PDF SOLUTIONS INC
Form 10-Q
November 05, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period ended September 30, 2010

or

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

Commission File Number 000-31311

## PDF SOLUTIONS, INC.
(Exact name of Registrant as Specified in its Charter)

| Delaware<br>(State or Other Jurisdiction of<br>Incorporation or Organization) | 25-1701361<br>(I.R.S. Employer<br>Identification No.) |
|---|---|
| 333 West San Carlos Street, Suite 700<br>San Jose, California<br>(Address of Principal Executive Offices) | 95110<br>(Zip Code) |

(408) 280-7900
(Registrant's Telephone Number, Including Area Code)

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

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

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

or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| £ Large accelerated filer | £ Accelerated filer | £ Non-accelerated filer<br>(Do not check if a smaller reporting company) | R 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 R

The number of shares outstanding of the Registrant’s Common Stock as of October 29, 2010 was 27,550,263.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements.

PDF SOLUTIONS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (In thousands, except par values) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $34,565 | $34,899 |
| Accounts receivable, net of allowance of $254 in 2010 and 2009 | 22,990 | 19,809 |
| Prepaid expenses and other current assets | 3,665 | 3,029 |
| Total current assets | 61,220 | 57,737 |
| Property and equipment, net | 949 | 1,573 |
| Non-current investments | 718 | 718 |
| Intangible assets, net | 1,633 | 2,954 |
| Other non-current assets | 673 | 495 |
| Total assets | $65,193 | $63,477 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | $109 | $115 |
| Accounts payable | 511 | 959 |
| Accrued compensation and related benefits | 3,722 | 4,438 |
| Taxes payable and other accrued liabilities | 2,306 | 3,502 |
| Deferred revenues | 3,188 | 1,584 |
| Billings in excess of recognized revenues | 826 | 1,953 |
| Total current liabilities | 10,662 | 12,551 |
| Long-term debt | 29 | 117 |
| Long-term income taxes payable | 2,948 | 3,218 |
| Other non-current liabilities | 1,436 | 1,704 |
| Total liabilities | 15,075 | 17,590 |
| Stockholders' equity: | | |
| Preferred stock, $0.00015 par value, 5,000 shares authorized: no shares issued and outstanding | — | — |
| Common stock, $0.00015 par value, 70,000 shares authorized: shares issued 31,211 at September 30, 2010 and 30,194 at December 31, 2009; shares outstanding 27,550 at September 30, 2010 and 26,651 at December 31, 2009 | 4 | 4 |
| Additional paid-in-capital | 198,943 | 194,081 |
| Treasury stock at cost, 3,661 shares at September 30, 2010 and 3,543 shares at December 31, 2009 | (19,253 ) | (18,715 ) |
| Accumulated deficit | (130,040 ) | (130,111 ) |
| Accumulated other comprehensive income | 464 | 628 |
| Total stockholders' equity | 50,118 | 45,887 |

| | | |
|---|---|---|
| Total liabilities and stockholders’ equity | $65,193 | $63,477 |

See notes to unaudited condensed consolidated financial statements

PDF SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (In thousands, except per share amounts) | | | |
| Revenues: | | | | |
| Design-to-silicon-yield solutions | $10,498 | $8,439 | $31,729 | $23,525 |
| Gainshare performance incentives | 4,330 | 5,439 | 13,703 | 10,126 |
| Total revenues | 14,828 | 13,878 | 45,432 | 33,651 |
| | | | | |
| Costs of design-to-silicon-yield solutions: | | | | |
| Direct costs of design-to-silicon-yield solutions | 5,790 | 5,270 | 18,040 | 16,423 |
| Amortization of acquired technology | 360 | 360 | 1,079 | 1,079 |
| Total costs of design-to-silicon-yield solutions | 6,150 | 5,630 | 19,119 | 17,502 |
| Gross profit | 8,678 | 8,248 | 26,313 | 16,149 |
| | | | | |
| Operating expenses: | | | | |
| Research and development | 4,291 | 4,689 | 12,588 | 15,547 |
| Selling, general and administrative | 3,228 | 4,321 | 12,299 | 12,842 |
| Amortization of other acquired intangible assets | 70 | 86 | 238 | 260 |
| Restructuring charges | 375 | 1,743 | 343 | 3,578 |
| Total operating expenses | 7,964 | 10,839 | 25,468 | 32,227 |
| | | | | |
| Income (loss) from operations | 714 | (2,591) | 845 | (16,078) |
| Interest and other income (expense), net | (636) | 7 | 30 | 121 |
| Income (loss) before income taxes | 78 | (2,584) | 875 | (15,957) |
| Income tax provision | 28 | 247 | 804 | 833 |
| Net income (loss) | $50 | $(2,831) | $71 | $(16,790) |
| | | | | |
| Net income (loss) per share: | | | | |
| Basic | $0.00 | $(0.11) | $0.00 | $(0.64) |
| Diluted | $0.00 | $(0.11) | $0.00 | $(0.64) |
| | | | | |
| Weighted average common shares: | | | | |
| Basic | 27,413 | 26,499 | 27,154 | 26,306 |
| Diluted | 27,581 | 26,499 | 27,382 | 26,306 |

See notes to unaudited condensed consolidated financial statements

PDF SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (In thousands) | |
| Operating activities: | | |
| Net income (loss) | $71 | $(16,790) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | |
| Depreciation and amortization | 695 | 1,097 |
| Stock-based compensation expenses | 4,029 | 3,545 |
| Amortization of acquired intangible assets | 1,317 | 1,339 |
| Losses on disposal of assets | — | 70 |
| Gain on debt extinguishment | — | (393) |
| Purchases of treasury stock in connection with tax withholdings on restricted stock units | (537) | (133) |
| Deferred taxes | (517) | (165) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net of allowances | (3,181) | 6,733 |
| Prepaid expenses and other assets | (146) | 2,034 |
| Accounts payable | (439) | 47 |
| Accrued compensation and related benefits | (828) | (2,113) |
| Taxes payable and other accrued liabilities | (1,776) | (1,205) |
| Deferred revenues | 1,592 | (251) |
| Billings in excess of recognized revenues | (1,128) | (660) |
| Net cash used in operating activities | (848) | (6,845) |
| Investing activities: | | |
| Maturities and sales of available-for-sale securities | — | 9,054 |
| Purchases of property and equipment | (121) | (294) |
| Net cash provided by (used in) investing activities | (121) | 8,760 |
| Financing activities: | | |
| Proceeds from exercise of stock options | 50 | — |
| Proceeds from Employee Stock Purchase Plan | 783 | 570 |
| Principal payments on long-term obligations | (87) | (234) |
| Net cash provided by financing activities | 746 | 336 |
| Effect of exchange rate changes on cash and cash equivalents | (111) | (761) |
| Net increase (decrease) in cash and cash equivalents | (334) | 1,490 |
| Cash and cash equivalents, beginning of period | 34,899 | 31,686 |
| Cash and cash equivalents, end of period | $34,565 | $33,176 |
| | | |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the period for: | | |
| Income taxes | $1,657 | $1,000 |
| Interest | $7 | $15 |

See notes to unaudited condensed consolidated financial statements

PDF SOLUTIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 1. BASIS OF PRESENTATION

### Basis of Presentation

The interim unaudited condensed consolidated financial statements included herein have been prepared by PDF Solutions, Inc. ("the Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"), including the instructions to the Quarterly Report on Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The interim unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments necessary (consisting only of normal recurring adjustments), to present a fair statement of results for the interim periods presented. The operating results for any interim period are not necessarily indicative of the results that may be expected for other interim periods or the full fiscal year. The accompanying interim unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2009.

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

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

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

Design-to-Silicon-Yield Solutions — Revenues that are derived from Design-to-Silicon-Yield solutions come from services and software licenses. The Company recognizes revenues for each element of Design-to-Silicon-Yield solutions as follows:

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

On occasion, the Company licenses its software products that are not essential to the provision of these services as a component of its fixed-price service contract. In such instances, the software products are licensed to customers over a specified term of the agreement with support and maintenance to be provided over the license term.

In October 2009, the Financial Accounting Standards Board ("FASB") amended the accounting standards for multiple-deliverable revenue arrangements to:

- provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

- require an entity to allocate revenue in an arrangement using best estimated selling prices ("BESP") of deliverables if a vendor does not have vendor-specific objective evidence of selling price ("VSOE") or third-party evidence of selling price ("TPE"); and

- eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

The Company elected to early adopt this accounting standard on April 1, 2010 on a prospective basis for applicable transactions originating or materially modified after January 1, 2010.

This guidance does not generally change the accounting for the Company's software transactions. It only affects certain revenue arrangements that include both solution implementation services and software products that are not essential to the provision of these services. The amount of product and service revenue recognized in a given period is affected by the Company's judgment as to whether an arrangement includes multiple deliverables and, if so, its determination of the fair value of each deliverable. In general, VSOE does not exist for the Company's solution implementation services and software products. Because its services and products include its unique technology, the Company is not able to determine TPE. Therefore, the Company will use BESP in its allocation of arrangement consideration. In determining BESP, the Company applies significant judgment as it weighs a variety of factors, based on the facts and circumstances of the arrangement. The Company typically arrives at an BESP for a product or service that is not sold separately by considering company-specific factors such as geographies, internal costs, gross margin objectives, pricing practices used to establish bundled pricing, and existing portfolio pricing and discounting.

After fair value is established for each deliverable, the total transaction amount is allocated to each deliverable based upon its fair value. Fees allocated to solution implementation services are recognized using the cost-to-cost percentage of completion method of contract accounting. Fees allocated to software and related support and maintenance are recognized under software revenue recognition guidance.

Prior to the adoption of this new accounting standard, under these arrangements, where VSOE existed for the support and maintenance element, the support and maintenance revenue was recognized separately over the term of the supporting period and the remaining fee was recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting. Where VSOE did not exist to allocate a portion of the total fixed-price to the undelivered elements, revenue was recognized for the total fixed-price as the lesser of either the percentage of completion method of contract accounting or ratably over the longer of either the term of the agreement or the support period.

The impact on total revenues with the adoption of this new accounting standard is shown in the following table (in thousands). Due to the nature of the arrangements, the Company is currently unable to determine the impact of the adoption of this new accounting standard on future revenues.

| | Three Months Ended September 30, 2010 | | Nine Months Ended September 30, 2010 | |
|---|---|---|---|---|
| | As Reported | Pro Forma Basis as if the Previous Accounting Guidance were in Effect | As Reported | Pro Forma Basis as if the Previous Accounting Guidance were in Effect |
| Total revenues | $14,828 | $13,719 | $45,432 | $42,220 |

Software Licenses — The Company also licenses its software products separately from its integrated solution implementations. For software license arrangements that do not require significant modification or customization of the underlying software, software license revenue is recognized under the residual method when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the fee is fixed or determinable, (4) collectability is probable, and (5) the arrangement does not require services that are essential to the functionality of the software. When arrangements include multiple elements such as support and maintenance, consulting (other than for its fixed price solution implementations), installation, and training, revenue is allocated to each element of a transaction based upon its fair value as determined by the Company's VSOE and such services are recorded as services revenue. VSOE

for maintenance is generally established based upon negotiated renewal rates while VSOE for consulting, installation, and training services is established based upon the Company's customary pricing for such services when sold separately. Revenue for software licenses with extended payment terms is not recognized in excess of amounts due. For software license arrangements that require significant modification or customization of the underlying software, the software license revenue is recognized as services are performed using the cost-to-cost percentage of completion method of contract accounting, and such revenue is recorded as services revenue.

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

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

2. RECENT ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING CHANGES

In October 2009, the FASB issued an Accounting Standards Update ("ASU") on software revenue recognition in relation to revenue arrangements that include software elements. This standard removes from the scope of software revenue recognition accounting, revenue arrangements for tangible products that contain both software and non-software components that function together to deliver the tangible products' essential functionality. It also amends the determination of how arrangement consideration should be allocated to deliverables in a multiple-deliverable revenue arrangement. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Effective April 1, 2010, the Company elected to early adopt this standard with prospective application. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued an ASU on revenue recognition in relation to multiple-deliverable revenue arrangements. This update provides guidance on accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. The amendments in this update will replace the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Effective April 1, 2010, the Company elected to early adopt this standard with prospective application. Refer to Note 1 "Basis of Presentation" to the Condensed Consolidated Financial Statements for further discussion of the impact of the early adoption of this standard on the Company's consolidated financial statements.

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

3. INVESTMENTS

The following table summarizes the Company's investments at September 30, 2010 and December 31, 2009 (in thousands):

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

As of September 30, 2010 and December 31, 2009, the Company's investments consisted entirely of auction-rate securities. Please refer to Note 12 "Fair Value" for further discussion of auction-rate securities.

4. ACCOUNTS RECEIVABLE

Accounts receivable include amounts that are unbilled at the end of the period. Unbilled accounts receivable are determined on an individual contract basis and were approximately $6.2 million and $6.4 million as of September 30, 2010 and December 31, 2009, respectively.

5. ACQUIRED INTANGIBLE ASSETS

Impairment on acquired intangible assets is evaluated when indicators of impairment exist. Acquired intangible assets are amortized over their useful lives unless these lives are determined to be indefinite. During the nine months ended September 30, 2010, there were no indicators of impairment related to the Company's intangible assets.

The following table provides information relating to the intangible assets as of September 30, 2010 and December 31, 2009 (in thousands):

| Acquired Identifiable Intangible | Amortization Period (Years) | September 30, 2010 Gross Carrying Amount | Accumulated Amortization | Foreign Currency Translation | September 30, 2010 Net Carrying Amount |
|---|---|---|---|---|---|
| Acquired technology | 4-5 | $11,800 | $ (10,707) | $— | $1,093 |
| Brand name | 4 | 510 | (504) | — | 6 |
| Customer relationships and backlog | 1-6 | 3,420 | (3,157) | — | 263 |
| Patents and applications | 7 | 1,400 | (1,129) | — | 271 |
| Other acquired intangibles | 4 | 255 | (277) | 22 | — |
| Total | | $17,385 | $ (15,774) | $22 | $1,633 |

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

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

| Year Ending December 31, | Amount |
|---|---|
| 2010 (remaining three-month period) | $264 |
| 2011 | 830 |
| 2012 | 435 |
| 2013 | 74 |
| 2014 | 30 |
| Total | $1,633 |

6. STOCKHOLDERS' EQUITY

Stock-based compensation is estimated at the grant date based on an award's fair value and is recognized on a straight-line basis over the vesting period of the stock purchase rights or stock options, as applicable, generally four years. Stock-based compensation expenses before taxes related to the Company's employee stock purchase plan and stock-option plans were allocated as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Cost of design-to-silicon-yield solutions | $413 | $278 | $1,454 | $1,111 |
| Research and development | 284 | 341 | 980 | 1,093 |
| Selling, general and administrative | 357 | 465 | 1,595 | 1,341 |
| Stock-based compensation expenses | $1,054 | $1,084 | $4,029 | $3,545 |

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

Stock Plans:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Expected life (in years) | 5.24 | 5.16 | 5.24 | 5.16 |
| Volatility | 61.6 % | 63.5 % | 62.4 % | 63.1 % |
| Risk-free interest rate | 1.48 % | 2.54 % | 2.09 % | 2.44 % |
| Expected dividend | — | — | — | — |

| | | | | |
|---|---|---|---|---|
| Weighted average fair value per share of options granted during the period | $2.03 | $1.24 | $2.35 | $1.11 |

Employee Stock Purchase Plan:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Expected life (in years) | 1.25 | 1.25 | 1.25 | 1.25 |
| Volatility | 54.9 % | 79.1 % | 65.4 % | 79.6 % |
| Risk-free interest rate | 0.40 % | 1.19 % | 0.50 % | 1.23 % |
| Expected dividend | — | — | — | — |
| Weighted average fair value per share of employee stock issued during the period | $1.60 | $1.12 | $1.55 | $0.90 |

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On September 30, 2010, the Company has in effect the following stock-based compensation plans:

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

Stock option activity under the Company's plans during the nine months ended September 30, 2010 was as follows:

| | Number of Options (in thousands) | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding, January 1, 2010 | 3,849 | $6.41 | | |
| Granted | 299 | 4.41 | | |
| Exercised | (24) | 2.12 | | |
| Canceled | (168) | 4.51 | | |
| Expired | (79) | 9.43 | | |
| Outstanding, September 30, 2010 | 3,877 | 6.33 | 7.40 | $306 |
| Vested and expected to vest, September 30, 2010 | 3,510 | 6.53 | 7.25 | $277 |
| Exercisable, September 30, 2010 | 1,609 | 9.24 | 5.29 | $131 |

The aggregate intrinsic value in the table above represents the total intrinsic value based on the Company's closing stock price of $3.69 as of September 30, 2010, which would have been received by the option holders had all "in-the-money" option holders exercised their options as of that date. The total intrinsic value of options exercised during the nine months ended September 30, 2010 was $63,000.

As of September 30, 2010, there was $3.9 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted average period of 2.7 years. The total fair value of options that vested during the nine months ended September 30, 2010 was $740,000.

Nonvested restricted stock units activity during the nine months ended September 30, 2010 was as follows:

| | Units (in thousands) | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested, January 1, 2010 | 979 | $6.84 |
| Granted | 28 | 3.96 |
| Vested | (404) | 5.68 |
| Forfeited | (77) | 6.96 |
| Nonvested, September 30, 2010 | 526 | 7.75 |

As of September 30, 2010, there was $3.3 million of total unrecognized compensation cost related to nonvested restricted stock units. That cost is expected to be recognized over a weighted average period of 1.5 years. The total compensation expense related to shares vested during the nine months ended September 30, 2010 was $2.2 million.

Employee Stock Purchase Plan — In July 2001, the Company adopted an Employee Stock Purchase Plan (“Purchase Plan”), under which eligible employees can contribute up to 10% of their compensation, as defined in the Purchase Plan, towards the purchase of shares of PDF common stock at a price of 85% of the lower of the fair market value at the beginning of the offering period or the end of each six-month offering period. Under the Purchase Plan, on January 1 of each year, starting with 2002, the number of shares reserved for issuance will automatically increase by the lesser of (1) 675,000 shares, (2) 2% of the Company’s outstanding common stock on the last day of the immediately preceding year, or (3) the number of shares determined by the board of directors. For the nine months ended September 30, 2010, the Purchase Plan compensation expense was $302,000.

Stock Repurchase Program — On October 29, 2007, the Board of Directors approved a program to repurchase up to $10.0 million of the Company’s common stock on the open market. The right to repurchase stock under this program would have expired on October 29, 2010. As of September 30, 2010, 2.7 million shares had been repurchased at the average price of $3.46 per share under this program and $749,000 remained available for future repurchases. See Note 14 ("Subsequent Events") for an amendment to this repurchase program that was approved by the Board of Directors on October 19, 2010 that extended the program's term and increased the aggregate amount available for repurchase under the program.

7. RESTRUCTURING

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

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

For the plan announced on October 28, 2008, the Company recorded restructuring charges of $6.8 million, primarily consisting of employee severance costs of $4.8 million and facility exit costs of $1.8 million. Of the $6.8 million, a charge of $343,000 was recorded during the nine months ended September 30, 2010, largely due to costs related to additional reductions in force in our foreign offices under this announced plan. The following table summarizes the activities of these restructuring liabilities (in thousands):

| Restructuring Announced on October 28, 2008 | Severance | Facility Exit | Professional and Other Fees | Total |
|---|---|---|---|---|
| Balances, January 1, 2008 | $— | $— | $— | $— |
| Restructuring charges | 909 | 1,251 | 36 | 2,196 |
| Adjustment of deferred rent | — | (266) | — | (266) |
| Non-cash adjustment | 36 | 266 | — | 302 |
| Payments | (85) | (143) | (5) | (233) |
| Balances, December 31, 2008 | 860 | 1,108 | 31 | 1,999 |
| Restructuring charges | 3,515 | 783 | 214 | 4,512 |
| Payments | (4,151) | (558) | (183) | (4,892) |
| Balances, December 31, 2009 | 224 | 1,333 | 62 | 1,619 |
| Restructuring charges (credits) | 420 | 19 | (96) | 343 |
| (Payments) refunds | (456) | (472) | 39 | (889) |
| Balances, September 30, 2010 | $188 | $880 | $5 | $1,073 |

As of September 30, 2010, of the remaining accrual of $1.1 million, $588,000 was included in accrued liabilities and $485,000 was included in other non-current liabilities. Accrued severance of $188,000 is expected to be paid out in the three months ending December 31, 2010. Accrued facility exit costs will be paid in accordance with the lease payment schedule through 2013.

## 8. INCOME TAXES

The Company accounts for temporary differences between the book and tax basis of assets and liabilities by recording deferred tax assets and liabilities. The Company must assess the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent the Company believes that recovery is not likely, the Company must establish a valuation allowance. Changes in the Company’s net deferred tax assets and valuation allowance in a period are recorded through the income tax provision in the condensed consolidated statements of operations.

The Company classifies its liabilities related to unrecognized tax benefits as long-term. The Company includes interest and penalties related to unrecognized tax benefits within its income tax provision. As of September 30, 2010 and December 31, 2009, the Company had $439,000 and $539,000, respectively, accrued for payment of interest and

penalties related to unrecognized tax benefits.

Income tax provision for the three and nine months ended September 30, 2010 was $28,000 and $804,000, respectively, primarily consisting of foreign withholding taxes and changes in unrecognized tax benefits and statutory taxes associated with out foreign subsidiaries. Income tax provision for the three and nine months ended September 30, 2009 was $247,000 and $833,000, respectively, primarily consisting of foreign withholding taxes changes in unrecognized tax benefits and statutory taxes associated with our foreign subsidiaries.

The Company’s total amount of unrecognized tax benefits as of September 30, 2010 was $8.7 million, of which $2.9 million, if recognized, would affect the Company’s effective tax rate. The Company’s total amount of unrecognized tax benefits as of December 31, 2009 was $8.3 million, of which $2.7 million, if recognized, would affect the Company's effective tax rate. The Company does not believe that it is reasonably possible that the change in unrecognized tax benefits over the next twelve months will materially impact its results of operations and financial position.

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

9. NET INCOME (LOSS) PER SHARE

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net income (loss) | $50 | $(2,831) | $71 | $(16,790) |
| Weighted average common shares outstanding — basic | 27,413 | 26,499 | 27,154 | 26,306 |
| Dilutive effect of employee equity plans | 168 | — | 228 | — |
| Weighted average common shares outstanding — diluted | 27,581 | 26,449 | 27,382 | 26,306 |
| Net income (loss) per share: | | | | |
| Basic | $0.00 | $(0.11) | $0.00 | $(0.64) |
| Diluted | $0.00 | $(0.11) | $0.00 | $(0.64) |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Outstanding options | 3,690 | 4,143 | 3,693 | 4,254 |
| Nonvested restricted stock units | 270 | 533 | 333 | 652 |
| Total | 3,960 | 4,676 | 4,026 | 4,906 |

10. COMPREHENSIVE INCOME (LOSS)

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net income (loss) | $50 | $(2,831) | $71 | $(16,790) |
| Unrealized loss on investments, net of income tax effects | — | (4) | — | (65) |
| Foreign currency translation adjustments, net of income tax effects | 612 | 223 | (164) | (818) |
| Comprehensive income (loss) | $662 | $(2,612) | $(93) | $(17,673) |

11. CUSTOMER AND GEOGRAPHIC INFORMATION

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or group, in deciding how to allocate resources and in assessing performance.

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

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

| Customer | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| A | 23 % | 25 % | 19 % | 15 % |
| B | 14 % | 17 % | 13 % | 22 % |
| C | 14 % | * % | 11 % | * % |
| D | 13 % | 11 % | 20 % | 10 % |

* represents less than 10%

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

| Customer | September 30, 2010 |
|---|---|