MICROTUNE INC
Form 10-Q
July 29, 2010

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 JUNE 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: 000-31029-40

MICROTUNE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**75-2883117**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2201 10th Street

Plano, Texas 75074

(Address of principal executive offices and zip code)

(972) 673-1600

(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 x 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.

Large accelerated filer	¨	Accelerated filer	x
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 x

As of July 23, 2010, there were approximately 54,261,717 shares of the registrant s Common Stock, $0.001 par value per share, outstanding.

MICROTUNE, INC.

FORM 10-Q

June 30, 2010

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PART I.

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MICROTUNE, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	June 30, 2010 (unaudited)	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 32,468	$ 32,291
Short-term investments	49,758	50,000
Accounts receivable, net	11,504	7,830
Inventories	6,942	7,387
Other current assets	7,963	4,906
Total current assets	108,635	102,414
Property and equipment, net	4,200	4,607
Long-term investments	242	
Goodwill	5,564	5,564
Intangible assets, net	2,841	2,804
Other assets and deferred charges	143	782
Total assets	$ 121,625	$ 116,171
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 9,094	$ 6,572
Accrued compensation	2,468	3,171
Accrued expenses	3,908	2,601
Deferred revenue	55	29
Total current liabilities	15,525	12,373
Non-current liabilities	237	223
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value; Authorized 25,000 shares; Issued and outstanding shares none		
Common stock, $0.001 par value; Authorized 150,000 shares; Issued and outstanding shares 54,262 and 53,876, respectively	54	54
Additional paid-in capital	470,256	467,677
Accumulated other comprehensive loss	(988)	(988)
Accumulated deficit	(363,459)	(363,168)
Total stockholders equity	105,863	103,575

Total liabilities and stockholders equity	$ 121,625	$ 116,171

See accompanying notes.

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MICROTUNE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net revenue	$ 24,342	$ 17,572	$ 46,714	$ 35,467
Cost of revenue	11,825	9,108	22,504	18,572
Gross margin	12,517	8,464	24,210	16,895
Operating expenses:				
Research and development	7,018	7,114	14,646	13,713
Selling, general and administrative	5,095	5,751	9,861	11,436
Restructuring costs			4	
Total operating expenses	12,113	12,865	24,511	25,149
Income (loss) from operations	404	(4,401)	(301)	(8,254)
Other income (expense):				
Interest income	235	361	465	779
Foreign currency gains (losses), net	(157)	76	(342)	(138)
Other, net	(3)	7	1	47
Income (loss) before income taxes	479	(3,957)	(177)	(7,566)
Income tax expense	40	83	114	131
Net income (loss)	$ 439	$ (4,040)	$ (291)	$ (7,697)
Net income (loss) per common share:				
Basic	$ 0.01	$ (0.08)	$ (0.01)	$ (0.15)
Diluted	$ 0.01	$ (0.08)	$ (0.01)	$ (0.15)
Weighted-average common shares outstanding:				
Basic	54,161	52,277	54,067	52,170
Diluted	54,900	52,277	54,067	52,170

See accompanying notes.

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MICROTUNE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Operating activities:		
Net loss	$ (291)	$ (7,697)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	821	991
Amortization of intangibles	127	
Allowance for uncollectable debt		17
Stock-based compensation	2,416	2,486
Loss on disposal of assets		9
Foreign currency loss	160	103
Changes in operating assets and liabilities:		
Accounts receivable	(3,852)	1,484
Inventories	445	4,686
Other assets	(2,464)	1,274
Accounts payable	2,417	(194)
Accrued expenses	1,753	1,252
Accrued compensation	(689)	(311)
Deferred revenue	26	(230)
Other liabilities	14	5
Net cash provided by operating activities	883	3,875
Investing activities:		
Purchases of property and equipment	(616)	(514)
Proceeds from maturity of certificates of deposit	20,242	40,242
Purchase of certificates of deposit	(20,242)	(50,000)
Net cash used in investing activities	(616)	(10,272)
Financing activities:		
Proceeds from issuance of common stock	339	521
Surrender of common stock by employees for payroll taxes	(176)	(32)
Net cash provided by financing activities	163	489
Effect of foreign currency exchange rate changes on cash	(253)	(14)
Net increase (decrease) in cash and cash equivalents	177	(5,922)
Cash and cash equivalents at beginning of period	32,291	46,097
Cash and cash equivalents at end of period	$ 32,468	$ 40,175
Non-cash investing activities:		
Acquisition of intellectual property	$ (164)	$
Investment in enterprise software and equipment	$	$ (13)

See accompanying notes.

MICROTUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010

(unaudited)

1. Summary of Significant Accounting Policies

Description of Business

Microtune, Inc. (Microtune) began operations in August 1996. We design and market receiver solutions for the cable, automotive entertainment electronics and digital television (DTV) markets. These solutions include radio frequency (RF) integrated circuits (ICs), digital signal processing ICs and subsystem module solutions. Our product portfolio consists of tuners, amplifiers, upconverters, demodulators and receivers, which permit the delivery, reception and exchange of broadband video, audio and data using terrestrial (off-air) and/or cable communications systems. Our products enable or target various consumer electronics, broadband communications and automotive entertainment electronics applications and devices, including cable television set-top boxes; DOCSIS®-based, high-speed voice and data cable modems; car audio, television and antenna amplifier systems; integrated digital television systems (iDTV), including high-definition televisions (HDTV); digital-to-analog converter boxes; and personal computer television (PC/TV) multimedia products. We sell our products to original equipment manufacturers (OEMs) and original design manufacturers (ODMs) who sell devices, subsystems and applications to consumers or service providers within the cable, automotive entertainment electronics and DTV markets.

We operate Microtune as a single business unit or reportable operating segment serving our target markets. We record our operating expenses by functional area and account type, but we do not record or analyze our operating expenses by market, product type or product. We attempt to analyze our net revenue by market, but in some cases we sell our products to resellers or distributors serving multiple end markets, giving us limited ability to determine market composition of our net revenue from these customers. In addition, certain of our OEM customers purchase products from us for applications in multiple end-markets, also limiting our ability to determine our net revenue contribution from each market.

General

The accompanying unaudited financial statements as of and for the second quarter and first half of 2010 and 2009 have been prepared by us pursuant to the rules and regulations of the United States Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. general accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

In the opinion of management, all adjustments which are of a normal and recurring nature and are necessary for a fair presentation of the financial position, results of operations, and cash flows as of and for the second quarter and first half of 2010 and 2009 have been made. Results of operations for the second quarter and first half of 2010 are not necessarily indicative of results of operations to be expected for the entire year or any other period.

Risk and Uncertainties

Our future results of operations and financial condition will be impacted by the following factors, among others: worldwide macroeconomic downturn, dependence on the worldwide cable, automotive entertainment electronics and DTV markets which are characterized by intense competition and rapidly changing technology; dependence on a few significant customers, third-party manufacturers and subcontractors; dependence on third-party distributors in certain markets; dependence on partners when we go to market with a joint solution; the successful development and marketing of new products in new and existing markets; and seasonality in the demand for the end products into which our products are incorporated. Our future results also may be impacted by foreign currency fluctuations as a result of our international operations and foreign currency based revenues, and product warranty liability and line down clauses in customer agreements.

Consolidation

Our consolidated financial statements include the financial statements of Microtune and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

We make estimates, judgments and assumptions that affect the amounts reported in the consolidated financial statements and the disclosures made in the accompanying notes, including valuing inventory, estimating warranty costs, determining the collectability of

MICROTUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2010

(unaudited)

accounts receivable and the valuation of deferred tax assets, contingent liabilities, liabilities for incentive compensation and other amounts. We also use estimates, judgments and assumptions to determine the valuation of investments, the valuation and recoverability of goodwill and intangibles and the remaining economic lives and carrying values of property and equipment and other long-lived assets. We believe that the estimates, judgments and assumptions upon which we rely are appropriate, based upon information available to us at the time that they are made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the consolidated financial statements, as well as the reported net revenue and expenses during the periods presented. If there are material differences between these estimates, judgments or assumptions and actual facts, our consolidated financial statements will be affected.

Cash and Cash Equivalents

We consider highly liquid investments with maturities of three months or less at date of purchase to be cash equivalents. Cash and cash equivalents consist of bank deposits and money market funds.

Investments

Our investments are comprised of high-quality securities purchased in accordance with our investment policy. Investments in debt securities are classified as held-to-maturity when we intend to hold them to maturity. Held-to-maturity investments are carried at amortized cost with the amortization of the purchase discount recorded in interest income. Investments in debt securities not classified as held-to-maturity and equity securities are classified as available-for-sale and carried at fair value, with unrealized gains and losses, net of tax, recorded in stockholders equity. Realized gains and losses and other-than-temporary declines in value, if any, on available-for-sale securities are reported in other income and expense as incurred and are determined based on the specific identification method. At June 30, 2010 and December 31, 2009, our short-term and long-term investments, which consisted of certificates of deposit insured by the Federal Deposit Insurance Corporation (FDIC), were categorized as held-to-maturity investments. The carrying values of our short-term and long-term investments approximate fair value. The certificates of deposit have contractual maturities of one to two years and will mature on various dates during the fourth quarter of 2010, the second quarter of 2011 and the first quarter of 2012.

Allowance for Doubtful Accounts

We evaluate the collectability of our accounts receivable based on several factors. In circumstances where we are aware of a specific customer s inability to meet its financial obligations to us, we record a specific allowance for doubtful accounts against amounts due to us and reduce the net recorded receivable to the amount we believe will be collected. We also consider recognizing allowances for doubtful accounts based on the length of time the receivables are outstanding compared to contractual terms, industry and geographic concentrations, the current business environment and our historical experience. Accounts receivable are written off after final collection efforts are exhausted. If the financial condition of our customers deteriorates or if economic conditions worsen, increases in the allowance for doubtful accounts may be required in the future. We cannot predict future changes in the financial stability of our customers, and there can be no assurance that our allowance for doubtful accounts will be adequate. Actual credit losses for the second quarter and first half of 2010 and 2009 were insignificant. The allowance for doubtful accounts was insignificant as of June 30, 2010 and December 31, 2009.

Inventory Valuation

Our inventories are stated at the lower of cost or estimated realizable value. Amounts are removed from inventory using the first-in, first-out (FIFO) method. Adjustments to reduce our inventories to estimated realizable value, including allowances for excess and obsolete inventories, are determined quarterly by comparing inventory levels of individual materials and parts to current demand forecasts for those items. In addition, we review other individual facts and circumstances to determine necessary adjustments to reduce our inventories to estimated realizable value, including current manufacturing yields, product returns and warranty claims. Actual amounts realized upon the sale of inventories may differ from estimates used to determine inventory valuation allowances due to changes in customer demand, technology changes and other factors. The net impact of changes in the inventory valuation allowances and accrued noncancelable inventory purchase obligations was insignificant for the second quarter of 2010 and was a charge to cost of revenue of $0.3 million for the second quarter of 2009. The net impact of changes in the inventory valuation allowances and accrued noncancelable inventory purchase obligations for the first half of 2010 and 2009 was a charge (benefit) to cost of revenue of $(0.1) million and $1.2 million, respectively.

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MICROTUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2010

(unaudited)

Property and Equipment

Our property and equipment are stated at cost, net of accumulated depreciation. We calculate depreciation using the straight-line method over the estimated useful lives of the assets, which generally range from 3 to 7 years. We depreciate leasehold improvements using the straight-line method over the lesser of their estimated useful lives or remaining lease terms.

Intangible Assets and Goodwill

Our intangible assets consist of developed technology, in-process research and development and goodwill recorded as the result of our acquisition of Auvitek International Ltd. (Auvitek) and intellectual property purchased for certain research and development projects. See Note 2. Our intangible assets with definite lives are being amortized on a straight-line basis over periods ranging from 3 to 6 years. During the second quarter of 2010, upon the completion of certain acquired in-process research and development, we began amortizing the related cost over its estimated useful life. Goodwill is the result of the difference between the aggregate consideration paid for Auvitek and the net of the fair values of the tangible and identifiable intangible assets acquired and the liabilities assumed.

Impairment of Goodwill and Other Long-lived Assets

We review goodwill for impairment at the reporting unit level on an annual basis in the fourth quarter or whenever events or changes in circumstances indicate impairment may exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. If the carrying amount of a reporting unit exceeds the reporting unit s fair value, we perform the second step of the goodwill impairment test to determine the amount of any impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit s goodwill with the carrying value of that goodwill.

We review long-lived assets, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. We evaluate the recoverability of other long-lived assets by a comparison of their carrying amount to projected undiscounted cash flows expected to be generated by the assets or asset group. If we determine our long-lived assets are impaired, we recognize the impairment in the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. No impairment was recognized during the second quarter and first half of 2010 and 2009.

Revenue Recognition

We recognize revenue when we receive a purchase order from our customer, our product has been shipped, title has transferred to our customer, the price that we will receive for our product is fixed or determinable and payment from our customer is considered probable. Title to our product transfers to our customer either when it is shipped to or received by our customer, based on the terms of our specific agreement with the customer.

Our revenue is recorded based on the facts then currently known to us. If we do not meet all the criteria above, we do not recognize revenue. If we are unable to determine the amount that is probable of collection once our product has shipped and title has transferred to our customer, we defer recognition of revenue until we can determine the amount that is probable of collection. Items that are considered when determining the amounts that are probable of collection include a customer s overall creditworthiness, payment history and rights to return unsold product.

For certain of our customers, we do not recognize revenue until receipt of payment because collection is not probable or the amount we will ultimately collect is not determinable at the date of the shipment. Upon shipment of product to these customers, title to the inventory transfers to the customer and the customer is invoiced. We account for these transactions by recording accounts receivable for the revenue value of the shipments, as the shipments represent valid receivables, and reducing inventory for the cost of the inventory shipped. The difference, representing the gross margin on the transactions, is recorded as deferred revenue. For financial statement presentation purposes, this deferred revenue balance is offset against any outstanding corresponding accounts receivable balances from the customer. When payment is received for the transaction, revenue is recognized for the value of the cash payment, cost of revenue is recorded for the cost of the inventory and the deferred revenue is relieved for the gross margin on the transaction. At June 30, 2010, there were no products shipped for which revenue was deferred due to the uncertainty of collection. At December 31, 2009, the sales value of products shipped for which revenue was deferred due to the uncertainty of collection was insignificant.

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MICROTUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2010

(unaudited)

When we defer revenue, the timing and amount of revenue we ultimately recognize is determined upon our receipt of payment, which can result in significant fluctuations in net revenue from period to period. In the second quarter and first half of 2010 and 2009, net revenue recognized upon receipt of payment was insignificant.

We also defer revenue when customers have made payments and we have not completed the earnings process. These payments are reflected as liabilities in our consolidated financial statements as deferred revenue. In these instances, we recognize revenue once the product is shipped, title has transferred to our customer and the earnings process is complete.

We grant limited stock rotation rights to certain distributors, allowing them to return qualifying product to us in accordance with their specific agreements for up to 5% of their aggregate net purchases for the previous six months. In these circumstances, we require the distributor to submit an offsetting purchase order that is, at a minimum, equivalent to the aggregate dollar amount of the product to be returned. We account for the return as a reduction to net revenue and a reduction to accounts receivable for the price of the items returned. Correspondingly, cost of revenue is reduced by the cost of returned inventory offset by an increase in inventory. Any returned inventory items are included in gross inventories, are reviewed along with our other inventory items and are recorded at the lower of cost or market. Historically, distributor returns under stock rotation rights have been insignificant. As a result, we do not establish a reserve for potential returns when product is shipped to distributors, rather we subsequently monitor distributor inventory levels and record a reserve for potential returns of estimated unsaleable inventory subject to stock rotation rights. We account for the reserve by reducing net revenue and cost of revenue. The difference, representing the gross margin on the transaction, is recorded as deferred revenue. We account for the shipment of replacement product as a sales transaction, which offsets the reduction of net revenue discussed above. At June 30, 2010 and December 31, 2009, the sales value of product shipped for which revenue was reserved due to distributor stock rotation rights was insignificant.

Research and Development Costs

Our research and development expenses consist primarily of personnel-related expenses, lab supplies, training and prototype materials. We expense all of our research and development costs in the period incurred, except for intellectual property purchased for certain research and development projects which is amortized on a straight-line basis over its estimated useful life. Research and development efforts currently are focused primarily on the development of our next generation of products.

Shipping and Handling Costs

Shipping and handling costs related to product shipments to customers are included in cost of revenue.

Warranty Costs

We generally provide a minimum of a one-year warranty on all products. In certain instances, a warranty beyond one year is provided to comply with statutory requirements of foreign jurisdictions. We record specific warranty provisions for any identified product issues, which have not been significant to date. There were no significant accrued warranty costs at June 30, 2010 and December 31, 2009.

Foreign Currency Remeasurement

Our functional currency and that of our foreign subsidiaries is the United States Dollar. The impact from the re-measurement of accounts not denominated in United States Dollars is recognized currently in our results of operations as a component of foreign currency gains and losses and results primarily from exchange rate fluctuations between the United States Dollar and the Euro.

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MICROTUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2010

(unaudited)

Income Taxes

Our income taxes are computed using the asset and liability method of accounting. Under the asset and liability method, a deferred income tax asset or liability is recognized for estimated future tax effects attributable to temporary differences and carryforwards. The measurement of deferred income tax assets is adjusted by a valuation allowance, if necessary, to recognize future income tax benefits only to the extent, based on available evidence, it is more likely than not such benefits will be realized. Our net deferred income tax assets were fully reserved at June 30, 2010 and December 31, 2009. Changes in uncertain income tax positions were as follows (in thousands):

Balance at December 31, 2009	$ 833
Tax positions taken in 2010	49
Interest recorded in 2010	23
Effect of changes in foreign currency exchange rates	1
Balance at June 30, 2010	$ 906

At June 30, 2010, the uncertain income tax positions related to transfer pricing adjustments with foreign subsidiaries acquired with Auvitek and foreign withholding taxes on certain cross-border transactions. We expect no material changes to uncertain income tax positions within the next twelve months.

We recognize interest and penalties related to uncertain income tax positions in income tax expense. Interest and penalties of $0.3 million and $0.2 million were accrued at June 30, 2010 and December 31, 2009, respectively, related to uncertain income tax positions assumed in the acquisition of Auvitek.

In conjunction with the purchase price allocation for the acquisition of Auvitek, we recorded an indemnification asset of $0.7 million representing the selling shareholders obligation to indemnify us for the outcome of potential contingent liabilities relating to uncertain tax positions. See Note 2. At June 30, 2010, the indemnification asset was $0.7 million.

Due to our net operating loss carryforward position, tax years in the United States remain open to examination until three years after the net operating losses from each year are utilized. Potential examination adjustments are limited to the net operating losses utilized from each year. For our international operations, the tax years 2005 through 2009 remain open to examination by the major taxing jurisdictions in which we operate.

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MICROTUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2010

(unaudited)

Income (Loss) Per Share

Basic income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period. Diluted income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period and dilutive common equivalent shares consisting of stock options, restricted stock units and employee rights to purchase stock under our employee stock purchase plan. Our computation of income (loss) per common share was as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income (loss)	$ 439	$ (4,040)	$ (291)	$ (7,697)
Weighted average common shares outstanding	54,161	52,277	54,067	52,170
Weighted average dilutive potential common shares:				
Stock options	135			
Restricted stock units	587			
Employee stock purchase plan	17			
Weighted average common and dilutive potential common shares	54,900	52,277	54,067	52,170
Basic income (loss) per common share	$ 0.01	$ (0.08)	$ (0.01)	$ (0.15)
Diluted income (loss) per common share	$ 0.01	$ (0.08)	$ (0.01)	$ (0.15)

The following table sets forth anti-dilutive securities that have been excluded from net income (loss) per share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Stock options	7,285	10,978	8,556	10,978
Restricted stock units	4	1,282	3,124	1,282
Employee stock purchase plan		98	87	98
Total anti-dilutive securities excluded	7,289	12,358	11,767	12,358

Stock-Based Compensation

We account for all share-based payment awards to employees and directors, including stock options, restricted stock units and employee stock purchases related to our employee stock purchase plan, using the fair value recognition provisions of ASC Topic 718, *Compensation Stock*

Compensation (ASC 718) and the provisions of Staff Accounting Bulletin No. 107, issued by the SEC. We use the Black-Scholes-Merton option-pricing formula to value share-based payments granted to employees and attribute the value of stock-based compensation to expense using the straight-line single option method. Stock-based compensation expense recognized each period includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the measurement date fair value estimate in accordance with the original provisions of SFAS No. 123, and (2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the measurement date fair value estimate in accordance with the provisions of ASC 718. Stock-based compensation expense recognized each period is based on the greater of the value of the portion of share-based payment awards under the straight-line method or the value of the portion of share-based payment awards that is ultimately expected to vest during the period. In accordance with ASC 718, we estimate forfeitures at the time of grant and revise our estimates, if necessary, in subsequent periods if actual forfeitures differ materially from those estimates. Stock-based compensation expense under ASC 718 for the second quarter of 2010 and 2009 was $1.2 million and $1.4 million, respectively, and $2.4 million and $2.5 million for the first half of 2010 and 2009, respectively, relating to employee and director stock options, restricted stock units and our employee stock purchase plan. See Note 9.

MICROTUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2010

(unaudited)

ASC 718 requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. Due to our historical net operating loss position, we have not recorded these excess tax benefits at June 30, 2010 and December 31, 2009.

Comprehensive Income

ASC Topic 220, *Comprehensive Income*, establishes standards for reporting and displaying comprehensive income and its components in the consolidated financial statements. Accumulated other comprehensive loss at June 30, 2010 and December 31, 2009 included foreign currency translation adjustments of $1.0 million related to changing the functional currency of our German subsidiaries from the German Mark to the United States Dollar in 2000. Comprehensive income (loss) for all periods presented is equivalent to net income (loss).

Risk Concentrations

Financial instruments that potentially expose us to concentrations of credit risk consist primarily of trade accounts receivable. At June 30, 2010, approximately 60% of our net accounts receivable were due from five of our customers. We periodically evaluate the creditworthiness of our customers financial condition and generally do not require collateral. We evaluate the collectability of our accounts receivable based on several factors. In circumstances when we are aware of a specific customer s inability to meet its financial obligations to us, we record a specific reserve for bad debts against amounts due to us and reduce the net recorded receivable to the amount we reasonably believe will be collected. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are outstanding, industry and geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers deteriorates or if economic conditions worsen, additional allowances may be required in the future. Historically, our bad debts have been insignificant and we are not currently aware of any significant uncollectible accounts.

We depend on third-party foundries, primarily IBM, TowerJazz, TSMC and X-FAB, and third-party assembly and test firms, primarily ASE, Amkor, Cirtek and SPIL, to manufacture all of our ICs. We do not have long-term supply agreements with our foundries but obtain ICs on a purchase order basis. The inability of a third-party foundry to continue manufacturing our ICs would have a material adverse effect on our operations. Our ICs are primarily manufactured in the United States, South Korea, Taiwan, China and the Philippines.

We use Ionics EMS, Inc. (Ionics) for nearly all assembly and calibration functions for our subsystem module solutions under a manufacturing agreement entered into during 2005. This agreement automatically renewed in May 2010 for one year and will automatically renew for additional one year periods each May unless either party provides notice of termination at least 365 days prior to any renewal term. For both the second quarter and first half of 2010, approximately 17% of our total net revenue was derived from the sale of our module products that were primarily manufactured by Ionics. We expect to continue to use a single provider for nearly all assembly and calibration functions for our subsystem module solutions. The unanticipated or sudden loss of this single provider would have a material adverse effect on our results of operations. We are also dependent upon third parties, some of whom are competitors, for the supply of components used in subsystem module manufacturing. Our failure to obtain components for module manufacturing would significantly impact our ability to ship subsystem modules to customers in a timely manner.

Commitments and Contingencies

We may be subject to the possibility of loss contingencies for various legal matters. Our discussion of legal matters includes pending litigation and matters in which any party has manifested a present intention to commence litigation related to such matters. There can be no assurance that additional contingencies of a legal nature or having legal aspects will not be asserted against us in the future. Such matters could relate to prior transactions or events or future transactions and events. See Note 8. We regularly evaluate current information available to us to determine whether any provisions for loss should be made. If we ultimately determine that a provision for loss should be made for a legal matter, the provision for loss could have a material adverse effect on our results of operations and financial condition.

Our future cash commitments are primarily for long-term facility leases. See Note 8.

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2. Acquisition of Auvitek International Ltd.

On July 31, 2009, Microtune completed the acquisition of Auvitek pursuant to the terms of the Agreement and Plan of Merger dated as of July 10, 2009. Auvitek was a supplier of advanced DTV demodulator ICs for the HDTV and TV-enabled peripherals markets with primary engineering operations based in Shanghai, China. The merger consideration consisted of (i) cash payments totaling $7.1 million, (ii) the issuance of 1,000,000 shares of Microtune common stock valued at $2.1 million and (iii) an earn-out payment based upon the achievement of certain performance metrics during the period July 1, 2009 through June 30, 2010. We previously determined that the achievement of such earn-out metrics was not probable and therefore that no payments would be earned. As such, the fair value assigned to the earn-out payments was insignificant and not included in the purchase price allocation. The acquisition of Auvitek allows Microtune to develop highly-integrated RF-to-digital solutions targeting the worldwide integrated DTV market, provides customers with more complete solutions and accelerates our penetration into the China DTV market. The results of operations for Auvitek were included in our consolidated statements of operations beginning on the date of acquisition.

An escrow fund of $1,000,000 was established for indemnification obligations, subject to a minimum threshold of $100,000 and a deductible of $100,000 on tax matters with unreleased funds to be distributed 24 months after the acquisition date of July 31, 2009. The purchase price allocated to current assets included an indemnification asset of $0.7 million representing the selling shareholders obligation to indemnify us for the outcome of potential contingent liabilities relating to uncertain tax positions. See Note 1. The indemnification asset was measured on the same basis as the liability for uncertain tax positions in accordance with ASC Topic 740 *Income Taxes*. Upon expiration of the selling shareholders obligation to indemnify us in July 2011, we will incur a charge to write off any remaining indemnification asset and will remain responsible for the outcome of potential contingent liabilities relating to uncertain tax positions.

3. Accounts Receivable, net

Accounts receivable, net consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Gross accounts receivable	$ 11,522	$ 7,848
Allowance for doubtful accounts	(18)	(18)
Accounts receivable, net	$ 11,504	$ 7,830

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4. Inventories

Inventories consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Finished goods	$ 3,031	$ 4,478
Work-in-process	3,644	2,802
Raw materials	267	107
Total inventories	$ 6,942	$ 7,387

5. Accrued Compensation

Accrued compensation consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Accrued vacation	$ 1,374	$ 1,145
Accrued restructuring compensation		854
Other	1,094	1,172
Total accrued compensation	$ 2,468	$ 3,171

At December 31, 2009, accrued restructuring compensation related to one-time employee termination benefits, primarily cash severance payments, from a restructuring plan. See Note 10.

6. Accrued Expenses

Accrued expenses consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Accrued legal fees	$ 1,341	$ 583
Other	2,567	2,018
Total accrued expenses	$ 3,908	$ 2,601

At June 30, 2010 and December 31, 2009, the accrued legal fees related primarily to amounts incurred in connection with the SEC litigation against certain former officers. See Note 8. The accrued expenses are expected to be paid during the next twelve months.

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7. Income Taxes

We have established a valuation allowance to fully reserve our net deferred tax assets at June 30, 2010 and December 31, 2009 due to the uncertainty of the timing and amount of future taxable income. For United States federal income tax purposes, at December 31, 2009, we had a net operating loss carryforward of approximately $181.6 million and an unused research and development credit carryforward of approximately $4.4 million that will begin to expire in 2021. A change in ownership, as defined in Section 382 of the Internal Revenue Code, may limit utilization of the United States federal net operating loss and research and development credit carryforwards.

In the second quarter and first half of 2010, our effective tax rate differed from the 34% statutory corporate tax rate primarily due to permanent differences, lower withholding tax rates and lower foreign tax rates. Income tax expense for the second quarter and first half of 2010 consisted of foreign income taxes and United States state income taxes.

In the second quarter and first half of 2009, our effective tax rate differed from the 34% statutory corporate tax rate primarily due to changes in valuation allowances, permanent differences, lower withholding tax rates and lower foreign tax rates. Income tax expense for the second quarter and first half of 2009 included the utilization of previously reserved net operating loss carryforwards and consisted of withholding taxes on certain cross-border transactions, United States state income taxes and foreign income taxes.

8. Commitments and Contingencies

Lease Commitments

We lease our corporate headquarters and principal IC design center in Plano, Texas under an operating lease with a ten year term, which began in April 2005. Rent expense is calculated using the straight-line method over the lease term. We lease a research and development facility in Germany under an operating lease with a twenty-two year term, which began in December 1999. In addition, we lease a research and development facility in Shanghai, China under an operating lease with a two year term, which began in September 2009. We also lease certain other facilities under operating leases and certain equipment and software under operating and capital leases which were deemed insignificant. Future minimum lease payments required under operating leases at June 30, 2010 were as follows (in thousands):

Year Ending December 31,	
2010	$ 765
2011	1,357
2012	1,057
2013	919
2014	854
Thereafter	2,924
Total future minimum lease payments	$ 7,876

Rent expense for the second quarter of 2010 and 2009 was $0.5 million and $0.3 million, respectively. Rent expense for the first half of 2010 and 2009 was $0.9 million and $0.7 million, respectively.

Purchase Commitments

As of July 23, 2010, we had approximately $20.6 million of cancelable and non-cancelable purchase commitments outstanding with our vendors. These commitments were entered into in the normal course of business.

Other Commitments

We are currently subject to line down clauses in contracts with certain automotive entertainment electronics customers. Such clauses require us to pay financial penalties if our failure to supply product in a timely manner causes the customer to slow down or stop their production. We are also subject to product liability clauses and/or intellectual property indemnification clauses in some of our customer contracts. Such clauses require us to pay financial penalties if we supply defective product, which results in financial

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damages to the customer, or to indemnify the customer for third-party actions based on the alleged infringement by our products of a third party s intellectual property. At June 30, 2010, we were unaware of any significant claims by any of our customers.

Legal Proceedings

From time to time, we may be involved in routine legal proceedings, as well as demands, claims and threatened litigation that arise in the normal course of our business. The ultimate amount of liability, if any, for any claims of any type (either alone or in the aggregate) may materially and adversely affect our financial condition, results of operations and liquidity. In addition, the ultimate outcome of any litigation is uncertain. Any outcome, whether favorable or unfavorable, may materially and adversely affect us due to legal costs and expenses, diversion of management attention and other factors. We expense legal costs in the period incurred. We cannot assure you that additional contingencies of a legal nature or contingencies having legal aspects will not be asserted against us in the future, and these matters could relate to prior, current or future transactions or events. Except as described below, we are not currently a party to any material litigation.

Audit Committee Investigation, Restatement, Derivative Litigation and SEC Investigation

In June 2006, the Audit Committee of our Board of Directors self-initiated an independent investigation into our stock option granting practices covering the period from the date of our initial public offering on August 4, 2000 through June 2006. As a result of the findings of the Audit Committee s investigation, on January 22, 2007, we restated our consolidated financial statements for the years ended December 31, 2005, 2004 and 2003, and the selected consolidated financial data as of and for the years ended December 31, 2005, 2004, 2003, 2002, 2001, 2000 and 1999 to record additional non-cash stock-based compensation expense and related tax liabilities related to certain mispriced stock option grants.

We voluntarily contacted the SEC in July 2006 regarding the Audit Committee s independent investigation, and representatives of the Audit Committee met with the SEC in February 2007 and again in July 2007 to discuss the findings of the Audit Committee s investigation. We fully cooperated with the SEC in its investigation of these matters. On June 30, 2008, we announced that we had agreed to settle with the SEC, without admitting or denying the allegations in the SEC s complaint, by consenting to the entry of a permanent injunction against future violations of the federal securities laws. We were not required to pay any civil penalty or other monetary damages as part of the settlement.

On June 30, 2008, the SEC filed suit in the United States District Court for the Northern District of Texas against Douglas J. Bartek, our former Chairman and Chief Executive Officer, who resigned in June 2003, and Nancy A. Richardson, our former Chief Financial Officer and General Counsel, who resigned in March 2004, alleging various violations of the U.S. securities laws related to our historical stock option granting practices. The SEC is seeking permanent injunctive relief, disgorgement, civil monetary penalties, a public company director and officer bar and reimbursement of bonuses and stock profits under Section 304 of the Sarbanes-Oxley Act. The suit against Mr. Bartek and Ms. Richardson is still pending and attorneys for Mr. Bartek and Ms. Richardson are actively preparing for trial.

We have incurred substantial expenses for legal, accounting, tax and other professional services in connection with the Audit Committee s investigation, the preparation of our restated consolidated financial statements, the defense of a related derivative lawsuit, the SEC investigation and the SEC litigation against Mr. Bartek and Ms. Richardson. We continue to incur substantial legal expenses related to the SEC litigation against Mr. Bartek and Ms. Richardson. We have advanced substantial legal expenses to Mr. Bartek and Ms. Richardson pursuant to our indemnification agreements with such former officers for legal proceedings related to these matters. We have recognized expenses of approximately $7.6 million through June 30, 2010 related to these matters, net of amounts reimbursed by our directors and officers liability insurance carriers, and currently have a receivable of $4.2 million at June 30, 2010 for amounts expected to be reimbursed by our directors and officers liability insurance carriers. As of June 30, 2010, we have exhausted $18.1 million of our $20 million directors and officers liability insurance coverage. Currently, no trial date has been set by the court and legal counsel for Mr. Bartek and Ms. Richardson have incurred substantial expenses to conduct discovery, take depositions, file various motions and prepare for trial. We expect further legal fees related to the SEC litigation against Mr. Bartek and Ms. Richardson to be substantial, although at a reduced rate as compared to prior periods, and our directors and officers liability insurance policy is expected to cover a significant portion of any future expenses until the insurance coverage is exhausted. If the SEC litigation against Mr. Bartek and Ms. Richardson is not resolved in the near future, we believe the remaining portion of the directors and officers liability insurance coverage will not be sufficient to cover all future legal fees related to the SEC litigation against Mr. Bartek and Ms. Richardson, and future expenses in excess of our insurance coverage could be substantial and could potentially have a material adverse effect on our results of operations. See Part II, Item 1A. Risk Factors.

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9. Stockholders Equity

Rights Plan

On March 4, 2002, our Board declared a dividend of one right for each share of our common stock issued and outstanding at the close of business on March 16, 2002. One right also attaches to each share of our common stock issued subsequent to March 16, 2002. The rights become exercisable to purchase one one-thousandth of a share of new Series A Preferred Stock (Series A), at $115.00 per right, when a person or entity acquires 15% or more of our common stock or announces a tender offer which could result in such a person or entity owning 15% or more of our common stock. Each one one-thousandth of a share of the Series A has terms designed to make it substantially the economic equivalent of one share of our common stock. Prior to a person or entity acquiring 15%, the rights can be redeemed for $0.001 each by action of our Board. Under certain circumstances, if a person or entity acquires 15% or more of our common stock, the rights permit our stockholders other than the acquiror to purchase our common stock having a market value of twice the exercise price of the rights, in lieu of the Series A. Alternatively, when the rights become exercisable, the Board may authorize the issuance of one share of our common stock in exchange for each right that is then exercisable. In addition, in the event of certain business combinations, the rights permit the purchase of the common stock of an acquiror at a 50% discount. Rights held by the acquiror will become null and void in both cases. The rights expire on March 3, 2012. At June 30, 2010, 54,261,717 rights were outstanding.

2010 Incentive Compensation Program

During the first quarter of 2010, our Board of Directors approved an annual incentive compensation program for fiscal year 2010 (2010 Bonus Program) covering executive officers, key managers and key employees that provides for incentive compensation to be paid, to the extent any such compensation is earned through the performance vesting of restricted stock units under the Amended and Restated Microtune, Inc. 2000 Stock Plan. An aggregate of 1,405,281 restricted stock units were awarded under the 2010 Bonus Program with a grant date fair value of $2.40 per share.

The number of total restricted stock units that ultimately vest and result in the issuance of underlying shares are calculated based on certain scoring factors, including net revenue and adjusted profitability. The vesting of the restricted stock units will be determined and the issuance of the underlying shares will occur during the first quarter of 2011. Any portion of the restricted stock units that do not vest will immediately be forfeited. During the second quarter and first half of 2010, amounts recognized under the 2010 Bonus Program in stock-based compensation expense relating to the restricted stock units were $0.5 million and $1.2 million, respectively.

Share-Based Awards

During the second quarter of 2010, we granted our employees approximately 464,000 restricted stock unit (RSU) awards in conjunction with our annual review of all employee compensation. The RSU awards generally vest in May 2014. The grant date fair value of these RSU awards was $2.49 per share.

Stock-Based Compensation

The following table summarizes the allocation of stock-based compensation expense under ASC 718 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009

Cost of revenue	$ 8	$ 21	$ 22	$ 19
Research and development	567	662	1,328	1,129
Selling, general and administrative	633	683	1,066	1,338
Total stock-based compensation expense included in operating expenses	$ 1,200	$ 1,345	$ 2,394	$ 2,467
Total stock-based compensation expense	$ 1,208	$ 1,366	$ 2,416	$ 2,486

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