

PDF SOLUTIONS INC  
Form 10-Q  
May 11, 2009  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**For the Quarterly Period ended March 31, 2009**

**or**

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

**For the transition period from                      to**

**Commission File Number 000-31311**

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**PDF SOLUTIONS, INC.**

(Exact name of Registrant as Specified in its Charter)

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**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**25-1701361**  
(I.R.S. Employer  
Identification No.)

**333 West San Carlos Street, Suite 700**  
**San Jose, California**  
(Address of Principal Executive Offices)

**95110**  
(Zip Code)

**(408) 280-7900**

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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  No

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The number of shares outstanding of the Registrant's Common Stock as of May 1, 2009 was 26,261,010.

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Table of Contents**Item 1. Financial Statements.****PDF SOLUTIONS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

	March 31, 2009	December 31, 2008
	(In thousands, except par values)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 32,780	\$ 31,686
Short-term investments	6,354	9,051
Accounts receivable, net of allowance of \$254 in 2009 and 2008	20,387	24,989
Prepaid expenses, deferred tax assets, and other current assets	3,639	5,147
Total current assets	63,160	70,873
Property and equipment, net	2,427	2,675
Non-current investments	718	718
Intangible assets, net	4,280	4,730
Deferred tax assets and other non-current assets	626	631
Total assets	\$ 71,211	\$ 79,627
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 336	\$ 370
Accounts payable	1,715	1,384
Accrued compensation and related benefits	5,850	6,525
Taxes payable and other accrued liabilities	3,093	3,723
Deferred revenue	2,057	1,792
Billings in excess of recognized revenue	247	748
Total current liabilities	13,298	14,542
Long-term debt	461	512
Long-term taxes payable	3,354	3,356
Long-term other liabilities	1,400	1,447
Total liabilities	18,513	19,857
Stockholders' equity:		
Preferred stock, \$0.00015 par value, 5,000 shares authorized: no shares issued and outstanding		
Common stock, \$0.00015 par value, 70,000 shares authorized: shares issued 29,680 in 2009 and 29,339 in 2008; shares outstanding 26,264 in 2009 and 25,923 in 2008	4	4
Additional paid-in-capital	190,685	189,132
Treasury stock at cost, 3,416 shares in 2009 and 2008	(18,402)	(18,402)
Accumulated deficit	(119,941)	(112,620)
Accumulated other comprehensive income	352	1,656
Total stockholders' equity	52,698	59,770
Total liabilities and stockholders' equity	\$ 71,211	\$ 79,627

*See notes to unaudited condensed consolidated financial statements*



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	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(In thousands, except per share amounts)</b>	
<b>Revenues:</b>		
Design-to-silicon-yield solutions	\$ 7,794	\$ 15,024
Gainshare performance incentives	2,396	5,323
Total revenues	10,190	20,347
<b>Cost of design-to-silicon-yield solutions:</b>		
Direct costs of design-to-silicon-yield solutions	6,290	7,766
Amortization of acquired technology	359	631
Total cost of design-to silicon-yield solutions	6,649	8,397
Gross margin	3,541	11,950
<b>Operating expenses:</b>		
Research and development	5,789	9,076
Selling, general and administrative	4,413	6,299
Amortization of other acquired intangible assets	87	194
Restructuring charges	633	
Total operating expenses	10,922	15,569
Loss from operations	(7,381)	(3,619)
Interest and other income, net	324	489
Loss before taxes	(7,057)	(3,130)
Income tax provision (benefit)	264	(617)
Net loss	\$ (7,321)	\$ (2,513)
Net loss per share basic and diluted	\$ (0.28)	\$ (0.09)
Weighted average common shares basic and diluted	26,092	27,840

*See notes to unaudited condensed consolidated financial statements*

Table of Contents**PDF SOLUTIONS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	Three Months Ended March 31,	
	2009	2008
	(In thousands)	
Operating activities:		
Net loss	\$ (7,321)	\$ (2,513)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	414	524
Stock-based compensation expense	1,136	1,983
Losses on disposal of property, plant and equipment	1	2
Amortization of acquired intangible assets	446	825
Tax shortfall related to stock-based compensation expense		(11)
Deferred taxes and other assets	(5)	(1,284)
Changes in operating assets and liabilities:		
Accounts receivable, net of allowances	4,595	62
Prepaid expenses and other assets	1,459	(418)
Accounts payable	415	(1,332)
Accrued compensation and related benefits	(609)	(525)
Taxes payable and other accrued liabilities	(624)	849
Deferred revenues	265	1,280
Billings in excess of recognized revenue	(502)	(199)
Net cash used in operating activities	(330)	(757)
Investing activities:		
Purchases of available-for-sale securities		(8,848)
Maturities and sales of available-for-sale securities	2,700	7,585
Purchases of property and equipment	(299)	(240)
Net cash provided by (used in) investing activities	2,401	(1,503)
Financing activities:		
Proceeds from exercise of stock options		40
Proceeds from Employee Stock Purchase Plan	417	
Purchases of treasury stock		(1,124)
Principal payments on long-term debt	(51)	(56)
Net cash provided by (used in) financing activities	366	(1,140)
Effect of exchange rate changes on cash	(1,343)	1,110
Net increase (decrease) in cash and cash equivalents	1,094	(2,290)
Cash and cash equivalents, beginning of period	31,686	35,315
Cash and cash equivalents, end of period	\$ 32,780	\$ 33,025
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Taxes	\$ 232	\$ 244
Interest	\$ 7	\$ 11

*See notes to unaudited condensed consolidated financial statements*

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**PDF SOLUTIONS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. BASIS OF PRESENTATION**

*Basis of Presentation*

The interim unaudited condensed consolidated financial statements included herein have been prepared by PDF Solutions, Inc., or the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC, including the instructions to the Quarterly Report on Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The interim unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments necessary, (consisting only of normal recurring adjustments) to present a fair statement of results for the interim periods presented. The operating results for any interim period are not necessarily indicative of the results that may be expected for other interim periods or the full fiscal year. The accompanying interim unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. A significant portion of the Company's revenues require estimates with respect to total costs which may be incurred and revenues earned. Actual results could differ from these estimates.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries after the elimination of all significant intercompany balances and transactions.

*Revenue Recognition*

The Company derives revenue from two sources: Design-to-Silicon-Yield Solutions, which includes Services and Software Licenses, and Gainshare Performance Incentives. The Company recognizes revenue in accordance with the provisions of American Institute of Certified Public Accountants Statement of Position, or SOP, No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* and SOP No. 97-2, *Software Revenue Recognition*, as amended.

*Design-to-Silicon-Yield Solutions* Revenue that is derived from Design-to-Silicon-Yield solutions comes from services and software licenses. The Company recognizes revenue for each element of Design-to-Silicon-Yield solutions as follows:



*Services* The Company generates a significant portion of its Design-to-Silicon-Yield solutions revenue from fixed-price solution implementation service contracts delivered over a specific period of time. These contracts require accurate estimation of costs to perform obligations and overall scope of each engagement. Revenue under contracts for solution implementation services is recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting. Losses on solution implementation contracts are recognized in the period when they become evident. Revisions in profit estimates are reflected in the period in which the conditions that require the revisions become known and can be estimated.

On occasion, the Company has licensed its software products as a component of its fixed-price services contracts. In such instances, the software products are licensed to customers over a specified term of the agreement with support and maintenance to be provided over the license term. Under these arrangements, where vendor-specific objective evidence of fair value, or VSOE, exists for the support and maintenance element, the support and maintenance revenue is recognized separately over the term of the support period. The remaining fee is recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting. VSOE for maintenance, in these instances, is generally based upon the Company's customary pricing for maintenance when sold separately and is measured by the renewal rate offered to the customer. Under arrangements where software products are licensed as a component of its fixed-price service contract and where VSOE does not exist to allocate a portion of the total fixed-price to the undelivered elements, revenue is recognized for the total fixed-price as the lesser of either the percentage of completion method of contract accounting or ratably over the longer of either the term of the agreement or the support period. Costs incurred under these arrangements are deferred and recognized in proportion to revenue recognized under these arrangements.

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Revenue from related support and maintenance services is recognized ratably over the term of the support and maintenance contract, generally one year, while revenue from consulting, installation and training services is recognized as the services are performed. When bundled with software licenses in multiple element arrangements, support and maintenance, consulting (other than for its fixed-price solution implementations), installation, and training revenue is allocated to each element of a transaction based upon its fair value as determined by the Company's VSOE. VSOE for all elements is generally based upon the Company's customary pricing for such services when sold separately and support and maintenance services is also measured by the renewal rate offered to the customer. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the longest period of the undelivered elements.

*Software Licenses* The Company also licenses its software products separately from its integrated solution implementations. For software license arrangements that do not require significant modification or customization of the underlying software, software license revenue is recognized under the residual method when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the fee is fixed or determinable, (4) collectibility is probable, and (5) the arrangement does not require services that are essential to the functionality of the software. When arrangements include multiple elements such as support and maintenance, consulting (other than for its fixed price solution implementations), installation, and training, revenue is allocated to each element of a transaction based upon its fair value as determined by the Company's VSOE and such services are recorded as services. VSOE for all elements is generally based upon the Company's customary pricing for such services when sold separately and support and maintenance services is also measured by the renewal rate offered to the customer. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the longest period of the undelivered elements, and such revenue is recorded as services. Revenue for software licenses with extended payment terms is not recognized in excess of amounts due. For software license arrangements that require significant modification or customization of the underlying software, the software license revenue is recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting, and such revenue is recorded as services.

*Gainshare Performance Incentives* When the Company enters into a contract to provide yield improvement services, the contract usually includes two components: (1) a fixed fee for performance by the Company of services delivered over a specific period of time; and (2) a gainshare performance incentives component where the customer may pay a variable fee, usually after the fixed fee period has ended. Revenue derived from gainshare performance incentives represents profit sharing and performance incentives earned based upon the Company's customers reaching certain defined operational levels established in related solution implementation services contracts. Gainshare performance incentives periods are usually subsequent to the delivery of all contractual services and therefore have no cost to the Company. Due to the uncertainties surrounding attainment of such operational levels, the Company recognizes gainshare performance incentives revenue (to the extent of completion of the related solution implementation contract) upon receipt of performance reports or other related information from the customer supporting the determination of amounts and probability of collection.

*Software Development Costs* Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized in accordance with SFAS No. 86, *Computer Software to be Sold, Leased or Otherwise Marketed*. Because the Company believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

**2. RECENT ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING CHANGES**

In April 2009, the FASB issued FSP No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, or FSP No. 157-4. FSP No. 157-4 provides guidance for estimating fair value in accordance with SFAS No. 157, when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP No. 157-4 is effective for interim and annual reporting periods ending after June 15, 2009 and will be adopted by the Company in the second quarter of fiscal 2009. The adoption of FAS No. 157-4 is not expected to have a material impact on the Company's operating results and financial position.

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In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, or FSP FAS 115-2 and 124-2. FSP FAS 115-2 and 124-2 amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments in the financial statements. FSP FAS 115-2 and 124-2 are effective for interim and annual reporting periods ending after June 15, 2009 and will be adopted by the Company in the second quarter of fiscal 2009. The Company is currently evaluating the potential impact, if any, that the adoption of FSP FAS 115-2 and 124-2 will have on its consolidated financial statements.

In April 2009, the FASB issued FSP No. 107, *Disclosures about Fair Value of Financial Instruments*, or FSP No. 107, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends the Accounting Principals Board, or the APB, Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. FSP No. 107 is effective for interim and annual reporting periods ending after June 15, 2009, and will be adopted by the Company in the second quarter of fiscal 2009. The adoption of FSP No 107 is not expected to have a material effect on the Company's operating results and financial position.

Effective January 1, 2009, the Company adopted the provisions of the FASB's SFAS No. 141 (revised 2007), *Business Combinations*, or SFAS No. 141R. SFAS No. 141R establishes principles and requirements for how an acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and the goodwill acquired. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. The adoption of SFAS No. 141R did not have an effect on the Company's financial results and position.

**3. INVESTMENTS**

The following tables summarize the Company's investments (in thousands):

	March 31, 2009			
	Amortized Costs	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
Agency obligations	\$ 5,927	\$ 28	\$	\$ 5,955
Auction-rate securities	1,000		(282)	718
Corporate securities	400		(1)	399
	\$ 7,327	\$ 28	\$ (283)	\$ 7,072
Included in short term investments				6,354
Included in non-current investments				718
Total				\$ 7,072

	December 31, 2008			
	Amortized Costs	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
Commercial paper	\$ 2,043	\$ 4	\$	\$ 2,047
Agency obligations	6,544	68		6,612
Auction-rate securities	1,000		(282)	718
Corporate Securities	400		(8)	392

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	\$	9,987	\$	72	\$	(290)	\$	9,769
Included in short-term investments							\$	9,051
Included in non-current investments								718
Total							\$	9,769

As of March 31, 2009 and December 31, 2008, all securities, other than auction-rate securities held by the Company, had a maturity of one year or less. Please refer to Note 12 Fair Value for further discussion of auction-rate securities.

**4. ACCOUNTS RECEIVABLE**

Accounts receivable include amounts that are unbilled at the end of the period. Unbilled accounts receivable are determined on an individual contract basis and were approximately \$9.5 million and \$10.5 million as of March 31, 2009 and December 31, 2008, respectively.

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SFAS No. 142, *Goodwill and other Intangible Assets*, requires goodwill to be tested for impairment on an annual basis (or more frequently if indicators of impairment exist) and requires purchased intangible assets other than goodwill to be amortized over their useful lives unless these lives are determined to be indefinite. The Company completed its annual impairment test in the fourth quarter of 2008 and the Company observed impairment indicators during the fourth quarter of 2008 including the trading of common stock below the Company's book value and a further deterioration in the semiconductor industry, brought on by the deteriorating global economic environment. The Company also evaluated its acquired intangible assets for impairment. As a result of the impairment analyses, the Company recorded an impairment charge of \$64 million related to goodwill and \$6.3 million relating to its acquired intangible assets during the fourth quarter of 2008.

The following table provides information relating to the intangible assets and goodwill as of March 31, 2009 and December 31, 2008 (in thousands):

Acquired Identifiable Intangibles	Amortization Period (Years)	December 31, 2008 Net Carrying Amount	Amortization	Foreign Currency Translation	March 31, 2009 Net Carrying Amount
Acquired technology	4 - 5	\$ 3,608	\$ (359)	\$	\$ 3,249
Brand name	4	129	(18)		111
Customer relationships and backlog	1 - 6	489	(32)		457
Patent and applications	7	400	(18)		382
Other acquired intangibles	4	104	(19)	(4)	81
Total		\$ 4,730	\$ (446)	\$ (4)	\$ 4,280

	Amortization Period (Years)	December 31, 2007 Net Carrying Amount	Acquisitions	Purchase Price Adjustments	Amortization	Foreign Currency Translation	Impairment	December 31, 2008 Net Carrying Amount
Goodwill	N/A	\$ 65,170	\$ 147	\$ (216)	\$	\$ (1,102)	\$ (63,999)	\$
Acquired identifiable intangibles:								
Acquired technology	4-5	\$ 9,184	\$ 420	\$	\$ (2,576)	\$	\$ (3,420)	\$ 3,608
Brand name	4	361			(128)		(104)	129
Customer relationships and backlog	1-6	1,812	1,230		(509)		(2,044)	489
Patents and applications	7	1,283			(200)		(683)	400
Other acquired intangibles	4	178			(72)	(2)		104
Total		\$ 12,818	\$ 1,650	\$	\$ (3,485)	\$ (2)	\$ (6,251)	\$ 4,730

The Company expects the annual amortization of acquired intangible assets to be as follows (in thousands):

Year Ending December 31,	Amount
2009 (remaining nine-month period)	\$ 1,334
2010	1,577
2011	829
2012	435

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2013		74
2014 and thereafter		31
Total	\$	4,280

**6. STOCKHOLDERS EQUITY**

The Company accounts for stock-based compensation in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment*. Stock-based compensation expenses before taxes related to the Company's employee stock purchase plan and stock-option plans were allocated as follows (in thousands):

		Three Months Ended March 31,	
	2009	2008	
Cost of design-to-silicon-yield solutions	\$	389	\$ 530
Research and development		348	595
Selling, general and administrative		399	858
Stock-based compensation expenses	\$	1,136	\$ 1,983

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The Company estimated the fair value of share-based payments using the Black-Scholes-Merton option-pricing model with the following weighted average assumptions and weighted average fair values:

	Stock Plans		Employee Stock Purchase Plan	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2009	2008	2009	2008
Expected life (in years)	5.16	5.77	1.25	1.33
Volatility	61.3%	58.2%	79.7%	54.9%
Risk-free interest rate	2.03%	2.91%	1.28%	3.10%
Expected dividend				
Weighted average fair value per share of options granted during the period	\$ 0.57	\$ 3.84		
Weighted average fair value per share of employee stock issued during the period			\$ 0.81	\$ 3.60

On March 31, 2009, the Company has in effect the following stock-based compensation plans:

*Stock Plans* During 2001, the Company terminated the 1996 and 1997 Stock Plans as to future option grants, and adopted the 2001 Stock Plan. Under the 2001 Stock Plan, on January 1 of each year, starting with year 2002, the number of shares in the reserve will increase by the lesser of (1) 3,000,000 shares, (2) 5% of the outstanding common stock on the last day of the immediately preceding year, or (3) the number of shares determined by the board of directors. Under the 2001 Stock Plan, the Company may grant stock purchase rights and stock options to purchase shares of common stock to employees, directors and consultants. The exercise price for stock options must generally be at prices not less than the fair market value at the date of grant for incentive stock options and not less than 85% of fair market value for non-statutory stock options. Stock options generally expire ten years from the date of grant and become vested and exercisable ratably over a four-year period.

Stock option activity under the Company's plan during the three months ended March 31, 2009 was as follows:

	Number of Options (in thousands)	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, January 1, 2009	4,412	\$ 8.93		
Granted	30	1.16		
Exercised				
Canceled	(19)	8.73		
Expired	(53)	9.58		
Outstanding, March 31, 2009	4,370	8.87	6.97	\$ 23
Vested and expected to vest	4,071	8.96	6.84	\$ 20
Exercisable at March 31, 2009	2,618	9.54	5.80	\$ 11



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The aggregate intrinsic value in the table above represents the total intrinsic value based on the Company's closing stock price of \$1.57 as of March 31, 2009, which would have been received by the option holders had all in-the-money option holders exercised their options as of that date. There were no stock options exercised during the three months ended March 31, 2009.

As of March 31, 2009, there was \$6.2 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted average period of 2.5 years. The total fair value of shares vested during the three months ended March 31, 2009 was \$838,000.

Nonvested shares (restricted stock units) activity during the three months ended March 31, 2009 were as follows:

	Shares (in thousands)	Weighted Average Grant Date Fair Value
Nonvested, January 1, 2009	852	\$ 8.64
Granted		
Vested	(8)	10.73
Forfeited	(9)	12.36
Nonvested, March 31, 2009	835	8.63

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As of March 31, 2009, there was \$4.0 million of total unrecognized compensation cost related to nonvested restricted stock units. That cost is expected to be recognized over a weighted average period of 3.3 years. The total compensation expense related to shares expected to vest during the three months ended March 31, 2009 was \$367,000.

*Employee Stock Purchase Plan* In July 2001, the Company adopted an Employee Stock Purchase Plan, or Purchase Plan, under which eligible employees can contribute up to 10% of their compensation, as defined in the Purchase Plan, towards the purchase of shares of PDF common stock at a price of 85% of the lower of the fair market value at the beginning of the offering period or the end of each six-month offering period. Under the Purchase Plan, on January 1 of each year, starting with 2002, the number of shares reserved for issuance will automatically increase by the lesser of (1) 675,000 shares, (2) 2% of the Company's outstanding common stock on the last day of the immediately preceding year, or (3) the number of shares determined by the board of directors. For the three months ended March 31, 2009, the Purchase Plan compensation expense was \$59,000.

*Stock Repurchase Program* On March 26, 2003, the Company's Board of Directors approved a share repurchase program to purchase up to \$10.0 million of its outstanding common stock. The program was completed in August 2007 with 988,000 shares repurchased at the average price of \$10.12 per share. On October 29, 2007, the Board of Directors approved a new program to repurchase up to an additional \$10.0 million of the Company's common stock on the open market. The right to repurchase stock under this program will expire on October 29, 2010. As of March 31, 2009, 2.4 million shares have been repurchased at the average price of \$3.46 per share under this program and \$1.6 million remained available for future repurchases.

## 7. RESTRUCTURING

In 2008, the Company announced two restructuring plans to better allocate its resources to improve its operational results in light of current market conditions, one on April 29, 2008 and the other on October 28, 2008.

For the plan announced on April 29, 2008, the Company recorded restructuring charges of \$1.5 million during the three months ended June 30, 2008, which primarily consisted of employee severance costs of \$1.4 million. All severance costs and related fees were paid out and the activities were completed as of March 31, 2009.

For the plan announced on October 28, 2008, the Company recorded restructuring charges of \$1.5 million during the three months ended December 31, 2008 and an additional \$633,000 during the three months ended March 31, 2009 and expect to incur additional charges as part of the continuing cost control efforts during the three months ending June 30, 2009. The restructuring charges primarily consisted of employee severance costs of \$1.5 million and facility exit costs of \$985,000. The following table summarizes the activities of these restructuring liabilities (in thousands):

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Restructuring Announced on October 28, 2008	Severance		Facility Exit		Professional and Other Fees		Total
Balance, January 1, 2009	\$	860	\$	1,108	\$	31	\$ 1,999
Restructuring charges		582				51	633
Payments		(771)		(110)		(50)	(931)
Balance, March 31, 2009	\$	671	\$	998	\$	32	\$ 1,701

As of March 31, 2009, of the remaining accrual of \$1.7 million, \$1.2 million was included in accrued liabilities and \$544,000 was included in long-term other liabilities. Accrued severance of \$671,000 and accrued professional and other fees of \$28,000 are expected to be paid out in the second quarter of 2009. Accrued facility exit costs will be paid in accordance with the lease payment schedule through 2013.

## 8. INCOME TAXES

The Company accounts for temporary differences between the book and tax basis of assets and liabilities by recording deferred tax assets and liabilities in accordance with SFAS No. 109, *Accounting for Income Taxes*, and Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109*, or FIN No. 48. The Company must assess the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent the Company believes that recovery is not likely, the Company must establish a valuation allowance. Changes in the Company's net deferred tax assets, less offsetting valuation allowance, in a period are recorded through the income tax provision in the condensed consolidated statements of operations.

In accordance with FIN No. 48, the Company classifies its liabilities related to unrecognized tax benefits as long-term. The Company includes interest and penalties related to unrecognized tax benefits within the Company's income tax provision (benefit). As of March 31, 2009 and December 31, 2008, the Company had \$636,000 and \$562,000, respectively, accrued for payment of interest and penalties related to unrecognized tax benefits.

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The Company's total amount of unrecognized tax benefits as of March 31, 2009 was \$8.4 million, of which \$2.9 million, if recognized, would affect the Company's effective tax rate. The Company's total amount of unrecognized tax benefits as of December 31, 2008 was \$8.2 million of which \$2.8 million, if recognized, would affect the Company's effective tax rate. As of March 31, 2009, the Company has recognized a net amount of \$3.4 million as long-term taxes payable for unrecognized tax benefits in its consolidated balance sheets. The Company does not expect the change in unrecognized tax benefits over the next twelve months to materially impact its results of operations and financial position.

The Company conducts business globally and, as a result, files numerous consolidated and separate income tax returns in the U.S. federal, various state and foreign jurisdictions. Because the Company used some of the tax attributes carried forward from previous years to tax years that are still open, statutes of limitation remain open for all tax years to the extent of the attributes carried forward into tax year 2001 for federal tax purposes and tax year 2002 for California tax purposes. With few exceptions, the Company is no longer subject to income tax examinations in its major foreign subsidiaries' jurisdictions for years before 2004.

**9. NET LOSS PER SHARE**

Basic net loss per share is computed by dividing net loss by the weighted average common shares outstanding for the period (excluding outstanding stock options and shares subject to repurchase). Diluted net loss per share reflects the weighted average common shares outstanding plus the potential effect of dilutive securities which are convertible into common shares (using the treasury stock method), except in cases where the effect would be anti-dilutive. The following is a reconciliation of the numerators and denominators used in computing basic and diluted net loss per share (in thousands, except per share amount):

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Net loss	\$ (7,321)	\$ (2,513)
Denominator for basic calculation:		
Weighted average common shares outstanding- basic	26,092	27,840
Dilutive items		
Stock options outstanding		
Denominator for diluted computation	26,092	27,840
Net loss per share - basic and diluted	\$ (0.28)	\$ (0.09)

**10. COMPREHENSIVE LOSS**

The components of comprehensive loss are as follows (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Net loss	\$ (7,321)	\$ (2,513)
Unrealized loss on investments, net of income tax effects	(37)	(42)
Foreign currency translation adjustments, net of income tax effects	(1,267)	1,958

Comprehensive loss	\$	(8,625)	\$	(597)
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**11. CUSTOMER AND GEOGRAPHIC INFORMATION**

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or group, in deciding how to allocate resources and in assessing performance.

The Company's chief operating decision maker, the Chief Executive Officer, reviews discrete financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. Accordingly the Company considers itself to be in one operating segment, specifically the licensing and implementation of yield improvement solutions for integrated circuit manufacturers.

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The Company had revenues from individual customers in excess of 10% of total revenues as follows:

Customer	Three Months Ended March 31,	
	2009	2008
A	29%	16%
B	10%	*%
C	*%	18%

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\* represents less than 10%

The Company had gross accounts receivable from the following individual customers in excess of 10% of gross accounts receivable as follows:

Customer	March 31, 2009	December 31, 2008
	A	19%
B	12%	*%
C	*%	12%
D	15%	11%
E	11%	*%
F	*%	12%

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\* represents less than 10%

Revenues from customers by geographic area are as follows (in thousands):

	Three Months Ended March 31,	
	2009	2008
Asia	\$ 5,458	\$ 10,399
United States	4,066	5,608
Europe	666	4,340
Total	\$ 10,190	\$ 20,347

As of March 31, 2009 and December 31, 2008, long-lived assets related to PDF Solutions S.A.S. (formerly Si Automation S.A.), located in France, totaled \$273,000 and \$336,000, respectively. The majority of the Company's remaining long-lived assets are in the United States.

## 12. FAIR VALUE

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Under SFAS No. 157, fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. SFAS No. 157 refers to the multiple assumptions used to value financial instruments as inputs, and establishes hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon its own market assumptions. These inputs are ranked according to a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels.

- Level 1      Inputs are quoted prices in active markets for identical assets or liabilities.
- Level 2      Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.
- Level 3      Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

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The following table represents the Company's assets measured at fair value on a recurring basis as of March 31, 2009 and the basis for that measurement (in thousands):

Assets	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market mutual funds	\$ 26,569	\$ 26,569		\$
Agency Obligations	5,955		5,955	
Corporate Securities	399		399	
Auction-rate securities	718			718
Total	\$ 33,641	\$ 26,569	\$ 6,354	\$ 718

The Company holds investments in auction-rate securities, or ARS, which are variable rate debt instruments whose interest rates are reset through a dutch auction process at regular intervals, typically every 28 days. All ARS are backed by pools of student loans guaranteed by governmental agencies and private entities, and were rated AAA/Aaa at the date of acquisition. The liquidity and fair value of these securities has been reduced by the uncertainty in the credit markets and the exposure of these securities to the financial condition of bond insurance companies, as evidenced by the rating downgrade of MBIA (bond insurer on one of the Company's ARS) from Aaa to A2, by Moody's Investor Services on June 19, 2008. All ARS have failed to sell at auction since February 2008, and as a result, their interest rates were reset to the maximum LIBOR + 150 basis points. The only activity since February 2008 was the repurchase of \$500,000 of ARS at par by issuers. As a result of these auction failures, there was limited active market with observable prices for these securities as of March 31, 2009; therefore, the Company computed the fair value of these securities based on a discounted cash flow model, using significant level 3 inputs, to take into account the lack of liquidity. The Company does not believe that the student loans backing these securities, the principal of these assets, is at risk. Furthermore, the Company intends to hold these securities until the credit markets recover and these securities resume pricing at or near par. As a result, the Company recorded a temporary impairment to other comprehensive income and classified these securities as non-current investments. The valuation may be revised in future periods as market conditions evolve.

The following represents the reconciliation of the beginning and ending balance of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three months ended March 31, 2009 (in thousands):

	Available-For-Sale Securities
Beginning balance, January 1, 2009	\$ 718
Total gains and losses (realized / unrealized):	
Included in earnings	
Included in other comprehensive income, before income tax effects	
Purchases, issuances, and settlements	
Transfers, in and/or (out) of Level 3	
Ending balance, March 31, 2009	\$ 718
The amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at March 31, 2009	\$

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.****Forward-Looking Statements**



The following discussion of our financial condition and results of operations contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In some cases, you can identify forward-looking statements by terminology such as may, could, will, should, expect, plan, anticipate, believe, estimate, predict, continue, the negative effect of terms like these or other similar expressions. Any statement concerning future financial performance (including future revenues, earnings or growth rates), ongoing business strategies or prospects, and possible actions taken by us or our subsidiaries, which may be provided by us are also forward-looking statements. These forward-looking statements are only predictions. Forward-looking statements are based on current expectations and projections about future events and are inherently subject to a variety of risks and uncertainties, many of which are beyond our control, which could cause actual results to differ materially from those anticipated or projected. All forward-looking statements included in this document are based on information available to us on the date of filing and we further caution investors that our business and financial performance are subject to substantial risks and uncertainties. We assume no obligation to update any such forward-looking statements. In evaluating these statements, you should specifically consider various factors, including the risk factors set forth in Part II, Item 1A and set forth at the end of Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission on March 16, 2009.

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**Overview**

We analyze our customers' integrated circuit, or IC design and manufacturing processes to identify, quantify, and correct the issues that cause yield loss to improve our customers' profitability by improving time-to-market, increasing yield and reducing total design and manufacturing costs. We package our solutions in various ways to meet our customers' specific business and budgetary needs, each of which provides us various revenue streams. We receive a mix of fixed fees and variable, performance-based fees for the vast majority of our Integrated Yield Ramp offerings. The fixed fees are typically reflective of the length of time and the resources needed to characterize a customer's manufacturing process and receive preliminary results of proposed yield improvement suggestions. The variable fee, or what we call gainshare performance incentives, usually depends on our achieving certain yield targets by a deadline. Variable fees are currently typically tied to wafer volume on the node size of the manufacturing facility where we performed the yield improvement. We receive license fees and service fees for related installation, integration, training, and maintenance and support services for our software that we license on a stand-alone basis.

***History***

From our incorporation in 1992 through late 1995, we were primarily focused on research and development of our proprietary manufacturing process simulation and yield and performance modeling software. From late 1995 through late 1998, we continued to refine and sell our software, while expanding our offering to include yield and performance improvement consulting services. In late 1998, we began to sell our software and consulting services, together with our newly developed proprietary technologies, under the term Design-to-Silicon-Yield solutions, reflecting our current business model. In April 2000, we expanded our research and development team and gained additional technology by acquiring AISS. AISS now operates as PDF Solutions, GmbH, a German company, which continues to develop software and provide development services to the semiconductor industry. In July 2001, we completed the initial public offering of our common stock. In 2003, we enhanced our product and service offerings, including increased software applications, through the acquisitions of IDS and WaferYield. In 2006, we further complemented our technology offering by acquiring Si Automation S.A. and adding its Fraud Detection and Classification, or FDC software capabilities to our integrated solution. In 2007, we increased our IP solutions portfolio, particularly in logic design technology, through the acquisition of Fabbrix, Inc. In 2008, we solidified our market leading position in the FDC software market, particularly in Korea, and now provide complementary technology to our maestria product through the acquisition of certain assets of Triant.

***Industry Trend***

Subject to the current general economic downturn, demand for consumer electronics and communications devices continues to drive technological innovation in the semiconductor industry as the need for products with greater performance, lower power consumption, reduced costs and smaller size continues to grow with each new product generation. In addition, advances in computing systems and mobile devices have fueled demand for higher capacity memory chips. To meet these demands, IC manufacturers and designers are constantly challenged to improve the overall performance of their ICs by designing and manufacturing ICs with more embedded applications to create greater functionality while lowering cost per transistor. As a result, both logic and memory manufacturers have migrated to more and more advanced manufacturing nodes, capable of integrating more devices with higher performance, higher density, and lower power. As this trend continues, companies will continually be challenged to improve process capabilities to optimally produce ICs with minimal random and systematic yield loss, which is driven by the lack of compatibility between the design and its respective manufacturing process. We believe that as volume production of deep submicron ICs continues to grow, the difficulties of integrating IC designs with their respective processes and ramping new manufacturing processes will create a greater need for products and services that address the yield loss and escalating cost issues the semiconductor industry is facing today and will face in the future.

*Financial Highlights*

The semiconductor industry is currently experiencing significant challenges, primarily due to a deteriorating macroeconomic environment, and it is unclear when a turnaround may occur. As a result of this downturn, some of our customers faced financial challenges in fiscal 2008 and may continue to face such challenges in fiscal 2009. The current economic downturn has contributed to the substantial reduction in our revenue and could continue to harm our business, operating results and financial condition.

We plan operating expense levels primarily based on forecasted revenue levels. To partially offset the impact of our expected decrease in revenue, we have implemented several cost savings initiatives, including reducing headcount and other discretionary spending. During the year ended December 31, 2008, we initiated two restructuring plans to improve our operating results and to align our cost structure with expected revenue.

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Financial highlights for the three months ended March 31, 2009 were as follows:

- Total revenue for the three months ended March 31, 2009 was \$10.2 million, a decrease of \$10.2 million, or 50% compared to the three months ended March 31, 2008. Design-to-Silicon-Yield solutions revenue for the three months ended March 31, 2009 was \$7.8 million, a decrease of \$7.2 million, or 48%, compared to \$15.0 million for the three months ended March 31, 2008. The decrease in Design-to-Silicon Yield solutions revenue was primarily the result of lower bookings, as customers have delayed purchases for capacity expansion and investment in leading-edge technology. The dramatic downturn in the semiconductor industry combined with weakness in worldwide economies has been the primary contributors to this reduction. Gainshare performance incentives revenue for the three months ended March 31, 2009 was \$2.4 million, a decrease of \$2.9 million, or 55%, compared to \$5.3 million for the three months ended March 31, 2008. The decrease in revenue from Gainshare performance incentives was primarily the result of reduced volumes in customer manufacturing facilities.
- Net loss for the three months ended March 31, 2009 was \$7.3 million, compared to \$2.5 million for the three months ended March 31, 2008. The increase in net loss was primarily attributable to a significant decrease in revenue, partially offset by decreases in operating expenses as the result of our cost control efforts.
- Net loss per basic and diluted share was \$0.28 for the three months ended March 31, 2009 compared to \$0.09 for the three months ended March 31, 2008, an increase in net loss of \$0.19 per basic and diluted share.
- Cash, cash equivalents and investments decreased \$1.6 million to \$39.9 million during the three months ended March 31, 2009, primarily due to the negative effect of changes in foreign currency exchange rates.

**Critical Accounting Policies**

Financial Reporting Release No. 60 requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Item 7 of the consolidated financial statements on the Annual Report on Form 10-K for the year ended December 31, 2008, includes a summary of the significant accounting policies and methods used in the preparation of our condensed consolidated financial statements. The following is a brief discussion of the more significant accounting policies and methods that we use.

**General**

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Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Our preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We based our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. The most significant estimates and assumptions relate to revenue recognition, software development costs, recoverability of goodwill and acquired intangible assets, estimated useful lives of acquired intangibles, stock based compensation, and the realization of deferred tax assets. Actual amounts may differ from such estimates under different assumptions or conditions.

### ***Revenue Recognition***

We derive revenue from two sources: Design-to-Silicon-Yield Solutions, which includes Services and Software Licenses, and Gainshare Performance Incentives. We recognize revenue in accordance with the provisions of American Institute of Certified Public Accountants Statement of Position, or SOP, No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* and SOP No. 97-2, *Software Revenue Recognition*, as amended.

*Design-to-Silicon-Yield Solutions* Revenue that is derived from Design-to-Silicon-Yield solutions comes from services and software licenses. We recognize revenue for each element of Design-to-Silicon-Yield solutions as follows:

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*Services* We generate a significant portion of our Design-to-Silicon-Yield solutions revenue from fixed-price solution implementation service contracts delivered over a specific period of time. These contracts require accurate estimation of cost to perform obligations and overall scope of each engagement. Revenue under contracts for solution implementation services is recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting. Losses on solution implementation contracts are recognized in the period when they become evident. Revisions in profit estimates are reflected in the period in which the conditions that require the revisions become known and can be estimated. If we do not accurately estimate the resources required or the scope of work to be performed, or do not manage the projects properly within the planned period of time or satisfy our obligations under contracts, resulting contract margins could be materially different than those anticipated when the contract was executed. Any such reductions in contract margin could have a material negative impact on our operating results.

On occasion, we have licensed our software products as a component of our fixed price services contracts. In such instances, the software products are licensed to customers over a specified term of the agreement with support and maintenance to be provided over the license term. Under these arrangements, where vendor-specific objective evidence of fair value ( VSOE ) exists for the support and maintenance element, the support and maintenance revenue is recognized separately over the term of the supporting period. The remaining fee is recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting. VSOE for maintenance, in these instances, is generally established based upon a negotiated renewal rate. Under arrangements where software products are licensed as a component of its fixed-price service contract and where VSOE does not exist to allocate a portion of the total fixed-price to the undelivered elements, revenue is recognized for the total fixed-price as the lesser of either the percentage of completion method of contract accounting or ratably over the longer of either the term of the agreement or the supporting period. Costs incurred under these arrangements are deferred and recognized in proportion to revenue recognized under these arrangements.

Revenue from related support and maintenance services is recognized ratably over the term of the support and maintenance contract, generally one year, while revenue from consulting, installation and training services is recognized as services are performed. When bundled with software licenses in multiple element arrangements, support and maintenance, consulting (other than for our fixed price solution implementations), installation, and training revenue is allocated to each element of a transaction based upon its fair value as determined by our VSOE. VSOE is generally established for maintenance based upon negotiated renewal rates while VSOE for consulting, installation, and training is established based upon our customary pricing for such services when sold separately. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the longest service period of the undelivered elements

*Software Licenses* We also license our software products separate from our integrated solution implementations. For software license arrangements that do not require significant modification or customization of the underlying software, software license revenue is recognized under the residual method when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the fee is fixed or determinable, (4) collectibility is probable, and (5) the arrangement does not require services that are essential to the functionality of the software. When arrangements include multiple elements such as support and maintenance, consulting (other than for our fixed price solution implementations), installation, and training, revenue is allocated to each element of a transaction based upon its fair value as determined by our VSOE and such services are recorded as services. VSOE is generally established for maintenance based upon negotiated renewal rates while VSOE for consulting, installation and training services is established based upon our customary pricing for such services when sold separately. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the longest period of the undelivered elements. Revenue for software licenses with extended payment terms is not recognized in excess of amounts due. For software license arrangements that require significant modification or customization of the

underlying software, the software license revenue is recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting, and such revenue is recorded as services.

*Gainshare Performance Incentives* When we enter into a contract to provide yield improvement services, the contract usually includes two components: (1) a fixed fee for performance by us of services delivered over a specific period of time; and (2) a gainshare performance incentives component where the customer may pay a variable fee, usually after the fixed fee period has ended. Revenue derived from gainshare performance incentives represents profit sharing and performance incentives earned based upon our customers reaching certain defined operational levels established in related solution implementation service contracts. Gainshare performance incentives periods are usually subsequent to the delivery of all contractual services and therefore have no cost to us. Due to the uncertainties surrounding attainment of such operational levels, we recognize gainshare performance incentives revenue (to the extent of completion of the related solution implementation contract) upon receipt of performance reports or other related information from our customers supporting the determination of amounts and probability of collection. Gainshare performance incentives revenue is dependent on many factors which are outside our control, including among others, continued production of the related ICs by our customers, sustained yield improvements by our customers and our ability to enter into new Design-to-Silicon-Yield solutions contracts containing provisions for gainshare performance incentives.

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***Software Development Costs***

Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized in accordance with Statement of Accounting Standards, or SFAS No. 86, *Computer Software to be Sold, Leased or Otherwise Marketed*. Because we believe our current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

***Goodwill and Acquired Intangible Assets***

As of March 31, 2009, the recorded value of our goodwill and intangible assets was zero and \$4.3 million, respectively. In assessing the valuation and recoverability of our goodwill and intangible assets, we must make assumptions regarding estimated future cash flows to be derived from the acquired assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets, which would have a material adverse effect on our operating results. We evaluate goodwill for impairment pursuant to the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*. We have selected December 31 as the date upon which to perform our annual testing for impairment. During the fourth quarter of fiscal 2008, we observed impairment indicators, relating to our long-lived assets, including the trading of our common stock below our book value and a further deterioration in the semiconductor industry brought on by the deteriorating global economic environment which triggered the necessity of an impairment test for our intangible and long lived assets as of December 31, 2008. In accordance with SFAS No. 144, we assessed the recoverability of our intangible and long-lived assets by comparing the carrying value of those intangible and long lived assets to the undiscounted cash flows of each asset group. The analysis indicated that the carrying value of certain assets exceeded the undiscounted cash flows. As such, we determined that certain acquired intangible assets were impaired. We measured the amount of impairment by calculating the amount by which the carrying value of the intangible assets exceeded their estimated fair values, which were based on projected discounted future net cash flows. As a result of this impairment analysis, we recorded an impairment charge of \$6.3 million during the fourth quarter of 2008.

We completed our annual impairment analysis of goodwill as of December 31, 2008, including the second step prescribed by SFAS No. 142. As part of the second step of our goodwill impairment test, we determined the fair value of our goodwill by allocating the estimated fair value of our reporting unit to our assets and liabilities, including the estimated fair value of our unrecorded intangible assets, on a fair value basis. After allocating its assets and liabilities on a fair value basis, we recorded an impairment of all of our goodwill of \$64.0 million.

We are currently amortizing our acquired intangible assets over estimated useful lives of one to seven years, which are based on the estimated period of benefit to be derived from such assets. However, a decrease in the estimated useful lives of such assets would cause additional amortization expense or an impairment of such asset in future periods.

***Income Taxes***

Realization of deferred tax assets is dependent on our ability to generate future taxable income and utilize tax planning strategies. We have recorded a deferred tax asset in the amount that is more likely than not to be realized based on current estimations and assumptions. We evaluate the valuation allowance on a quarterly basis. Any resulting changes to the valuation allowance will result in an adjustment to income in the



period the determination is made.

***Stock-Based Compensation***

We account for stock-based compensation in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment*, or SFAS No. 123R. Under the provisions of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the award's fair-value as calculated by the Black-Scholes-Merton, or BSM, option-pricing model and is recognized as expense ratably over the requisite service period. The BSM model requires various highly judgmental assumptions including volatility, forfeiture rates, and expected option life. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

**Recent Accounting Pronouncements and Accounting Changes**

See Note 2 of Notes to Condensed Consolidated Financial Statements (Unaudited) of this Quarterly Report on Form 10-Q for a description of recent accounting pronouncements and accounting changes, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

Table of Contents**Results of Operations**

The following table sets forth, for the periods indicated, the percentage of total revenue represented by the line items reflected in our condensed consolidated statements of operations:

	Three Months Ended March 31,	
	2009	2008
Revenues:		
Design-to-silicon-yield solutions	76%	74%
Gainshare performance incentives	24	26
Total revenues	100%	100%
Cost of design-to-silicon-yield solutions:		
Direct costs of design-to-silicon-yield solutions	62	38
Amortization of acquired technology	3	3
Total cost of design-to silicon-yield solutions	65	41
Gross margin	35	59
Operating expenses:		
Research and development	57	45
Selling, general and administrative	43	31
Amortization of other acquired intangible assets	1	1
Restructuring charges	6	
Total operating expenses	107	77
Loss from operations	(72)	(18)
Interest and other income, net	3	3
Loss before taxes	(69)	(15)
Income tax provision (benefit)	3	(3)
Net loss	(72)%	(12)%

**Comparison of the Three Months Ended March 31, 2009 and 2008**

Three Months Ended March 31,

Three Months Ended March 31,