products or otherwise face significant economic difficulties, particularly in the current global economic recession, our software and license revenues may decline.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. The Sarbanes-Oxley Act of 2002 requires management and our independent registered public accounting firm to evaluate and assess the effectiveness of our internal control over financial reporting. These Sarbanes-Oxley Act requirements may be modified, supplemented or amended from time to time. Implementing these changes may take a significant amount of

time and may require specific compliance training of our personnel. In the future, we may discover areas of our internal controls that need improvement. If our independent registered public accounting firm or we discover a material weakness, the disclosure of that fact, even if quickly remediated, could reduce the market's confidence in our financial statements and harm our stock price. We may not be able to effectively and timely implement necessary control changes and employee training to ensure continued compliance with the Sarbanes-Oxley Act and other regulatory and reporting requirements. Our rapid growth in recent years, including through numerous acquisitions and our possible future expansion through acquisitions, present challenges to maintain the internal control and disclosure control standards applicable to public companies. If we fail to maintain effective internal controls, we could be subject to regulatory scrutiny and sanctions and investors could lose confidence in the accuracy and completeness of our financial reports.

We rely on third-party technologies for the development of our products and our inability to use these technologies in the future would harm our ability to remain competitive.

We rely on third parties for technologies that are integrated into our products, such as wafer fabrication and assembly and test technologies used by our contract manufacturers, as well as licensed MIPS and ARM architecture technologies. If we are unable to continue to use or license these technologies on reasonable terms, or if these technologies fail to operate properly, we may not be able to secure alternatives in a timely manner and our ability to remain competitive would be harmed, which could harm our business, financial condition and results of operations. In addition, if we are unable to successfully license technology from third parties to develop future products, we may not be able to develop such products in a timely manner or at all.

Our open source business could be seriously harmed by the outcome of lawsuits challenging the use and distribution of Linux-based software products.

We rely on Linux system software as the basis of our software products. Several lawsuits have been filed challenging the right to use and/or distribute Linux system software and software applications based on Linux. Although we are not a party to or directly involved in any of the lawsuits relating to Linux, we expect that further lawsuits could be filed against Linux in the future which would challenge the use and distribution of our Linux-based software products. It is impossible to estimate or anticipate all of the financial or other impacts the results of these litigation matters could have on our business. Success by a plaintiff in one or more of these lawsuits could have a material adverse effect on our open source business.

Legal uncertainty surrounding the use and distribution of open source software may cause the market for Linux-based products to disappear, fail to further develop or fail to develop at a rate sufficient to sustain our business.

The majority of our open source software products are licensed from third parties under the General Public License, or GPL, and similar open source licenses. There remains some significant confusion among our customers about the scope of their obligations and rights with respect to using and distributing Linux-based products. One element of this confusion is whether the GPL and other open source licenses require customers to (i) make all of the source code for their products available to the public, and/or (ii) license all of the code underlying such products under an open source license. There is little or no legal precedent for interpreting the terms of the GPL and similar open source licenses, including the determination of which types of programs or products would be considered derived works and thus potentially subject to the terms of such open source licenses. If this confusion remains, increases or is prolonged by litigation, the market for Linux-based products may disappear, fail to further develop or fail to develop at a rate sufficient to sustain our open source business.

Our open source business depends on Linux developers to continue to improve Linux and Linux-based applications that are incorporated into our open source products.

Our ability to release major upgrades of MontaVista Linux is largely dependent upon the release of new versions of the Linux kernel. The Linux kernel is the heart of the Linux system software. Linus Torvalds and a small group of engineers are primarily responsible for the development, evolution and maintenance of the Linux kernel. In addition, other individuals and small groups of developers are largely responsible for Linux programs tailored to specific tasks or computer architectures. If Mr. Torvalds or other key developers fail to further develop the Linux kernel or other programs on which we rely, we will need to either develop them ourselves or rely on another party for development. This development effort could be costly and time consuming, and could delay or entirely prevent our open source product release and upgrade schedule.

We may be unsuccessful in marketing our open source products because we encounter widespread negative perceptions about Linux and open source software in general.

Some people still incorrectly believe that anyone who writes a software program that runs on Linux will necessarily need to publicly disclose the source code for that software. If a potential customer believes their source code will need to be made public if they use our open source product, they may be less likely to purchase our open source product. We devote substantial time and attention helping potential customers understand the legal implications of using our open source products, including that fact that in most instances, applications developed to run on Linux may be distributed under a proprietary license. In many cases, we are required to address these issues at different levels across an organization (such as at the engineering, managerial and executive levels), which can be very time consuming. We are sometimes unsuccessful at convincing a potential customer that using Linux-based system software will not have negative consequences for that customer. Furthermore, many potential customers believe that they should not be required to pay for our open source products, since our open-source products are based on open source (also sometimes called “free”) software. They believe that open source products are all publicly available at no charge. There is also the misconception that distributors of Linux software cannot offer warranties or indemnifications with respect to Linux software. Each of these customers’ fears or misperceptions could cause us to lose potential orders or cause our customers to delay purchase decisions, which could significantly lengthen our sales cycle. These misperceptions could cause the market for Linux-based products to disappear, fail to further develop, or fail to develop at a rate sufficient to sustain our open source business.

Our open source software may contain errors or defects that could delay introduction of new products, result in costly remedial expenditures or cause disputes with customers.

Most of the open source software that we sell and distribute is developed by third parties with whom we have no business relationship, including thousands of individual software programmers. To successfully release our open source products, we must assemble and test software developed by thousands of disparate sources. Despite our efforts, errors have been and may continue to be found in our open source products. If errors are discovered, we may not be able to successfully correct them in a timely manner or at all. Errors and failures in our open source products could result in a loss of, or delay in, market acceptance of our open-source products and could damage our reputation and our ability to convince commercial users of the benefits of Linux-based systems software and other open source software products. In addition, we may need to make significant expenditures of capital resources to reduce errors and failures.

We face intense competition related to our open source products, and expect competition to increase in the future, which could reduce our open source-related revenue and customer base.

The market for Linux-based systems software is highly competitive, and we expect competition to intensify in the future. We consider the primary competitors for our MontaVista software products to be Wind River Systems, Inc., a subsidiary of Intel Corporation and, to a lesser extent, Canonical Ltd. and Mentor Graphics Corporation. In addition, potential customers for our open source products may believe that they can build their own open source product cheaper or more efficiently than purchasing our products.

In addition to competitors in the business of distributing a commercial Linux-based operating system, we face competition from some hardware companies who offer Linux-based operating systems and related software components at little or no charge. We also face competition from Linux-based software distributions provided by new and emerging consortiums and software stacks such as Linaro and Android. And because, apart from such hardware vendors and consortiums, there is a large Linux code base generally available at no charge, certain customers or potential customers have made, and will continue to make, efforts to develop their own Linux-based operating system without purchasing or otherwise obtaining it from a third-party vendor. To the extent that the quality and availability of non-commercial Linux-based operating system software continues to improve, it could have a material adverse effect on our ability to sell open source software.

Our third-party contractors are concentrated primarily in Asia, an area subject to earthquake and other risks. Any disruption to the operations of these contractors could cause significant delays in the production or shipment of our products.

Substantially all of our products are manufactured by third-party contractors located in Taiwan and to a lesser extent manufactured by third-party contractors located in Japan, Malaysia and Korea. The risk of an earthquake in any of those countries or elsewhere in Asia is significant due to the proximity of major earthquake fault lines to the facilities of our foundries and assembly and test subcontractors. For example, several major earthquakes have occurred in Taiwan and Japan since our incorporation in 2000, the most recent being the major earthquake and tsunami that occurred in March 2011 in Japan. Although our third-party contractors did not suffer any significant damage as a result of these most recent earthquakes, the occurrence of additional earthquakes, other natural disasters or other events causing closures could result in the disruption of our foundry or assembly and test capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling or testing from the affected contractor to another third-party vendor. We may not be able to obtain alternate capacity on favorable terms, if at all.

We may experience difficulties in transitioning to new wafer fabrication process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

To remain competitive, we expect to continue to transition our semiconductor products to increasingly smaller line width geometries. This transition requires us to modify our designs to work with the manufacturing processes of our foundries. We periodically evaluate the benefits, on a product-by-product basis, of migrating to new process technologies to reduce cost and improve performance. We may face difficulties, delays and expenses as we continue to transition our products to new processes. We are dependent on our relationships with our foundry contractors to transition to new processes successfully. We cannot assure you that the foundries that we use will be able to effectively manage the transition or that we will be able to maintain our existing foundry relationships or develop new ones. If any of our foundry contractors or we experience significant delays in this transition or fail to efficiently implement this transition, we could experience reduced manufacturing yields, delays in product deliveries and increased expenses, all of which could harm our relationships with our customers and our results of operations. As new processes become more prevalent, we expect to continue to integrate greater levels of functionality, as well as customer and third-party intellectual property, into our products. However, we may not be able to achieve higher levels of design integration or deliver new integrated products on a timely basis.

We may need to raise additional capital, which might not be available or which, if available, may be on terms that are not favorable to use.

We believe our existing cash and cash equivalent balances and cash expected to be generated from our operations will be sufficient to meet our working capital, capital expenditures and other needs for at least the next 12 months. In the future, we may seek to raise additional funds, and we cannot be certain that we will be able to obtain additional financing on favorable terms, if at all. If we issue equity securities to raise additional funds, the ownership percentage of our stockholders would be reduced, and the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. If we borrow money, we may incur significant interest charges, which could harm our profitability. Holders of debt would also have rights, preferences or privileges senior to those of existing holders of our common stock. If we cannot raise needed funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, which could harm our business, operating results and financial condition.

We may incur impairments to goodwill or long-lived assets.

We review our long-lived assets, including goodwill and other intangible assets, for impairment annually in the fourth quarter or whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Significant negative industry or economic trends, including a significant decline in the market price of our common stock, reduced estimates of future cash flows for our reporting units or disruptions to our business could lead to an impairment charge of our long-lived assets, including goodwill and other intangible assets.

Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. If our actual results, or the plans and estimates used in future impairment analyses are lower than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges. We operate in highly competitive environments and projections of future operating results and cash flows may vary significantly from results. Additionally, if our analysis results in impairment to our goodwill, we may be required to record a charge to earnings in our financial statements during a period in which such impairment is determined to exist, which may negatively impact our business, financial condition and results of operations.

The complexity of accounting regulations and related interpretations and policies, particularly those related to revenue recognition, could materially affect our financial results for a given period.

Although we use standardized agreements designed to meet current revenue recognition criteria under generally accepted accounting principles, we might negotiate and revise terms and conditions of these standardized agreements, particularly in multi-element license and services transactions. As we increase our transactions to more complex multi-element transactions, negotiation of mutually acceptable terms and conditions may require us to defer recognition of revenue on such licenses. We believe that we are in compliance with the guidance as provided under multiple element arrangements; however, bigger and more complex, multi-element transactions may require additional accounting analysis to account for them accurately. Errors in such analysis in any period could lead to unanticipated changes in our revenue accounting practices and may affect the timing of revenue recognition, which could adversely affect our financial results. If we later discover that we have interpreted and applied revenue recognition rules differently than prescribed by generally accepted accounting principles in the U.S., we could be required to devote significant management resources, and incur the expense associated with an audit, restatement or other examination of our financial statements.

Our future effective tax rates could be affected by the allocation of our income among different geographic regions, which could affect our future operating results, financial condition and cash flows.

As a global company, we are subject to taxation in the United States and various other countries and states. Significant judgment is required to determine and estimate worldwide tax liabilities. We may further expand our international operations and staff to better support our international markets. As a result, we anticipate that our consolidated pre-tax income will be subject to tax at relatively lower tax rates when compared to the United States federal statutory tax rate. Further, because we have established valuation allowance against our deferred tax assets in the United States, combined with lower foreign tax rates, our effective income tax rate is expected to be lower than the United States federal statutory rate. Our future effective income tax rates could be adversely affected if tax authorities were to successfully challenge our international tax structure or if the relative mix of United States and international income changes for any reason, or United States or foreign tax laws were to change. Accordingly, there can be no assurance that our income tax rate will continue to be less than the United States federal statutory rate.

Any significant change in our future effective tax rates could adversely impact our consolidated financial position, results of operations and cash flows. Our future effective tax rates may be adversely affected by a number of factors including:

- changes in tax laws in the countries in which we operate or the interpretation of such laws including the Base Erosion Profit Shifting, or BEPS, project being conducted by the Organization for Economic Co-operation and Development and the appeal of the U.S. tax court's recent opinion on the exclusion of stock compensation expense in inter-company cost sharing arrangement;
- increase in expenses not deductible for tax purposes;
- changes in share-based compensation expense;
- change in the mix of income among different taxing jurisdictions;
- audit examinations with adverse outcomes;
- changes in generally accepted accounting principles; and
- our ability to use tax attributes such as research and development tax credits and net operating losses.

Although we reserve for uncertain tax positions, including related penalties and interest, the amounts ultimately paid upon resolution of audits could be materially different from the amounts previously included in our income tax expense and therefore could have a material impact on our tax provision, net income and cash flows. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to record additional income tax expense or establish an additional valuation allowance, which could materially impact our financial position and results of operations. (See Note 8 of the Notes to Condensed Consolidated Financial Statements).

Changes in valuation allowance of deferred tax assets may affect our future operating results

We record a valuation allowance to reduce our net deferred tax assets to the amount that we believe is more-likely-than-not to be realized. In assessing the need for a valuation allowance, we consider historical levels of income, expectations and risks associated with estimates of future taxable income. We periodically evaluate our deferred tax asset balance for realizability. To the extent we believe it is more-likely-than-not that some portion of our deferred tax assets will not be realized, we will increase the valuation allowance against the deferred tax assets. Realization of our deferred tax assets is dependent primarily upon future taxable income in related tax jurisdictions. If our assumptions and consequently our estimates change in the future, the valuation allowances may be increased or decreased, resulting in a respective increase or decrease in income tax expense.

Risks Related to our Common Stock

The market price of our common stock may be volatile, which could cause the value of your investment to decline.

The trading prices of the securities of technology companies have been highly volatile. Further, our common stock has a limited trading history. Since our initial public offering in May 2007 through June 2016, our stock price has fluctuated from a low of $7.61 to a high of $76.38. We cannot predict the extent to which the trading market will continue to develop or how liquid the market may become. The trading price of our common stock is therefore likely to be highly volatile and could be subject to wide fluctuations in price in response to various factors, some of which are beyond our control. These factors include:

- quarterly variations in our results of operations or those of our competitors;
- general economic conditions and slow or negative growth of related markets;
- announcements by us or our competitors of design wins, acquisitions, new products, significant contracts, commercial relationships or capital commitments;
- our ability to develop and market new and enhanced products on a timely basis;
- commencement of, or our involvement in, litigation;

- disruption to our operations;
- the emergence of new sales channels in which we are unable to compete effectively;
- any major change in our board of directors or management;
- changes in financial estimates including our ability to meet our future revenue and operating profit or loss projections;
- changes in governmental regulations; and
- changes in earnings estimates or recommendations by securities analysts.

Furthermore, the stock market in general, and the market for semiconductor and other technology companies in particular, have experienced price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our actual operating performance. These trading price fluctuations may also make it more difficult for us to use our common stock as a means to make acquisitions or to use options to purchase our common stock to attract and retain employees. In addition, in the past, following periods of volatility in the overall market and the market price of a company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

Delaware law and our amended and restated certificate of incorporation and bylaws contain provisions that could delay or discourage takeover attempts that stockholders may consider favorable.

Provisions in our amended and restated certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. These provisions include the following:

- the division of our board of directors into three classes;
- the right of the board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or due to the resignation or departure of an existing board member;
- the prohibition of cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;
- the requirement for the advance notice of nominations for election to the board of directors or for proposing matters that can be acted upon at a stockholders' meeting;
- the ability of our board of directors to alter our bylaws without obtaining stockholder approval;
- the ability of the board of directors to issue, without stockholder approval, up to 10,000,000 shares of preferred stock with terms set by the board of directors, which rights could be senior to those of our common stock;
- the elimination of the rights of stockholders to call a special meeting of stockholders and to take action by written consent in lieu of a meeting;
- the required approval of at least 66 2/3% of the shares entitled to vote at an election of directors to adopt, amend or repeal our bylaws or repeal the provisions of our amended and restated certificate of incorporation regarding the election and removal of directors and the inability of stockholders to take action by written consent in lieu of a meeting; and
- the required approval of at least a majority of the shares entitled to vote at an election of directors to remove directors without cause.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, particularly those owning 15% or more of our outstanding voting stock, from merging or combining with us. These provisions in our amended and restated certificate of incorporation and bylaws and under Delaware law could discourage potential takeover attempts, could reduce the price that investors are willing to pay for shares of our common stock in the future and could potentially result in the market price being lower than they would without these provisions.

Item 5. Other Information

The members of our board of directors and our officers entered into a revised indemnity agreement which was revised to be consistent with current industry standards. A copy of the revised indemnity agreement is filed as Exhibit 10.1 to this Quarterly Report on Form 10-Q and incorporated herein by reference.

Item 6. Exhibits

See the Exhibit Index which follows the signature page of this Quarterly Report on Form 10-Q, which is incorporated here by reference.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

		CAVIUM, INC.
Date: August 8, 2016	By:	/S/ ARTHUR D. CHADWICK
		Arthur D. Chadwick
		Chief Financial Officer and Vice President of Finance and Administration

EXHIBIT INDEX

Exhibit Number	Description
2.1*	Agreement and Plan of Merger and Reorganization between the Registrant, Quasar Acquisition Corporation and QLogic Corporation, dated June 15, 2016 (1)
2.2*	Agreement and Plan of Merger and Reorganization between the Registrant, Cavium Semiconductor Corporation, Cavium Networks LLC, and Xpliant, Inc. dated July 30, 2014 (2)
2.3*	Amendment No. 1 to the Agreement and Plan of Merger and Reorganization between the Registrant, Cavium Semiconductor Corporation, Cavium Networks LLC, and Xpliant, Inc. dated October 8, 2014 (3)
2.4*	Amendment No. 2 to the Agreement and Plan of Merger and Reorganization between the Registrant, Cavium Semiconductor Corporation, Cavium Networks LLC, and Xpliant, Inc. dated June 30, 2015 (4)
3.1	Restated Certificate of Incorporation of the Registrant (5)
3.2	Amended and Restated Bylaws of the Registrant(6)
4.1	Reference is made to Exhibits 3.1 and 3.2
4.2	Form of the Registrant’s Common Stock Certificate (7)
10.1†	Indemnity agreement (8)
10.2†	Non-employee Directors Compensation Policy
10.3†	2016 Equity Incentive Plan (9)
10.4†	Letter Agreement, dated July 22, 2016, between the Registrant and Brad Bass (10)
10.5†	Letter Agreement, dated July 22, 2016, between the Registrant and Dr. Edward Frank (11)
10.6†	Employment Agreement, dated July 22, 2016, between the Registrant and Muhammad Raghib Hussain (12)
31.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Syed B. Ali, President and Chief Executive Officer
31.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Arthur D. Chadwick, Chief Financial Officer
32.1**	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Syed B. Ali, President and Chief Executive Officer and Arthur D. Chadwick, Chief Financial Officer
101.INS	XBRL Instance Document

101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Filed as Exhibit 2.1 to the Registrant's Quarterly Report on Form 8-K (No. 001-33435), filed with the SEC on June 15, 2016, and incorporated herein by reference.

(2) Filed as Exhibit 2.1 to the Registrant's Quarterly Report on Form 10-Q (No. 001-33435), filed with the SEC on August 1, 2014, and incorporated herein by reference.

(3) Filed as Exhibit 2.2 to the Registrant's Quarterly Report on Form 10-Q (No. 001-33435), filed with the SEC on October 31, 2014, and incorporated herein by reference.

(4) Filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K (No. 001-33435), filed with the SEC on April 3, 2015, and incorporated herein by reference.

(5) Filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K (No. 001-33435), filed with the SEC on June 20, 2011, and incorporated herein by reference.

Exhibit Number	Description
(6)	Filed as Exhibit 3.5 to the Registrant’s registration statement on Form S-1/A (No. 333-140660), filed with the SEC on April 13, 2007, as amended, and incorporated herein by reference.
(7)	Filed as Exhibit 4.2 to the Registrant’s registration statement on Form S-1/A (No. 333-140660), filed with the SEC on April 24, 2007, as amended, and incorporated herein by reference.
(8)	Filed as Exhibit 10.1 to the Registrant’s registration statement on Form 10-Q (No. 001-33435), filed with the SEC on April 29, 2016, and incorporated herein by reference.
(9)	Filed as Exhibit 10.1 to the Registrant’s registration statement on Form 8-K (No. 001-33435), filed with the SEC on June 15, 2016, and incorporated herein by reference.
(10)	Filed as Exhibit 10.1 to the Registrant’s registration statement on Form 8-K (No. 001-33435), filed with the SEC on July 26, 2016, and incorporated herein by reference.
(11)	Filed as Exhibit 10.2 to the Registrant’s registration statement on Form 8-K (No. 001-33435), filed with the SEC on July 26, 2016, and incorporated herein by reference.
(12)	Filed as Exhibit 10.3 to the Registrant’s registration statement on Form 8-K (No. 001-33435), filed with the SEC on July 26, 2016, and incorporated herein by reference.
*	Certain schedules related to identified agreements have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Registrant undertakes to furnish supplemental copies of any omitted schedules upon request by the SEC.
**	This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.
†	Management contract or compensatory plan or arrangement.