NETLOGIC MICROSYSTEMS INC
Form 10-Q
August 07, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition Period from ______ to ______

Commission File Number: 000-50838

NETLOGIC MICROSYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0455244**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1875 Charleston Rd.

Mountain View, CA 94043

(650) 961-6676

(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at July 31, 2007
Common Stock, $0.01 par value per share	**20,961,241 shares**

Table of Contents

NETLOGIC MICROSYSTEMS, INC.

FORM 10-Q

TABLE OF CONTENTS

		Page No.
PART I: INTERIM FINANCIAL INFORMATION		3
Item 1.	Financial Statements (unaudited)	3
	Condensed Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006	3
	Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006	4
	Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006	5
	Notes to Unaudited Condensed Consolidated Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	21
Item 4.	Controls and Procedures	22
PART II: OTHER INFORMATION		22
Item 1A.	Risk Factors	22
Item 4.	Submission of Matters to a Vote of Stockholders	25
Item 6.	Exhibits	25
Signatures		26

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

NETLOGIC MICROSYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

(UNAUDITED)

	June 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 73,717	$ 50,752
Short-term investments	30,982	39,127
Accounts receivable, net	7,924	7,736
Inventory	9,770	10,703
Prepaid expenses and other current assets	1,881	1,387
Total current assets	124,274	109,705
Property and equipment, net	6,456	5,530
Goodwill	37,069	37,069
Intangible asset	4,713	5,362
Other assets	108	103
Total assets	$ 172,620	$ 157,769
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,908	$ 4,930
Accrued liabilities	7,681	7,353
Deferred income	208	54
Software license and other obligations, current	2,083	1,382
Total current liabilities	14,880	13,719
Software license and other obligations, long-term		1,243
Other liabilities	275	283
Total liabilities	15,155	15,245
Stockholders' equity:		
Common stock and additional paid-in capital	235,703	224,851
Deferred stock-based compensation	(42)	(182)
Accumulated other comprehensive income (loss)	(18)	8
Accumulated deficit	(78,178)	(82,153)
Total stockholders' equity	157,465	142,524
Total liabilities and stockholders' equity	$ 172,620	$ 157,769

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

Table of Contents

NETLOGIC MICROSYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT FOR PER SHARE AMOUNTS)

(UNAUDITED)

	Three months ended		Six months ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Revenue	$ 25,835	$ 25,831	$ 49,246	$ 49,155
Cost of revenue	9,249	10,094	18,100	19,030
Gross profit	16,586	15,737	31,146	30,125
Operating expenses:				
Research and development	10,886	9,703	20,934	17,764
In-process research and development				10,700
Selling, general and administrative	4,561	3,996	8,521	7,603
Total operating expenses	15,447	13,699	29,455	36,067
Income (loss) from operations	1,139	2,038	1,691	(5,942)
Interest and other income, net	1,291	923	2,462	1,604
Income (loss) before income taxes	2,430	2,961	4,153	(4,338)
Provision for income taxes	92	23	178	48
Net income (loss)	$ 2,338	$ 2,938	$ 3,975	$ (4,386)
Net income (loss) per share Basic	$ 0.11	$ 0.15	$ 0.19	$ (0.23)
Net income (loss) per share Diluted	$ 0.11	$ 0.14	$ 0.18	$ (0.23)
Shares used in calculation Basic	20,691	19,923	20,548	19,393
Shares used in calculation Diluted	21,773	21,508	21,628	19,393

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

Table of Contents

NETLOGIC MICROSYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(UNAUDITED)

	Six months ended June 30,	
	2007	**2006**
Cash flows from operating activities:		
Net income (loss)	$ 3,975	$ (4,386)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,618	2,438
Accretion of discount on debt securities	(694)	
Stock-based compensation	6,815	5,591
Provision for (recovery of) doubtful accounts	(25)	45
Provision for inventory reserves	327	1,400
Tax benefit from stock-based awards	(16)	
In-process research and development		10,700
Changes in assets and liabilities, net of effect of NSE assets acquired:		
Accounts receivable	(163)	(5,033)
Inventory	605	(2,858)
Prepaid expenses and other assets	(498)	(580)
Accounts payable	(22)	26
Accrued liabilities	344	1,750
Deferred income	154	307
Other long-term liabilities	(8)	(3)
Net cash provided by operating activities	13,412	9,397
Cash flows from investing activities:		
Proceeds of short-term investments	22,636	
Purchase of short-term investments	(13,935)	
Purchase of property and equipment	(1,177)	(947)
Cash paid for acquisition		(754)
Net cash provided by (used in) investing activities	7,524	(1,701)
Cash flows from financing activities:		
Proceeds from issuance of common stock	4,236	3,327
Payments of software license obligations	(2,238)	(800)
Tax benefit from stock based-awards	16	
Proceeds from payment of notes receivable from stockholders		20
Net cash provided by financing activities	2,014	2,547
Effects of exchange rate on cash and cash equivalents	15	(10)
Net increase in cash and cash equivalents	22,965	10,233
Cash and cash equivalents at the beginning of period	50,752	65,788
Cash and cash equivalents at the end of period	$ 73,717	$ 76,021

Supplemental disclosure of non-cash financing activities:		
Issuance of common stock in connection with the acquisiton of Cypress' NSE assets	$	$ 56,201
Software license obligations	$	$ 3,233

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

Table of Contents

NetLogic Microsystems, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of NetLogic Microsystems, Inc. (we, our and the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America and with the instructions for Form 10-Q and Regulation S-X statements. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of management, all adjustments, consisting of only normal recurring items, considered necessary for a fair statement of the results of operations for the periods shown.

These unaudited financial statements should be read in conjunction with the audited financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2006. Operating results for the three and six-month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Critical Accounting Policies and Estimates

The preparation of our unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We based these estimates and assumptions on historical experience and evaluate them on an on-going basis to help ensure they remain reasonable under current conditions. Actual results could differ from those estimates. During the six-month period ended June 30, 2007, there were no changes to the critical accounting policies and estimates discussed in our 2006 annual report on Form 10-K.

2. Basic and Diluted Net Income (Loss) Per Share

We compute net income (loss) per share in accordance with SFAS 128, Earnings per Share. Basic net income (loss) per share is computed by dividing net income attributable to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period. Diluted net income per share gives effect to all dilutive potential common shares outstanding during the period including stock options and warrants using the treasury stock method.

Table of Contents

The following is a reconciliation of the weighted average common shares used to calculate basic net income (loss) per share to the weighted average common and potential common shares used to calculate diluted net income (loss) per share for the three and six months ended June 30, 2007 and 2006 (in thousands, except per share data):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Numerator:				
Net income (loss)	$ 2,338	$ 2,938	$ 3,975	$ (4,386)
Denominator:				
Weighted-average common shares outstanding	20,727	19,990	20,584	19,460
Less: shares subject to repurchase	(36)	(67)	(36)	(67)
Shares used in calculation - basic	20,691	19,923	20,548	19,393
Stock options and warrants	1,046	1,518	1,044	
Shares subject to repurchase	36	67	36	
Shares used in calculation - diluted	21,773	21,508	21,628	19,393
Net income (loss) per share:				
Basic	$ 0.11	$ 0.15	$ 0.19	$ (0.23)
Diluted	$ 0.11	$ 0.14	$ 0.18	$ (0.23)

For the three and six months ended June 30, 2007 and 2006, employee stock options to purchase the following number of shares of common stock were excluded from the computation of diluted net income (loss) per share as their effect would be anti-dilutive (in thousands):

Three months ended June 30,		Six months ended June 30,	
2007	2006	2007	2006
1,432	634	1,823	3,349

3. Share-Based Compensation

We have adopted stock plans that provide for grants to employees of equity-based awards, which include stock options and restricted stock. In addition, we have an Employee Stock Purchase Plan (ESPP), that allows employees to purchase our common stock at a discount through payroll deductions. The estimated fair value of our equity-based awards, less expected forfeitures, is amortized over the awards service period. We also grant stock options and restricted stock to new employees in accordance with Nasdaq Marketplace rule 4350(i)(1)(A)(iv) as an inducement material to the new employee s entering into employment with the Company.

The following table summarizes share-based compensation expense recorded for the periods presented:

	Three months ended		Six months ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Cost of revenue	$ 143	$ 131	$ 334	$ 148
Research and development	2,223	1,972	4,294	3,565
Selling, general and administrative	1,173	956	2,187	1,878

Total	$ 3,539	$ 3,059	$ 6,815	$ 5,591

Stock Options

The exercise price of each stock option generally equals the market price of our common stock on the date of grant. Most options vest over four years and expire no later than ten years from the grant date. During the three and six months

ended June 30, 2007, we granted stock options to purchase approximately 558,000 and 1,015,000 shares of common stock, respectively. During the three and six months ended June 30, 2006, we granted stock options to purchase approximately 30,000 and 636,000 shares of common stock, respectively.

Restricted Stock

During the three and six months ended June 30, 2007, we granted approximately 15,000 and 35,000 shares of restricted stock, respectively. During the three and six months ended June 30, 2006, we granted zero and approximately 216,000 shares of restricted stock, respectively. These awards will vest over the requisite service period, which generally is two years. The fair value of the restricted stock was estimated using the fair value of our common stock on the date of the grant. The fair value of the restricted stock is being amortized on a straight-line basis over the service period, and is reduced for estimated forfeitures.

Employee Stock Purchase Plan

Our ESPP provides that eligible employees may purchase up to $25,000 worth of our common stock annually over the course of two six-month offering periods. The purchase price to be paid by participants is 85% of the price per share of our common stock either at the beginning or the end of each six-month offering period, whichever is less. During the six months ended June 30, 2007 and 2006, approximately 26,000 and 11,000 shares, respectively, were purchased under ESPP.

Valuation Assumptions

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. This model was developed for use in estimating the value of publicly traded options that have no vesting restrictions and are fully transferable. Our employee stock options have characteristics significantly different from those of publicly traded options as they have vesting requirements and are not fully transferable. The weighted average assumptions used in the model are outlined in the following table:

	Three months ended June 30,		Six months ended June 30,	
	2007	**2006**	**2007**	**2006**
Stock Option Plans:				
Risk-free interest rate	4.84%	4.86%	4.85%	4.59%
Expected life of options	4.79 years	4.42 years	4.80 years	4.25 years
Expected dividend yield	0%	0%	0%	0%
Volatility	55%	59%	57%	56%
Weighted average fair value	$ 15.08	$ 17.50	$ 14.12	$ 17.12
Employee Stock Purchase Plan:				
Risk-free interest rate	5.09%	4.14%	5.09%	4.14%
Expected life of options	0.5 years	0.5 years	0.5 years	0.5 years
Expected dividend yield	0%	0%	0%	0%
Volatility	59%	56%	59%	56%
Weighted average fair value	$ 7.19	$ 6.93	$ 7.19	$ 6.93

The computation of the expected volatility assumption used in the Black-Scholes calculations for new grants is based on a combination of historical and implied volatilities. When establishing the expected life assumption, we semi-annually review historical employee exercise behavior with respect to option grants with similar vesting periods.

4. Income Taxes

We adopted the provisions of Financial Standards Accounting Board Interpretation (FIN) 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement (SFAS) 109, on January 1, 2007. As a result of the implementation of FIN 48, we recognized no material adjustment in the liability for unrecognized income tax benefits. At January 1, 2007 (the date of adoption) and June 30, 2007, we had $2.6 million and $3.0 million, respectively, of unrecognized tax benefits, none of which would affect our effective tax rate if recognized.

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of June 30, 2007, we have no accrued interest or penalties related to uncertain tax positions. The tax years 1999-2006 remain open to examination

Table of Contents

by one or more of the major taxing jurisdictions in which we are subject to taxation on our taxable income. The Company does not anticipate that total unrecognized tax benefits will significantly change due to the settlement of audits and the expiration of statue of limitations prior to June 30, 2008.

5. Business Combination

On February 15, 2006, we completed the acquisition of net assets of the NSE business of Cypress including the Ayama 10000, Ayama 20000, and NSE70000 product families, as well as the Sahasra 50000 Algorithmic Search Engine family (the Business). The Sahasra algorithmic technology complements our Layer 7 processing initiative and is a beneficial building block in driving towards low-cost Layer 7 applications acceleration and security processing solutions. In addition, the NSE70000, Ayama 10000 and Ayama 20000 expanded our product offerings in the high-volume, entry-level Layer 3 switch market. These factors contributed to a purchase price in excess of the fair value of net tangible assets acquired from Cypress and as a result, we recorded goodwill in connection with this transaction. The results of operations relating to the Business have been included in the results of operations from the acquisition date.

Under the terms of the agreement, we paid $1,000 in cash and issued 1,488,063 shares of common stock valued at $49.7 million to Cypress on February 15, 2006 and agreed to issue additional shares upon receipt of audited financial statements of the Business. In addition, we had agreed to pay Cypress up to an additional $10.0 million in cash and up to an additional $10.0 million in shares of our common stock if certain revenue milestones associated with the Business were achieved in the twelve-month period after the close of the transaction, but those revenue milestones were not met during the period, which ended March 31, 2007, and that additional consideration will not be paid.

On April 11, 2006, we issued the additional 165,344 shares of our common stock to Cypress upon its delivery to us of the audited financial statements of the Business. The additional shares were valued at $6.5 million, which was added to the purchase price and recorded as an increase to goodwill in 2006.

The acquisition was accounted for as a purchase business combination. The total purchase price of the Business was approximately $57.0 million, determined as follows (in thousands of dollars):

Cash	$ 1
Value of NetLogic common stock issued	56,201
Direct transaction costs	753
Total purchase price	$ 56,955

The value of the 1,488,063 shares of common stock issued on February 15, 2006 was determined based on the average price of the common stock over a five-day period including the two days before and after January 25, 2006 (the date the definitive agreement was signed and announced), or $33.43 per share. The value of the additional 165,344 shares of the common stock issued on April 11, 2006 was determined based on the closing price of the common stock on that date, or $39.03 per share.

Under the purchase method of accounting, the total purchase price is allocated to the Business net tangible and intangible assets based on their fair values as of the date of the completion of the acquisition. Based on management estimates of the fair values, the estimated purchase price was allocated as follows (in thousands):

Tangible assets	$ 1,850
Amortizable intangible assets:	
Developed technology	6,500
Backlog	836
In-process research and development	10,700
Goodwill	37,069
Total purchase price allocation	$ 56,955

Developed technology comprised products that had reached technological feasibility as of the acquisition date and included the Ayama10000, Ayama 20000, and NSE70000 product families. The value assigned to developed technology was based upon future discounted cash flows related to the existing products projected income streams using a discount rate of 20%. We believe that this discount rate was appropriate given the business risks inherent in marketing and selling these products. Factors considered in estimating the discounted cash flows to be derived from the existing technology included risks related to the characteristics and applications of the technology, existing and future markets and an assessment of the age of the technology within its life span. We expect to amortize the existing technology intangible asset on a straight-line basis over an estimated life of five years.

Table of Contents

The backlog intangible asset represented the value of the sales and marketing costs required to establish the order backlog and was valued using the cost savings approach. We estimated those orders would be delivered and billed within six months from the acquisition date, which was the period over which the asset was amortized.

Of the total estimated purchase price, an estimate of $10.7 million was allocated to in-process research and development (IPRD) based upon our estimate of the fair values of assets acquired, and was charged to expense during the year ended December 31, 2006. We acquired only one IPRD project, which was related to the Sahasra algorithmic technology that had not reached technological feasibility as of the acquisition date and had no alternative use. The Sahasra algorithmic technology complements the Company s Layer 7 processing initiative and is a beneficial building block in driving towards low-cost Layer 7 applications acceleration and security processing solutions.

The fair value assigned to IPRD was determined using the income approach, under which we considered the importance of products under development to our overall development plans, estimated the costs to develop the purchased IPRD into commercially viable products, estimated the resulting net cash flows from the products when completed and discounted the net cash flows to their present values. We used a discount rate of 23% in the present value calculations, which were derived from a weighted-average cost of capital analysis, adjusted to reflect additional risks related to the products development and success, as well as the products stage of completion. The estimates used in valuing IPRD were based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable. Those assumptions may be incomplete or inaccurate, and unanticipated events and circumstances may occur. Accordingly, actual results may vary from the projected results.

To date, there have been no significant differences between the actual and estimated results of the IPRD project. As of June 30, 2007, we had incurred total post-acquisition costs of approximately $1.4 million related to the IPRD project, and we estimate that an additional investment of approximately $1.7 million will be required to complete the project. The Company expects to complete the project by the end of 2007 and benefit from the IPRD project beginning in 2008.

Of the total estimated purchase price, approximately $37.1 million has been allocated to goodwill. Goodwill represents the excess of the purchase price of an acquired business over the fair value of the underlying net tangible and intangible assets, and is deductible for tax purposes. In accordance with the Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, goodwill is not amortized but instead is tested for impairment at least annually, and more frequently if certain indicators are present. In the event we determine that the value of goodwill has become impaired, we will incur an accounting charge for the amount of impairment during the fiscal quarter in which such determination is made.

6. Goodwill and Other Intangible Assets

The following table summarizes the components of goodwill, other intangible assets and related accumulated amortization balances, which were recorded as a result of the business combination described in Note 5 (in thousands):

	June 30, 2007		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**
Goodwill	$ 37,069	$	$ 37,069
Other intangible assets:			
Developed technology	$ 6,500	$ (1,787)	$ 4,713
Backlog	836	(836)	
Total	$ 7,336	$ (2,623)	$ 4,713

Backlog, with an estimated useful life of six months, was classified within prepaid expenses and other current assets and is fully amortized as of June 30, 2007. For the three and six months ended June 30, 2007, amortization expense related to other intangible assets was $0.3 million and $0.7 million, respectively, all of which was included in cost of sales because the amortization expense related to products sold during such periods. As of June 30, 2007, the estimated future amortization expense of other intangible assets in the table above is as follows (in thousands):

Fiscal Year	Estimated Amortization
2007 (remaining 6 months)	$ 651
2008	1,300
2009	1,300
2010	1,300
2011	162
Total	$ 4,713

Table of Contents

In accordance with SFAS 142, we evaluate goodwill for impairment at least on an annual basis or whenever events and changes in circumstances suggest that the carrying amount may not be recoverable from its estimated future cash flow. No assurances can be given that future evaluations of goodwill will not result in charges as a result of future impairment.

7. Cash and Cash Equivalents

We consider all highly liquid investments purchased with a remaining maturity of three months or less at the date of purchase to be cash equivalents. These investments consist primarily of money market funds, which are readily convertible to cash and are stated at cost, which approximates market value. We deposit cash and cash equivalents with high credit quality financial institutions.

Short-term investments are comprised primarily of government agency debt securities with remaining contractual maturities on the date of purchase greater than 90 days but less than one year. Investments in debt securities are classified as available-for-sale and carried at fair value. As of June 30, 2007, we had approximately $21,000 of unrealized loss on short-term investments, which was recorded in accumulated other comprehensive loss within the stockholders section of our consolidated balance sheet.

8. Balance Sheet Components

The components of our inventory at June 30, 2007 and December 31, 2006 were as follows (in thousands):

	June 30, 2007	December 31, 2006
Inventories:		
Finished goods	$ 3,453	$ 1,903
Work-in-progress	6,317	8,800
	$ 9,770	$ 10,703

The components of our accrued liabilities at June 30, 2007 and December 31, 2006 were as follows (in thousands):

	June 30, 2007	December 31, 2006
Accrued liabilities:		
Accrued payroll and related expenses	$ 2,885	$ 3,365
Accrued warranty	1,369	1,270
Accrued inventory purchases	1,090	897
Other accured expenses	2,337	1,821
	$ 7,681	$ 7,353

9. Product Warranties

We provide a limited product warranty from one to three years from the date of sale. We provide for the estimated future costs of repair or replacement upon shipment of the product. Our warranty accrual is estimated based on actual and

historical claims compared to historical revenue and assumes that we have to replace products subject to a claim. The following table summarizes activity related to product warranty liability during the three and six months ended June 30, 2007 and 2006 (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	**2006**	**2007**	**2006**
Warranty accrual:				
Beginning balance	$ 1,309	$ 1,265	$ 1,270	$ 531
Provision for warranty	63	256	209	1,028
Settlements made during the period	(3)	(20)	(110)	(58)
Ending balance	$ 1,369	$ 1,501	$ 1,369	$ 1,501

During the three and six months ended June 30 , 2006, we provided an additional warranty reserve of $0.2 million and $0.9 million, respectively, to address a warranty issue related to specific devices sold to one of our international customers. The devices were tested by both us and the customer and passed quality assurance inspection at the time they were sold. The customer subsequently identified malfunctioning systems that included our devices. No specific warranty reserve was provided for additional units shipped subsequent to June 30, 2006 as the customer modified the software associated with its products to remedy the observed malfunction. As of June 30, 2007, we maintained $0.7 million of warranty reserves for anticipated replacement costs of the parts sold to this customer.

We entered into a master purchase agreement with Cisco in November 2005 under which we provided Cisco and its contract manufacturers a warranty period of as much as five years (in the case of epidemic failure). The extended warranty period in the master purchase agreement with Cisco has not had a material impact on our results of operations or financial condition based on our warranty analysis, which included an evaluation of our historical warranty cost information and experience.

10. Commitments and Contingencies

Purchase Commitments

At June 30, 2007, we had approximately $8.2 million in firm, non-cancelable and unconditional purchase commitments with suppliers.

Contingencies

We may become party to claims and litigation proceedings arising in the normal course of business. The legal responsibility and financial impact with respect to claims and litigation that may arise cannot currently be ascertained, and presently we do not know of any matters that will result in the payment of monetary damages, net of any applicable insurance proceeds, that, in the aggregate, would be material in relation to our business, financial position, results of operations or cash flows. There can be no assurance that any such matters would be resolved without costly litigation, in a manner that is not adverse to our business, financial position, results of operations or cash flows, or without requiring royalty payments in the future which might adversely impact gross margins.

Indemnities, Commitments and Guarantees

In the normal course of business, we have made certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These include agreements to indemnify our customers with respect to liabilities associated with the infringement of other parties technology based upon our products, obligation to indemnify our lessors under facility lease agreements, and obligations to indemnify our directors and officers to the maximum extent permitted under the laws of the state of Delaware. The duration of such indemnification obligations, commitments and guarantees varies and, in certain cases, is indefinite. We have not recorded any liability for any such indemnification obligations, commitments and guarantees in the accompanying balance sheets. We do, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is probable.

Under master purchase agreements signed with Cisco in November 2005, we have agreed to indemnify Cisco for costs incurred in rectifying epidemic failures, up to the greater of (on a per claim basis) 25% of all amounts paid to us by Cisco during the preceding 12 months or $9.0

million, plus replacement costs. If we are required to make payments under the indemnity, our operating results may be adversely affected.

12

Table of Contents

11. Comprehensive Income

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The components of comprehensive income (loss) are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Net income (loss)	$ 2,338	$ 2,938	$ 3,975	$ (4,386)
Currency translation adjustments	5	48	(5)	59
Unrealized gain (loss) on short-term investments	1		(21)	
Comprehensive income (loss)	$ 2,344	$ 2,986	$ 3,949	$ (4,327)

12. Related Party Transactions

We lease our headquarters facility in Mountain View, California from an affiliate of Berg & Berg Enterprises, LLC (the Affiliate), which has held shares of our common stock. During the three and six months ended June 30, 2007, we made lease payments of approximately $210,000 and $420,000, respectively, under this lease arrangement.

13. Operating Segments and Geographic Information

We operate in one business segment. We sell our products directly to customers in the United States, Asia and Europe. Sales for geographic regions reported below are based upon the customer headquarter locations. Following is a summary of geographic information related to revenue for the three and six months ended June 30, 2007 and 2006:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Revenue:				
United States	50%	41%	45%	45%
Malaysia	31%	36%	36%	31%
Asia, exlcuding Malaysia	13%	15%	13%	19%
Other	6%	8%	6%	5%
Total	100%	100%	100%	100%

As of June 30, 2007 and December 31, 2006, the following customers accounted for more than 10% of our total accounts receivable:

	June 30, 2007	December 31, 2006
Solectron Corporation	33%	57%
Sanmina Corporation	16%	11%

14. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) 157, Fair Value Measurements which clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a

fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective the first quarter of 2008 with early adoption permitted. We have not yet determined the impact, if any, that the implementation of SFAS 157 will have on our financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards (SFAS) 159, Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of SFAS 115. SFAS 159 permits entities to choose, at

specified election dates, to measure eligible items at fair value (the fair value option). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. This accounting standard is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. The effect, if any, of adopting SFAS 159 on our financial position and results of operations has not been finalized.

Item 2: Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which include, without limitation, statements about the market for our technology, our strategy and competition. Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed forward-looking statements. For example, the words believes , anticipates , plans , expects , intends and similar expressions are intended to identify forward-looking statements. In addition, all the information under Item 3 below constitutes a forward-looking statement. Our actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a discrepancy include, but are not limited to, those discussed in Business , Risk Factors , Management s Discussion and Analysis of Financial Condition and Results of Operation and Qualitative and Quantitative Disclosures About Market Risk in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2007 and under Management s discussion and Analysis of Financial Condition and Results of Operations and Risk Factors below. All forward-looking statements in this document are based on information available to us as of the date of this report and we assume no obligation to update any such forward-looking statements. The following discussion should be read in conjunction with our condensed financial statements and the accompanying notes contained in this quarterly report, except as required by law. Unless expressly stated or the context otherwise requires, the terms we , our , us and NetLogic Microsystems refer to NetLogic Microsystems, Inc.

Overview

We are a semiconductor company that designs, develops and markets high performance knowledge-based processors for a variety of advanced wireline and wireless networking systems, such as routers, switches, wireless infrastructure equipment, network security appliances, network access equipment and networked storage devices. Our knowledge-based processors accelerate a wide variety of complex functions to enable emerging quad-play networks and services, or the convergence of voice, video, data and mobility over a single unified Internet Protocol infrastructure.

Knowledge-based processors are integrated circuits that employ an advanced processor architecture and a large knowledge or signature database containing information on the network, as well as applications and content that run on the network to make complex decisions about individual packets of information traveling through the network. Our knowledge-based processors significantly enhance the ability of networking original equipment manufacturers, or OEMs, to supply network service providers with systems offering more advanced functionality for the Internet, such as high-definition video delivery over the Internet, or IPTV, voice transmission over the Internet, or VoIP, unified threat management, or UTM, virtual private networks, or VPNs, rich content delivery over mobile wireless networks, and streaming video and audio.

Our knowledge-based processors incorporate advanced technologies that enable rapid processing, such as a superscalar architecture, which uses parallel-processing techniques, and deep pipelining, which segments processing tasks into smaller sub-tasks, for higher decision throughput. These technologies enable networking systems to perform a broad range of network-aware and content-aware processing functions, such as application-based routing, UTM network security, intrusion detection and prevention, virus inspection, access control for network security, prioritization of traffic flow to maintain quality of service, or QoS, and statistical measurement of Internet traffic for transaction billing.

Since the second half of 2003, we have experienced significant revenue growth caused by a rapid rise in new customer orders for our knowledge-based processors. Our total revenue increased by 253% from $13.5 million for fiscal 2003 to $47.8 million for fiscal 2004, and by 71% from fiscal 2004 to $81.8 million for fiscal 2005. Our total revenue for fiscal year ended December 31, 2006 was $96.8 million, which represented an increase of 18% over fiscal 2005.

As a fabless semiconductor company, our business is less capital intensive than others because we rely on third parties to manufacture, assemble, and test our products. In general, we do not anticipate making significant capital expenditures. In the future, as we launch new products or expand our operations, however, we may require additional funds to procure product mask sets, order elevated quantities of wafers from our foundry partners, perform qualification testing and assemble and test those products.

Table of Contents

We employ a direct sales force, a sales representative network and a distributor to sell our products. A substantial portion of our revenue comes from customers headquartered in the United States; however, we also earn a significant amount from customers headquartered in countries outside the United States. All revenue to date has been denominated in U.S. dollars.

Our product sales cycles can take up to 24 months to complete and volume production can take an additional six months to be achieved, if at all. Cancellations of customer orders or changes in product specifications might result in the loss of anticipated sales without allowing us sufficient time to reduce our inventory or operating expenses. Our recent rapid revenue growth makes it difficult for us to assess the impact of seasonal factors on our business.