

WIND RIVER SYSTEMS INC  
Form 10-Q  
December 10, 2008  
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**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 October 31, 2008

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-33061

**WIND RIVER SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**94-2873391**  
(I.R.S. Employer  
Identification Number)

**500 Wind River Way, Alameda, California 94501**  
(Address of principal executive offices)

**(510) 748-4100**  
(Registrant's telephone number, including area code)

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). Yes  No

As of November 28, 2008, there were 76,246,338 shares of the registrant's \$0.001 par value common stock outstanding.

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**WIND RIVER SYSTEMS, INC.**

**FORM 10-Q**

**FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2008**

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Unless stated otherwise, references in this report to Wind River, we, our, us or the Company refer to Wind River Systems, Inc., a Delaware corporation, and its consolidated subsidiaries.

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****WIND RIVER SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share amounts)****(Unaudited)**

|   | <b>Three Months Ended<br/>October 31,</b> |                | <b>Nine Months Ended<br/>October 31,</b> |                |
|---|---|----------------|--|----------------|
|   | <b>2008</b>                               | <b>2007</b>    | <b>2008</b>                              | <b>2007</b>    |
| <b>Revenues, net:</b>                       |   |                |  |                |
| Product                                     | \$ 37,440                                 | \$ 29,735      | \$ 105,214                               | \$ 89,924      |
| Subscription                                | 31,823                                    | 30,886         | 97,400                                   | 89,939         |
| Service                                     | 22,313                                    | 21,022         | 68,742                                   | 64,458         |
| <b>Total revenues, net</b>                  | <b>91,576</b>                             | <b>81,643</b>  | <b>271,356</b>                           | <b>244,321</b> |
| <b>Cost of revenues:</b>                    |   |                |  |                |
| Product                                     | 756                                       | 586            | 2,138                                    | 1,778          |
| Subscription                                | 3,476                                     | 4,288          | 11,782                                   | 13,046         |
| Service                                     | 16,033                                    | 14,403         | 48,842                                   | 42,754         |
| Amortization of purchased intangibles       | 513                                       | 691            | 1,572                                    | 1,896          |
| <b>Total cost of revenues</b>               | <b>20,778</b>                             | <b>19,968</b>  | <b>64,334</b>                            | <b>59,474</b>  |
| <b>Gross profit</b>                         | <b>70,798</b>                             | <b>61,675</b>  | <b>207,022</b>                           | <b>184,847</b> |
| <b>Operating expenses:</b>                  |   |                |  |                |
| Selling and marketing                       | 34,222                                    | 32,852         | 102,486                                  | 98,163         |
| Product development and engineering         | 22,016                                    | 20,588         | 63,148                                   | 61,288         |
| General and administrative                  | 8,099                                     | 9,050          | 25,304                                   | 28,612         |
| Amortization of other intangibles           | 197                                       | 145            | 412                                      | 417            |
| Restructuring and other charges (reversals) | (63)                                      | 642            | 2,854                                    | 642            |
| <b>Total operating expenses</b>             | <b>64,471</b>                             | <b>63,277</b>  | <b>194,204</b>                           | <b>189,122</b> |
| <b>Income (loss) from operations</b>        | <b>6,327</b>                              | <b>(1,602)</b> | <b>12,818</b>                            | <b>(4,275)</b> |
| <b>Other income:</b>                        |   |                |  |                |
| Interest income                             | 1,859                                     | 2,615          | 6,038                                    | 7,128          |
| Interest expense                            | (99)                                      | (131)          | (320)                                    | (335)          |
| Other expense, net                          | (935)                                     | (53)           | (667)                                    | (454)          |
| <b>Total other income, net</b>              | <b>825</b>                                | <b>2,431</b>   | <b>5,051</b>                             | <b>6,339</b>   |
| <b>Income before income taxes</b>           | <b>7,152</b>                              | <b>829</b>     | <b>17,869</b>                            | <b>2,064</b>   |
| <b>Provision for income taxes</b>           | <b>1,236</b>                              | <b>927</b>     | <b>2,696</b>                             | <b>2,400</b>   |

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|  |          |           |           |           |
|--|----------|-----------|-----------|-----------|
| <b>Net income (loss)</b>                     | \$ 5,916 | \$ (98)   | \$ 15,173 | \$ (336)  |
| <b>Net income (loss) per share:</b>          |          |           |           |           |
| Basic and diluted                            | \$ 0.08  | \$ (0.00) | \$ 0.19   | \$ (0.00) |
| <b>Shares used in per share calculation:</b> |          |           |           |           |
| Basic  | 77,316   | 87,081    | 79,993    | 86,174    |
| Diluted                                      | 78,637   | 87,081    | 80,889    | 86,174    |

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

**Table of Contents****WIND RIVER SYSTEMS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)****(Unaudited)**

|   | <b>October<br/>31,<br/>2008</b> | <b>January 31,<br/>2008</b> |
|---|---------------------------------|-----------------------------|
| <b>ASSETS</b>                                     |                                 |                             |
| Current assets:                                   |                                 |                             |
| Cash and cash equivalents                         | \$ 64,148                       | \$ 101,635                  |
| Short-term investments                            | 16,665                          | 22,646                      |
| Accounts receivable, net                          | 71,790                          | 85,680                      |
| Prepaid and other current assets                  | 17,932                          | 18,855                      |
| <b>Total current assets</b>                       | <b>170,535</b>                  | <b>228,816</b>              |
| Long-term investments                             | 80,407                          | 119,867                     |
| Property and equipment, net                       | 77,602                          | 77,981                      |
| Goodwill  | 122,084                         | 114,371                     |
| Other intangibles, net                            | 12,182                          | 4,961                       |
| Other assets                                      | 16,360                          | 17,923                      |
| <b>Total assets</b>                               | <b>\$ 479,170</b>               | <b>\$ 563,919</b>           |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>        |                                 |                             |
| Current liabilities:                              |                                 |                             |
| Accounts payable                                  | \$ 8,617                        | \$ 9,341                    |
| Accrued and other current liabilities             | 17,249                          | 21,817                      |
| Accrued compensation                              | 26,034                          | 24,433                      |
| Income taxes payable                              | 4,213                           | 614                         |
| Deferred revenues                                 | 107,135                         | 119,886                     |
| <b>Total current liabilities</b>                  | <b>163,248</b>                  | <b>176,091</b>              |
| Long-term deferred revenues                       | 18,686                          | 14,647                      |
| Other long-term liabilities                       | 11,793                          | 7,589                       |
| <b>Total liabilities</b>                          | <b>193,727</b>                  | <b>198,327</b>              |
| Minority Interest                                 | 154                             |                             |
| Stockholders' equity:                             |                                 |                             |
| Common stock                                      | 92                              | 91                          |
| Additional paid-in-capital                        | 887,524                         | 865,565                     |
| Treasury stock                                    | (152,683)                       | (49,802)                    |
| Accumulated other comprehensive income (loss)     | (6,736)                         | 7,057                       |
| Accumulated deficit                               | (442,908)                       | (457,319)                   |
| <b>Total stockholders' equity</b>                 | <b>285,289</b>                  | <b>365,592</b>              |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 479,170</b>               | <b>\$ 563,919</b>           |

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

**Table of Contents****WIND RIVER SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

|  | <b>Nine Months Ended<br/>October 31,</b> |                  |
|--|--|------------------|
|  | <b>2008</b>                              | <b>2007</b>      |
| <b>Cash flows from operating activities:</b>   |  |                  |
| Net income (loss)  | \$ 15,173                                | \$ (336)         |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |  |                  |
| Depreciation and amortization  | 8,878                                    | 9,387            |
| Stock-based compensation expense   | 12,627                                   | 16,118           |
| 401(k) common stock match  | 1,894                                    | 1,645            |
| Non-cash restructuring charges   |  | 333              |
| Other-than-temporary impairment of investments   | 804                                      |                  |
| Realized (gain) loss from sales of available-for-sale securities, net                    | (490)                                    | 51               |
| Changes in assets and liabilities, net of effect of acquisitions:                        |  |                  |
| Accounts receivable  | 11,177                                   | 4,247            |
| Accounts payable   | (1,269)                                  | (1,272)          |
| Accrued liabilities  | (4,826)                                  | 4,536            |
| Accrued compensation   | 2,476                                    | 1,854            |
| Income taxes payable   | 4,104                                    | 1,147            |
| Deferred revenues  | (5,539)                                  | (15,466)         |
| Other assets and liabilities   | (383)                                    | 1,108            |
| Net cash provided by operating activities  | 44,626                                   | 23,352           |
| <b>Cash flows from investing activities:</b>   |  |                  |
| Acquisitions of property and equipment   | (6,090)                                  | (7,990)          |
| Acquisitions, net of cash acquired   | (15,331)                                 | (11,484)         |
| Purchases of investments   | (37,468)                                 | (79,604)         |
| Sales of investments   | 28,987                                   | 665              |
| Maturities of investments  | 51,078                                   | 66,691           |
| Net cash provided by (used in) investing activities                                      | 21,176                                   | (31,722)         |
| <b>Cash flows from financing activities:</b>   |  |                  |
| Issuance of common stock   | 9,416                                    | 16,800           |
| Repurchase of common stock   | (105,621)                                | (6,536)          |
| Repayment of loan  | (887)                                    |                  |
| Net cash provided by (used in) financing activities                                      | (97,092)                                 | 10,264           |
| Effect of exchange rate changes on cash and cash equivalents                             | (6,197)                                  | 5,134            |
| <b>Net increase (decrease) in cash and cash equivalents</b>                              | <b>(37,487)</b>                          | <b>7,028</b>     |
| <b>Cash and cash equivalents at beginning of period</b>                                  | <b>101,635</b>                           | <b>71,316</b>    |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$ 64,148</b>                         | <b>\$ 78,344</b> |



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

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**WIND RIVER SYSTEMS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**Note 1: The Company and Summary of Significant Accounting Policies**

*The Company*

Wind River Systems, Inc. ( Wind River or the Company ) is a global leader in Device Software Optimization ( DSO ). The Company develops, markets and sells operating systems, middleware and software development tools that allow its customers to develop, run, and manage their device products faster, better, at lower cost and more reliably. Wind River offers its customers a choice of leading real-time, proprietary operating systems and open-source-based, commercial-grade Linux operating systems. Wind River also offers its comprehensive, Eclipse-based Workbench software development suite that allows its customers to manage the design, development, debugging and testing of their device software systems, as well as leading device management solutions that allow its customers to remotely monitor and manage their devices in either lab or field environments. Wind River's customers manufacture devices as varied as set-top boxes, automobile braking and navigation systems, mobile handsets, Internet routers, avionics control panels and coronary pacemakers.

Wind River markets its products and services in North America, EMEA (comprising Europe, the Middle East and Africa), Japan and the Asia Pacific region, primarily through its own direct sales organization, which consists of sales persons and field engineers. Wind River also licenses distributors, primarily in international regions, to serve customers in regions not serviced by its direct sales force. Wind River was incorporated in California in February 1983 and reincorporated in Delaware in April 1993.

*Basis of Presentation*

Wind River has prepared the condensed consolidated financial statements included herein, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, Wind River believes that the disclosures are adequate to ensure the information presented is not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in Wind River's Annual Report on Form 10-K for the fiscal year ended January 31, 2008 filed with the SEC on April 15, 2008.

Wind River believes that all necessary adjustments, which consist of normal recurring items, have been included in the accompanying consolidated financial statements to state fairly the results of the interim periods. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for Wind River's fiscal year ending January 31, 2009.

The condensed consolidated financial statements include the financial information of Wind River and its subsidiaries. All significant inter-company accounts and transactions have been eliminated.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Specifically, estimates are used for, but not limited to, the accounting for stock-based compensation, the allowance for doubtful accounts, sales returns and other allowances, valuation of investments, goodwill and purchased intangibles, restructuring and other charges, deferred tax assets and liabilities and income taxes, percentage of completion accounting, accrued compensation and other accruals, and the outcome of litigation and other contingencies. Wind River bases its estimates on historical experience and various other assumptions that are believed to be reasonable based on the specific circumstances. Wind River's management has discussed these estimates with the Audit Committee of the Board of Directors. These estimates and assumptions form the basis for making judgments about the carrying value of certain assets and liabilities. Actual results could differ from these estimates.



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**Table of Contents***Segment Information*

At the beginning of fiscal 2009, the Company adopted a reorganization plan to better align its resources with its strategic business objectives. As part of this plan, the Company reorganized its operations into four product divisions. As a result of this reorganization, the Company changed its reportable segments and segment disclosures during the first quarter of fiscal 2009 in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 131, *Disclosures about Segments of an Enterprise and Related Information*. In addition, the Company has recast its segment disclosures for periods prior to fiscal 2009 to present the new reportable segments. See Note 11, Segment and Geographic Information, for further information.

*Recent Accounting Pronouncements*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 provides accounting guidance on the definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. In February 2008, the FASB issued FSP No. FAS 157-2 *Effective Date of FASB Statement No. 157* ( FSP FAS 157-2 ), which delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Effective February 1, 2008, the Company adopted SFAS 157 for financial assets and liabilities recognized at fair value on a recurring basis. The adoption did not have a material impact on the Company's consolidated financial statements. In accordance with FSP FAS 157-2, the Company will adopt SFAS 157 for its other assets and liabilities measured at fair value in the first quarter of fiscal 2010. The Company is evaluating the impact that this statement will have on its consolidated financial statements. In October 2008, the FASB issued FSP No. FAS 157-3, *Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active* ( FSP FAS 157-3 ), to clarify the application of the provision of SFAS 157 in an inactive market and how an entity would determine fair value in an inactive market. FSP FAS 157-3 is effective immediately and applies to the Company's October 31, 2008 financial statements. The application of the provision of FSP FAS 157-3 did not materially affect the Company's consolidated financial statements as of and for the period ended October 31, 2008. See Note 3, Financial Instruments, for further information regarding the Company's fair value measurements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ), which will replace SFAS 141. SFAS 141R retains the fundamental requirements of SFAS 141, but revises certain principles, including the definition of a business combination, the recognition and measurement of assets acquired and liabilities assumed in a business combination, the accounting for goodwill, and financial statement disclosure. SFAS 141R also changes the accounting of contingent purchase consideration, requires the capitalization of in-process research and development at fair value, and prescribes the expensing of restructuring and acquisition related costs. The adoption of SFAS 141R will change the Company's accounting treatment for business combinations on a prospective basis beginning in the first quarter of fiscal year 2010. The Company is evaluating the impact that this statement will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* ( SFAS 160 ), which addresses the accounting and reporting standards for the noncontrolling or minority interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 will be effective in the first quarter of fiscal 2010. The Company does not believe the adoption of SFAS 160 will have a material effect on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133* ( SFAS 161 ). SFAS 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for and their effect on an entity's financial position, financial performance, and cash flows. SFAS 161 will be effective in the first quarter of fiscal year 2010. The Company does not believe the adoption of SFAS 161 will have a material effect on its consolidated financial statements.

In April 2008, the FASB issued FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP FAS 142-3 ). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ). FSP FAS 142-3 is intended to improve the consistency between the useful life of an intangible asset determined under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R and other U.S. GAAP. FSP FAS 142-3 is effective for fiscal years and interim periods beginning after December 15, 2008. The Company is evaluating the impact of the adoption of FSP SFAS 142-3 on its consolidated financial statements.

**Table of Contents****Note 2: Acquisitions, Goodwill and Intangible Assets***Acquisition of MIZI Research, Inc.*

On October 15, 2008, the Company acquired approximately 99% of the outstanding shares of MIZI Research, Inc ( MIZI ), a privately held Korean company, for approximately \$16.6 million, comprised of approximately \$15.8 million in cash consideration plus acquisition related costs. In addition, in connection with the acquisition, the Company agreed to pay potential retention and performance bonuses of up to an aggregate of \$1.75 million. These bonuses require post-acquisition services to be provided to the Company and, accordingly, the bonuses will be accrued as compensation expense over the related contingency period, provided the related criteria are probable of being satisfied.

MIZI is an independent software company that specializes in the development of embedded Linux-based mobile application platforms. With this acquisition, the Company gains access to mobile expertise that can be leveraged across its various mobile alliances and it accelerates its mobile services presence in Asia Pacific. These factors contributed to a purchase price in excess of fair value of MIZI's net tangible and intangible assets acquired and as a result, the Company has recorded goodwill in connection with the transaction. Wind River accounted for this acquisition as a non-taxable purchase and, in accordance with SFAS 141, Business Combinations, ( SFAS 141 ), the total consideration was allocated to the tangible and intangible assets acquired and liabilities assumed, based on their estimated fair values.

The following table reflects the preliminary allocation of the total purchase price of \$16.6 million as of the date of purchase (in thousands, except estimated useful economic life):

|  | Estimated<br>Useful<br>Economic<br>Life (Years) | Purchase Price<br>Allocation |
|--|---|------------------------------|
| Property and equipment, net                  |   | \$ 303                       |
| Core and developed technology                | 5   | 900                          |
| Customer contracts and related relationships | 4   | 7,500                        |
| Non-compete agreements                       | 2   | 700                          |
| Trade name/trademarks                        | 3   | 200                          |
| Goodwill                                     |   | 10,630                       |
| Net current liabilities                      |   | (1,069)                      |
| Deferred tax liability                       |   | (2,558)                      |
| <b>Total purchase price</b>                  |   | <b>\$ 16,606</b>             |

In performing the preliminary purchase price allocation of acquired intangible assets, Wind River considered its intention for the future use of the assets, analyses of historical financial performance, and estimates of the future performance of MIZI, among other factors. Wind River used the income valuation approach in determining the fair values of the acquired intangible assets using discount rates of 33% to 35%. The goodwill of \$10.6 million represents Wind River's assigned value for the long-term potential of the integration of MIZI into Wind River's overall Linux product strategy and professional services organization. The final purchase price allocation will depend primarily upon the finalization of the value of acquired deferred tax assets. The goodwill of \$10.6 million has been allocated to the Linux reportable segment.

The condensed consolidated financial statements include the operating results of MIZI from the date of acquisition. Pro forma results of operations have not been presented and separate financial statements for MIZI will not need to be filed because the effect of this acquisition was not material to the consolidated statement of operations, balance sheets, or cash flows of Wind River and is not otherwise required by the rules and regulations of the Securities and Exchange Commission.

At the date of the acquisition, MIZI had four short-term borrowing arrangements with the Industrial Bank of Korea ( IBK ). The amount outstanding under these agreements with IBK at the date of acquisition was approximately \$887,000. The amounts outstanding under these agreements were repaid and the loan facilities were closed prior to October 31, 2008.

**Table of Contents***Acquisition of S.C. Comsys S.R.L.*

In August 2007, Wind River acquired all of the outstanding shares of S.C. Comsys S.R.L. ( Comsys ), a privately held professional services company based in Romania. The acquisition has enabled the Company to increase the number of skilled consultants in its professional services organization and to expand its service offerings throughout Europe and globally. The Company paid initial cash consideration of approximately \$1.4 million, comprised of approximately \$1.3 million in cash consideration, plus acquisition related costs. In addition, the Company agreed to pay Comsys former shareholders a potential earn-out distribution of up to \$250,000, which will be payable if certain specified future performance criteria are met. The performance criteria consist of post-acquisition services to be provided to the Company and, accordingly, the distribution amount will be accrued as compensation expense over the contingency period, provided the criteria are probable of being satisfied.

The purchase did not qualify as a business combination under SFAS 141, as the acquiree was deemed to be a development-stage operation as of the acquisition date. Accordingly, the purchase was recorded as an asset acquisition and the total consideration was allocated to the assets acquired and liabilities assumed, excluding goodwill, based on their estimated fair values. Assembled workforce associated with an asset acquisition qualifies as an identified intangible asset and, therefore, the Company allocated \$1.5 million of the purchase price to assembled workforce, which represents the value of the acquired workforce-in-place.

The following table reflects the allocation of the total purchase price of \$1.4 million as of the date of acquisition (in thousands, except estimated useful economic life):

|                             | Estimated<br>Useful<br>Economic<br>Life (Years) | Purchase Price<br>Allocation |
|-----------------------------|---|------------------------------|
| Net current assets          |   | \$ 53                        |
| Property and equipment, net |   | 63                           |
| Assembled workforce         | 5   | 1,544                        |
| Deferred tax liability      |   | (247)                        |
| <b>Total purchase price</b> |   | <b>\$ 1,413</b>              |

The Company finalized the allocation of the total purchase price during the second quarter of fiscal 2009 after making an additional cash payment of \$66,000 related to the initial purchase consideration.

*Acquisition of the RTLinux Business*

In February 2007, the Company acquired the intellectual property, including patents, copyrights, trademarks and associated product rights for the RTLinux business from Finite State Machine Labs, Inc. The Company paid approximately \$10.1 million, comprised of \$9.8 million in cash consideration, plus acquisition related costs. For additional information, see Note 2, Acquisitions, Goodwill and Purchased Intangibles, of the notes to consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2008.

**Table of Contents***Goodwill*

The following table presents goodwill by reportable segment (in thousands):

|                                       | October 31,<br>2008 | January 31,<br>2008 |
|---------------------------------------|---------------------|---------------------|
| VxWorks                               | \$ 66,375           | \$ 68,113           |
| Linux                                 | 24,874              | 14,617              |
| Non-Core Products and Design Services | 14,931              | 15,321              |
| All other                             | 15,904              | 16,320              |
| <b>Total</b>                          | <b>\$ 122,084</b>   | <b>\$ 114,371</b>   |

The increase in goodwill during the nine months ended October 31, 2008 was related primarily to the Company's acquisition of MIZI, which was allocated to the Linux product division. The increase was partially offset by translation adjustments of goodwill denominated in foreign currencies.

The Company assesses goodwill for impairment in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ), which requires that goodwill be tested for impairment at the reporting unit level at least annually or more frequently upon the occurrence of certain events, as defined by SFAS 142. At the beginning of fiscal 2009, the Company adopted a reorganization plan to better align its resources with its strategic business objectives. As part of this plan, the Company reorganized its operations into four product divisions. In connection with this reorganization, the Company changed its reporting units for goodwill impairment testing. As a result, the Company determined that an interim goodwill impairment review was required during the first quarter of fiscal 2009. In addition, the Company completed its annual goodwill impairment review during the second quarter of fiscal 2009. The results of the reviews did not indicate an impairment. There were no events or changes in circumstances during the three months ended October 31, 2008, which triggered an impairment review. Given the current economic environment and the uncertainties regarding the potential impact on the Company's business, if forecasted revenue and margin growth rates of certain reporting units are not achieved, it is reasonably possible that an impairment review may be triggered for goodwill prior to the next annual review in the second quarter of fiscal 2010. If a triggering event causes an impairment review to be required before the next annual review, it is not possible at this time to determine if an impairment charge would result or if such charge would be material.

*Other Intangibles*

Other intangibles consist of the following (in thousands):

|  | Gross Carrying<br>Amount | October 31, 2008<br>Accumulated<br>Amortization | Net              |
|--|--------------------------|---|------------------|
| Developed and core technology and patents        | \$ 35,809                | \$ (33,611)                                     | \$ 2,198         |
| Assembled workforce                              | 1,543                    | (369)   | 1,174            |
| Customer relationships, contracts and agreements | 25,267                   | (16,457)  | 8,810            |
| <b>Total</b>                                     | <b>\$ 62,619</b>         | <b>\$ (50,437)</b>                              | <b>\$ 12,182</b> |

|  | Gross Carrying<br>Amount | January 31, 2008<br>Accumulated<br>Amortization | Net      |
|--|--------------------------|---|----------|
| Developed and core technology and patents        | \$ 35,349                | \$ (32,664)                                     | \$ 2,685 |
| Assembled workforce                              | 1,528                    | (136)   | 1,392    |
| Customer relationships, contracts and agreements | 17,056                   | (16,172)  | 884      |

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|       |           |             |          |
|-------|-----------|-------------|----------|
| Total | \$ 53,933 | \$ (48,972) | \$ 4,961 |
|-------|-----------|-------------|----------|

The increase in other intangibles, net, during the nine months ended October 31, 2008 was related primarily to the Company's acquisition of MIZI. The increase was partially offset by translation adjustments of other intangibles denominated in foreign currencies. Developed and core technology and patents are being amortized over a weighted average period of 3.9 years. Assembled workforce is being amortized over a period of 5.0 years, and customer relationships, contracts and agreements are being amortized over a weighted average period of 3.9 years.



**Table of Contents****Note 3: Financial Instruments***Fair Value of Financial Instruments*

The Company measures its financial assets and liabilities, including cash equivalents, available-for-sale securities and derivative financial instruments, at fair value on a quarterly basis in accordance with SFAS 157. This standard establishes a fair value hierarchy that requires the Company to maximize its use of observable inputs and minimize the use of unobservable inputs in its fair value measurements. The classification of a financial asset or liability within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs that SFAS 157 establishes for measuring fair value are as follows:

**Level 1:** Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets at the measurement date.

**Level 2:** Inputs that reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the asset or the liability; or inputs that are derived principally from or corroborated by observable market data by correlation or other means at the measurement date.

**Level 3:** Unobservable inputs that reflect the Company's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following table summarizes the Company's fair value measurements by level as of October 31, 2008 for its financial assets and liabilities measured at fair value on a recurring basis (in thousands):

|  | Level 1          | Level 2          | Level 3         | Total             |
|--|------------------|------------------|-----------------|-------------------|
| <b>Assets:</b>                             |                  |                  |                 |                   |
| Cash and cash equivalents:                 |                  |                  |                 |                   |
| Money market funds                         | \$ 48,750        | \$               | \$              | \$ 48,750         |
| Available-for-sale investments:            |                  |                  |                 |                   |
| U.S. government and agency debt securities |                  | 35,999           |                 | 35,999            |
| Corporate debt securities                  |                  | 27,733           |                 | 27,733            |
| Asset backed and other securities          |                  | 25,970           |                 | 25,970            |
| Time deposits                              | 97               |                  |                 | 97                |
| Other (The Reserve Funds)                  |                  |                  | 7,273           | 7,273             |
| Derivatives                                |                  | 29               |                 | 29                |
| <b>Total</b>                               | <b>\$ 48,847</b> | <b>\$ 89,731</b> | <b>\$ 7,273</b> | <b>\$ 145,851</b> |
| <b>Liabilities:</b>                        |                  |                  |                 |                   |
| Derivatives                                | \$               | \$ 2,886         | \$              | \$ 2,886          |

Fixed income securities classified as Level 2 assets consist of securities priced using quoted market prices for similar instruments, non-binding market prices that are corroborated by observable market data. The Company's derivative instruments are classified as Level 2 as they are not actively traded and are valued using pricing models that use observable market inputs. Level 3 assets include the Company's investments in the Reserve Primary Money Market Fund and the Reserve International Fund (the Reserve Funds) as discussed below.

The recent uncertainties in the credit market have affected the Company's investments in the Reserve Funds because the Reserve Funds held securities issued by Lehman Brothers, which filed for Chapter 11 bankruptcy protection on September 15, 2008. As a result, reliable Level 1 or Level 2 inputs are not available to value the Reserve Funds. In light of these events, the Company changed its fair value measurement of the Reserve Funds from Level 1 to Level 3 within the SFAS 157 three-tier fair value hierarchy. To determine the fair value for the investment in the Reserve Funds, the Company changed its valuation technique from market approach for its investment in the Reserve Funds to Level 3 analyses, under which the Reserve Funds are valued using unobservable inputs and management judgment due to the absence of comparable quoted market prices and inherent lack of liquidity for these funds. Based on the outcomes of these analyses, the Company concluded that the fair value of its investment in the Reserve Funds was lower than their carrying value and, as a result, recorded an other-than-temporary impairment charge

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for \$273,000 in other expense, net in the Condensed Consolidated Statements of Operations for the period ended October 31, 2008. Changes in market conditions could result in further adjustments to the fair value of these investments. The following table provides a summary of changes in fair value of the Company's Level 3 financial assets as of October 31, 2008 (in thousands):

|   | <b>Level 3</b> |
|---|----------------|
| Balance as of July 31, 2008               | \$             |
| Transfer from Level 1 - The Reserve Funds | 7,546          |
| Other-than-temporary impairment recorded  | (273)          |
| Balance as of October 31, 2008            | \$ 7,273       |

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As of October 31, 2008, the Company reclassified its investment in the Reserve Funds from cash and cash equivalents to short-term investments because it reasonably expects that it will be able to redeem this investment and have the proceeds available for use in its operations within the next twelve months. However, the Company does not expect that it will have to liquidate this investment in the next twelve months in order to meet its liquidity needs. Further, while the Company believes it has the right to the recovery of its investments in the Reserve Funds and expects that it will be able to redeem these investments within the next twelve months, the Company cannot predict with certainty when the Reserve Funds will disperse the Company's funds, or the amounts that the Company will ultimately receive.

*Available-for-sale Investments*

The Company invests its excess operating cash in various marketable investments, including U.S. government and agency debt securities, corporate debt securities and asset backed and other debt securities. As of October 31, 2008, the Company classified all of its outstanding securities as available-for-sale. Such securities are recorded at fair value and unrealized holding gains and losses, net of the related tax effect, if any, are reported as a component of accumulated other comprehensive income on the condensed consolidated balance sheet until realized. Realized gains and losses are determined based upon the specific identification method and are reflected as a component of other income (expense), net on the Company's condensed consolidated statement of operations in the period of sale.

The Company regularly reviews its investments in unrealized loss positions for other-than-temporary impairments. This evaluation includes, but is not limited to, significant quantitative and qualitative assessments and estimates regarding credit ratings, collateralization, the length of time and significance of a security's loss position and the Company's intent and ability to hold a security to maturity or forecasted recovery. Unrealized losses on other-than-temporarily impaired securities are recognized in other income (expense), net on the condensed consolidated statement of operations in the period that the Company determines that an other-than-temporary impairment has occurred.

During the nine months ended October 31, 2008, the Company determined that three asset backed securities within its portfolio were other-than-temporarily impaired due to a deterioration in the quality of collateralized support, an overall under-collateralization and a significant non-recoverable decline in fair value. As a result, the Company recorded an other-than-temporary impairment loss of \$150,000 and \$531,000 related to these securities during the three and nine months ended October 31, 2008, respectively. As of October 31, 2008, the Company determined that no other securities in its investment portfolio were other-than-temporarily impaired.

*Derivative Financial Instruments*

The Company enters into foreign currency forward contracts to manage foreign currency exposures related to certain non-functional currency related inter-company and other balances. Transaction gains and losses on the Company's contracts and the change in fair value of its outstanding forward contracts are recognized each period in other income (expense), net. The notional amounts and fair values of the Company's outstanding foreign currency purchase and sell contracts were as follows at October 31, 2008 (in thousands):

|                    | <b>Notional<br/>Amount</b> | <b>Fair Value<br/>Loss</b> |
|--------------------|----------------------------|----------------------------|
| Forward Contracts: |                            |                            |
| Purchase           | \$ 52,613                  | \$ (1,991)                 |
| Sell               | \$ 27,448                  | \$ (866)                   |

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The Company's derivative financial instruments generally have maturities of thirty days or less and, as of October 31, 2008, there were no derivative financial instruments outstanding with maturities in excess of six months. The Company does not enter into derivative financial instruments for trading or speculative purposes.

**Note 4: Deferred Revenues**

Deferred revenues consist of the following (in thousands):

|                                   | October 31,<br>2008 | January 31,<br>2008 |
|-----------------------------------|---------------------|---------------------|
| Current deferred revenues:        |                     |                     |
| Subscription                      | \$ 65,263           | \$ 83,252           |
| Maintenance and other             | 41,872              | 36,634              |
| Total current deferred revenues   | 107,135             | 119,886             |
| Long-term deferred revenues:      |                     |                     |
| Subscription                      | 8,144               | 13,237              |
| Maintenance and other             | 10,542              | 1,410               |
| Total long-term deferred revenues | 18,686              | 14,647              |
| Total deferred revenues           | \$ 125,821          | \$ 134,533          |

Deferred subscription revenues represent customer billings and payments made in advance for software licensed over a subscription period. Subscription periods vary from annual to multi-year and are classified as such. Long-term deferred revenues represent the portion of multi-year contracts that are due to be recognized as revenue in a time period greater than one year from the balance sheet date. Maintenance and other deferred revenues primarily include deferred maintenance, service and product revenues. Deferred maintenance revenues represent customer billings and payments made in advance for annual support contracts. Maintenance is typically billed on a per annum basis in advance and revenue is recognized ratably over the maintenance period. Deferred service revenues include pre-payments for software consulting and training services. Revenue for these contracts is recognized as the services are performed. Deferred product revenues primarily include software license transactions that are not separable from subscription or consulting services.

**Note 5: Restructuring and Other Charges**

At the beginning of fiscal 2009, the Company adopted a reorganization plan to better align its resources with its strategic business objectives and to support profitable growth in the future. As part of this plan, the Company eliminated approximately 82 positions, primarily in North America. As a result, the Company recognized restructuring charges of \$2.7 million during the nine months ended October 31, 2008 related to severance, medical and outplacement benefits for terminated employees. In addition, during the nine months ended October 31, 2008, the Company recognized restructuring charges of \$115,000 related to the revision of certain sublease income assumptions for a partially vacated facility in the United Kingdom and \$46,000 related to other costs associated with the reorganization.

The following table sets forth an analysis of the components of restructuring charges and other activity within the restructuring accrual for the nine months ended October 31, 2008 (in thousands):

|  | Work<br>Force<br>Reduction | Consolidation<br>of Excess<br>Facilities | Other | Total   |
|--|----------------------------|--|-------|---------|
| Restructuring liabilities as of January 31, 2008 | \$ 327                     | \$ 508                                   | \$    | \$ 835  |
| Restructuring charges, net                       | 2,693                      | 115                                      | 46    | 2,854   |
| Cash payments                                    | (2,988)                    | (203)                                    | (44)  | (3,235) |
| Foreign exchange effects                         | (5)                        | (70)                                     |       | (75)    |

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|  |    |    |    |     |    |   |    |     |
|--|----|----|----|-----|----|---|----|-----|
| Restructuring liabilities as of October 31, 2008 | \$ | 27 | \$ | 350 | \$ | 2 | \$ | 379 |
|--|----|----|----|-----|----|---|----|-----|

The remaining restructuring liability as of October 31, 2008 is included as a component of accrued liabilities and other long-term liabilities on the accompanying condensed consolidated balance sheet and is related primarily to employee severance benefits and a lease obligation on the partially vacated facility in the United Kingdom. The Company has paid the majority of the severance benefits and expects to pay the remaining severance benefits by the end of fiscal 2009. The remaining lease obligation will be settled over the remaining lease term, which expires in fiscal year 2012.

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**Table of Contents****Note 6: Income Taxes**

The Company had a provision for income taxes of \$1.2 million and \$927,000 for the three months ended October 31, 2008 and 2007, respectively, and a provision for income taxes of \$2.7 million and \$2.4 million for the nine months ended October 31, 2008 and 2007. The provision for income taxes is based on estimates of the Company's expected liability or benefit for domestic and foreign income taxes and foreign withholding taxes incurred during the year, and is calculated by applying the estimated annual effective tax rate to the income (loss) before income taxes, adjusted for any discrete items.

Deferred income taxes are recorded in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109), and are determined based on the differences between financial reporting and the tax basis of assets and liabilities using the tax rates of laws in effect when the differences are expected to reverse. SFAS 109 provides for recognition of deferred tax assets if the realization of such assets is more likely than not to occur. With the primary exception of the U.S. tax jurisdiction, the Company has determined that it is more likely than not that its deferred taxes will be realized. Accordingly, the Company has net deferred tax assets of \$5.9 million primarily related to certain international jurisdictions and a full valuation allowance against the remainder of its deferred tax assets as of October 31, 2008.

Should Wind River determine that it is more likely than not that the U.S. deferred tax assets will be realized, the Company will adjust the related valuation allowance and recognize a material increase to income in the period that such determination is made. Significant management judgment is required in determining the period in which the reversal of a valuation allowance should occur. While the Company has experienced an increase in profitability during the nine months ended October 31, 2008 compared to the same period in the prior year, the significant uncertainty in the current economic climate makes it difficult to objectively verify the impact on the Company's future profitability. Accordingly, considering this and other evidence, Wind River's management has determined that it is more likely than not that its U.S. deferred tax assets will not be realized at this time. Wind River continues to evaluate the ability to realize, by jurisdiction, its deferred tax assets and related valuation allowances on a quarterly basis. If the current economic environment does not have a significant negative impact on the Company's future profitability, it is reasonably possible that a material adjustment to the valuation allowance may occur within the near term.

There were no material changes to the Company's unrecognized tax benefits for the nine months ended October 31, 2008. As of October 31, 2008, the Company's unrecognized tax benefits including interest totaled \$17.1 million of which \$1.4 million is included as a component of other long-term liabilities and \$3.8 million is included as a reduction of other long-term assets on the condensed consolidated balance sheet. If recognized, the portion of unrecognized tax benefits that would decrease the Company's provision for income taxes and increase net income is \$5.2 million. The remaining \$11.9 million balance of unrecognized tax benefits relates to deferred tax assets in jurisdictions where a full valuation allowance is recorded, which has no impact to the condensed consolidated financial statements. The Company believes that it is reasonably possible that a decrease of up to \$73,000 in unrecognized tax benefits could be recorded in the next 12 months as a result of the expiration of statutes of limitations in certain jurisdictions, which would allow the Company to meet the recognition and measurement requirements with respect to those tax benefits.

The Company recognizes interest and penalties accrued on unrecognized tax benefits as well as interest received from favorable settlements within provision for income taxes on the condensed consolidated statement of operations. As of October 31, 2008, the Company had \$148,000 accrued for interest and penalties associated with unrecognized tax benefits, which are included as a component of other long-term liabilities on the condensed consolidated balance sheet.

The Company is subject to taxation in the U.S. and various state and foreign jurisdictions. The material jurisdictions that are subject to examination by tax authorities for tax years after fiscal year 2005 primarily include the U.S., the State of California, Canada, Germany, France and Japan. In addition, tax attribute carryforwards in years prior to fiscal year 2005 may also be subject to examination until they are fully utilized. The Company currently has an ongoing U.S. federal income tax examination for fiscal year 2005, a California income tax examination for fiscal years 2006 and 2007, and a German income tax examination for calendar years 2003 through 2005. The Company believes all uncertain tax positions have been sufficiently provided for in connection with the U.S. federal, California and German periods under examination and any other open tax year. The Company is not under examination in any other income tax jurisdiction at the present time.

**Table of Contents****Note 7: Comprehensive Income (Loss)**

The following table summarizes the components of comprehensive income (loss) (in thousands):

|   | Three Months Ended<br>October 31, |          | Nine Months Ended<br>October 31, |          |
|---|-----------------------------------|----------|----------------------------------|----------|
|   | 2008                              | 2007     | 2008                             | 2007     |
| Net income (loss)   | \$ 5,916                          | \$ (98)  | \$ 15,173                        | \$ (336) |
| Other comprehensive income (loss):                                    |                                   |          |                                  |          |
| Foreign currency translation adjustments                              | (12,725)                          | 3,254    | (10,540)                         | 5,544    |
| Unrealized gain (loss) on investments                                 | (1,698)                           | 347      | (3,567)                          | 745      |
| Impairments and realized (gains) losses included in net income (loss) | 391                               | (20)     | 314                              | 51       |
| Other comprehensive income (loss)                                     | (14,032)                          | 3,581    | (13,793)                         | 6,340    |
| Total comprehensive income (loss)                                     | \$ (8,116)                        | \$ 3,483 | \$ 1,380                         | \$ 6,004 |

**Note 8: Net Income (Loss) Per Share Computation**

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. For purposes of computing basic net income (loss) per share, the weighted average number of outstanding shares of common stock excludes unvested restricted stock awards. Diluted net income (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common shares outstanding during the period and all dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of unvested restricted stock awards, outstanding options and shares issuable under the Company's employee stock purchase plan, using the treasury stock method.

The following table provides a reconciliation of the numerators and denominators of the basic and diluted per share computations (in thousands, except per share amounts):

|   | Three Months Ended<br>October 31, |           | Nine Months Ended<br>October 31, |           |
|---|-----------------------------------|-----------|----------------------------------|-----------|
|   | 2008                              | 2007      | 2008                             | 2007      |
| <b>Numerator:</b>                                   |                                   |           |                                  |           |
| Net income (loss)                                   | \$ 5,916                          | \$ (98)   | \$ 15,173                        | \$ (336)  |
| <b>Denominator:</b>                                 |                                   |           |                                  |           |
| Weighted average common shares outstanding- basic   | 77,316                            | 87,081    | 79,993                           | 86,174    |
| Effect of dilutive potential common shares          | 1,321                             |           | 896                              |           |
| Weighted average common shares outstanding- diluted | 78,637                            | 87,081    | 80,889                           | 86,174    |
| <b>Net income (loss) per share</b>                  |                                   |           |                                  |           |
| Basic   | \$ 0.08                           | \$ (0.00) | \$ 0.19                          | \$ (0.00) |
| Diluted   | \$ 0.08                           | \$ (0.00) | \$ 0.19                          | \$ (0.00) |

The above computation excludes all anti-dilutive outstanding options, restricted stock awards and shares issuable under the Company's employee stock purchase plan, which amounted to approximately 9.4 million and 10.4 million shares for the three and nine months ended October 31, 2008, respectively. Since Wind River had a net loss for the three and nine months ended October 31, 2007, there is no difference between basic and diluted net loss per share. If the Company had recorded net income for the three and nine months ended October 31, 2007, it would have included in the computation dilutive potential common shares totaling approximately 1.1 million shares for each period, exclusive of anti-dilutive potential common shares, which amounted to approximately 9.5 million and 9.8 million shares, respectively.

**Note 9: Common Stock**

*Common Stock*

Wind River's Board of Directors (the Board) has approved common stock repurchase programs authorizing management to repurchase shares of the Company's common stock in the open market or through negotiated transactions. Wind River may repurchase shares from time to time at management's discretion in accordance with applicable securities laws. Repurchased shares are funded from available working capital or through the liquidation of long-term investments and are recorded as treasury stock on a last-in, first-out basis.



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In fiscal 2003 and 2008, the Board approved stock repurchase programs that authorized Wind River to acquire up to \$30.0 million and \$50.0 million, respectively, of outstanding common stock. The Company completed these repurchase programs during the first quarter of fiscal 2008 and the first quarter of fiscal 2009, respectively. During each of the first and second quarters of fiscal 2009, the Board approved additional stock repurchase programs that authorized the Company to repurchase up to an additional \$50.0 million of outstanding common stock under each plan. As of October 31, 2008, approximately \$45.0 million remained available for repurchases under the Company's stock repurchase programs.

During the three and nine months ended October 31, 2008, the Company repurchased 2.0 million shares and 13.0 million shares, respectively, for a total cost of \$20.0 million or an average of \$9.94 per share and \$105.3 million or an average of \$8.12 per share, respectively, inclusive of broker commissions. During the nine months ended October 31, 2007, the Company repurchased 652,000 shares for a total cost of \$6.5 million or an average of \$10.03 per share. Repurchases under the Board approved plans are exclusive of shares repurchased from employees to satisfy tax withholding obligations upon the vesting of restricted stock units.

The Board and the Company's stockholders have authorized the allocation of up to 300,000 shares of common stock from treasury stock each year for replenishment of the Company's 1993 Employee Stock Purchase Plan (ESPP). For fiscal 2009 and in each prior year commencing in fiscal 2004, the allocation program has provided 300,000 shares for issuance to employees under the ESPP.

**Note 10: Stock-Based Compensation Plans**

The Company has adopted certain equity incentive and stock purchase plans as described in Note 10, Stock-Based Compensation Plans, of the notes to consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2008.

*Stock-Based Compensation Expense*

The Company recorded stock-based compensation expense as follows for the three and nine months ended October 31, 2008 and 2007 (in thousands):

|  | Three Months Ended<br>October 31, |                 | Nine Months Ended<br>October 31, |                  |
|--|-----------------------------------|-----------------|----------------------------------|------------------|
|  | 2008                              | 2007            | 2008                             | 2007             |
| Cost of revenues                                 | \$ 579                            | \$ 593          | \$ 1,808                         | \$ 1,869         |
| Selling and marketing expenses                   | 1,367                             | 1,511           | 4,231                            | 4,493            |
| Product development and engineering expenses (1) | 824                               | 1,011           | 2,601                            | 3,238            |
| General and administrative expenses              | 1,378                             | 2,139           | 3,987                            | 6,518            |
| <b>Total stock-based compensation expense</b>    | <b>\$ 4,148</b>                   | <b>\$ 5,254</b> | <b>\$ 12,627</b>                 | <b>\$ 16,118</b> |

- (1) Includes stock-based compensation expense of \$309,000 for the nine months ended October 31, 2007 related to restricted stock issued in connection with the Interpeak acquisition.

*Valuation Assumptions*

Wind River uses the Black-Scholes option pricing model to determine the fair value of stock options and stock purchase rights. The fair value of each option grant or stock purchase right is estimated on the date of grant and is affected by the Company's stock price and a number of highly complex and subjective variables including, but not limited to, the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise and cancellation behaviors.

The Company used the following valuation assumptions to estimate the fair value of options granted during the three and nine months ended October 31, 2008 and 2007:

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|                          | Three Months Ended<br>October 31, |               | Nine Months Ended<br>October 31, |               |
|--------------------------|-----------------------------------|---------------|----------------------------------|---------------|
|                          | 2008                              | 2007          | 2008                             | 2007          |
| Risk-free interest rate  | 2.25% - 2.27%                     | 4.11% - 4.12% | 1.95% - 3.51%                    | 4.11% - 5.08% |
| Expected life (in years) | 3.8 - 3.9                         | 3.8 - 3.9     | 3.8 - 5.4                        | 3.8 - 5.3     |
| Expected volatility      | 42.9% - 43.2%                     | 43.7% - 43.9% | 42.9% - 53.3%                    | 36.3% - 47.7% |
| Dividend yield           | 0%                                | 0%            | 0%                               | 0%            |

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The weighted average fair value of stock option awards granted during the three and nine months ended October 31, 2008 was \$3.34 and \$3.01, respectively, and the weighted average fair value of stock option awards granted during the three and nine months ended October 31, 2007 was \$4.17 and \$3.76, respectively.

The Company used the following weighted average valuation assumptions to estimate the fair value of stock purchase rights granted during the nine months ended October 31, 2008 and 2007:

|                          | <b>Nine Months Ended<br/>October 31,</b> |             |
|--------------------------|--|-------------|
|                          | <b>2008</b>                              | <b>2007</b> |
| Risk-free interest rate  | 2.42%                                    | 5.02%       |
| Expected life (in years) | 0.5                                      | 0.3         |
| Expected volatility      | 46.3%                                    | 27.7%       |
| Dividend yield           | 0%                                       | 0%          |

The weighted average fair value of common stock purchase rights granted under the ESPP during the nine months ended October 31, 2008 and 2007 was \$3.06 and \$2.28, respectively. No common stock purchase rights were granted under the ESPP during the three months ended October 31, 2008 or 2007.

*Stock Option Activity*

The following table summarizes option activity under the Company's equity incentive plans for the nine months ended October 31, 2008 (in thousands, except exercise prices):

|  | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise Price</b> |
|--|---------------|--|
| Outstanding at January 31, 2008        | 15,340        | \$ 11.02                                       |
| Granted                                | 1,170         | 7.87   |
| Exercised                              | (989)         | 7.52   |
| Cancelled                              | (730)         | 12.66  |
| <b>Outstanding at October 31, 2008</b> | <b>14,791</b> | <b>\$ 10.93</b>                                |

As of October 31, 2008, there was approximately \$14.1 million of total unrecognized compensation cost related to unvested stock options granted under Wind River's equity incentive plans. That cost is expected to be recognized over a weighted average period of approximately 1.8 years.

*Restricted Stock Unit Activity*

The following table summarizes the restricted stock unit activity under the Company's equity incentive plans for the nine months ended October 31, 2008 (in thousands, except fair values):

|                                 | <b>Shares</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|---------------------------------|---------------|---|
| Outstanding at January 31, 2008 | 592           | \$ 10.14  |
| Granted                         | 1,124         | 7.34  |
| Vested                          | (136)         | 10.17   |
| Cancelled                       | (68)          | 8.62  |

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|                                 |       |    |      |
|---------------------------------|-------|----|------|
| Outstanding at October 31, 2008 | 1,512 | \$ | 8.12 |
|---------------------------------|-------|----|------|

During the nine months ended October 31, 2008, the Company issued approximately 136,000 shares related to restricted stock units that vested during the period. At the election of employees, a majority of these vested restricted stock units were settled on a net share basis. As a result, the Company repurchased 44,723 shares of common stock from

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employees for a total cost of \$361,000 in order to meet employee minimum statutory withholding obligations for applicable income and other employment taxes. These repurchases were recorded as treasury stock on the condensed consolidated balance sheet and are included within financing activities on the condensed consolidated statement of cash flows.

As of October 31, 2008, there was approximately \$7.9 million in unrecognized stock-based compensation cost related to unvested restricted stock units. That cost is expected to be recognized over a weighted average period of approximately 3.1 years.

### **Note 11: Segment and Geographic Information**

SFAS 131 requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation and major customers. The Company historically managed its operations as one industry segment, technology for device operating systems, and operated as one segment under SFAS 131. At the beginning of fiscal 2009, the Company adopted a reorganization plan to better align its resources with its strategic business objectives. As part of this plan, the Company reorganized its operations into four product divisions: VxWorks, Linux, Tools and Common Technologies and Device Management. In addition, the Company records revenues and expenses from non-core products and design services separate from these four product divisions. As a result of this reorganization, the Company has commenced reporting its results of operations for each of the following reportable segments:

*VxWorks.* Consists of Wind River's proprietary VxWorks real-time operating system and related products and services.

*Linux.* Comprises Wind River's open-source-based, commercial-grade Linux operating systems and related products and services.

*Non-Core Products and Design Services.* Consists of the Company's pSOS real-time operating system, which was acquired from Integrated Systems, Inc. in fiscal 2001, certain other non-core products and turn-key product design services.

*All Other.* Includes Wind River's proprietary development tools and common technologies, device management products and related services.

The Company's chief operating decision maker ( CODM ), defined as the Company's chief financial officer and chief executive officer, reviews financial information presented on an operating segment basis for purposes of making operating decisions and in assessing financial performance. In its evaluations of the segments, the CODM uses internal management reporting that provides segment revenues and operating income, excluding stock-based compensation expense, amortization of purchased and other intangibles, certain corporate marketing expenses, general and administrative expenses and restructuring and other charges. The CODM believes that segment operating income excluding these expenses is an appropriate measure for evaluating the operational performance of the Company's segments. However, this measure should be considered in addition to, not as a substitute for, or superior to, income (loss) from operations or other measures of financial performance prepared in accordance with U.S. GAAP. The CODM does not review asset information on an operating segment basis. The Company has recast its segment disclosures for periods prior to fiscal 2009 to present these new reportable segments.

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The following table presents summarized information by segment (in thousands):

|   | Three Months Ended<br>October 31, |                   | Nine Months Ended<br>October 31, |                   |
|---|-----------------------------------|-------------------|----------------------------------|-------------------|
|   | 2008                              | 2007              | 2008                             | 2007              |
| <b>Revenues by segment, net:</b>                                |                                   |                   |                                  |                   |
| VxWorks   | \$ 65,495                         | \$ 60,157         | \$ 199,080                       | \$ 180,837        |
| Linux   | 13,346                            | 7,814             | 31,466                           | 19,848            |
| Non-Core Products and Design Services                           | 6,142                             | 6,645             | 21,093                           | 24,168            |
| All other   | 6,593                             | 7,027             | 19,717                           | 19,468            |
| <b>Total revenues, net</b>                                      | <b>\$ 91,576</b>                  | <b>\$ 81,643</b>  | <b>\$ 271,356</b>                | <b>\$ 244,321</b> |
| <b>Segment income (loss) from operations:</b>                   |                                   |                   |                                  |                   |
| VxWorks   | \$ 25,314                         | \$ 16,316         | \$ 77,194                        | \$ 51,399         |
| Linux   | (4,647)                           | (1,011)           | (15,295)                         | (4,703)           |
| Non-Core Products and Design Services                           | 3,146                             | 2,642             | 7,846                            | 8,497             |
| All other   | (2,508)                           | (2,162)           | (7,773)                          | (6,855)           |
| <b>Corporate unallocated expenses:</b>                          |                                   |                   |                                  |                   |
| Stock-based compensation  | (2,770)                           | (3,115)           | (8,640)                          | (9,600)           |
| Amortization of purchased and other intangibles                 | (710)                             | (836)             | (1,984)                          | (2,313)           |
| Corporate marketing   | (3,462)                           | (3,744)           | (10,372)                         | (11,446)          |
| General and administrative (including stock-based compensation) | (8,099)                           | (9,050)           | (25,304)                         | (28,612)          |
| Restructuring and other charges                                 | 63                                | (642)             | (2,854)                          | (642)             |
| <b>Income (loss) from operations</b>                            | <b>\$ 6,327</b>                   | <b>\$ (1,602)</b> | <b>\$ 12,818</b>                 | <b>\$ (4,275)</b> |

Wind River markets its products and related services to customers in four geographic regions: North America (the United States and Canada), EMEA (Europe, the Middle East, and Africa), Japan and Asia Pacific. Internationally, Wind River markets its products and services primarily through its subsidiaries and various distributors. Revenues are generally attributed to geographic areas based on the country in which the customer is domiciled.

Revenue information by region is presented below (in thousands):

|               | Three Months<br>Ended<br>October 31, |                  | Nine Months Ended<br>October 31, |                   |
|---------------|--------------------------------------|------------------|----------------------------------|-------------------|
|               | 2008                                 | 2007             | 2008                             | 2007              |
| North America | \$ 51,890                            | \$ 43,281        | \$ 138,832                       | \$ 135,254        |
| EMEA          | 20,489                               | 20,282           | 69,698                           | 54,884            |
| Japan         | 10,959                               | 9,461            | 34,696                           | 30,909            |
| Asia Pacific  | 8,238                                | 8,619            | 28,130                           | 23,274            |
| <b>Total</b>  | <b>\$ 91,576</b>                     | <b>\$ 81,643</b> | <b>\$ 271,356</b>                | <b>\$ 244,321</b> |

Revenue information by revenue type is presented below (in thousands):

|  | Three Months<br>Ended<br>October 31, | Nine Months Ended<br>October 31, |
|--|--------------------------------------|----------------------------------|
|--|--------------------------------------|----------------------------------|

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|                                     | 2008      | 2007      | 2008       | 2007       |
|-------------------------------------|-----------|-----------|------------|------------|
| Perpetual and term license revenues | \$ 21,329 | \$ 9,266  | \$ 48,856  | \$ 28,257  |
| Production license revenues         | 16,111    | 20,469    | 56,358     | 61,667     |
| Subscription revenues               | 31,823    | 30,886    | 97,400     | 89,939     |
| Maintenance revenues                | 8,974     | 8,032     | 25,075     | 24,840     |
| Other service revenues              | 13,339    | 12,990    | 43,667     | 39,618     |
| Total                               | \$ 91,576 | \$ 81,643 | \$ 271,356 | \$ 244,321 |

No single customer accounted for more than 10% of Wind River's total revenues during the three and nine months ended October 31, 2008 or 2007.

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### **Note 12: Legal Proceedings**

As summarized more fully below, from time to time, the Company may be subject to a variety of claims or lawsuits or be involved in a variety of investigations or proceedings, including claims relating to alleged infringement of patents or other intellectual property rights, contractual disputes, employee claims and other claims that arise in the ordinary course of its business. Wind River believes that the outcome of its outstanding legal proceedings, claims and litigation will not have a material adverse effect on its business, results of operations, cash flows or financial condition. However, such matters involve complex questions of fact and law and could involve significant costs and the diversion of resources to defend. Additionally, the results of litigation are inherently uncertain, and therefore it is at least reasonably possible that an adverse outcome could have a material impact on the Company's consolidated results of operations and cash flows.

#### *RED.Com, Inc. Litigation*

See Note 13, Subsequent Event, below for further information.

#### *Derivative Litigation*

Between September 8, 2006 and November 15, 2006, three separate stockholder derivative complaints were filed in the Superior Court of the State of California, Alameda County, against various officers and directors of the Company and naming the Company as a nominal defendant. On December 20, 2006, the Court consolidated these actions and appointed co-lead counsel. On February 21, 2007, co-lead counsel filed a consolidated and amended complaint (Case Number RG06288009) that asserts causes of action for accounting; breach of fiduciary duty; restitution/unjust enrichment; rescission; and violation of California Corporations Code § 25402. On February 9, 2007, a fourth, substantially identical purported shareholder derivative complaint entitled *Castronovo v. Berger, et al.* (Case Number RG07310636) was filed in the Superior Court of the State of California, Alameda County. The Company filed demurrers to the complaints in the consolidated actions and the complaint in the *Castronovo* action. On July 17, 2007, subsequent to the filing of those demurrers, the Court approved a stipulation of the parties consolidating the *Castronovo* action with the three previously filed actions, thereby obviating any ruling on the Company's demurrer to the complaint in the *Castronovo* action.

On April 2, 2008, the parties executed a Stipulation of Settlement incorporating the terms of a settlement. The settlement involved certain corporate governance changes and a payment of \$750,000 by the Company to plaintiffs' counsel for attorneys' fees and expenses. On August 1, 2008, the Court entered an order approving the settlement, awarding \$750,000 to plaintiffs' counsel for their attorneys' fees and expenses and dismissing the litigation with prejudice. There were no objections to the settlement and the deadline for any appeal of the settlement has expired. The Company accrued the \$750,000 fee award during fiscal year 2008 and the award was paid during the third quarter of fiscal year 2009.

### **Note 13: Subsequent Event**

On November 14, 2008, RED.Com, Inc. (doing business as RED Digital Camera) (RED) filed a complaint against the Company in the Superior Court of the State of California, Santa Clara County. The complaint asserts causes of action against the Company for fraud in the inducement, breach of contract and negligent representation in connection with a services agreement entered into between the Company and RED in January 2006, pursuant to which the Company performed certain design services related to RED's RED ONE digital cinema camera. RED's complaint seeks compensatory damages in an amount to be proven at trial, as well as punitive damages and attorneys' fees and costs. The Company believes that RED's complaint is without merit and intends to defend itself vigorously.



**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward-Looking Statements**

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. When used in this Quarterly Report on Form 10-Q, the words could, may, anticipate, believe, estimate, expect, intend, plan and variations of such words and similar expressions as they relate to our management or to Wind River are intended to identify these forward-looking statements. These forward-looking statements include, but are not limited to statements related to our expected business, results of operations, future financial position, business strategy, including acceptance of our product lines and business models, our ability to increase our revenues, including deferred revenues, our ability to grow our open-source-based Linux business, the mix of licensing models adopted by our customers, our ability to increase our services backlog, our cost of product, subscription and services, savings related to our reorganization plan, our financing plans and capital requirements, our investments, impairment losses on investments, intangible assets and goodwill, our expenses, including changes in selling and marketing, product development and engineering and general and administrative expenses, our restructuring charges, the potential release of all or a portion of our valuation allowance associated with our U.S. deferred tax assets, our accounting for certain acquisitions, the effect of recent accounting pronouncements, the likelihood of realization of deferred taxes, the potential effect of litigation against us, forecasted trends relating to our sales or the markets in which we operate and similar matters and include statements based on current expectations, estimates, forecasts and projections about the economies and markets in which we operate and our beliefs and assumptions regarding these economies and markets.*

*These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those contemplated herein. Factors that could cause or contribute to such differences include, but are not limited to, the success of our implementation of new and current products, business models and market strategies, the ability to address rapidly changing technology and markets and to deliver our products on a timely basis, our ability to grow our open-source-based Linux business, the ability of our customers to sell products that include our software, the impact of competitive products and pricing, weakness in the economy generally or in the technology sector specifically, the success of our strategic relationships, the costs of litigation against us, as well as the impact of other costs and other factors discussed under Part II, Item 1A, Risk Factors.*

*These forward-looking statements speak only as of the date this Quarterly Report on Form 10-Q was filed and of information actually known by us at that time. We do not intend to update these forward-looking statements to reflect events or circumstances that occur after the filing of this Quarterly Report on Form 10-Q or to reflect the occurrence or effect of anticipated events, except as required by law.*

*The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included elsewhere in this report.*

**Overview**

Wind River is a global leader in Device Software Optimization ( DSO ). We develop, market and sell operating systems, middleware and software development tools that allow our customers to develop, run, and manage their device products faster, better, at lower cost and more reliably. We offer our customers a choice of leading real-time, proprietary operating systems and open-source-based, commercial-grade Linux operating systems. We also offer our comprehensive, Eclipse-based Workbench software development suite that allows our customers to manage the design, development, debugging and testing of their device software systems, as well as leading device management solutions that allow our customers to remotely monitor and manage their devices in either lab or field environments. Our customers manufacture devices as varied as set-top boxes, automobile braking and navigation systems, mobile handsets, Internet routers, avionics control panels and coronary pacemakers. Our operating systems are currently deployed in millions of devices.

We market our products and services in North America, EMEA (comprising Europe, the Middle East and Africa), Japan and the Asia Pacific region, primarily through our own direct sales organization, which consists of sales persons and field engineers. We also license distributors, primarily in international regions, to serve customers in regions not serviced by our direct sales force. We were incorporated in California in February 1983 and reincorporated in Delaware in April 1993.

For additional information about our business and operating model, please see Executive Operating and Financial Summary under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended January 31, 2008.

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### *Recent Operating Results*

Our total revenues were \$91.6 million and \$81.6 million during the three months ended October 31, 2008 and 2007, respectively, and \$271.4 million and \$244.3 million during the nine months ended October 31, 2008 and 2007, respectively. The increase in revenues was due primarily to growth in perpetual and multi-year term license revenues, subscription revenues and other service revenues. For the three months ended October 31, 2008 and 2007, we had a net income of \$5.9 million or \$0.08 per diluted share and a net loss of \$98,000 or \$0.00 per diluted share, respectively. For the nine months ended October 31, 2008 and 2007, we had net income of \$15.2 million or \$0.19 per diluted share and a net loss of \$336,000 or \$0.00 per diluted share, respectively.

Our total deferred revenues decreased to \$125.8 million at October 31, 2008 from \$134.5 million at January 31, 2008. The decrease was due to the ratable recognition of subscription contracts, lower sales of new subscription contracts resulting primarily from customer purchases under our term license model, and due to negative foreign exchange impacts. The decline was partially offset by increased multi-year maintenance revenues related to a large perpetual contract and, to a lesser extent, due to maintenance revenues related to other term licenses transactions invoiced during the first nine months of fiscal 2009.

We generated cash flows from operations of \$44.6 million and \$23.4 million during the nine months ended October 31, 2008 and 2007, respectively. The increase of \$21.3 million was due primarily to the growth in earnings and strong cash collections.

At the beginning of fiscal 2009, we adopted a reorganization plan to better align our resources with our strategic business objectives. As part of this plan, we reorganized our operations into four product divisions: VxWorks, Linux, Tools and Common Technologies and Device Management. This realignment was designed to help us focus on new technology and market opportunities, to become more nimble and agile with customers and partners, and to drive and measure returns on our investments. As a result of this reorganization, engineering, product management, and test personnel were allocated among the four product divisions, while sales, marketing, and other operational and support staff remain organized along functional lines. In addition, we record revenues and expenses from non-core products and design services separate from these four product divisions. As a result of this change in structure, we have commenced reporting our results of operations for each of the following reportable segments:

*VxWorks.* Consists of our proprietary VxWorks real-time operating system and related products and services.

*Linux.* Comprises our open-source-based, commercial-grade Linux operating systems and related products and services.

*Non-Core Products and Design Services.* Consists of our pSOS real-time operating system, which was acquired from Integrated Systems, Inc. in fiscal 2001, certain other non-core products and turn-key product design services.

*All Other.* Includes our proprietary development tools and common technologies, device management products and related services. We have recast our segment disclosures for periods prior to fiscal 2009 to present these new reportable segments.

In addition, as a result of this reorganization, we eliminated approximately 82 positions, primarily in North America, in the first and second quarters of fiscal 2009 and recognized total restructuring charges of \$2.9 million related primarily to these terminations.

At the beginning of fiscal 2009, we began offering our customers the option to purchase our solutions under a multiple-year term license model with separately priced maintenance. Under this model, customers are able to enter into renewable, limited-term licenses with us, which provide them with development rights to use our products for a limited term rather than on a perpetual basis. These customers can also purchase support and maintenance for a separate fee on an annual, renewable basis, and may also obtain the right to receive upgrades in addition to updates. Under this model, we will also charge our customers a production license fee for every copy of our proprietary software included by our customer in each final, manufactured device. The term license model provides customers with another method to access our technology that meets their budgetary and cash flow requirements. Term license revenues were approximately 13% and 6% of total revenues, respectively, in the three and nine months ended October 31, 2008.

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Under applicable accounting rules, for a multiple-year term license, the majority of license revenue is required to be recognized in the quarter in which the products are delivered and a smaller amount relating to the fair value of maintenance to be deferred and recognized subsequently over the maintenance period. By contrast, under the subscription-based enterprise license model that has been offered to customers since November 2002, revenue is recognized ratably over the subscription

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period. Therefore, a multiple-year term license will result in higher current-quarter revenue than an equal-size order for a subscription-based enterprise license, but will result in decreased deferred revenue compared to the subscription-based enterprise license. We anticipate that a number of customers will transition from enterprise licensing to multiple-year term licensing in the current year and this may impact the timing of our reported revenues. The mix of multiple-year term licensing orders and enterprise licensing orders in any given quarter can vary and may consequently have an impact on that quarter's reported revenues.

### *Recent Development*

On October 15, 2008, we completed the acquisition of approximately 99% of the outstanding shares of MIZI Research, Inc. (MIZI), a privately held company based in Korea. MIZI is an independent software company that specializes in the development of embedded Linux-based mobile application platforms. This acquisition will enable us to gain access to mobile expertise that can be leveraged across our various mobile alliances as well as accelerate our mobile services presence in Asia Pacific. The total acquisition consideration was approximately \$16.6 million, comprised of approximately \$15.8 million in cash consideration, plus acquisition related costs. In addition, in connection with the acquisition, we agreed to pay potential retention and performance bonuses of up to an aggregate of \$1.75 million, which will be payable and recognized as compensation expense if certain specified future service and performance criteria are met. We accounted for this acquisition as a non-taxable purchase and, in accordance with SFAS 141, Business Combinations, (SFAS 141), the total consideration was allocated to the intangible assets acquired and tangible assets and liabilities assumed, based on their estimated fair values. See Note 2, Acquisitions, Goodwill and Intangible Assets in the notes to the accompanying condensed consolidated financial statements for additional information regarding this acquisition.

### *Recent Accounting Pronouncements*

See Note 1, The Company and Summary of Significant Accounting Policies, of the notes to condensed consolidated financial statements for further information regarding recent accounting standards and pronouncements.

## **Critical Accounting Policies and Estimates**

### *General*

Management's discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which were prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The application of U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The policies and estimates that we believe are most critical to an understanding of our financial results and condition and that require a higher degree of judgment and complexity include:

Revenue recognition;

Estimating sales returns and other allowances, and allowance for doubtful accounts;

Valuation of long-lived assets, including goodwill and purchased intangibles;

Valuation of investments;

Accounting for income taxes; and

Stock-based compensation.

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For a more comprehensive discussion of these critical accounting policies, please see Critical Accounting Policies and Estimates, under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for the fiscal year ended January 31, 2008.

### **Results of Operations for the Three and Nine Months Ended October 31, 2008 and 2007**

#### *Revenues*

We recognize revenues from three sources: (1) product revenues, (2) subscription revenues and (3) service revenues; in each case, net of sales returns and other allowances. Product revenues consist of revenues from production licenses (sometimes referred to as royalties), fees for stand-alone software and software programming tools sold under our perpetual and term licensing models and from sales of our hardware products. Subscription revenues consist primarily of revenues from the licensing of products and services under our enterprise licensing model, including items such as development tools,

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operating systems, various protocols and interfaces and maintenance and support services such as installation and training, which are licensed over a limited period of time, typically 12 months. Service revenues are derived from fees from professional services, which include design and development fees, software maintenance contracts, and customer training and consulting. Generally, our customer agreements do not allow the right of return or sales price adjustments. The table below sets forth a summary of our revenue during the three and nine months ended October 31, 2008 and 2007:

|                       | Three Months Ended October 31,     |           | Percentage of Total Revenues, net |      | Nine Months Ended October 31, |            | Percentage of Total Revenues, net |      |
|-----------------------|------------------------------------|-----------|-----------------------------------|------|-------------------------------|------------|-----------------------------------|------|
|                       | 2008                               | 2007      | 2008                              | 2007 | 2008                          | 2007       | 2008                              | 2007 |
|                       | (In thousands, except percentages) |           |                                   |      |                               |            |                                   |      |
| Product revenues      | \$ 37,440                          | \$ 29,735 | 41%                               | 36%  | \$ 105,214                    | \$ 89,924  | 39%                               | 37%  |
| Subscription revenues | 31,823                             | 30,886    | 35                                | 38   | 97,400                        | 89,939     | 36                                | 37   |
| Service revenues      | 22,313                             | 21,022    | 24                                | 26   | 68,742                        | 64,458     | 25                                | 26   |
| Total revenues, net   | \$ 91,576                          | \$ 81,643 | 100%                              | 100% | \$ 271,356                    | \$ 244,321 | 100%                              | 100% |

Total revenues increased \$9.9 million or 12% and \$27.0 million or 11% in the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. These increases were due primarily to an increased volume of product revenues, related to increased levels of business and customer purchases under our term license model. Term license revenues were approximately 13% and 6% of total revenues, respectively, in the three and nine months ended October 31, 2008.

*Product Revenues.* Product revenues are comprised of perpetual development license revenues, including hardware product revenues, term license revenues and production license revenues from both perpetual and subscription licensing. The table below sets forth information for such components:

|                                     | Three Months Ended October 31,     |           | Percentage of Total Revenues, net |      | Nine Months Ended October 31, |           | Percentage of Total Revenues, net |      |
|-------------------------------------|------------------------------------|-----------|-----------------------------------|------|-------------------------------|-----------|-----------------------------------|------|
|                                     | 2008                               | 2007      | 2008                              | 2007 | 2008                          | 2007      | 2008                              | 2007 |
|                                     | (In thousands, except percentages) |           |                                   |      |                               |           |                                   |      |
| Perpetual and term license revenues | \$ 21,329                          | \$ 9,266  | 23%                               | 11%  | \$ 48,856                     | \$ 28,257 | 18%                               | 12%  |
| Production license revenues         | 16,111                             | 20,469    | 18                                | 25   | 56,358                        | 61,667    | 21                                | 25   |
| Total product revenues, net         | \$ 37,440                          | \$ 29,735 | 41%                               | 36%  | \$ 105,214                    | \$ 89,924 | 39%                               | 37%  |

Perpetual and term license revenues increased \$12.1 million or 130% and \$20.6 million or 73% in the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. The increase during the three and nine months ended October 31, 2008 was primarily related to a higher volume of revenues recognized under our term license model. In addition, the increase during the nine months ended October 31, 2008 was due to a large perpetual license deal recognized during the first quarter of fiscal 2009. We expect perpetual and hardware revenues to remain relatively flat over the remainder of fiscal year 2009. Term license revenues can fluctuate from quarter to quarter depending on the rate of customer adoption of our multi-year term license model.

Production license revenues decreased \$4.4 million or 21% in the three months ended October 31, 2008 and decreased \$5.3 million or 9% in the nine months ended October 31, 2008, as compared to the same periods of the prior year. The decrease was primarily related to a lower volume of production license block purchases in the third quarter of fiscal 2009, as compared to the same period of the prior year. The variability and timing of revenues derived from our license compliance programs also has an impact on production license revenues. We expect production license revenues to remain relatively flat over the remainder of fiscal year 2009, as compared to the same period of the prior fiscal year.

*Subscription Revenues.* Subscription revenues increased \$937,000 or 3% and \$7.5 million or 8% in the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. These increases were primarily attributable to the ratable recognition of subscription revenues related to higher volumes of subscription business with our customers in prior periods. We expect that subscription revenues in the fourth quarter of fiscal year 2009 will decrease slightly compared to the same period of the prior fiscal year, as the adoption of

our multi-year term license model continues to gain momentum.

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*Service Revenues.* Service revenues are derived from fees for professional services, which include design and development fees, software maintenance contracts, customer training and consulting.

|                                    | Three Months Ended                 |                  | Percentage of            |                          | Nine Months Ended |                  | Percentage of            |                          |
|------------------------------------|------------------------------------|------------------|--------------------------|--------------------------|-------------------|------------------|--------------------------|--------------------------|
|                                    | October 31, 2008                   | October 31, 2007 | Total Revenues, net 2008 | Total Revenues, net 2007 | October 31, 2008  | October 31, 2007 | Total Revenues, net 2008 | Total Revenues, net 2007 |
|                                    | (In thousands, except percentages) |                  |                          |                          |                   |                  |                          |                          |
| Maintenance revenues               | \$ 8,974                           | \$ 8,032         | 10%                      | 10%                      | \$ 25,075         | \$ 24,840        | 9%                       | 10%                      |
| Other service revenues             | 13,339                             | 12,990           | 14                       | 16                       | 43,667            | 39,618           | 16                       | 16                       |
| <b>Total service revenues, net</b> | <b>\$ 22,313</b>                   | <b>\$ 21,022</b> | <b>24%</b>               | <b>26%</b>               | <b>\$ 68,742</b>  | <b>\$ 64,458</b> | <b>25%</b>               | <b>26%</b>               |

Maintenance revenues increased \$942,000 or 12% and \$235,000 or 1% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. These increases during the three and nine months ended October 31, 2008 were primarily related to a higher volume of revenues recognized under our multi-year term license model. We expect maintenance revenues will increase during the remainder of fiscal year 2009.

Other service revenues, which consist of professional services and training, increased \$349,000 or 3% and \$4.0 million or 10% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. These increases were primarily attributable to the recognition of revenue related to a number of fixed price contracts, which had been previously deferred as the revenue recognition criteria had not been met until the current fiscal year. In addition, these increases resulted from higher levels of business with certain large customers, particularly in the aerospace and defense, consumer and semiconductor sectors. During the three months ended October 31, 2008 and 2007, we generated \$6.5 million and \$3.7 million, respectively, in revenue from fixed-price services contracts and \$21.4 million and \$9.3 million during the nine months ended October 31, 2008 and 2007, respectively. Fixed-price services contracts are accounted for under the percentage-of-completion method of accounting. Time-and-materials service contracts are recognized as services are performed. We expect other service revenues to increase over the remainder of fiscal year 2009.

Our services backlog, which represents contractual commitments for our professional services not yet billed or delivered, has increased by \$10.4 million or 56% from \$18.7 million at January 31, 2008 to \$29.1 million at October 31, 2008. The change reflects the impact of one large contract that was signed during the second quarter of fiscal 2009 and an increase in the overall volume of professional service consulting business with our customers. We expect that most of our services backlog will be billed and delivered within the next 12 months, but service contracts are subject to change or termination, and management does not believe that services backlog, as of any particular date, is a reliable indicator of future performance. Our services backlog, which is not reflected on our balance sheet, is not subject to our normal accounting controls for information that is either reported in or derived from our basic financial statements, and the concept of backlog is not defined in the accounting literature, making comparisons with other companies difficult and potentially misleading. We expect services backlog to increase over the remainder of fiscal year 2009.

*Revenues by Segment*

|                                       | Three Months Ended                 |                  | Percentage of            |                          | Nine Months Ended |                   | Percentage of            |                          |
|---------------------------------------|------------------------------------|------------------|--------------------------|--------------------------|-------------------|-------------------|--------------------------|--------------------------|
|                                       | October 31, 2008                   | October 31, 2007 | Total Revenues, net 2008 | Total Revenues, net 2007 | October 31, 2008  | October 31, 2007  | Total Revenues, net 2008 | Total Revenues, net 2007 |
|                                       | (In thousands, except percentages) |                  |                          |                          |                   |                   |                          |                          |
| VxWorks                               | \$ 65,495                          | \$ 60,157        | 72%                      | 74%                      | \$ 199,080        | \$ 180,837        | 73%                      | 74%                      |
| Linux                                 | 13,346                             | 7,814            | 15                       | 10                       | 31,466            | 19,848            | 12                       | 8                        |
| Non-Core Products and Design Services | 6,142                              | 6,645            | 6                        | 8                        | 21,093            | 24,168            | 8                        | 10                       |
| All other                             | 6,593                              | 7,027            | 7                        | 8                        | 19,717            | 19,468            | 7                        | 8                        |
| <b>Total revenues, net</b>            | <b>\$ 91,576</b>                   | <b>\$ 81,643</b> | <b>100%</b>              | <b>100%</b>              | <b>\$ 271,356</b> | <b>\$ 244,321</b> | <b>100%</b>              | <b>100%</b>              |



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Our VxWorks segment comprises our proprietary VxWorks real-time operating system and related products and services. VxWorks revenues increased \$5.3 million or 9% and \$18.2 million or 10% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. These increases were attributable to growing demand for our VxWorks platforms licensed under our term license model, and for the nine months ended October 31, 2008, the increase also resulted from a large perpetual license transaction that was recognized in revenues during the first quarter of fiscal 2009.

Our Linux segment comprises our open-source-based, commercial-grade Linux operating systems and related products and services. Linux revenues increased \$5.5 million or 71% and \$11.6 million or 59% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. These increases were attributable to growing demand for our Linux platforms and services primarily in our networking, automotive and digital consumer markets.

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Our Non-Core Products and Design Services segment consists of our pSOS real-time operating system, which was acquired from Integrated Systems, Inc. in fiscal 2001, certain other non-core products and turn-key product design services. Non-Core Products and Design Services revenues decreased \$503,000 or 8% and \$3.1 million or 13% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year due to lower levels of business. In addition, the decrease for the nine months ended October 31, 2008 was related to a large perpetual and production license contract that was recognized during the second quarter of fiscal 2008.

Our all other segment includes our proprietary development tools, common technologies, device management products and related services. All other segment revenues decreased \$434,000 or 6% and increased \$249,000 or 1% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year.

*Revenues by Geography*

|                     | Three Months Ended                 |                  | Percentage of            |                          | Nine Months Ended |                  | Percentage of            |                          |
|---------------------|------------------------------------|------------------|--------------------------|--------------------------|-------------------|------------------|--------------------------|--------------------------|
|                     | October 31, 2008                   | October 31, 2007 | Total Revenues, net 2008 | Total Revenues, net 2007 | October 31, 2008  | October 31, 2007 | Total Revenues, net 2008 | Total Revenues, net 2007 |
|                     | (In thousands, except percentages) |                  |                          |                          |                   |                  |                          |                          |
| North America       | \$ 51,890                          | \$ 43,281        | 57%                      | 53%                      | \$ 138,832        | \$ 135,254       | 51%                      | 55%                      |
| EMEA                | 20,489                             | 20,282           | 22                       | 25                       | 69,698            | 54,884           | 26                       | 22                       |
| Japan               | 10,959                             | 9,461            | 12                       | 12                       | 34,696            | 30,909           | 13                       | 13                       |
| Asia Pacific        | 8,238                              | 8,619            | 9                        | 10                       | 28,130            | 23,274           | 10                       | 10                       |
| Total revenues, net | \$ 91,576                          | \$ 81,643        | 100%                     | 100%                     | \$ 271,356        | \$ 244,321       | 100%                     | 100%                     |

Revenues from international sales increased 3% to \$39.7 million during the three months ended October 31, 2008 from \$38.4 million in the three months ended October 31, 2007 and increased 22% to \$132.5 million during the nine months ended October 31, 2008 from \$109.1 million in the nine months ended October 31, 2007. The increase for the three months ended October 31, 2008 was due to a 16% increase in revenues from Japan and a 1% increase in revenues from EMEA, offset in part by a 4% decrease in revenues from Asia Pacific. The increase for the nine months ended October 31, 2008 was due to a 27% increase in revenues from EMEA, a 21% increase in revenues from Asia Pacific and a 12% increase in revenues from Japan. The general level of increased revenues in each geographic area resulted primarily from higher customer demand for our software and services, including products purchased under the term license model, both domestically and internationally. International revenues accounted for 43% and 47% of total revenues during the three months ended October 31, 2008 and 2007, respectively, and 49% and 45% of total revenues during the nine months ended October 31, 2008 and 2007, respectively. The increase in the percentage of revenues associated with North America in the three months ended October 31, 2008 compared to the same period in the prior year was due primarily to a higher percentage of term license revenues in North America. The decrease in the percentage of revenues associated with North America in the nine months ended October 31, 2008 compared to the same period in the prior year was due primarily to lower levels of compliance activity and other production license revenues in the current year in North America. Our international sales are primarily denominated in United States Dollars, Euros, British Pounds and Japanese Yen. We expect international sales to continue to represent a significant portion of our revenues, although the actual percentage may fluctuate from period to period.

The change in average exchange rates between the dollar and other currencies between the three and nine month periods ended October 31, 2008 and the three and nine month periods ended October 31, 2007 impacted our international revenues and international operating expenses. These changes accounted for \$754,000 and \$5.5 million of the increase in international revenues, and \$177,000 and \$5.0 million of the increase in international operating expenses, respectively, in the three and nine month periods in fiscal 2009 as compared to the comparable periods in fiscal 2008.

**Table of Contents***Deferred Revenues*

Our deferred revenues consist of the following:

|                                     | October 31,<br>2008 | January 31,<br>2008 | Dollar<br>Change  | Percent<br>Change |
|-------------------------------------|---------------------|---------------------|-------------------|-------------------|
| (In thousands, except percentages)  |                     |                     |                   |                   |
| <b>Current deferred revenues:</b>   |                     |                     |                   |                   |
| Subscription                        | \$ 65,263           | \$ 83,252           | \$ (17,989)       | (22)%             |
| Maintenance and other               | 41,872              | 36,634              | 5,238             | 14                |
| Total current deferred revenues     | 107,135             | 119,886             | (12,751)          | (11)              |
| <b>Long-term deferred revenues:</b> |                     |                     |                   |                   |
| Subscription                        | 8,144               | 13,237              | (5,093)           | (38)              |
| Maintenance and other               | 10,542              | 1,410               | 9,132             | 648               |
| Total long-term deferred revenues   | 18,686              | 14,647              | 4,039             | 28                |
| <b>Total deferred revenues</b>      | <b>\$ 125,821</b>   | <b>\$ 134,533</b>   | <b>\$ (8,712)</b> | <b>(6)%</b>       |

Deferred subscription revenues represent customer billings and payments made in advance for software licensed over a subscription period. Subscription periods vary from annual to multi-year and are classified as such. Long-term deferred revenues represent the portion of multi-year contracts that are due to be recognized as revenue in a time period greater than one year from the balance sheet date. Maintenance and other deferred revenues primarily include deferred maintenance, service and product revenues. Deferred maintenance revenues represent customer billings and payments made in advance for annual support contracts. Maintenance is typically billed on a per annum basis in advance and revenue is recognized ratably over the maintenance period. Deferred service revenues include pre-payments for software consulting and training services. Revenue for these contracts is recognized as the services are performed. Deferred product revenues primarily include software license transactions that are not separable from subscription or consulting services.

Our total deferred revenues decreased to \$125.8 million at October 31, 2008 from \$134.5 million at January 31, 2008. The decrease was due to the ratable recognition of subscription contracts and lower sales of new subscription contracts, resulting primarily from a higher mix of customer purchases under our term license model during the first nine months of fiscal 2009. The decline was partially offset by increased multi-year maintenance revenues related to a large perpetual contract and, to a lesser extent, due to maintenance revenues related to other term license transactions invoiced during the first nine months of fiscal 2009.

*Cost of Revenues*

|                                       | Three Months Ended<br>October 31, |                  | Percentage of<br>Associated Revenues, net |      | Nine Months Ended<br>October 31, |                  | Percentage of<br>Associated Revenues, net |      |
|---------------------------------------|-----------------------------------|------------------|---|------|----------------------------------|------------------|---|------|
|                                       | 2008                              | 2007             | 2008                                      | 2007 | 2008                             | 2007             | 2008                                      | 2007 |
| (In thousands, except percentages)    |                                   |                  |   |      |                                  |                  |   |      |
| Product                               | \$ 756                            | \$ 586           | 2%  | 2%   | \$ 2,138                         | \$ 1,778         | 2%  | 2%   |
| Subscription                          | 3,476                             | 4,288            | 11  | 14   | 11,782                           | 13,046           | 12  | 15   |
| Service                               | 16,033                            | 14,403           | 72%                                       | 69%  | 48,842                           | 42,754           | 71%                                       | 66%  |
| Amortization of purchased intangibles | 513                               | 691              |   |      | 1,572                            | 1,896            |   |      |
| <b>Total cost of revenues</b>         | <b>\$ 20,778</b>                  | <b>\$ 19,968</b> |   |      | <b>\$ 64,334</b>                 | <b>\$ 59,474</b> |   |      |
| Gross profit                          | \$ 70,798                         | \$ 61,675        |   |      | \$ 207,022                       | \$ 184,847       |   |      |
| Gross profit percentage               | 77%                               | 76%              |   |      | 76%                              | 76%              |   |      |

*Cost of Product.* Product-related costs consist primarily of salaries, benefits, and stock-based compensation for employees involved in production, other direct production costs, royalty payments to third parties for the use of their software, and shipping costs. Cost of product

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increased slightly in absolute dollars, but remained relatively flat as a percentage of associated revenues, during the three and nine months ended October 31, 2008, respectively, as compared to the same periods of the prior year. The increase in absolute dollars is primarily attributable to the overall increase in product revenues during the periods. Product-related cost of revenues may be affected in the future by costs of distribution related to the introduction of new products, royalty costs for use of third-party software in our products and by the amortization of capitalized software development costs.

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*Cost of Subscription.* Subscription-related costs consist primarily of salaries, benefits, and stock-based compensation for employees, other direct production costs, royalty payments to third parties for the use of their software, shipping costs and costs of providing subscription-related maintenance and support services. Cost of subscription decreased in absolute dollars and as a percentage of associated revenues during the three and nine months ended October 31, 2008, as compared to the same periods in the prior year. The decreases were related primarily to decreased service costs associated with subscription revenue contracts.

We expect cost of subscription to continue to remain relatively flat as a percentage of subscription revenue over the remainder of fiscal year 2009, based on the level of sales of our subscription-based Wind River platforms. Cost of subscriptions may be affected in the future by direct production costs, stock-based compensation for employees, amortization of capitalized software development costs, costs of distribution, royalty costs for use of third party software in our products, and the costs of providing subscription-related maintenance and support services.

*Cost of Services.* Service-related cost of revenues consist primarily of personnel related costs such as salaries, benefits, and stock-based compensation, associated with providing services, including consulting services, to customers and the infrastructure to manage a services organization, as well as costs to recruit, develop and retain services professionals. Cost of services increased by \$1.6 million or 11% and \$6.1 million or 14% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. These increases were primarily related to increased compensation costs of \$2.3 million and \$9.2 million during the three and nine months ended October 31, 2008, respectively, attributable to increased headcount, employee compensation and the timing of recognition of employee costs associated with certain service revenue contracts. In addition, increased facilities and information technology costs of \$252,000 and \$479,000 during the three and nine months ended October 31, 2008, respectively, also contributed to the overall increase. These increases were partially offset by a decline in costs for outsourced consulting of \$1.1 million and \$4.0 million during the three and nine months ended October 31, 2008, respectively, related to lower utilization of third-party consultants. We expect cost of services to continue to fluctuate as a percentage of service revenues based on our ability to fully utilize our professional services organization.

*Amortization of Purchased Intangibles.* Amortization of purchased intangibles relates to the amortization of completed technology and assembled workforce associated with acquisitions. The decrease during the three and nine months ended October 31, 2008 as compared to the same periods in the prior year was primarily attributable to lower amortization associated with intangibles acquired as part of the RTLinux acquisition, which were significantly impaired during the fourth quarter of fiscal 2008. This decrease was partially offset by increased amortization related to the MIZI and Comsys acquisitions, which were completed during the third quarter of fiscal 2009 and 2008, respectively.

We expect amortization of purchased intangibles to increase over the remainder of fiscal year 2009 due to the MIZI acquisition completed on October 15, 2008.

*Operating Expenses*

We allocate the total costs for information technology, facilities and fixed asset depreciation to each of the functional areas based on headcount data. Information technology allocated costs include salaries, employee-related costs, outside consulting costs for projects, communication costs, hardware and software maintenance contracts costs and depreciation expense for fixed assets. Facilities allocated costs include rent for the corporate offices as well as shared function offices, property taxes, depreciation expenses for office furniture and other department operating costs. Fixed asset depreciation allocated costs include straight-line depreciation expense on buildings, leasehold improvements, computer equipment, software, furniture and office equipment.

The slight increase in absolute dollars in operating expenses relates primarily to increases in personnel expenses, professional fees, general operating expenses and restructuring and other charges.

*Selling and Marketing.* Selling and marketing expenses consist primarily of product and other marketing related expenses, compensation related expenses, sales commissions, facility costs and travel costs.

|                                 | Three Months Ended<br>October 31,  |           | Percent<br>Change | Nine Months Ended<br>October 31, |           | Percent<br>Change |
|---------------------------------|------------------------------------|-----------|-------------------|----------------------------------|-----------|-------------------|
|                                 | 2008                               | 2007      |                   | 2008                             | 2007      |                   |
|                                 | (In thousands, except percentages) |           |                   |                                  |           |                   |
| Selling and marketing           | \$ 34,222                          | \$ 32,852 | 4%                | \$ 102,486                       | \$ 98,163 | 4%                |
| As a percentage of net revenues | 37%                                | 40%       |                   | 38%                              | 40%       |                   |



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Total selling and marketing expenses increased by \$1.4 million and \$4.3 million during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The increase during the three and nine months ended October 31, 2008 primarily reflects higher employee-related costs of \$2.1 million and \$4.3 million, respectively, related to increased employee compensation including commissions. The increase during the nine months ended October 31, 2008 was also attributable to higher outside consulting fees of \$402,000 resulting from a higher utilization of third-party consultants in the selling and marketing organization. The increases during the three and nine months ended October 31, 2008 were partially offset by decreased costs associated with marketing programs of \$316,000 and \$537,000, respectively. We expect selling and marketing expenses to increase slightly in absolute dollars over the remainder of fiscal year 2009.

*Product Development and Engineering Expenses.* Product development and engineering expenses consist primarily of payroll and stock-based compensation related expenses, facility costs and consulting fees for our product research and development organization.

|                                     | Three Months Ended                 |                     | Percent<br>Change | Nine Months Ended   |                     | Percent<br>Change |
|-------------------------------------|------------------------------------|---------------------|-------------------|---------------------|---------------------|-------------------|
|                                     | October 31,<br>2008                | October 31,<br>2007 |                   | October 31,<br>2008 | October 31,<br>2007 |                   |
|                                     | (In thousands, except percentages) |                     |                   |                     |                     |                   |
| Product development and engineering | \$ 22,016                          | \$ 20,588           | 7%                | \$ 63,148           | \$ 61,288           | 3%                |
| As a percentage of net revenues     | 24%                                | 25%                 |                   | 23%                 | 25%                 |                   |

Total product development and engineering expenses increased by \$1.4 million and \$1.9 million during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The increases during the three and nine months ended October 31, 2008 primarily reflects higher employee-related costs of \$2.0 million and \$4.9 million, respectively, associated with increased headcount and higher employee compensation. The increases during the three and nine months ended October 31, 2008 were partially offset by decreased outside consulting fees of \$631,000 and \$3.3 million, respectively, related to the transfer of third-party design services to our development center in China.

We expect product development and engineering expenses to increase in absolute dollars over the remainder of fiscal year 2009 as we continue to invest in new and existing products.

*General and Administrative Expenses.* General and administrative expenses consist primarily of compensation-related expenses, facilities-related expenses and external fees for professional services, such as legal and accounting.

|                                 | Three Months Ended                 |                     | Percent<br>Change | Nine Months Ended   |                     | Percent<br>Change |
|---------------------------------|------------------------------------|---------------------|-------------------|---------------------|---------------------|-------------------|
|                                 | October 31,<br>2008                | October 31,<br>2007 |                   | October 31,<br>2008 | October 31,<br>2007 |                   |
|                                 | (In thousands, except percentages) |                     |                   |                     |                     |                   |
| General and administrative      | \$ 8,099                           | \$ 9,050            | (11)%             | \$ 25,304           | \$ 28,612           | (12)%             |
| As a percentage of net revenues | 9%                                 | 11%                 |                   | 9%                  | 12%                 |                   |

Total general and administrative expenses decreased by \$951,000 and \$3.3 million during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The decrease during the three and nine months ended October 31, 2008 was due to decreased stock-based compensation expense of \$762,000 and \$2.5 million, respectively, and lower legal, accounting and consulting fees of \$226,000 and \$1.5 million, respectively. In addition, lower facilities and information technology costs of \$162,000 and \$903,000, respectively, also contributed to the decrease. These decreases during the three and nine months ended October 31, 2008 were partially offset by increased employee-related costs of \$295,000 and \$2.1 million, respectively, associated with increased headcount and higher employee compensation.

We expect general and administrative expenses to increase in absolute dollars over the remainder of fiscal year 2009.

*Amortization of Other Intangibles*

Amortization of other intangibles represents the amortization of acquisition-related intangible assets. The increase during the three months ended October 31, 2008, as compared to the same period in the prior year, is related to the MIZI acquisition. The slight decrease during the nine months ended October 31, 2008, as compared to the same periods in the prior year, was attributable to lower amortization associated with intangibles acquired as part of the RTLinux acquisition, which were significantly impaired during the fourth quarter of fiscal 2008.

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We expect amortization of other intangibles to increase for the remainder of fiscal 2009 due to the MIZI acquisition completed on October 15, 2008.



**Table of Contents***Restructuring Charges*

At the beginning of fiscal 2009, we adopted a reorganization plan to better align our resources with our strategic business objectives and to support profitable growth in the future. As part of this plan, we eliminated approximately 82 positions, primarily in North America. As a result, we recognized restructuring charges of \$2.7 million during the nine months ended October 31, 2008 related to severance, medical and outplacement benefits for terminated employees. We anticipate cost savings of approximately \$7.5 million to \$8.5 million in fiscal 2009 associated with our reorganization plan. In addition, as of October 31, 2008, we recognized restructuring charges of \$115,000 related to the revision of certain sublease income assumptions for a partially vacated facility in the United Kingdom and \$46,000 related to other costs associated with the reorganization.

The following table sets forth an analysis of the components of restructuring charges and other activity within the restructuring accrual during the nine months ended October 31, 2008 (in thousands):

|  | Work<br>Force<br>Reduction | Consolidation<br>of Excess<br>Facilities | Other | Total   |
|--|----------------------------|--|-------|---------|
| Restructuring liabilities as of January 31, 2008 | \$ 327                     | \$ 508                                   | \$    | \$ 835  |
| Restructuring charges, net                       | 2,693                      | 115                                      | 46    | 2,854   |
| Cash payments                                    | (2,988)                    | (203)                                    | (44)  | (3,235) |
| Foreign exchange effects                         | (5)                        | (70)                                     |       | (75)    |
| Restructuring liabilities as of October 31, 2008 | \$ 27                      | \$ 350                                   | \$ 2  | \$ 379  |

The remaining restructuring liability as of October 31, 2008 is included as a component of accrued liabilities and other long-term liabilities on the accompanying condensed consolidated balance sheet and is related primarily to a lease obligation on the partially vacated facility in the United Kingdom. We expect to pay the remaining severance benefits during fiscal year 2009. The remaining lease obligation will be settled over the remaining lease term, which expires in fiscal year 2012.

*Operating Income (Loss) by Segment*

|   | Three Months Ended                 |            |                   | Nine Months Ended   |            |                   |
|---|------------------------------------|------------|-------------------|---------------------|------------|-------------------|
|   | October 31,<br>2008                | 2007       | Percent<br>Change | October 31,<br>2008 | 2007       | Percent<br>Change |
|   | (In thousands, except percentages) |            |                   |                     |            |                   |
| VxWorks   | \$ 25,314                          | \$ 16,316  | 55%               | \$ 77,194           | \$ 51,399  | 50%               |
| Linux   | (4,647)                            | (1,011)    | 360               | (15,295)            | (4,703)    | 225               |
| Non-Core Products and Design Services                           | 3,146                              | 2,642      | 19                | 7,846               | 8,497      | (8)               |
| All other   | (2,508)                            | (2,162)    | 16                | (7,773)             | (6,855)    | 13                |
| Corporate unallocated expenses:                                 |                                    |            |                   |                     |            |                   |
| Stock-based compensation  | (2,770)                            | (3,115)    | (11)              | (8,640)             | (9,600)    | (10)              |
| Amortization of purchased and other intangibles                 | (710)                              | (836)      | (15)              | (1,984)             | (2,313)    | (14)              |
| Corporate marketing   | (3,462)                            | (3,744)    | (8)               | (10,372)            | (11,446)   | (9)               |
| General and administrative (including stock-based compensation) | (8,099)                            | (9,050)    | (11)              | (25,304)            | (28,612)   | (12)              |
| Restructuring and other charges                                 | 63                                 | (642)      | (110)             | (2,854)             | (642)      | 345               |
| Income (loss) from operations                                   | \$ 6,327                           | \$ (1,602) | (495)%            | \$ 12,818           | \$ (4,275) | (400)%            |

Operating income for the VxWorks segment increased \$9.0 million and \$25.8 million during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The increases during the three and nine months ended October 31, 2008 resulted from an increase in revenues of \$5.3 million and \$18.2 million, respectively, and a decline in expenses of \$3.7 million and \$7.6 million, respectively, related to lower cost of revenues resulting from a lower mix of service revenues. The increased revenues in fiscal 2009 were attributable to growing demand for our VxWorks platforms licensed under our term license model and a large perpetual license transaction that

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was recognized in revenues during the first quarter of fiscal 2009.

Operating loss for the Linux segment increased by \$3.6 million and \$10.6 million during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The increases during the three and nine months ended October 31, 2008 reflect an increase in expenses of \$9.2 million and \$22.2 million, respectively, resulting from increased cost of revenues associated with a higher mix of service revenues and a rise in engineering expenses due to our continued investment in the Linux business. The increases in expenses were partially offset by increased revenues of \$5.5 million and \$11.6 million, respectively, during the three and nine months ended October 31, 2008.

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Operating income for the Non-Core Products and Design Services segment increased by \$504,000 but decreased by \$651,000 during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The increase during the three months ended October 31, 2008 resulted from a decline in expenses of \$1.0 million partially offset by a decline in revenues of \$503,000. The decrease during the nine months ended October 31, 2008 reflects a decline in revenues of \$3.1 million, primarily related to a large perpetual and production license contract that was recognized during the second quarter of fiscal 2008. The decrease in revenues was partially offset by a decline in expenses of \$2.4 million, related to lower cost of revenues and lower selling expense during the nine months ended October 31, 2008.

Operating loss for all other segments increased by \$346,000 and \$918,000 during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The increase during the three months ended October 31, 2008 reflects a decline in revenues of \$434,000, partially offset by a slight decline in expenses. The increase during the nine months ended October 31, 2008 reflects an increase in expenses of \$1.2 million, resulting from a rise in cost of sales, which was partially offset by a decline in operating expenses. The increase in expenses was partially offset by increased revenues of 249,000 during the nine months ended October 31, 2008.

*Stock-based Compensation*

We recorded stock-based compensation expense as follows for the three and nine months ended October 31, 2008 and 2007 (in thousands):

|   | Three Months Ended<br>October 31, |                 | Nine Months Ended<br>October 31, |                  |
|---|-----------------------------------|-----------------|----------------------------------|------------------|
|   | 2008                              | 2007            | 2008                             | 2007             |
| Cost of revenues                              | \$ 579                            | \$ 593          | \$ 1,808                         | \$ 1,869         |
| Selling and marketing expenses                | 1,367                             | 1,511           | 4,231                            | 4,493            |
| Product development and engineering expenses  | 824                               | 1,011           | 2,601                            | 3,238            |
| General and administrative expenses           | 1,378                             | 2,139           | 3,987                            | 6,518            |
| <b>Total stock-based compensation expense</b> | <b>\$ 4,148</b>                   | <b>\$ 5,254</b> | <b>\$ 12,627</b>                 | <b>\$ 16,118</b> |

The decrease in stock-based compensation during the three and nine months ended October 31, 2008, as compared to the same periods in the prior year, is related primarily to equity grants that were fully amortized during fiscal 2008. In addition, we recognized stock-based compensation expense of \$309,000 during the nine months ended October 31, 2007 related to restricted stock issued in connection with the Interpeak acquisition.

As of October 31, 2008, there was approximately \$22.3 million of unrecognized compensation cost related to unvested stock options, restricted stock units and employee stock purchase rights granted under our equity incentive plans. This cost is expected to be recognized over a weighted-average period of approximately 2.2 years.

*Other Income, net*

|                                | Three Months Ended<br>October 31, |                 | Nine Months Ended<br>October 31, |                 |
|--------------------------------|-----------------------------------|-----------------|----------------------------------|-----------------|
|                                | 2008                              | 2007            | 2008                             | 2007            |
|                                | (In thousands)                    |                 |                                  |                 |
| Interest income                | \$ 1,859                          | \$ 2,615        | \$ 6,038                         | \$ 7,128        |
| Interest expense               | (99)                              | (131)           | (320)                            | (335)           |
| Other expense, net             | (935)                             | (53)            | (667)                            | (454)           |
| <b>Total other income, net</b> | <b>\$ 825</b>                     | <b>\$ 2,431</b> | <b>\$ 5,051</b>                  | <b>\$ 6,339</b> |

*Interest Income.* Interest income decreased by \$756,000 or 29% and \$1.1 million or 15% during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. These decreases were due primarily to lower yields on lower cash, cash equivalent and investment balances. The average yield for the three months ended October 31, 2008 was 4.55% compared to 5.02% for the three months ended October 31, 2007 and 4.40% for the nine months ended October 31, 2008 compared to 4.95% for the nine months ended

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October 31, 2007. Cash, cash equivalents and investments totaled \$161.2 million and \$223.0 million as of October 31, 2008 and 2007, respectively.

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*Interest Expense.* Interest expense decreased slightly during the three and nine months ended October 31, 2008 as compared to the same periods in the prior year, related primarily to bank fees and other miscellaneous interest charges.

*Other Expense, Net.* Other expense, net increased by \$882,000 and \$213,000 during the three and nine months ended October 31, 2008, respectively, as compared to the same periods in the prior year. The changes were related primarily to net foreign currency losses, an impairment of other assets and other-than-temporary impairments of investments as explained below.

During the nine months ended October 31, 2008, we determined that three asset-backed securities within our investment portfolio were other-than-temporarily impaired due to a deterioration in the quality of collateralized support, an overall under-collateralization and a significant non-recoverable decline in fair value. As a result, we recorded other-than-temporary impairment losses of \$150,000 and \$531,000 related to these securities during the three and nine months ended October 31, 2008, respectively. In addition, during the three months ended October 31, 2008, we recorded other-than-temporary impairment losses of \$273,000 related to our investment in the Reserve Primary Money Market Fund and the Reserve International Fund (the Reserve Funds) because the Reserve Funds held securities issued by Lehman Brothers, which filed for bankruptcy protection on September 15, 2008. The total recorded other-than-temporary impairment losses were \$423,000 and \$804,000 during the three and nine months ended October 31, 2008, respectively.

*Provision for Income Taxes*

We had a provision for income taxes of \$1.2 million and \$927,000 for the three months ended October 31, 2008 and 2007, respectively, and a provision for income taxes of \$2.7 million and \$2.4 million for the nine months ended October 31, 2008 and 2007. The provision for income taxes is based on estimates of our expected benefit or liability for domestic and foreign income taxes, and is calculated by applying our estimated annual effective tax rate to the income (loss) before income taxes, adjusted for any discrete items. Our provision for income taxes increased by \$309,000 for the three months ended October 31, 2008 as compared to the three months ended October 31, 2007 and increased by 296,000 for the nine months ended October 31, 2008 as compared to the nine months ended October 31, 2007 due primarily to the increase in year-to-date pretax income and the impact of changes in jurisdictional forecasts for the business.

Deferred income taxes are recorded in accordance with SFAS No. 109, *Accounting for Income Taxes* ( SFAS 109 ) and are determined based on the differences between financial reporting and the tax basis of assets and liabilities using the tax rates in effect when the differences are expected to reverse. SFAS 109 provides for recognition of deferred tax assets if the realization of such assets is more likely than not to occur. With the primary exception of the U.S. tax jurisdiction, we have determined that it is more likely than not that our deferred taxes will be realized. Accordingly, we have net deferred tax assets of \$5.9 million primarily related to certain international jurisdictions and a full valuation allowance against the remainder of our deferred tax assets as of October 31, 2008.

Should we determine that it is more likely than not that our U.S. deferred tax assets will be realized, we will adjust the related valuation allowance and recognize a material increase to income in the period that such determination is made. Significant management judgment is required in determining the period in which the reversal of a valuation allowance should occur. While we have experienced an increase in profitability during the nine months ended October 31, 2008 compared to the same period in the prior year, the significant uncertainty in the current economic climate makes it difficult to objectively verify the impact on the Company's future profitability. Accordingly, considering this and other evidence, we have determined that it is more likely than not that our U.S. deferred tax assets will not be realized at this time. We will continue to evaluate the ability to realize, by jurisdiction, its deferred tax assets and related valuation allowances on a quarterly basis. If the current economic environment does not have a significant negative impact on our future profitability, it is reasonably possible that a material adjustment to the valuation allowance may occur within the near term.

**Liquidity and Capital Resources**

As of October 31, 2008, we had working capital of approximately \$7.3 million, and cash, cash equivalents and investments of approximately \$161.2 million, which included \$64.1 million of cash and cash equivalents, \$16.7 million of short-term investments and \$80.4 million of investments with maturities greater than one year. We invest primarily in highly liquid, investment-grade instruments.

**Table of Contents***Cash Flows*

Our consolidated statements of cash flows are summarized below (in thousands):

|   | Nine Months Ended<br>October 31, |             |
|---|----------------------------------|-------------|
|   | 2008                             | 2007        |
| Net cash provided by operating activities           | \$ 44,626                        | \$ 23,352   |
| Net cash provided by (used in) investing activities | \$ 21,176                        | \$ (31,722) |
| Net cash provided by (used in) financing activities | \$ (97,092)                      | \$ 10,264   |

Net cash provided by operating activities primarily consists of the net income (loss) for the periods under consideration, adjusted to reflect non-cash charges such as stock-based compensation, depreciation and amortization expenses and changes in assets and liabilities. During the nine months ended October 31, 2008, our operating activities provided net cash of \$44.6 million compared to \$23.4 million in the nine months ended October 31, 2007.

Net cash provided by operating activities for the nine months ended October 31, 2008, consisted of cash provided by operations of \$38.9 million and an increase in cash of \$5.7 million arising from changes in assets and liabilities, primarily related to a decrease in accounts receivable of \$11.2 million offset by a decrease in deferred revenues of \$5.5 million. The decrease in accounts receivable was primarily due to strong cash collections during the first half of fiscal 2009, in particular, cash received in connection with a large perpetual contract. The decline in deferred revenue is related to lower sales of subscription contracts in fiscal 2009.

Net cash provided by operating activities for the nine months ended October 31, 2007, consisted of cash provided by operations of \$27.2 million and a decrease in cash of \$3.8 million arising from changes in assets and liabilities, primarily related to a decrease in deferred revenues of \$15.5 million, and partially offset by a decrease in accounts receivable of \$4.2 million and an increase in accrued liabilities of \$4.5 million. The decrease in accounts receivable was primarily due to strong cash collections earlier in the fiscal year. The decrease in deferred revenues was due primarily to slower growth in our subscription business over the second and third quarters of fiscal 2008, an increase in our services business which is not immediately recognized as deferred revenues and the revenue recognition of various large contracts, which had been previously deferred as the revenue recognition criteria had not been met until the current fiscal year.

During the nine months ended October 31, 2008, cash from operations included net income of \$15.2 million and non-cash expenses primarily related to stock-based compensation and depreciation and amortization of \$12.6 million and \$8.9 million, respectively. During the nine months ended October 31, 2007, cash from operations included a net loss of \$336,000 offset primarily by stock-based compensation and depreciation and amortization of \$16.1 million and \$9.4 million, respectively. Our operating cash flows depend heavily on the level of our sales. To a large extent, our sales depend on general economic conditions affecting us and our customers, as well as the timing of new product introductions and other competitive factors and our ability to control expenses successfully.

Our investing activities provided net cash of \$21.2 million and used net cash of \$31.7 million in the nine months ended October 31, 2008 and 2007, respectively. Investing activities generally relate to the purchase of investments, business acquisitions and equipment purchases, partially offset by cash provided from the sale and maturity of investments. The acquisition of property and equipment totaled \$6.1 million and \$8.0 million for the nine months ended October 31, 2008 and 2007, respectively. During the nine months ended October 31, 2008, our maturities and sales of investments, net of purchases, were \$42.6 million as compared to purchases, net of maturities and sale of investments, of \$12.2 million during the nine months ended October 31, 2007. During the nine months ended October 31, 2008, we expended cash, net of cash acquired, of \$15.3 million primarily related to our acquisition of MIZI business, and during the nine months ended October 31, 2007, we expended cash, net of cash acquired, of \$11.5 million related to our acquisition of Comsys and the RTLinux business.

Our financing activities used net cash of \$97.1 million and provided net cash of \$10.3 million in the nine months ended October 31, 2008 and 2007, respectively. During the nine months ended October 31, 2008, and 2007, we received \$9.4 million and \$16.8 million, respectively, due to the issuance of common stock from employee stock option exercises and purchases under our employee stock purchase plan. During the nine months ended October 31, 2008, we repurchased approximately 13.0 million shares of our common stock for approximately \$105.6 million, including repurchases from employees of 44,723 shares for \$361,000 to satisfy employee withholding taxes upon the vesting of restricted stock units. During the nine months ended October 31, 2007, we repurchased approximately 652,000 shares of our common stock for approximately \$6.5 million.



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Our Board of Directors (the Board) has approved common stock repurchase programs authorizing us to repurchase shares of our common stock in the open market or through negotiated transactions. We may repurchase shares from time to time at our discretion in accordance with applicable securities laws. Repurchased shares are funded from available working capital or through the liquidation of long-term investments and are recorded as treasury stock on a last-in, first-out basis.

In fiscal 2003 and 2008, the Board approved stock repurchase programs that authorized us to acquire up to \$30.0 million and \$50.0 million, respectively, of our outstanding common stock. We completed these repurchase programs during the first quarter of fiscal 2008 and the first quarter of fiscal 2009, respectively. During each of the first and second quarters of fiscal 2009, the Board approved additional stock repurchase programs that authorized us to repurchase up to an additional \$50.0 million of outstanding common stock under each plan. As of October 31, 2008, approximately \$45.0 million remained available for repurchases under our stock repurchase programs.

Our total cash and cash equivalents and investments held outside of the United States in various foreign subsidiaries was \$36.3 million as of October 31, 2008, and the remaining \$124.9 million was held in the United States. We believe that our cash and cash equivalents and investments allow us to use our cash resources for strategic investments to gain access to new technologies, acquisitions, provision of working capital, and the repurchase of shares.

In light of the difficult conditions in global financial markets over the last several months, we have been more proactively managing our cash equivalents and fixed income portfolio. We believe the overall credit quality of our portfolio is strong, with our cash equivalents and fixed income portfolio invested in securities with a weighted-average credit rating exceeding AA. Our fixed income investments and publicly traded securities, apart from our investments in the Reserve Funds, are priced by pricing vendors and are classified as Level 1 or Level 2 investments, as measured under SFAS 157, as these vendors either provide a quoted market price in an active market or use observable inputs. In addition, we also compare these prices to prices provided by two other pricing vendors on a sample basis, when available, to ensure that the ultimate prices used to establish fair value are reasonable. See Note 3: Financial Instruments in the Notes to the Consolidated Financial Statements.

### *Sufficiency of Cash Reserves*

We believe that existing cash, cash equivalents and investments, together with cash generated from operations will be sufficient to fund our operating activities, capital expenditures, and other obligations for the foreseeable future. However, if during that period or thereafter we are not successful in generating sufficient cash flows from operations or in raising additional financing when required in sufficient amounts on terms acceptable to us, our business could suffer.

We currently plan to reinvest our cash generated from operations in highly liquid, investment-grade instruments, consistent with past investment practices, and therefore net cash used in investing activities may increase. However, cash could also be used in the future for acquisitions, stock repurchases or other strategic investments.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We invest our excess operating cash in various marketable investments, including money market funds, U.S. government and agency debt securities, corporate debt securities and asset backed and other securities. Investments in both fixed rate and floating rate investments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates. In addition, we may suffer losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates or other factors in the current unstable credit environment.

We have an investment policy, which seeks to mitigate interest rate risks, which has been approved by our Board of Directors. We place our investments with high quality credit issuers and, by policy, limit the amount of credit exposure to any one issuer. Our first priority is to reduce the risk of principal loss. Consequently, we seek to preserve our invested funds by limiting default risk, market risk and reinvestment risk. We limit default risk by investing in only high quality credit securities that we believe to be low risk and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer.

During the nine months ended October 31, 2008, we determined that three asset-backed securities within our investment portfolio were other-than-temporarily impaired due to deterioration in the quality of collateralized support, an





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overall under-collateralization and a significant non-recoverable decline in fair value. As a result, we recorded other-than-temporary impairment losses of \$150,000 and \$531,000 related to these securities during the three and nine months ended October 31, 2008, respectively. In addition, during the three months ended October 31, 2008, we recorded other-than-temporary impairment losses of \$273,000 related to our investment in the Reserve Primary Money Market Fund and the Reserve International Fund as a result of the Lehman Brothers filing for Chapter 11 bankruptcy protection on September 15, 2008. The total recorded other-than-temporary impairment losses were \$423,000 and \$804,000 during the three and nine months ended October 31, 2008, respectively.

**Foreign Currency Risk**

We conduct our business in North America, EMEA, Japan and Asia Pacific. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or changes in economic conditions in foreign markets. Revenues and related expenses generated from our international subsidiaries are generally denominated in the currencies of their local countries. Primary currencies include the Euro, the British Pound and the Japanese Yen. The statements of operations of our international subsidiaries are generally translated into U.S. Dollars at the average exchange rates in each applicable period.

We are also exposed to foreign exchange rate fluctuations as we convert the financial statements of our foreign subsidiaries into U.S. Dollars. Changes in foreign currency exchange rates generally result in translation gains and losses that are deferred within accumulated other comprehensive income (loss) on our consolidated balance sheet and are recognized in the statement of operations upon the liquidation of a foreign subsidiary. The change in average exchange rates between the dollar and other currencies between the three and nine month periods ended October 31, 2008 and the three and nine month periods ended October 31, 2007 impacted our international revenues and international operating expenses. These changes accounted for \$754,000 and \$5.5 million of the increase in international revenues, and \$177,000 and \$5.0 million of the increase in international operating expenses, respectively, in the three and nine month periods in fiscal 2009 as compared to the comparable periods in fiscal 2008.

We enter into foreign currency forward exchange contracts to manage foreign currency exposures related to certain non-functional currency transaction related inter-company and other balances. Transaction gains and losses on the contracts and the assets and liabilities are recognized each period in other income (expense), net. The notional amounts and fair values of our outstanding derivative financial instruments were as follows at October 31, 2008 (in thousands):

|                    | <b>Notional<br/>Amount</b> | <b>Fair Value<br/>Loss</b> |
|--------------------|----------------------------|----------------------------|
| Forward Contracts: |                            |                            |
| Purchase           | \$ 52,613                  | \$ (1,991)                 |
| Sell               | \$ 27,448                  | \$ (866)                   |

We do not enter into derivative financial instruments for trading or speculative purposes. The foreign currency exchange rate risk associated with our forward exchange contracts is limited as the exposure is substantially offset by exchange rate changes of the underlying hedged amounts.

As of October 31, 2008, cash and cash equivalents held outside the U.S., which are held primarily in currencies other than the U.S. dollar, totaled approximately \$33.6 million.

**Equity Price Risk**

As of October 31, 2008, there have been no material changes to our equity price risk since the fiscal year ended January 31, 2008. For further information, see Item 7A, Quantitative and Qualitative Disclosures about Market Risk, in our Form 10-K for the fiscal year ended January 31, 2008.

**ITEM 4. CONTROLS AND PROCEDURES**  
**Evaluation of Disclosure Control and Procedures**

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Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of October 31, 2008 to ensure that information we are required to

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disclose in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported, within the time periods specified in Securities and Exchange Commission rules and forms and (ii) is accumulated and communicated to our management including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

As summarized more fully below, from time to time, we may be subject to a variety of claims or lawsuits or be involved in a variety of investigations or proceedings, including claims relating to alleged infringement of patents or other intellectual property rights, contractual disputes, employee claims and other claims that arise in the ordinary course of our business. Wind River believes that the outcome of its outstanding legal proceedings, claims and litigation will not have a material adverse effect on its business, results of operations, cash flows or financial condition. However, such matters involve complex questions of fact and law and could involve significant costs and the diversion of resources to defend. Additionally, the results of litigation are inherently uncertain, and an adverse outcome is at least reasonably possible.

*RED.Com, Inc. Litigation*

On November 14, 2008, RED.Com, Inc. (doing business as RED Digital Camera) ( RED ) filed a complaint against the Company in the Superior Court of the State of California, Santa Clara County. The complaint asserts causes of action against the Company for fraud in the inducement, breach of contract and negligent representation in connection with a services agreement entered into between the Company and RED in January 2006, pursuant to which the Company performed certain design services related to RED s RED ONE digital cinema camera. RED s complaint seeks compensatory damages in an amount to be proven at trial, as well as punitive damages and attorneys fees and costs. The Company believes that RED s complaint is without merit and intends to defend itself vigorously.

*Derivative Litigation*

Between September 8, 2006 and November 15, 2006, three separate stockholder derivative complaints were filed in the Superior Court of the State of California, Alameda County, against various officers and directors of the Company and naming the Company as a nominal defendant. On December 20, 2006, the Court consolidated these actions and appointed co-lead counsel. On February 21, 2007, co-lead counsel filed a consolidated and amended complaint (Case Number RG06288009) that asserts causes of action for accounting; breach of fiduciary duty; restitution/unjust enrichment; rescission; and violation of California Corporations Code § 25402. On February 9, 2007, a fourth, substantially identical purported shareholder derivative complaint entitled *Castronovo v. Berger, et al.* (Case Number RG07310636) was filed in the Superior Court of the State of California, Alameda County. The Company filed demurrers to the complaints in the consolidated actions and the complaint in the *Castronovo* action. On July 17, 2007, subsequent to the filing of those demurrers, the Court approved a stipulation of the parties consolidating the *Castronovo* action with the three previously filed actions, thereby obviating any ruling on the Company s demurrer to the complaint in the *Castronovo* action.

On April 2, 2008, the parties executed a Stipulation of Settlement incorporating the terms of a settlement. The settlement involved certain corporate governance changes and a payment of \$750,000 by the Company to plaintiffs counsel for attorneys fees and expenses. On August 1, 2008, the Court entered an order approving the settlement, awarding \$750,000 to plaintiffs counsel for their attorneys fees and expenses and dismissing the litigation with prejudice. There were no objections to the settlement and the deadline for any appeal of the settlement has expired. The Company accrued the \$750,000 fee award during fiscal year 2008 and the award was paid during the third quarter of fiscal year 2009.

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**ITEM 1A. RISK FACTORS**

**Factors That May Affect Our Future Results or the Market Price of Our Stock**

*Our business faces significant risks. The risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations or have a negative impact on our stock price. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.*

**If we do not continue to address new and rapidly changing markets and increasingly complex technologies successfully, to deliver our products on a timely basis, and to offer products that are attractive to our customers, our revenues and operating results will decline.**

The Device Software Optimization market is characterized by ongoing technological developments, evolving industry standards and rapid changes in customer requirements and product offerings in the device market. In addition, customers developing different types of devices require different product offerings, features and functionality. If we fail to continually update our existing products to keep them current with customer needs or to develop new or enhanced products to take advantage of new technologies, emerging standards and expanding customer requirements, our existing products could become obsolete and our financial performance would suffer. Also, we have from time to time experienced delays in the commercial release of new technologies, new products and enhancements of existing products. These delays are commonplace in the software industry due to the complexity and unpredictability of the development work required. If we fail to commercially release new products on a regular and timely basis, our financial performance could suffer. We must effectively market and sell new product offerings to key customers, because once a customer has designed a product with a particular operating system, that customer typically is reluctant to change its supplier due to the significant related costs. If we cannot adapt or respond in a cost-effective and timely manner to new technologies and new customer requirements, or if the new products we develop are not attractive to our customers, sales of our products could decline.

**If we do not select the right areas for investment or the right vertical markets in which to concentrate our sales and marketing efforts or if we are not successful in implementing or developing new business initiatives or if new business initiatives adversely affect our other businesses, our financial performance could suffer.**

We regularly evaluate new products, technologies, business models and strategic business initiatives. For example, in response to growing customer interest in open-source software solutions, we began offering open-source products and services in 2005 and our open-source business has become an increasingly important part of our business. In addition, at the beginning of fiscal year 2009, we adopted a strategic plan to focus increased engineering, sales and marketing resources in certain targeted growth product areas, including Linux platforms, device management solutions, Multiple Independent Levels of Security (MILS), aerospace and defense security solutions and multiprocessing capabilities. Investments in new business areas or strategic business initiatives can be expensive and time consuming and can divert management attention and internal resources away from other business opportunities. If we do not select the right areas for investment or if we are not successful in implementing or developing new business initiatives or if new business initiatives adversely affect our other businesses, our financial performance could suffer.

In addition, we regularly target certain vertical markets in which we concentrate increased sales and marketing efforts. We are now concentrating increased sales and marketing efforts in certain targeted growth vertical markets, including aerospace and defense (especially MILS), network equipment, mobile handsets, industrial, automotive infotainment, mobile Internet devices, and digital living. Many of these markets have experienced and may continue to experience rapid technological changes and industry consolidations and other disruptions. If we do not select the right vertical markets in which to concentrate our sales and marketing efforts or if these markets change or fail to grow as we anticipate or if we are not successful in licensing our products to customers in these targeted markets, our financial performance could suffer.

**General economic weakness and geopolitical factors may harm our operating results and financial condition.**

Our results of operations are dependent to a large extent upon the state of the global economy. General economic weakness or weaker economic conditions in the United States, Europe or the Asia-Pacific region could adversely impact our customers and our results of operations and financial condition. Challenging economic conditions may decrease our customers' demand for our products and services or impair the ability of our customers to pay for products and services they have purchased. As a result, our revenues could decrease and reserves for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by unusual events that have affected global financial markets. If the global credit market continues to deteriorate, our investment portfolio may be further impacted and



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our investments may experience other-than-temporary declines in fair value, requiring an additional impairment charge that could adversely impact our financial results. See Note 3, **Financial Instruments** to the unaudited financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information regarding the impairment of our investment in the Reserve Funds.

In addition, geopolitical factors such as terrorist activities, armed conflict or global health conditions that adversely affect the global economy may adversely affect our operating results and financial condition.

### **Our adoption of a reorganization plan may cause disruptions in our business and operations and will result in restructuring and other charges.**

In fiscal year 2008, our organization was structured along functional lines. At the beginning of our fiscal year 2009, we adopted a reorganization plan to better align our resources with our strategic business objectives. As part of this reorganization plan, we reorganized our operations into four product divisions: VxWorks, Linux, Tools and Common Technologies and Device Management. This management reorganization may divert the attention of management from business and operational issues and may affect product development or marketing plans or schedules. If we did not choose the correct strategy for our reorganization, or if we are unable to execute effectively on the new strategy and organizational structure, we may not be able to meet the needs of our customers and partners for products and services. We must effectively manage the implementation of our new organizational structure to avoid any resulting confusion or conflict that might affect our ability to respond to our customers and partners in a nimble and agile manner, which could negatively impact our business, results of operations and financial condition.

As part of this reorganization plan, we eliminated approximately 82 positions during the first and second quarters of fiscal year 2009. We have incurred restructuring and other charges of \$2.9 million in connection with this reorganization plan, related primarily to cash severance costs.

### **If we fail to grow our open-source business, our revenues and operating results could decline or could fail to grow. As our Linux products compete with open-source software that is available publicly at little or no cost, there can be no assurance that our customers will determine that our open-source products offer a compelling value proposition or that we will be successful in licensing our Linux products on profitable terms.**

We have been offering Linux platforms since 2005. Our Linux platform business has become an increasingly important part of our business as Linux has been increasingly adopted by device manufacturers for more device applications and as growth in our proprietary VxWorks business has slowed. We anticipate that our Linux business will be the fastest-growing part of our business in the near future. If we fail to grow our Linux business, our revenues and operating results could decline or could fail to grow as much as we anticipate.

We cannot be certain whether any of our current or future open-source product offerings will be successfully adopted by new or current customers. In addition, even if our open-source products are adopted by our customers, they may not be profitable. Our open-source products compete with, among other things, open-source software that is otherwise publicly available for little or no cost. There can be no assurance that our customers will determine that our open-source products offer a compelling value proposition or that we will be successful in licensing our products on profitable terms. Very few open-source software companies have been profitable. To date, our open-source-based business has not been profitable, and we may not be able to generate profits in this business in the future.

As part of our open-source strategy, we are investing in and promoting the efforts of various industry consortia and standard setting organizations, and expect that industry consolidation in support of these specific standards and software will position us well to benefit from market convergence on the standards and software that we support. However, there can be no assurance that the consortia or standards organizations in which we choose to participate will be adopted by the marketplace, and if they are not we may have diverted our resources away from alternative strategies and product development that may instead become the marketplace leaders. Our strategy also anticipates that we will work closely with hardware and software partners to increase the adoption of our Linux-based products, and that we may also benefit from the development or distribution efforts these partners may provide related to our open-source products. If we are not able to successfully motivate our partners to support our open-source product development and distribution efforts, our products and services may not be adopted downstream by shared customers.

While we attempt to grow our open-source-based business, we simultaneously continue to offer our proprietary software products to the marketplace. It is possible that our efforts to grow our open-source business could result in a decline in sales of our proprietary software either as a result of a diversion of internal resources or customer preference. If such sales declines were to occur, our revenues and earnings could be adversely affected.





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**Our open-source products may subject us to increased legal risks.**

As our products that are distributed with open-source software components are increasingly adopted (and as we expand our portfolio of products both through internal development and acquisition of technology, such as that acquired from Interpeak and FSMLabs), we may face increased legal risks that could affect our future ability to develop or sell our open-source products.

The language of the open-source licenses that govern software we distribute with our products is at times ambiguous, which creates vulnerability to third-party allegations of non-compliance with terms of applicable open-source licenses. For instance, we distribute open-source software with (and in some cases incorporate open-source software into) our products, including certain open-source software components subject to the GPL. Distributing or combining open-source software with or into our products creates some risk that the GPL (or other applicable open-source software license) will be interpreted in a manner that could impose unanticipated conditions or restrictions on our products, including a requirement to disclose our own products in source code form. We take steps to ensure that proprietary software that we do not wish to disclose in source code form is not distributed or combined with open-source software in ways that would require such proprietary software to be made subject to an open-source software license. However, few courts have interpreted open-source software licenses, and the manner in which these licenses may be interpreted and enforced remains uncertain. With the growth in our professional services and engineering efforts related to open-source software, we may become increasingly vulnerable to third-party allegations that our own development efforts or technology have resulted in infringing work or work that has unintentionally become subject to open-source obligations. As we grow and develop our open-source strategy and business, we may also become subject to challenges that other aspects of our business model or strategy do not comply with applicable open-source licenses. Even if no legal pronouncement is made, if the informal developer communities comprising the open-source software movement adopt a negative position toward our business or development efforts, they may cease their support of our company and this disruption in our relationship with the open-source software community could adversely affect our ability to effectively market and sell open-source products.

Our open-source strategy may also make us increasingly vulnerable to claims that our products infringe third-party intellectual property rights, as many of the open-source software components we may distribute with our products are developed by numerous independent parties over whom we exercise no supervision or control and who therefore may have engaged in infringing acts while developing the open-source software without our knowledge. This risk is further exacerbated by our lack of access to unpublished software patent applications. Defending claims of infringement, even claims without significant merit, can be expensive. An adverse legal decision affecting our intellectual property could materially harm our business.

In addition, it is possible that a court could hold the GPL to be unenforceable through a legal challenge, or that someone could assert a claim for proprietary rights in a program developed and distributed under them. If an open-source license that applies to the licensing of components of our open-source products is found to be partially or completely unenforceable, or if there are claims of infringement, we could be required to obtain licenses from third parties in order to continue offering our products, reengineer our products, or discontinue the sale of our products in the event reengineering could not be accomplished on a timely basis. An adverse legal decision affecting our intellectual property or the terms upon which we license our products could materially harm our business.

Uncertainty regarding the legal risks related to open-source software components could affect sales of our open-source products generally. Some of our potential customers may be reluctant to incorporate open-source software into their own products if they perceive significant risks that their own software systems could become subject to GPL licensing terms.

Also, as a vendor of software intended to be embedded into Linux-based devices, we may be subject to claims based on actions by our customers or device end users in their use of open-source code received from us. For instance, if our customers develop and distribute software received from us in a manner that violates GPL licensing terms or infringes third party intellectual property rights, we may be subject to legal claims under such theories as contributory infringement, inducing infringement or vicarious liability.

Finally, as a result of legal concerns about open-source software, we are facing increased pressure from our customers to adopt additional indemnification or otherwise protect them from potential threats by third parties related to open-source software. We have in the past agreed to indemnify certain of our customers against certain potential liabilities associated with our open-source products and we may decide to revise or expand our indemnification policies and practices in the future to address customer requirements. Our financial condition and results of operations may be adversely affected if we have to indemnify our customers for the liabilities posed by open-source software.

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**Our mix of licensing models and professional services revenues impacts the timing of our reported revenues, and our inability to accurately manage the volume of business expected for each licensing model and the relative mix of professional services revenues could increase fluctuations in our revenue and financial results.**

Because we license our development products under business models that recognize revenue differently, the rate of adoption of license models by our customers impacts the timing of our reported revenues. Under our subscription license model, revenues are recognized ratably over the subscription period. By contrast, our perpetual and term license models require a majority of license revenues to be recognized in the quarter in which the products are delivered and a smaller amount relating to the fair value of the maintenance is deferred and recognized subsequently over the maintenance period. An order for a subscription-based license will result in lower current-quarter revenue than an equal-sized order for a perpetual license. As a result, our reported revenues are affected by the selection of license model type by our customers. In addition, our ability to recognize revenues can be deferred when a transaction includes multiple elements. There is a risk that we will not be able to continue or increase our rate of adoption of our subscription-based, perpetual-based or term-based license models, or that we may choose to focus our sales efforts and resources on particular, significant perpetual, term or subscription license opportunities that may or may not result in a sale. The impact on revenues and deferred revenues will continue to depend on the rate at which customers license products under our perpetual, term or subscription license models or under multiple element arrangements. If we are unable to manage the rate of adoption of our license models by our customers at any time, our business, results of operations and financial condition would be negatively affected.

In addition, although our subscription licenses represent a potential source of renewable license revenue, there is also a risk that new and transitioned customers will not renew their licenses at the end of the subscription term. There is a further risk that the more complex and time consuming negotiations required for subscription licenses may affect our ability to close such transactions, and that customers who purchase subscription licenses may spend less in the aggregate over the term of the subscription license than if they had been required to purchase perpetual licenses. The impact on revenues and deferred revenues will continue to depend on the rate at which customers license products under our perpetual, term or subscription license models. In addition, an increase in the number of subscription license renewals or multi-year terms may result in larger deferred revenues. To the extent that the subscription licensing rate is higher than we expect, we may experience a larger decline in revenues, as well as an increase in deferred revenues.

Our revenues for any period and our deferred revenues at the end of any period can also be affected by the extent to which customers retain us to provide professional services rather than licensing our software solutions. We have noticed an increasing number of services-led engagements with our customers and our professional services are becoming an increasingly important enabler to sales of our products. We have experienced increased demand for our professional services as market and industry conditions change rapidly. We believe that more customers are opting to retain us to provide professional services to them in order to develop and/or prove a concept in advance of licensing our software solutions from us. Revenues from service engagements are generally recognized when the contracted services are performed and contracted future revenue from services engagements is included in deferred revenue and/or services backlog. Services backlog is not recorded on our consolidated balance sheets. In addition, the relative size of our services revenues as compared to our other revenues can affect our operating margins and earnings as we typically realize smaller operating margins on earnings generated from services engagements than earnings derived from licenses of our software solutions.

**Because a significant portion of our revenues continues to be derived from production licenses, we are dependent upon the ability of our customers to develop and penetrate new markets successfully.**

Our production license revenues depend both upon our ability to successfully negotiate production license agreements with our customers and, in turn, upon our customers' successful commercialization of their underlying products. As our open-source business grows, we may not be able to rely on receiving per unit fees from our customers. For our open-source business, we may instead need to rely on other fees to compensate for the production license fees that we have traditionally received for our proprietary products. Also, we derive significant revenues from customers that develop products in highly competitive and technologically complex markets such as the Internet infrastructure, server and storage, digital consumer, aerospace and defense, industrial control and automotive markets. If these customers sell fewer products or otherwise face significant economic difficulties, our revenues will decline. We cannot control our customers' product development or commercialization or predict their success. In addition, we depend upon our customers to accurately report the use of their products in order for us to collect our revenues from production licenses. If our customers are not successful with their products or do not accurately report use of their products to us, our production license revenues may decline significantly.

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**Numerous factors may cause our total revenues and net income to fluctuate significantly from period to period. These fluctuations increase the difficulty of financial planning and forecasting and may result in decreases in our available cash and declines in the market price of our stock.**

A number of factors, many of which are outside our control, may cause or contribute to significant fluctuations in our total revenues and net income. These fluctuations make financial planning and forecasting more difficult. In addition, these fluctuations may result in unanticipated decreases in our available cash, which could negatively impact our operations. As discussed more fully below, these fluctuations also could increase the volatility of our stock price. Factors that may cause or contribute to fluctuations in our revenues and net income include:

acceptance by our customers of our current and new product offerings;

the number and timing of orders we receive, including disproportionately higher receipt and shipment of orders in the last month of the quarter;

changes in the length of our products' sales cycles, which increase as our customers' purchase decisions become more strategic and are made at higher management levels;

reductions in the number of engineering projects started by our customers due to their own difficult financial or economic conditions;

the impact of impairment charges arising from past acquisitions;

the success of our customers' products from which we derive our production license revenues;

the mix of our revenues as between sales of products that have more upfront revenue, subscriptions that have more deferred revenues and services which have lower profit margins;

our ability to control our operating expenses, and fully realize the impact of the restructuring plans we have implemented;

our ability to continue to develop, introduce and ship competitive new products and product enhancements quickly;

possible deferrals of orders by customers in anticipation of new product introductions;

announcements, product introductions and price reductions by our competitors;

our ability to manage costs for fixed-price consulting agreements;

seasonal product purchases by our customers, which historically have been higher in our fourth fiscal quarter;

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the impact of, and our ability to react to, natural disasters and/or events of terrorism;

the impact of, and our ability to react to, business disruptions arising from or relating to internet service interruptions or computer viruses;

changes in business cycles that affect the markets in which we sell our products and services;

economic, political and other conditions in the United States and internationally;

foreign currency exchange rates;

the impact of changes to existing accounting pronouncements; and

the impact of any stock-based compensation charges arising from the issuance of stock options, restricted stock, stock appreciation rights or any other stock-based awards.

One or more of the foregoing factors may cause our operating expenses to be disproportionately high or may cause our net revenues and net income to fluctuate significantly. Results from prior periods are thus not necessarily indicative of the results of future periods.

**We face intense competition in the Device Software Optimization industry, which could decrease demand for our products or cause us to reduce our prices.**

The Device Software Optimization industry is characterized by rapid change, new and complex technology and intense competition. Our ability to maintain our current market share depends upon our ability to satisfy customer requirements, enhance existing products and develop and introduce new products. Due to the complexity of the markets in which we operate, where our customers often develop device systems in-house, it is difficult to assess the impact of competition on our business and our related share of these markets. We have faced increasing competition in recent years as customers have decreased research and development budgets, sought to increase the value they receive from vendors, including us, attempted to leverage a more competitive bidding process when spending research and development budgets and/or deferred or canceled projects, in whole or in part. As a result, we believe that some customers have elected not to purchase our products and have chosen to undertake such development in-house, selected solutions they perceive to be less expensive or relied upon existing licenses from us rather than making new purchases. We expect the intensity of competition to increase in the future. Increased competitiveness may result in reductions in the prices of our products, royalties and services, lower-than-expected gross margins or loss of market share, any of which would harm our business.

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Our primary competition comes from internal research and development departments of companies that develop device systems in-house. In many cases, companies that develop device systems in-house have already made significant investments of time and effort in developing their own internal systems, making acceptance of our products as a replacement more difficult. Additionally, many of these in-house departments may increasingly choose to use open-source software, such as the Linux operating system. We also compete with independent software vendors and, to a limited extent, with open-source software vendors. Some of the companies that develop device systems in-house and some of these independent software vendors, such as Microsoft Corporation, have significantly greater financial, technical, marketing, sales and other resources and significantly greater name recognition than we do.

Demands for rapid change and the increasing complexity of the technology in our industry intensify the competition we face. In addition, our competitors may consolidate or establish strategic alliances to expand product offerings and resources or address new market segments. As a result, they may be able to respond more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the development, promotion, sale and support of their products. These factors favor larger competitors that have the resources to develop new technologies or to respond more quickly with new product offerings or product enhancements. We may be unable to meet the pace of rapid development set by our competitors or may incur additional costs attempting to do so, which may cause declines in our operating results. Our competitors may foresee the course of market developments more accurately than we do and could in the future develop new technologies that compete with our products or even render our products obsolete, any of which could adversely affect our competitive position and therefore our operating results.

### **Our significant international business activities subject us to increased costs and other risks.**

We develop and sell a substantial percentage of our products internationally. For the three and nine months ended October 31, 2008, revenues from international sales were \$39.7 million, or 43% of total revenues, and \$132.5 million, or 49% of total revenues, respectively, as compared to \$38.4 million, or 47% of total revenues, and \$109.1 million, or 45% of total revenues for the three and nine months ended October 31, 2007, respectively. Additionally, we have investments in, or have made acquisitions of, companies located outside the United States. Over the long term, we expect to continue to make investments to further support and expand our international operations and increase our direct sales force and distribution network in EMEA, Japan and Asia Pacific. In particular, we intend to increase significantly our engineering and professional services resources in China, Korea, Romania and Canada. Risks inherent in international operations include:

the imposition of governmental controls and regulatory requirements;

the costs and risks of localizing products for foreign countries;

differences in business cultures and sales cycles;

differences in operation and sales support expenses;

unexpected changes in tariffs, import and export restrictions and other barriers and restrictions;

greater difficulty in accounts receivable collection;

other increased costs of doing business;

restrictions on repatriation of earnings;

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exposure to adverse movements in foreign currency exchange rates;

the costs and difficulties associated with complying with a variety of foreign laws and domestic laws applicable to foreign operations, including the U.S. Foreign Corrupt Practices Act;

difficulties in staffing and managing foreign subsidiaries and branch operations;

increased risks of intellectual property infringement and less stringent intellectual property protection laws;

the costs and risks of operating in countries experiencing geopolitical conflict and/or terrorism;

the effect of our adoption of global pricing models;

difficulties in integrating products and operations from foreign acquisitions;

the impact of local health and political crises that prohibit or severely limit travel or other interaction with a local economic market;

exposure to local economic slowdowns; and

the need to guarantee credit instruments extended to support foreign operations.

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Any of these events, regionally and as a whole, could reduce our international sales and increase our costs of doing business internationally and have a material adverse effect on our gross profit and net operating results.

**Patent, trademark or copyright infringement, trade secret misappropriation, product liability or professional liability claims against us may result in costly litigation, cause product shipment delays or require us to expend significant resources. In addition, patent or copyright claims may require us to enter into royalty or licensing arrangements.**

We occasionally receive communications from third parties alleging patent, trademark or copyright infringement, trade secret misappropriation or other intellectual property claims, and there is always the chance that third parties may assert infringement claims against us or against our customers under circumstances that might require us to provide indemnification. Growth of our open-source business increases this risk in part because many of the open-source software components that we may incorporate into or distribute with our products are developed by numerous independent parties over whom we exercise no supervision or control. Additionally, because our products are increasingly used in applications, such as network infrastructure, transportation, medical and mission-critical business systems, in which the failure of the device system could cause property damage, personal injury or economic loss, we may face product liability or professional liability claims. For example, we are defendants in a suit filed by RED.Com, Inc. ( RED ) relating to certain design services that we provided to RED. For additional information regarding this lawsuit, see Part II, ITEM 1, Legal Proceedings.

Although our agreements with our customers contain provisions intended to limit our exposure to infringement and liability claims, our agreements may not be effective in limiting our exposure in all circumstances. Any of these types of claims, with or without merit, could result in claims for indemnification by us or costly litigation, could require us to expend significant resources to develop non-infringing technology or remedy product defects, cause product shipment delays or require us to pay significant damages if the claims are successful. In the case of infringement of another party's intellectual property, we may be required to enter into royalty or licensing agreements; however, we cannot be certain that the necessary licenses will be available or that they can be obtained on commercially reasonable terms. If we are not successful in defending these claims or, with respect to infringement claims, were to fail to obtain royalty or licensing agreements in a timely manner and on reasonable terms, our business, financial condition and results of operations would be materially adversely affected.

**The rights upon which we rely to protect the intellectual property underlying our products may not be adequate, which could enable third parties to use our technology without our permission and reduce our ability to compete.**

Our success depends significantly upon the proprietary technology contained in our products. We currently rely on a combination of patents, copyrights, trademarks, trade secret laws, and contractual provisions to establish and protect our intellectual property rights in our technology and products. We cannot be certain that the steps that we take to protect our intellectual property will adequately protect our rights, that others will not independently develop or otherwise acquire equivalent or superior technology, or that we can maintain our technology as trade secrets. In addition, discovery and investigation of unauthorized use of our intellectual property is difficult. We expect software piracy, which is difficult to detect, to be a persistent problem, particularly in those foreign countries where the laws may not protect our intellectual property as fully as in the United States. The risks that we face may increase as we conduct more research and development activities in China, Korea, Romania, Israel and other foreign countries. Employees, consultants, and others who participate in the development of our products may breach their agreements with us regarding our intellectual property. We might not have adequate remedies for infringement or breach of our proprietary rights by third parties, employees or consultants. Further, we have in the past initiated, and in the future may initiate claims or litigation against third parties for infringement or breach of our proprietary rights or to establish the validity of our proprietary rights. Whether or not such litigation is determined in our favor, such actions could result in significant expenses to us, divert the efforts of our technical and management personnel from productive tasks or cause product shipment delays.

**The costs associated with acquisitions and investments could disrupt our business and harm our operating results.**

We anticipate that, as part of our business strategy, we will continue to evaluate acquisition and investment opportunities in businesses, products and technologies that complement ours. For example, in October 2008, we completed the acquisition of 99% of the outstanding shares of MIZI Research, Inc., a Korean company. These investments and acquisitions can be expensive and often require us to dedicate significant time and resources to the process. We have incurred significant costs in connection with acquisition transactions in prior fiscal years and may incur significant costs in connection with future transactions, whether or not they are consummated. Acquisitions involve additional risks including, among others, difficulties in integrating the operations, technologies, and products of the acquired companies; diverting management's attention from normal daily operations of the business; and potential difficulties in completing projects associated with in-process research and development. If we cannot successfully manage the integration of businesses we may acquire or are unable to realize the benefits of, or anticipated revenues from, our acquisitions, our business, financial condition and operating results could suffer.





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If revenues associated with acquired businesses do not meet our original expectations, acquisitions may result in charges relating to impairment of acquired goodwill and purchased intangibles.

### **If our strategic relationships are not successful, our product offerings, distribution and/or revenues may be adversely impacted.**

We have many strategic relationships with semiconductor companies, circuit board manufacturers, system manufacturers, other software companies, customers and others. In addition, we are playing an increasingly active and important role in open-source development projects and industry consortia. These strategic relationships and industry consortia are complex. Some of the companies that are our strategic partners in certain business areas or industry consortia are also our competitors in some business areas. Our strategic partners may also have concurrent relationships with other companies that provide open-source, proprietary or in-house solutions, which may put pressure on our product development roadmaps, timelines and prices. If we are not successful in developing and maintaining these strategic relationships, our business may be harmed. If our collaborative marketing and distribution agreements terminate or expire, the scope of our product offerings may be restricted, and the distribution of our products and our revenues may be adversely impacted.

### **The costs of software development can be high, and we may not realize revenues from our development efforts for a substantial period of time.**

Introducing new products that rapidly address changing market demands requires a continued high level of investment in research and development. If we are required to undertake extensive capital outlays to address changes in the device software optimization market, we may be unable to realize revenue as soon as we may expect. The costs associated with software development are increasing, including the costs of acquiring or licensing new technologies. Our investment in new and existing market opportunities prior to our ability to generate revenue from these new opportunities, if we are able to capitalize on these opportunities at all, may adversely affect our operating results.

### **Because certain of our customers provide products and services to U.S. Government agencies, as their supplier we may be subject to unique risks that could increase our costs and make revenue related to these customers more difficult to predict.**

As a subcontractor to the U.S. Government, we must comply with and are affected by certain laws and regulations related to the award, administration and performance of U.S. Government contracts and other regulations particularly related to the aerospace and defense industry, such as export control regulations including International Traffic in Arms Regulations. In addition, under applicable regulations, various audit agencies of the U.S. government conduct regular audits of contractors' compliance with a variety of U.S. government regulations and have the right to review retroactively the financial records under most U.S. government contracts. Further, as a U.S. Government subcontractor, we are subject to an increased risk of investigation, criminal prosecution, civil fraud, whistleblower lawsuits and other legal actions and liabilities to which purely private sector companies are not. This increases our internal procedures and costs, and as well, we may face an increased risk of non-compliance as these requirements involve separate processes that are outside our standard, commercial practices.

In addition, our contracts with customers providing products and services to the U.S. government are subject to uncertainty since their governmental contracts are subject to U.S. government appropriations that are changeable and determined on an annual basis. Also, the U.S. government has the right to modify, curtail or terminate customer contracts, which would result in corresponding changes to our contracts with our customers. Some of our contracts are subject to contract accounting, which requires judgment relative to assessing risk, estimating contract revenues and costs and making assumptions regarding scheduling and technical issues. Because of these risks, it is difficult to predict anticipated future revenues attributable to government related subcontracts. If we do not effectively manage these risks, our operating results could be materially negatively impacted.

### **If we lose key personnel or are unable to hire additional qualified personnel, our business may be harmed.**

Our success depends to a significant degree upon the continued contributions of key management, engineering, sales and other personnel, many of whom would be difficult to replace. We believe our future success will also depend, in large part, upon our ability to attract and retain highly skilled managerial, engineering, sales and other personnel, and upon the ability of management to operate effectively, both individually and as a group, in geographically disparate locations. In addition, our past reductions in force could potentially make attracting and retaining qualified employees more difficult in the future. The loss of the services of any of our key employees, the inability to attract or retain qualified personnel in the future, or delays in hiring required personnel, particularly engineers and sales personnel, could delay the development and introduction of, and negatively affect our ability to sell our products.

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In addition, companies in the software industry whose employees accept positions with competitors may claim that their competitors have engaged in unfair hiring practices or that there will be inappropriate disclosure of confidential or proprietary information. We may be subject to such claims in the future as we seek to hire additional qualified personnel. Such claims could result in material litigation. As a result, we could incur substantial costs in defending against these claims, regardless of their merits, and be subject to additional restrictions if any such litigation is not resolved in our favor.

### **Changes to existing accounting pronouncements or taxation rules or practices may cause adverse revenue fluctuations and affect our results of operations or how we conduct our business.**

A change in any accounting pronouncements or taxation rules or practices can have a significant effect on our results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements or taxation rules and varying interpretations of accounting pronouncements or taxation practice have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

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

Although we use standardized agreements designed to meet current revenue recognition criteria under generally accepted accounting principles, we must often negotiate and revise terms and conditions of these standardized agreements, particularly in multi-element license and services transactions. As our transactions have increased in complexity, particularly with the sale of larger, multi-element transactions, negotiation of mutually acceptable terms and conditions may require us to defer recognition of revenue on such licenses. We believe that we are in compliance with Statement of Position 97-2, *Software Revenue Recognition*, as amended; however, more complex, multi-element transactions require additional accounting analysis to account for them accurately. Errors in such analysis in any period could lead to unanticipated changes in our revenue accounting practices and may affect the timing of revenue recognition, which could adversely affect our financial results for any given period. If we discover that we have interpreted and applied revenue recognition rules differently than prescribed by generally accepted accounting principles in the U.S., we could be required to devote significant management resources, and incur the expense associated with an audit, restatement or other examination of our financial statements.

### **Business interruptions could adversely affect our business.**

Our operations and the operations of our vendors and customers are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure and other events beyond our control. For example, a substantial portion of our facilities, including our corporate headquarters, is located near major earthquake faults. In the event of a major earthquake, we could experience business interruptions, destruction of facilities and loss of life. We do not carry earthquake insurance and we have not set aside funds or reserves to cover such potential earthquake-related losses. In the event that a material business interruption occurs that affects us or our vendors or customers, shipments could be delayed and our business and financial results could be harmed.

### **Our common stock price is subject to volatility.**

In recent years, the stock markets in general and the shares of technology companies in particular have experienced extreme price fluctuations. These recent price fluctuations are not necessarily proportionate to the operating performance of the companies affected. Our stock price has similarly experienced significant volatility. As reported on The NASDAQ Global Select Market, during the three months ended October 31, 2008, our stock had an intra-day high sales price of \$12.99 and an intra-day low sales price of \$7.01. During fiscal year 2008, our stock had an intra-day high sales price of \$13.42 and an intra-day low sales price of \$7.88. In some of our past fiscal quarters, we experienced shortfalls in revenue and earnings from levels expected by securities analysts and investors, which have had an immediate and significant adverse effect on the trading price of our common stock. These factors relating to the fluctuations in our revenues and net income may continue to affect our stock price. Comments by, or changes in estimates from, securities analysts as well as significant developments involving our competitors or our industry could also affect our stock price. In addition, the market price of our common stock is affected by the stock performance of other technology companies generally, as well as companies in our industry and our customers in particular. Other broad market and industry factors may negatively affect our operating results or cause our stock price to decline, as may general political or economic conditions in the United States and globally, such as recessions, or interest rate or currency fluctuations. In particular, the stock market may be adversely impacted, or experience unusual volatility, as a result of the outbreak of armed conflict or hostilities involving the United States or incidences of terrorism in, or directed at, the United States or its allies.



**Table of Contents****Provisions in our charter documents, customer agreements, and Delaware law could prevent or delay a change in control of Wind River, which could hinder stockholders' ability to receive a premium for our stock.**

Provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a merger or consolidation that a stockholder may consider favorable. These provisions include:

authorizing the issuance of preferred stock without stockholder approval;

limiting the persons who may call special meetings of stockholders;

prohibiting stockholder actions by written consent; and

requiring super-majority voting to effect amendments to certain provisions of Wind River's certificate of incorporation and bylaws. Certain provisions of Delaware law also may discourage, delay, or prevent someone from acquiring or merging with us, and our agreements with certain of our customers require that we give prior notice of a change of control. Our various anti-takeover provisions could prevent or delay a change in control of the Company, which could hinder stockholders' ability to receive a premium for our stock.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS*****Issuer Purchases of Equity Securities***

The following table provides information about purchases Wind River made of shares of its common stock during the three months ended October 31, 2008:

| <b>Period</b>                                | <b>Total Number of Shares Repurchased (1)</b> | <b>Average Price Paid per Share (2)</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Program (3)</b> | <b>Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs</b> |
|--|---|---|---|---|
| August 1 - August 31, 2008                   |   | \$                                      |   | \$ 65,000,010   |
| September 1 - September 30, 2008             | 1,301,776                                     | \$ 9.90                                 | 1,301,776   | \$ 52,106,642   |
| October 1 - October 31, 2008                 | 713,861                                       | \$ 9.96                                 | 713,861   | \$ 45,000,072   |
| Total for the quarter ended October 31, 2008 | 2,015,637                                     | \$ 9.92                                 | 2,015,637   |   |

(1) Excludes 4,255 shares delivered by employees to satisfy tax withholding obligations upon the vesting of restricted stock units.

(2) Amounts are exclusive of broker commissions.

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- (3) In April 2008, Wind River's Board of Directors approved a new stock repurchase program that authorized the Company to repurchase up to \$50.0 million of outstanding common stock. In June 2008, Wind River's Board of Directors approved an additional stock repurchase program that authorized us to repurchase up to an additional \$50.0 million of outstanding common stock. As of October 31, 2008, approximately \$45.0 million was available for repurchases under these programs.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

### **ITEM 5. OTHER INFORMATION**

Not applicable.

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**ITEM 6. EXHIBITS**

- 3.1 Amended and Restated Certificate of Incorporation of Wind River Systems, Inc. (incorporated by reference to Exhibit 3.1(a)-(d) of the registrant's Report on Form 10-Q filed on December 15, 2000).
- 3.2 Certificate of Designation of Series A Junior Participating Preferred Stock (incorporated by reference to Exhibit 4.1 of the registrant's Report on Form 8-K filed November 4, 1999).
- 3.3 Amended and Restated Bylaws of Wind River Systems, Inc. (incorporated by reference to Exhibit 3.3 of the registrant's Report on Form 10-K filed on May 1, 2007).
- 4.1 Amended and Restated Stockholder Rights Plan dated as of September 29, 2007 between Wind River Systems, Inc. and American Stock Transfer and Trust Company, as rights agent, and form of Rights Certificate thereunder (incorporated by reference to Exhibit 4.1 to the registrant's Report on Form 8-K filed on October 3, 2006).
- 10.1 Wind River Systems, Inc. Vice Presidents' Severance Benefit Plan and Summary Plan Description, as amended and restated as of October 14, 2008 (incorporated by reference to Exhibit 10.2 of the registrant's Report on Form 8-K filed October 17, 2008).
- 10.2 Wind River Systems, Inc. Executive Officers' Change of Control Incentive and Severance Benefit Plan and Summary Plan Description, as amended and restated as of October 14, 2008 (incorporated by reference to Exhibit 10.3 of the registrant's Report on Form 8-K filed October 17, 2008).
- 10.3 Wind River Systems, Inc. Section 162(m) Performance Incentive Award Plan, as amended and restated as of October 14, 2008 (incorporated by reference to Exhibit 10.4 of the registrant's Report on Form 8-K filed October 17, 2008).
- 10.4 Amendment to Executive Employment Agreement dated October 16, 2008, by and between Wind River Systems, Inc. and Kenneth Klein (incorporated by reference to Exhibit 10.5 of the registrant's Report on Form 8-K filed October 17, 2008).
- 10.5 Amendment to Offer Letter dated October 16, 2008, between Wind River Systems, Inc. and Ian Halifax (incorporated by reference to Exhibit 10.6 of the registrant's Report on Form 8-K filed October 17, 2008).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURE**

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

**WIND RIVER SYSTEMS, INC.**

Date: December 10, 2008

By: /s/ IAN R. HALIFAX  
Ian R. Halifax

*Senior Vice President of Finance and*

*Administration, Chief Financial Officer and Secretary*

*(Duly Authorized Officer and Principal Financial Officer)*