PDF SOLUTIONS INC
Form 10-Q
May 10, 2010
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period ended March 31, 2010

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

PDF SOLUTIONS, INC.

(Exact name of Registrant as Specified in its Charter)

Delaware	**25-1701361**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

333 West San Carlos Street, Suite 700 **San Jose, California**	**95110**
(Address of Principal Executive Offices)	(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 x No o

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

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

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

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

The number of shares outstanding of the Registrant s Common Stock as of April 30, 2010 was 27,086,113.

Table of Contents

TABLE OF CONTENTS

	Page
PART I FINANCIAL INFORMATION	
Item 1. Financial Statements	3
Condensed Consolidated Balance Sheets (Unaudited)	3
Condensed Consolidated Statements of Operations (Unaudited)	4
Condensed Consolidated Statements of Cash Flows (Unaudited)	5
Notes to Condensed Consolidated Financial Statements (Unaudited)	6
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3. Quantitative and Qualitative Disclosures About Market Risk	21
Item 4. Controls and Procedures	21
PART II OTHER INFORMATION	
Item 1. Legal Proceedings	22
Item 1A. Risk Factors	22
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	22
Item 6. Exhibits	23
SIGNATURES	24
INDEX TO EXHIBITS	25

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

PDF SOLUTIONS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	March 31, 2010	December 31, 2009
	(In thousands, except par values)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 34,899	$ 34,899
Accounts receivable, net of allowance of $254 in 2010 and 2009	19,010	19,809
Prepaid expenses and other current assets	3,438	3,029
Total current assets	57,347	57,737
Property and equipment, net	1,297	1,573
Non-current investments	718	718
Intangible assets, net	2,505	2,954
Other non-current assets	740	495
Total assets	$ 62,607	$ 63,477
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 108	$ 115
Accounts payable	1,055	959
Accrued compensation and related benefits	3,565	4,438
Taxes payable and other accrued liabilities	2,946	3,502
Deferred revenues	1,791	1,584
Billings in excess of recognized revenues	1,450	1,953
Total current liabilities	10,915	12,551
Long-term debt	82	117
Long-term income taxes payable	3,035	3,218
Other non-current liabilities	1,636	1,704
Total liabilities	15,668	17,590
Commitments and contingencies (Note 13)		
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 30,669 at March 31, 2010 and 30,194 at December 31, 2009; shares outstanding 27,071 at March 31, 2010 and 26,651 at December 31, 2009	4	4
Additional paid-in-capital	195,996	194,081
Treasury stock at cost, 3,598 shares at March 31, 2010 and 3,543 shares at December 31, 2009	(18,988)	(18,715)
Accumulated deficit	(130,407)	(130,111)
Accumulated other comprehensive income	334	628
Total stockholders equity	46,939	45,887

Total liabilities and stockholders equity	$	62,607	$	63,477

See notes to unaudited condensed consolidated financial statements

3

Table of Contents

PDF SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended March 31, 2010	2009
	(In thousands, except per share amounts)	
Revenues:		
Design-to-silicon-yield solutions	$ 10,417	$ 7,794
Gainshare performance incentives	4,835	2,396
Total revenues	15,252	10,190
Cost of design-to-silicon-yield solutions:		
Direct costs of design-to-silicon-yield solutions	6,322	6,290
Amortization of acquired technology	359	359
Total cost of design-to silicon-yield solutions	6,681	6,649
Gross profit	8,571	3,541
Operating expenses:		
Research and development	3,962	5,789
Selling, general and administrative	4,579	4,413
Amortization of other acquired intangible assets	86	87
Restructuring charges	1	633
Total operating expenses	8,628	10,922
Loss from operations	(57)	(7,381)
Interest and other income, net	262	324
Income (loss) before income taxes	205	(7,057)
Income tax provision	501	264
Net loss	$ (296)	$ (7,321)
Net loss per share basic and diluted	$ (0.01)	$ (0.28)
Weighted average common shares basic and diluted	26,929	26,092

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,	
	2010	2009
	(In thousands)	
Operating activities:		
Net loss	$ (296)	$ (7,321)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	271	414
Stock-based compensation expense	1,505	1,136
Loss on disposal of property and equipment		1
Amortization of acquired intangible assets	445	446
Deferred taxes		(5)
Purchases of treasury stock in connection with tax withholdings on restricted stock grants	(273)	
Changes in operating assets and liabilities:		
Accounts receivable, net of allowances	799	4,595
Prepaid expenses and other assets	(804)	1,459
Accounts payable	144	415
Accrued compensation and related benefits	(799)	(609)
Taxes payable and other accrued liabilities	(730)	(624)
Deferred revenues	183	265
Billings in excess of recognized revenues	(503)	(502)
Net cash used in operating activities	(58)	(330)
Investing activities:		
Maturities and sales of available-for-sale securities		2,700
Purchases of property and equipment	(37)	(299)
Net cash provided by (used in) investing activities	(37)	2,401
Financing activities:		
Proceeds from Employee Stock Purchase Plan	411	417
Principal payments on long-term obligations	(31)	(51)
Net cash provided by financing activities	380	366
Effect of exchange rate changes on cash and cash equivalents	(285)	(1,343)
Net increase in cash and cash equivalents		1,094
Cash and cash equivalents, beginning of period	34,899	31,686
Cash and cash equivalents, end of period	$ 34,899	$ 32,780
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income Taxes	$ 811	$ 232
Interest	$ 3	$ 7

See notes to unaudited condensed consolidated financial statements

Table of Contents

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. (the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (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/A for the year ended December 31, 2009.

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.

Out-of-Period Adjustments In the three months ended March 31, 2010, the Company recorded out-of-period adjustments to reverse an accrual for fringe benefits of $155,000 and adjust for software license fee amortization of $42,000. The correction of these prior period errors in the current quarter resulted in a reduction to the Company s net loss of $197,000 for the three months ended March 31, 2010. The resulting errors also increased net loss for the year ended December 31, 2008 by $155,000 and increased net loss for the three and twelve months ended December 31, 2009 by $83,000. Management has assessed the impact of these adjustments and does not believe that these amounts were material, either individually or in the aggregate, to any prior period financial statements, and the impact of correcting these errors in the three months ended March 31, 2010 is not material to the financial statements for the three months ended March 31, 2010.

Significant Estimates 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.

Revenue Recognition The Company derives revenue from two sources: Design-to-Silicon-Yield Solutions, which includes Services and Software Licenses, and Gainshare Performance Incentives.

Design-to-Silicon-Yield Solutions Revenues that are derived from Design-to-Silicon-Yield solutions come 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 the 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 licenses its software products as a component of its fixed-price service contract. 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 support period.

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

Table of Contents

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 maintenance is generally established based upon negotiated renewal rates while VSOE for consulting, installation, and training services is established based upon the Company s customary pricing for such services when sold separately.

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) collectability 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 revenue. VSOE for maintenance is generally established based upon negotiated renewal rates while VSOE for consulting, installation, and training services is established based upon the Company s customary pricing for such services when sold separately. 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 revenue.

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 service 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. 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 October 2009, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update on revenue recognition in relation to multiple-deliverable revenue arrangements. This update provides guidance on accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. The amendments in this update will replace the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently evaluating the impact, if any, that the adoption of this updated standard will have on its financial results and position.

In October 2009, the FASB issued an Accounting Standards Update on software revenue recognition in relation to revenue arrangements that include software elements. This standard scopes out from software revenue recognition accounting revenue arrangements for tangible products that contain both software and non-software components that function together to deliver the tangible products essential functionality. It also amends the determination of how arrangement consideration should be allocated to deliverables in a multiple-deliverable revenue arrangement. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently evaluating the impact, if any, that the adoption of this update will have on its financial results and position.

Effective January 1, 2010, the Company adopted FASB s amendment to an Accounting Standards Update which requires additional fair value disclosures. This amendment requires disclosures in relation to inputs and valuation techniques used to measure fair value as well as disclosures in relation to significant transfers, beginning in the first quarter of 2010. Additionally, this amendment requires the presentation of disaggregated activity within the reconciliation for fair value measurements using significant unobservable inputs (Level 3), beginning in the first quarter of 2011. The adoption of this standard did not have a material impact on the Company s financial results and position.

Table of Contents

3. INVESTMENTS

The following table summarizes the Company s investments at March 31, 2010 and December 31, 2009 (in thousands):

	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
Auction-rate securities	$ 1,000	$	$ (282)	$ 718
Included in non-current investments				$ 718

As of March 31, 2010 and December 31, 2009, the Company s investments consisted entirely of auction-rate securities. 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 $7.1 million and $6.4 million as of March 31, 2010 and December 31, 2009, respectively.

5. ACQUIRED INTANGIBLE ASSETS

Impairment on acquired intangible assets is evaluated on an annual basis (or more frequently if indicators of impairment exist). Acquired intangible assets are 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 2009 and found no indicators of impairment. During the three months ended March 31, 2010, there were no indicators of impairment related to the Company s intangible assets.

The following table provides information relating to the intangible assets as of March 31, 2010 and December 31, 2009 (in thousands):

Acquired Identifiable Intangible	Amortization Period (Years)	March 31, 2010 Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	March 31, 2010 Net Carrying Amount
Acquired technology	4-5	$ 11,800	$ (9,988)	$	$ 1,812
Brand name	4	510	(469)		41
Customer relationships and backlog	1-6	3,420	(3,092)		328
Patents and applications	7	1,400	(1,092)		308
Other acquired intangibles	4	255	(265)	26	16

Total		$	17,385	$	(14,906)	$	26	$	2,505

Acquired Identifiable Intangible	**Amortization Period (Years)**		**December 31, 2009 Gross Carrying Amount**		**Accumulated Amortization**		**Foreign Currency Translation**		**December 31, 2009 Net Carrying Amount**
Acquired technology	4-5	$	11,800	$	(9,630)	$		$	2,170
Brand name	4		510		(452)				58
Customer relationships and backlog	1-6		3,420		(3,061)				359
Patents and applications	7		1,400		(1,074)				326
Other acquired intangibles	4		287		(258)		12		41
Total		$	17,417	$	(14,475)	$	12	$	2,954

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

Year Ending December 31,		**Amount**
2010 (remaining nine-month period)	$	1,135
2011		830
2012		435
2013		74
2014		31
Total	$	2,505

Table of Contents

6. STOCKHOLDERS EQUITY

Stock-based compensation is estimated at the grant date based on the award s fair value and is recognized on a straight-line basis over the vesting periods of the applicable stock purchase rights and stock options, generally four years. 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, 2010		Three Months Ended March 31, 2009	
Cost of design-to-silicon-yield solutions	$	602	$	389
Research and development		347		348
Selling, general and administrative		556		399
Stock-based compensation expenses	$	1,505	$	1,136

The Company estimated the fair value of share-based awards granted during the period using the Black-Scholes-Merton option-pricing model with the following weighted average assumptions, resulting in the following weighted average fair values:

	Stock Plans				Employee Stock Purchase Plan			
	Three Months Ended March 31, 2010		2009		Three Months Ended March 31, 2010		2009	
Expected life (in years)		5.24		5.16		1.25		1.25
Volatility		62.8%		61.3%		72.6%		79.7%
Risk-free interest rate		2.23%		2.03%		0.58%		1.28%
Expected dividend								
Weighted average fair value per share of options granted during the period	$	2.20	$	0.57				
Weighted average fair value per share of employee stock purchase plan rights during the period					$	1.40	$	0.81

On March 31, 2010, 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 Company s 2001 Stock Plan, on January 1 of each year, starting with 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 plans during the three months ended March 31, 2010 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, 2010	3,849	$ 6.41		
Granted	153	4.05		
Exercised				
Canceled	(101)	4.76		
Expired	(31)	9.71		
Outstanding, March 31, 2010	3,870	6.34	7.80	$ 1,165
Vested and expected to vest, March 31, 2010	3,431	6.62	7.59	$ 970
Exercisable, March 31, 2010	1,536	9.43	5.51	$ 152

The aggregate intrinsic value in the table above represents the total intrinsic value based on the Company s closing stock price of $4.36 per share as of March 31, 2010, which would have been received by the option holders had all in-the-money option holders exercised their options as of that date. No stock options were exercised during the three months ended March 31, 2010.

As of March 31, 2010, there was $4.3 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted average period of 3.1 years. The total fair value of shares vested during the three months ended March 31, 2010 was $253,000.

Table of Contents

Nonvested restricted stock units activity during the three months ended March 31, 2010 was as follows:

	Shares (in thousands)	Weighted Average Grant Date Fair Value Per Share
Nonvested, January 1, 2010	979	$ 6.86
Granted	28	3.98
Vested	(164)	4.62
Forfeited	(22)	6.39
Nonvested, March 31, 2010	821	7.32

As of March 31, 2010, there was $4.5 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 2.1 years. The total compensation expense related to shares vested during the three months ended March 31, 2010 was $966,000.

Employee Stock Purchase Plan In July 2001, the Company adopted an Employee Stock Purchase Plan (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 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, 2010, the Purchase Plan compensation expense was $113,000.

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. This 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, 2010, 2.6 million shares have been repurchased at the average price of $3.44 per share under this program and $1.0 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 $6.4 million, primarily consisting of employee severance costs of $4.5 million and facility exit costs of $1.8 million. Of the $6.4 million, $1,000 was recorded during the three months ended March 31, 2010. The following table summarizes the activities of these restructuring liabilities (in thousands):

Restructuring Announced on October 28, 2008	Severance	Facility Exit	Professional and Other Fees	Total
Balances, January 1, 2008	$	$	$	$
Restructuring charges	909	1,251	36	2,196
Adjustment of deferred rent		(266)		(266)
Non-cash adjustment	36	266		302
Payments	(85)	(143)	(5)	(233)
Balances, December 31, 2008	860	1,108	31	1,999
Restructuring charges	3,515	783	214	4,512
Payments	(4,151)	(558)	(183)	(4,892)
Balances, December 31, 2009	224	1,333	62	1,619
Restructuring charges (credits)	84	19	(102)	1
(Payments) refunds	(85)	(170)	42	(213)
Balances, March 31, 2010	$ 223	$ 1,182	$ 2	$ 1,407

As of March 31, 2010, of the remaining accrual of $1.4 million, $803,000 was included in accrued liabilities and $604,000 was included in long-term other liabilities. Accrued severance of $223,000 and accrued professional and other fees of $2,000 are expected to be paid out in the second fiscal quarter of 2010. Accrued facility exit expenses will be paid in accordance with the lease payment schedule through 2013.

Table of Contents

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. 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 and valuation allowance in a period are recorded through the income tax provision in the condensed consolidated statements of operations.

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. As of March 31, 2010 and December 31, 2009, the Company had $479,000 and $539,000, respectively, accrued for payment of interest and penalties related to unrecognized tax benefits.

Income tax provision for the three months ended March 31, 2010 was $501,000, primarily consisting of foreign withholding taxes of $764,000, partially offset by a reduction in the Company s reserves for uncertain tax positions of $325,000. Income tax provision for the three months ended March 31, 2009 was $264,000, primarily consisting of foreign withholding taxes and statutory taxes associated with the Company s foreign subsidiaries.

The Company s total amount of unrecognized tax benefits as of March 31, 2010 was $8.7 million, of which $3.0 million, if recognized, would affect the Company s effective tax rate. The Company s total amount of unrecognized tax benefits as of December 31, 2009 was $8.3 million, of which $2.7 million, if recognized, would affect the Company s effective tax rate. As of March 31, 2010, the Company has recognized a net amount of $3.0 million as long-term taxes payable for unrecognized tax benefits in its condensed consolidated balance sheet. The Company does not believe that it is reasonably possible that the change in unrecognized tax benefits over the next twelve months will 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 amounts):

	Three Months Ended March 31,			
	2010		2009	
Net loss	$	(296)	$	(7,321)
Denominator for basic calculation:				
Weighted average common shares outstanding- basic		26,929		26,092
Dilutive items				
Stock options outstanding				
Denominator for diluted computation		26,929		26,092
Net loss per share basic and diluted	$	(0.01)	$	(0.28)

The following table sets forth potential shares of common stock that are not included in the diluted net loss per share calculation above because to do so would be anti-dilutive for the periods indicated (in thousands):

	Three Months Ended March 31,	
	2010	2009
Outstanding options	3,870	4,370
Nonvested restricted stock units	821	835
Total	4,691	5,205

Table of Contents

10. COMPREHENSIVE LOSS

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

	Three Months Ended March 31, 2010		2009	
Net loss	$	(296)	$	(7,321)
Unrealized loss on investments, net of income tax effects				(37)
Foreign currency translation adjustments, net of income tax effects		(294)		(1,267)
Comprehensive loss	$	(590)	$	(8,625)

11. CUSTOMER AND GEOGRAPHIC INFORMATION

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.

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

Customer	Three Months Ended March 31, 2010	2009
A	20%	*%
B	15%	*%
C	12%	29%
D	*%	10%

* 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, 2010	December 31, 2009
A	18%	16%
B	13%	10%
C	19%	16%
E	13%	*%
F	*%	14%
G	*%	11%
H	*%	10%

* represents less than 10%

Geographical revenues from customers based upon the location of the customers facilities to which products were shipped or services were rendered are as follows (in thousands):

	Three Months Ended March 31,	
	2010	2009
Asia	$ 10,297	$ 5,458
United States	3,381	4,066
Europe	1,574	666
Total	$ 15,252	$ 10,190

12. FAIR VALUE

Fair value is 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. The multiple assumptions used to value financial instruments are referred to as inputs, and a hierarchy for inputs used in measuring fair value is established, 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

Table of Contents

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.

The following table represents the Company s assets measured at fair value on a recurring basis as of March 31, 2010 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	$ 25,261	$ 25,261	$	$
Auction-rate securities	718			718
Total	$ 25,979	$ 25,261	$	$ 718

The Company holds investments in auction-rate securities (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 associated with these instruments 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, 2010; 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 and it is not more likely than not that the Company will be required to sell the securities before recovery of the principal. 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.

There was no change in 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, 2010.

13. Commitments and Contingencies

Item 3, Legal Proceedings, on page 22 of the Company s Annual Report on Form 10-K/A for the year ended December 31, 2009, provides information on certain legal proceedings and claims in which the Company is involved. There have been no subsequent material developments to these matters.

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, should, expect, plan, anticipate, believe, estimate, predict, pote 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

Table of Contents

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 at the end of Item 1A in our Annual Report on Form 10-K/A for the year ended December 31, 2009 filed with the Securities and Exchange Commission on March 16, 2010.

Overview

We analyze our customers integrated circuit (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 Yield Improvement Solutions. 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, 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.

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

Financial highlights for the three months ended March 31, 2010 were as follows:

- Total revenues for the three months ended March 31, 2010 was $15.3 million, an increase of $5.1 million, or 50%, compared to the three months ended March 31, 2009. Design-to-Silicon-Yield solutions revenues for the three months ended March 31, 2010 was $10.4 million, an increase of $2.6 million, or 34%, compared to $7.8 million for the three months ended March 31, 2009. The increase in Design-to-Silicon-Yield solutions revenues was primarily the result of increased bookings. Gainshare performance incentives revenues for the

three months ended March 31, 2010 was $4.8 million, an increase of $2.4 million, or 102%, compared to the three months ended March 31, 2009. The increase was mainly due to increased wafer production by many of our customers.

- Net loss for the three months ended March 31, 2010 was $296,000, compared to $7.3 million for the three months ended March 31, 2009. The decrease in net loss was primarily attributable to a significant increase in revenues and a decrease in operating expenses during the three months ended March 31, 2010.

- Net loss per basic and diluted share was $0.01 for the three months ended March 31, 2010 compared to $0.28 for the three months ended March 31, 2009, a decrease in net loss of $0.27 per basic and diluted share.

- Cash, cash equivalents and investments remained unchanged at $35.6 million during the three months ended March 31, 2010.

Critical Accounting Policies

Item 7 of our Annual Report on Form 10-K/A for the year ended December 31, 2009, 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.

Table of Contents

General

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 and the realization of deferred tax assets. Actual amounts may differ from such estimates under different assumptions or conditions.

Revenue Recognition

We derive revenues from two sources: Design-to-Silicon-Yield Solutions, which include Services and Software Licenses, and Gainshare Performance Incentives.

Design-to-Silicon-Yield Solutions Revenues that are 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:

Services We generate a significant portion of our Design-to-Silicon-Yield solutions revenues 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 the overall scope of each engagement. Revenues under contracts for solution implementation services are 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 contracts were executed. Any such reductions in contract margin could have a material negative impact on our operating results.

On occasion, we license our software products as a component of our fixed price service 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 support period.

Revenues from related support and maintenance services are recognized ratably over the term of the support and maintenance contract, generally one year, while revenues from consulting, installation, and training services are 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 revenues are allocated to each element of a transaction based upon its fair value as determined by our VSOE. VSOE for maintenance is generally established 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.

Software Licenses We also license our software products separately 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) collectability 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 revenues. VSOE for maintenance is generally established 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. Revenues for software licenses with extended payment terms are not recognized in excess of amounts due. For software license arrangements that require significant modification or customization of the underlying software, the software license revenues are recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting, and such revenues are recorded as services revenue.

Table of Contents

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. Revenues derived from gainshare performance incentives represent 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 revenues (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 revenues are 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.

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. 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.

Intangible Assets

As of March 31, 2010, and December 31, 2009, the recorded value of our intangible assets was $2.5 million and $3.0 million, respectively. In assessing the valuation and recoverability of our long-lived 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. During the three months ended March 31, 2010, there were no indicators of impairment related to our intangible assets.

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 assets 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

Stock-based compensation is estimated at the grant date based on the award s fair value and is recognized on a straight-line basis over the vesting periods of the applicable stock purchase rights and stock options, generally four years. As stock-based compensation expense recognized is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

We have elected to use the Black-Scholes-Merton option-pricing model, which incorporates various assumptions including volatility, expected life and interest rates. The expected volatility is based on the historical volatility of our common stock over the most recent period commensurate with the estimated expected life of stock options. The expected life of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees. The interest rate assumption is based upon observed Treasury yield curve rates appropriate for the expected life of stock options.

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 revenues represented by the line items reflected in our condensed consolidated statements of operations:

	Three Months Ended March 31, 2010	2009
Revenues:		
Design-to-silicon-yield solutions	68%	76%
Gainshare performance incentives	32	24
Total revenues	100%	100%
Cost of design-to-silicon-yield solutions:		
Direct costs of design-to-silicon-yield solutions	42	62
Amortization of acquired technology	2	3
Total cost of design-to-silicon-yield solutions	44	65
Gross profit	56	35
Operating expenses:		
Research and development	26	57
Selling, general and administrative	30	43
Amortization of other acquired intangible assets	1	1
Restructuring charges		6
Total operating expenses	57	107
Loss from operations	(1)	(72)
Interest and other income, net	2	3
Income (loss) before taxes	1	(69)
Income tax provision	3	3
Net loss	(2)%	(72)%

Comparison of the Three Months Ended March 31, 2010 and 2009

Revenues (In thousands, except for percentages)	**Three Months Ended March 31, 2010**	**2009**	**$ Change**	**% Change**	**Three Months Ended March 31, 2010 % of Revenues**	**2009 % of Revenues**
Design-to-silicon-yield solutions	$ 10,417	$ 7,794	$ 2,623	34%	68%	76%
Gainshare performance incentives	4,835	2,396	2,439	102%	32%	24%
Total	$ 15,252	$ 10,190	$ 5,062	50%	100%	100%

Design-to-Silicon-Yield Solutions. Design-to-Silicon-Yield solutions revenue is derived from services (including solution implementations, software support and maintenance, consulting, and training) and software licenses, provided during our customer yield improvement engagements as well as during solution product sales. Design-to-Silicon-Yield solutions revenue increased $2.6 million for the three months ended March 31, 2010 compared to the three months ended March 31, 2009, primarily due to an increase of $2.3 million in fixed fee integrated solutions and an increase of $329,000 in software and software related services. The increases were primarily the result of increased bookings. We booked two new fixed-price solution implementation service contracts and one extension to an existing service contract during the three

months ended March 31, 2010, as compared to zero new service contacts and one extension to an existing service contract during the three months ended March 31, 2009. Our Design-to-Silicon-Yield Solutions revenue may fluctuate in the future and is dependent on a number of factors including our ability to obtain new customers at emerging technology nodes.

Gainshare Performance Incentives. Gainshare performance incentives revenue represents profit sharing and performance incentives earned based upon our customers reaching certain defined operational levels. Revenue derived from gainshare performance incentives increased $2.4 million for the three months ended March 31, 2010 compared to the three months ended March 31, 2009. The increase was due to increased wafer production by many of our customers due to increased demand for wafers resulting from low levels of inventory from the previous period. The revenue from gainshare performance incentives was generated from six customers and six engagements for the three months ended March 31, 2010 and six customers and seven engagements for the three months ended March 31, 2009. Our gainshare performance incentives revenue may continue to fluctuate from period to period. Gainshare performance incentives revenue is dependent on many factors that are outside our control, including among others, continued production of 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.

Table of Contents

Cost of Design-to-Silicon-Yield Solutions (In thousands, except for percentages)	Three Months Ended March 31, 2010	2009	$ Change	% Change	Three Months Ended March 30, 2010 % of Revenues	2009 % of Revenues
Direct costs of design-to-silicon-yield solutions	$ 6,322	$ 6,290	$ 32	1%	42%	62%
Amortization of acquired technology	359	359		%	2%	3%
Total	$ 6,681	$ 6,649	$ 32	%	44%	65%

Costs of Design-to-Silicon-Yield Solutions. Costs of Design-to-Silicon-Yield solutions consist of costs incurred to provide and support our services, costs recognized in connection with licensing our software, and amortization of acquired technology.

Direct Costs of Design-to-Silicon-Yield Solutions. Direct costs of Design-to-Silicon-Yield solutions consist of services costs and software licenses costs. Services costs consist of material, labor, overhead costs, and stock-based compensation charges associated with solution implementations. Costs include purchased materials, employee compensation and related benefits, travel and facilities-related costs. Software license costs consist of costs associated with licensing third-party software sold in conjunction with our software products and expenses incurred to produce and distribute our product documentation. Direct costs of Design-to-Silicon-Yield solutions was $6.3 million for the three months ended March 31, 2010 and 2009. The direct costs of Design-to-Silicon-Yield solutions decreased as a percentage of revenues in the three months ended March 31, 2010 to 42%, compared to 62% in the three months ended March 31, 2009, primarily due to a significant increase in revenues as our costs are relatively fixed in nature. If we do not accurately estimate the resources required or the scope of work to be performed, or we 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 contracts were executed. Any such reductions in contract margin could have a material negative impact on our operating results.

Amortization of Acquired Technology. Amortization of acquired technology consists of amortization of intangible assets acquired as a result of certain business combinations. Amortization of acquired technology expense was $359,000 for each of the three months ended March 31, 2010 and 2009. We anticipate amortization of acquired technology to be $926,000 for the remaining nine months in 2010, $626,000 in 2011 and $263,000 in 2012.

Research and Development (In thousands, except for percentages)	Three Months Ended March 31, 2010	2009	$ Change	% Change	Three Months Ended March 31, 2010 % of Revenues	2009 % of Revenues
Research and development	$ 3,962	$ 5,789	$ (1,827)	(32)%	26%	57%

Research and Development. Research and development expenses consist primarily of personnel-related costs to support product development activities, including compensation and benefits, outside development services, travel and facilities cost allocations, and stock-based compensation charges. Research and development expenses decreased $1.8 million for the three months ended March 31, 2010 compared to the three months ended March 31, 2009, primarily due to a decrease of $1.1 million in personnel expenses and a decrease of $416,000 in the use of outside services, both the result of our cost control efforts. We anticipate our expenses in research and development will fluctuate in absolute dollars from period to period as a result of cost control initiatives and the timing of when we hire personnel as a result of the size and the timing

of product development projects.

					Three Months Ended March 31,	
					2010	2009
	Three Months Ended March 31,		$	%	% of	% of
Selling, General and Administrative (In thousands, except for percentages)	**2010**	**2009**	**Change**	**Change**	**Revenue**	**Revenue**
Selling, general and administrative	$ 4,579	$ 4,413	$ 166	4%	30%	43%

Selling, General and Administrative. Selling, general and administrative expenses consist primarily of compensation and benefits for sales, marketing and general and administrative personnel in addition to outside sales commissions, legal and accounting services, marketing communications, travel and facilities cost allocations, and stock-based compensation charges. Selling, general and administrative expenses increased $166,000 for the three months ended March 31, 2010 compared to the three months ended March 31, 2009, primarily due to an increase of $403,000 in legal fees, partially offset by a decrease of $207,000 in personnel expenses as the result of our cost control efforts. We anticipate our selling, general and administrative expenses will fluctuate in absolute dollars from period to period as a result of cost control initiatives and to support increased selling efforts in the future.

18

Table of Contents

Amortization of Other Acquired Intangible Assets (In thousands, except for percentages)	Three Months Ended March 31, 2010	2009	$ Change	% Change	Three Months Ended March 31, 2010 % of Revenues	2009 % of Revenues
Amortization of other acquired intangible assets	$ 86	$ 87	$ (1)	(1)%	1%	1%

Amortization of Other Acquired Intangible Assets. Amortization of other acquired intangible assets consists of amortization of intangibles acquired as a result of certain business combinations. Amortization of other acquired intangible assets remained flat for the three months ended March 31, 2010 compared to the three months ended March 31, 2009. We anticipate amortization of other acquired intangible assets to be $207,000 in the remaining nine months in 2010, $204,000 in 2011, $174,000 in 2012, and $105,000 in 2013 and thereafter.

Restructuring Charges (In thousands, except for percentages)	Three Months Ended March 31, 2010	2009	$ Change	% Change	Three Months Ended March 31, 2010 % of Revenues	2009 % of Revenues
Restructuring charges	$ 1	$ 633	$ (632)	(100)%	%	6%

Restructuring Charges. Restructuring charges for the three months ended March 31, 2010 decreased $632,000 compared to the three months ended March 31, 2009. Restructuring expenses for the three months ended March 31, 2009 consisted primarily of severance costs and were the result of our continued cost control efforts.

Three Months Ended March 31,