MICROTUNE INC
Form 10-Q
August 14, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark one)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2001

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 Number)

2201 10th Street
Plano, Texas 75074
(Address of principal executive office 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 filing requirements for the past 90 days.

YES [X] NO [ ]

As of July 31, 2001, 39,751,223 shares of the Registrant's common stock were outstanding.

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Microtune, Inc.

FORM 10-Q
June 30, 2001

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PART I Financial Information

Item 1. Financial Statements

Microtune, Inc.
Consolidated Balance Sheets
(in thousands, except per share data)
(unaudited)

Assets	June 30, 2001	Dec
Current assets:		
Cash and cash equivalents..	$ 71,067	
Accounts receivable, net of allowance for doubtful accounts of $579 at June 30, 2001 and $456 at December 31, 2000............................	9,403	
Inventories..	13,203	
Deferred income taxes..	1,450	
Other current assets...	1,146	
Total current assets...	96,269	

Property and equipment, net	18,382
Intangible assets, net of accumulated amortization of $2,430 at June 30, 2001 and $2,481 at December 31, 2000	5,302
Goodwill, net of accumulated amortization of $8,390 at June 30, 2001 and $5,570 at December 31, 2000	19,886
Deferred income taxes	208
Other assets and deferred charges	2,032
Total assets	$142,079
Liabilities and Stockholders' Equity	
Current liabilities:	
Accounts payable	$ 5,188
Accrued expenses	8,718
Accrued compensation	1,773
Total current liabilities	15,679
Deferred income taxes	950
Other noncurrent liabilities	993
Commitments	-
Stockholders' equity:	
Preferred stock, $0.001 par value Authorized shares - 25,000 at June 30, 2001 and December 31, 2000	-
Common stock, $0.001 par value Authorized shares - 150,000 at June 30, 2001 and December 31, 2000; issued and outstanding shares - 39,601 at June 30, 2001 and 38,547 at December 31, 2000	40
Additional paid-in capital	184,041
Loans receivable from stockholders	(35)
Accumulated other comprehensive loss	(988)
Accumulated deficit	(58,601)
Total stockholders' equity	124,457
Total liabilities and stockholders' equity	$142,079

See accompanying notes.

Microtune, Inc.

Consolidated Statements of Operations
(in thousands, except per share data)
(unaudited)

	Three Months Ended June 30,	
	2001	2000

Net revenues	$ 14,455	$ 15,065
Cost of revenues	10,101	9,860
Gross margin	4,354	5,205
Operating expenses:		
Research and development:		
Stock option compensation	339	359
Other	3,579	3,093
	3,918	3,452
Acquired in-process research and development	-	-
Selling, general and administration:		
Stock option compensation	420	856
Other	4,249	4,795
	4,669	5,651
Amortization of intangible assets and goodwill	1,804	2,215
Total operating expenses	10,391	11,318
Loss from operations	(6,037)	(6,113)
Other income (expense):		
Interest income	814	220
Foreign currency translation and transaction gains (losses), net	(1,221)	(806)
Other	18	289
Loss before income taxes	(6,426)	(6,410)
Income tax expense (benefit)	(185)	386
Net loss	$ (6,241)	$ (6,796)
Basic and diluted loss per common share	$ (0.16)	$ (0.86)
Weighted-average shares used in computing basic and diluted loss per common share	39,327	7,881

See accompanying notes.

Microtune, Inc.

Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Six Months E
	2001
Operating activities:	
Net loss	$(11,785)
Adjustments to reconcile net loss to net cash used in operating	

activities, net of effects of business combination:	
Depreciation	3,116
Amortization of intangible assets and goodwill	3,606
Acquired in-process research and development	-
Foreign currency translation and transaction gains (losses), net	1,166
Stock option compensation	1,713
Deferred income taxes	(2,844)
Changes in operating assets and liabilities:	
Accounts receivable	2,898
Inventories	3,186
Other assets	(462)
Accounts payable	(1,575)
Accrued expenses	608
Accrued compensation	(115)
Net cash used in operating activities	(488)
Investing activities:	
Net cash acquired in acquisition of HMTF Acquisition	-
Purchases of property and equipment	(6,423)
Sale of property and equipment	92
Loan receivable	(1,000)
Purchase of intangible assets	(34)
Net cash used in investing activities	(7,365)
Financing activities:	
Proceeds from issuance of preferred stock	-
Proceeds from issuance of common stock upon the exercise of options and from shares purchased under Employee Stock Purchase Plan	1,669
Proceeds from loans receivable from stockholders	753
Net cash provided by financing activities	2,422
Effect of foreign currency exchange rate changes on cash	(1,152)
Net change in cash and cash equivalents	(6,583)
Cash and cash equivalents at beginning of period	77,650
Cash and cash equivalents at end of period	$ 71,067

See accompanying notes.

Microtune, Inc.

Notes to Consolidated Financial Statements

June 30, 2001

(unaudited)

1. Basis of Presentation

General

The accompanying unaudited financial statements as of and for the three and six months ended June 30, 2001 and 2000 have been prepared by Microtune, Inc. (the Company), pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

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 three and six months ended June 30, 2001 have been made. Results of operations for the three and six months ended June 30, 2001, are not necessarily indicative of results of operations to be expected for the entire year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Foreign Currency Translation

Through June 30, 2000, the Company used the U.S. Dollar as its functional currency, except that the German Mark was used as its functional currency for Microtune GmbH & Co. KG (Microtune KG) and its subsidiaries (collectively, the Subsidiaries). Foreign currency exchange gains and losses resulting from the translation of financial statements denominated in German Marks of Microtune KG into U.S. Dollars through June 30, 2000, were included as a component of stockholders' equity. Foreign currency exchange gains and losses resulting from the remeasurement of financial statements not denominated in German Marks of Microtune KG outside of Germany into German Marks were recognized currently in the Company's results of operations as a component of foreign currency gains and losses.

Effective July 1, 2000, the Company changed the functional currency of the Subsidiaries to the U.S. Dollar from the German Mark to reflect the manner in which the Subsidiaries are now managed and operated. Subsequent to June 30, 2000, the financial statements of the Subsidiaries are remeasured into the U.S. Dollar. The impact from the remeasurement of financial statements not denominated in U.S. Dollars is recognized currently in the Company's results of operations as a component of foreign currency gains and losses.

Adoption of New Accounting Pronouncements

Effective January 1, 2000, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, Accounting for Derivatives and Hedging Activities. SFAS No. 133 requires that all derivatives be recognized at fair value on the balance sheet and that related gains and losses be included in net income or comprehensive income depending on the nature of the hedging relationship. Currently, the Company has not entered into contracts that will be classified as derivative financial instruments under SFAS No. 133. However, the Company may enter into contracts that are classified as derivative financial instruments in the future. Adoption of SFAS No. 133 did not have an impact on the results of operations or financial position of

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the Company. However, management cannot estimate its impact on future results of operations and financial position.

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized, but will be subject to annual impairment tests. Other intangible assets will continue to be amortized over their useful lives.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the nonamortization provisions of SFAS No. 142 is expected to result in an increase in net income of $5.8 million ($0.15 per share) per year. During 2002, the Company will perform the first of the required impairment test of goodwill and indefinite lived intangible assets as of January 1, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

2. Completion of Initial Public Offering

On August 4, 2000, the Company completed its initial public offering. The Company issued 4.6 million shares of its common stock resulting in net proceeds of approximately $66.8 million. Upon the completion of the initial public offering, all then outstanding convertible preferred stock converted into an aggregate of approximately 23.1 million shares of common stock and all outstanding warrants were automatically exercised for approximately 2.2 million shares of common stock.

3. Acquisition of HMTF Acquisition (Bermuda), Ltd.

On January 10, 2000, the Company combined with HMTF Acquisition (Bermuda), Ltd. (HMTF Acquisition), the ultimate parent company of Temic Telefunken Hochfrequenztechnik GmbH (Temic), in a transaction accounted for as a purchase business combination. HMTF Acquisition acquired Temic on December 22, 1999. Temic is now called Microtune KG. The consideration in the combination consisted of 3,318,513 shares of Series E Preferred Stock and warrants to purchase up to 2,212,342 shares of common stock at an exercise price of $0.001 per share. The results of operations of HMTF Acquisition are included in the results of the Company from the date of acquisition. The components of the aggregate cost of the combination were as follows (in thousands, except share data):

Fair market value of 3,318,513 shares of Series E Preferred Stock	$55,548
Fair market value of warrants to purchase 2,212,342 shares of the Company's common stock	7,411
Transaction costs	185
Total combination cost	$63,144

The fair market values of the Series E Preferred Stock and the warrants were based on the estimated fair market value of the Company's common stock at the date of the combination and the cash purchase price paid by HMTF Acquisition for Microtune KG on December 22, 1999 of $60.0 million.

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The cost of the acquisition has been allocated to the assets and liabilities acquired and to acquired in-process research and development, with the remainder recorded as excess cost over net assets acquired, based on estimates of fair values as follows (in thousands):

Working capital	$11,206
Property and equipment	6,118
Intangible assets	8,037
Goodwill	28,276
Acquired in-process research and development costs charged to expense	12,692
Deferred income taxes	(1,914)
Other assets and liabilities, net	(2,283)
Loans receivable from stockholders	1,012
Total combination cost	$63,144

The estimates of the fair values of intangible assets and acquired in-process research and development were determined based on information furnished by management of Microtune KG. Amounts allocated to acquired in-process research and development were expensed at the date of acquisition because the purchased research and development had no alternative future uses, and had not reached technological feasibility based on the status of design and development activities that required further refinement and testing. The acquired in-process research and development projects were assessed, analyzed and valued using the exclusion approach articulated by the Securities and Exchange Commission. The estimates used in valuing the research and development were based upon assumptions regarding future events and circumstances management believes to be reasonable, but that are inherently uncertain and unpredictable. The relative stage of completion and projected operating cash flows of the underlying in-process projects acquired were the most significant and uncertain assumptions utilized in the valuation analysis of the acquired in-process research and development. Such uncertainties could give rise to unforeseen budget overruns and revenue shortfalls in the event that the Company is unable to successfully complete and commercialize the projects.

The acquired in-process technology relates to the development of new tuners and modules for cable modem, set-top box, multimedia and automotive applications, focusing on increased functionality, cost effectiveness and size reduction, while maintaining a low level of power consumption. The estimated percentage completion of the development projects as of the acquisition date was approximately 70%, 50%, 70% and 60% for projects in the cable modem, set-top box, multimedia and automotive product groups, respectively. There have been no significant changes in estimates of costs required to complete the development efforts since the acquisition date. During 2000, the development projects as of the acquisition date in the cable modem, set-top box and multimedia product groups were completed at a cost of approximately $335,000, $50,000 and $340,000, respectively. As of June 30, 2001, the amount expended toward completing the development projects in the automotive group as of the acquisition date was approximately $1,760,000. As of June 30, 2001, the estimated cost of completion of the development projects in the automotive product group is approximately $290,000 and the projects are expected to be completed by December 2002.

The value of the acquired in-process research and development was determined by discounting the estimated projected net cash flows related to the applicable products for the next ten years, including costs to complete the development of the technology and the future revenues to be earned upon release of the products. The rate utilized to discount the net cash flows to present value was 22% based on the weighted average cost of capital adjusted for the risks associated with the estimated growth, profitability, developmental and market risks of the acquired development projects. Projected net cash flows from such products are based on estimates of revenues and operating profit (loss) related to such products. Management expects that the purchased research and development projects generally will be successfully developed into commercially viable products. However, there can be no assurance that commercial viability or timely release of these products will be achieved.

4. Earnings Per Share

Basic earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period. Diluted earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period and common equivalent shares consisting of preferred stock, stock options, warrants, restricted stock subject to repurchase rights and employee stock purchase plan options.

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

	Six Months Ended June 30,	
	2001	2000
Preferred stock convertible into common stock.............	-	23,097
Stock options..	7,382	7,791
Warrants...	-	2,253
Restricted common stock..................................	153	321
Employee stock purchase plan.............................	12	-
Total anti-dilutive securities excluded..................	7,547	33,462

5. Cash and Cash Equivalents

Cash and cash equivalents consist of bank deposits, money market funds and asset-backed commercial paper. The Company's investments in asset-backed commercial paper are comprised of high-quality securities in accordance with the Company's investment policy. The Company considers highly liquid investments with original maturities of three months or less to be cash equivalents.

6. Inventories

Inventories consists of the following (in thousands):

	June 30, 2001	December 2000
Finished goods...	$ 3,649	$ 4
Work-in-process..	2,481	2
Raw materials..	7,073	9
	$13,203	$16

Inventories are stated at the lower of standard cost, which approximates actual cost determined on a first-in, first-out basis, or estimated realizable value.

7. Property and Equipment

Property and equipment, at cost, consists of the following (in thousands):

	June 30, 2001	December 2000
Leasehold improvements	$ 1,415	$ 1
Manufacturing equipment	16,808	13
Other equipment	4,806	3
Furniture and fixtures	675	1
Computer software	3,130	1
Total property and equipment	26,834	20
Less accumulated depreciation	8,452	5
	$18,382	$15

8. Accrued Expenses

Accrued expenses consists of the following (in thousands):

	June 30, 2001
Accrued warranty obligation	$ 672
Accrued income taxes	4,137
Deferred income taxes	168
Other	3,741
	$8,718

9. Income Taxes

Prior to our combination with Microtune KG, the Company had not recognized any provision for income taxes. For U.S. federal income tax purposes, at December 31, 2000, the Company had a net operating loss carryforward of approximately $26.0 million and an unused research and development credit carryforward of approximately $1.0 million, which begins to expire in 2011. Due to the uncertainty of our ability to utilize these deferred tax assets, they have been fully reserved.

The benefit for the three and six months ended June 30, 2001, and the provision for the three and six months ended June 30, 2000, consists of foreign income taxes and U.S. state franchise taxes. Effective January 1, 2001, the German government reduced tax rates of retained earnings, previously 40%, and earnings distributed as a dividend, previously 30%, to a flat rate of 25%. The impact of this change on deferred income taxes was recorded in the third quarter of 2000 when the law was inacted.

10. Commitments and Contingencies

On January 24, 2001, the Company filed a lawsuit alleging patent infringement in the United States Court for the Eastern District of Texas, Sherman Division, against Broadcom Corporation. The lawsuit alleges that Broadcom Corporation's BCM3415 microchip infringes on the Company's U.S. patent no. 5,737,035. The Company's complaint is seeking monetary damages resulting from the alleged infringement as well as injunctive relief precluding Broadcom Corporation from taking any further action which infringes the Company's 5,737,035 patent. The lawsuit is still at an early stage.

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11. Stock Plans

During 1999 through July 2000, the Company issued stock options that were deemed to have been issued at less than fair market value at the date of grant and recorded $16.5 million and $3.2 million in 2000 and 1999, respectively, for deferred stock compensation. This deferred stock compensation is being recognized over the respective vesting periods of the stock options, which range from one to six years. As of June 30, 2001, and December 31, 2000, unamortized deferred stock compensation was $12.2 million and $14.6 million, respectively.

12. Geographic Information and Significant Customers

The Company's headquarters and main design center are located in Plano, Texas. The Company has other sales offices and design centers in the United States, Korea, Taiwan and Hong Kong. The Company also has a systems application design center in Germany and two manufacturing facilities in the Philippines. Net revenues by geographical area are summarized below (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
North America.............	$ 6,145	$ 7,441	$ 16,148	$ 13,851
Europe....................	3,778	3,389	7,456	6,595
Asia Pacific..............	4,425	4,184	8,321	7,976
Other.....................	107	51	189	539
	$ 14,455	$ 15,065	$ 32,114	$ 28,961

Sales to DaimlerChrysler accounted for approximately 24% of consolidated net revenues for the six months ended June 30, 2001. Sales to DaimlerChrysler and Motorola/General Instruments accounted for approximately 25% and 10%, respectively, of consolidated net revenues for the six months ended June 30, 2000.

Sales to DaimlerChrysler, Motorola/General Instruments, Askey and Panasonic accounted for approximately 29%, 13%, 11% and 11%, respectively, of consolidated net revenues for the three months ended June 30, 2001. Sales to DaimlerChrysler and Motorola/General Instruments accounted for approximately 24% and 10%, respectively, of consolidated net revenues for the three months ended June 30, 2000.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations'

Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words "believes," "anticipates," "estimates," "expects," "intends," and words of similar import, may constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Readers are referred to the disclosures under the caption "Factors Affecting Future Operating Results and Stock Price" in this report and to the risk factors set out in our Annual Report filed on Form 10-K for fiscal year 2000, which describe factors that could cause actual events to differ from those contained in any forward looking statements.

Overview

History

We were incorporated in Texas in May 1996 and began operations in August 1996. In June 2000, we reincorporated in Delaware. From inception until December 31, 1999, our primary activities consisted of raising capital, recruiting radio frequency and analog engineers, developing our silicon integrated circuit tuner for broadband radio frequencies and initiating relationships with potential customers and suppliers.

In January 2000, we combined with Temic Telefunken Hochfrequenztechnik GmbH (GmbH) and its affiliated companies (collectively, referred to as Temic). Temic was founded in the early 1900's in Germany. In the late 1940's, Temic began developing mechanical radio frequency tuners, and in the late 1960's, it was the first company to develop an electronic radio frequency tuner. The two companies have been operating as one company since the combination in January 2000. In addition, GmbH converted to a KG and changed its name to Microtune GmbH & Co. KG, referred to as Microtune KG, in August 2000.

Financial Information

We are a radio frequency silicon and systems company, specializing in high-performance radio frequency tuners, amplifiers and transceivers to the broadband communications markets. We design, develop and sell highly integrated broadband gateway radio frequency integrated circuits and modules for use in cable modems, PC/TVs, set-top boxes, cable telephony, digital TV, automotive entertainment and other consumer electronics devices.

Since inception we have incurred significant losses, and as of June 30, 2001, we had an accumulated deficit of approximately $58.6 million. As a result of our combination with Microtune KG, our primary activities have expanded to include the design, manufacture and sale of radio frequency modules. In March 2000, we began shipment of our single chip silicon tuner and in December 2000, we began shipment of our silicon upstream amplifier. Tuner modules were developed, manufactured and marketed by Microtune KG prior to the combination. Our limited combined operating history combined with business risks, including those risks set forth under the caption "Factors Affecting Future Operating Results and Stock Price" in this report and the risk factors set out in our Annual Report filed on Form 10-K for the fiscal year 2000, make the prediction of future results of operations difficult, and as a result there can be no assurance that we will achieve or sustain revenue growth or profitability.

The time lag between product availability and volume shipment can be significant due to a sales process that includes customer qualification of our products and can take as long as two years, during which we continue to evolve our technology.

We recognize revenues from our products upon shipment to a customer or upon notification of customer receipt, depending on the contract terms. We provide at least a one-year warranty on all products and record a related provision for estimated warranty costs at the date of sale.

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We have invested heavily in research and development of our radio frequency integrated circuits and systems technology. We expect to increase our investment in these areas in absolute dollars to further develop our radio frequency products. This investment will include the continued recruitment of radio frequency and analog integrated circuit designers and systems engineers, acquisition of test, development and production equipment and expansion of facilities for research and manufacturing. As a result, we may continue to incur substantial losses from operations for the foreseeable future.

We use IBM to manufacture our wafers and Amkor to assemble our radio frequency integrated circuits. We perform final testing, packing and shipping of our radio frequency integrated circuits at our facility in Plano, Texas, and overseas at Amkor. With respect to our tuner modules, we perform all of our assembly and calibration functions in our factories in Manila, Philippines. Test functions are performed in our factories in Manila, Philippines, and at our facility in Huntsville, Alabama. As a result of our combination, we have recently experienced a period of rapid growth and expansion. To manage this growth and any future growth effectively, we intend to enhance our existing operational and financial systems. We also moved our U.S. corporate headquarters to a new facility in Plano, Texas, during September 2000.

Results of Operations

The following table sets forth, for the periods presented, certain data from our consolidated statements of operations expressed as a percentage of net revenues:

	Three Months Ended June 30,		Six Months Ended June 3	
	2001	2000	2001	2000
Net revenues	100 %	100 %	100 %	100
Cost of revenues	70	65	75	69
Gross margin	30	35	25	31
Operating expenses:				
Research and development:				
Stock option compensation	2	2	2	2
Other	25	20	24	19
	27	22	26	21
Acquired in-process research and development	-	-	-	44
Selling, general and administration:				
Stock option compensation	3	6	3	5

Other	29	32	26	28
	32	38	29	33
Amortization of intangible assets and goodwill	13	15	11	15
Total operating expenses	72	75	66	113
Loss from operations	(42)	(40)	(41)	(82)
Other income (expense)	(2)	(2)	2	4
Loss before income taxes	(44)	(42)	(39)	(78)
Income tax expense (benefit)	(1)	3	(2)	3
Net loss	(43) %	(45) %	(37) %	(81)

Comparison of the Three and Six Months Ended June 30, 2001 and 2000.

Net Revenues

Revenues are recorded net of a provision for returns. Our net revenues increased $3.2 million, or 11%, to $32.1 million in the six months ended June 30, 2001, from $29.0 million in the six months ended June 30, 2000. The increase is primarily due to increased demand for our products in the cable modem market in the first quarter of 2001 and the increased demand for our products in the automotive entertainment market in the second quarter of 2001. Our net revenues decreased $0.6 million, or 4%, to $14.5 million in the three months ended June 30, 2001, from $15.1 million in the three months ended June 30, 2000. This decrease is primarily due to lower demand for our cable modem products offset by increased demand for our automotive entertainment products . Our industry has recently experienced a buildup of inventories that has negatively impacted current demand for our products in the three and six months ended June 30, 2001. We expect softness in demand and increasing pressure to reduce the selling prices of our cable modem products in the near future as the industry completes its inventory correction. However, we expect to see increasing revenues as a result of expected gains in market share for our automotive entertainment products, set-top box products and cable telephony products.

Cost of Revenues

Cost of revenues includes the cost of purchases for subcontracted materials, integrated circuit assembly, factory labor and overhead and warranty costs. In addition, we perform final testing of our products and incur cost for the depreciation of our test and handling equipment, labor, quality assurance and logistics. Our subcontracted materials experience cyclical trends in pricing due to fluctuations in demand. Our cost of revenues in the six months ended June 30, 2001 were $24.2 million, or 75% of net revenues, compared to $19.9 million, or 69% of net revenues, in the six months ended June 30, 2000. Our cost of revenues in the three months ended June 30, 2001 were $10.1 million, or 70% of net revenues, compared to $9.9 million, or 65% of net revenues, in the three months ended June 30, 2000. Our gross margins in the three and six months ended June 30, 2001 have decreased compared to the same periods for 2000 as a result of lower loading of our factories and decreased demand in the industry which has resulted in increased competition. In addition, our gross margins in the six months ended June 30, 2001 have decreased compared to the same period for 2000 as a result of a reserve of $1.7 million for excess inventory that was recorded in the first quarter of 2001. In the near future, we believe gross margins may improve due to increased efficiencies in our factories and increasing levels of our silicon in our product mix partially offset by increased selling price pressures. However, we do not expect gross margins to consistently increase each quarter. As we add new products to our manufacturing lines, we will incur higher cost of revenues, which we expect will be offset as we negotiate volume discounts with our suppliers and become more efficient in manufacturing each new product.

Research and Development

Research and development expenses consist of personnel-related expenses, lab supplies, training and prototype subcontract materials. We expense all of our research and development costs in the period incurred. Research and development expenses for the six months ended June 30, 2001 were $8.2 million, or 26% of net revenues, compared to $6.3 million, or 21% of net revenues, in the six months ended June 30, 2000. Research and development expenses for the three months ended June 30, 2001 were $3.9 million, or 27% of net revenues, compared to $3.5 million, or 22% of net revenues, in the three months ended June 30, 2000. The increase in research and development expenses reflects continued recruiting of engineers and increased prototype activity in the silicon design process. We expect that research and development expenses will increase in absolute dollars in future periods, and may fluctuate significantly as a percentage of total revenues from period to period. Stock option compensation related to research and development was $0.7 million and $0.6 million in the six months ended June 30, 2001 and 2000, respectively, and $0.3 million and

$0.4 million in the three months ended June 30, 2001 and 2000, respectively, but does not affect our total stockholders' equity or cash flows.

Acquired In-Process Research and Development

As a result of our combination with Microtune KG, we recorded acquired in-process research and development costs of $12.7 million for the six months ended June 30, 2000. Amounts allocated to acquired in-process research and development were expensed at the date of combination, because the purchased research and development had not reached technological feasibility based on the status of design and development activities that required further refinement and testing. Acquired in-process research and development did not affect our cash flows from operations.

Selling, General and Administration

Selling, general and administration expenses include our personnel-related expenses for administrative, financial, human resources, marketing and sales, and information technology departments, and include expenditures related to legal, public relations and financial advisors. In addition, these expenses include promotional and marketing costs, sales commissions, shipping costs to customers and reserves for bad debts. Selling, general and administration expenses for the six months ended June 30, 2001 were $9.2 million, or 29% of net revenues, compared to $9.5 million, or 33% of net revenues, in the six months ended June 30, 2000. Selling, general and administration expenses for the three months ended June 30, 2001 were $4.7 million, or 32% of net revenues, compared to $5.7 million, or 38% of net revenues, in the three months ended June 30, 2000. The decrease for both periods relates to reductions in certain duplications in headcount and overhead that existed when the Company and Temic first merged. Stock option compensation related to selling, general and administration was $1.0 million and $1.4 million in the six months ended June 30, 2001 and 2000, respectively, and $0.4 million and $0.9 million in the three months ended June 30, 2001 and 2000, respectively, but does not affect our total stockholders' equity or cash flows. The decrease in stock option compensation is primarily due to the termination of options for employees who are no longer employed by the Company.

Amortization of Intangible Assets and Goodwill

Amortization of intangible assets and goodwill for the six months ended June 30, 2001 was $3.6 million compared to $4.4 million, for the six months ended June 30, 2000. Amortization of intangible assets and goodwill for the three months ended June 30, 2001 was $1.8 million compared to $2.2 million, for the three months ended June 30, 2000. Amortization of intangible assets and goodwill results principally from our combination with Microtune KG. The combination has been accounted for using the purchase method of accounting. The purchase price allocated to intangible assets of $8.0 million is being amortized over the estimated useful lives of the related assets of one to five years. Goodwill resulting from the transaction totaled $28.3 million and is being amortized over five years. The amount of amortization for intangible assets and goodwill will decrease effective January 1, 2002, as a result of the effective date of SFAS No. 142, Goodwill and Other Intangible Assets, and it is currently estimated that annual amortization of intangible assets and goodwill will decrease $5.8 million.

Other Income and Expense

Other income consists of interest income from investment of cash and cash equivalents, foreign currency gains and losses and other non-operating income and expenses.

Interest income increased for the six months ended June 30, 2001 to $1.9 million compared to $0.5 million, for the six months ended June 30, 2000. Interest income increased for the three months ended June 30, 2001 to $0.8 million compared to $0.2 million, for the three months ended June 30, 2000. The increase is mainly due to the investment of proceeds from our initial public offering on August 4, 2000.

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The foreign currency translation and transaction gain (loss), net relates to the operations of Microtune KG and its subsidiaries. We used the German Mark as the functional currency for Microtune KG's and its subsidiaries' financial statements through June 30, 2000. Foreign currency exchange gains and losses resulting from the remeasurement of financial statements not denominated in German Marks of Microtune KG and its subsidiaries outside of Germany into German Marks were recognized in the statements of operations as a component of foreign currency gains and losses through June 30, 2000. Foreign currency exchange gains and losses resulting from the translation of financial statements denominated in German Marks of Microtune KG and its subsidiaries into U.S. Dollars were included as a component of stockholders' equity through June 30, 2000.

Starting July 1, 2000, we used the U.S. Dollar as the functional currency for Microtune KG's and its subsidiaries' financial statements. The functional currency was changed to the U.S. Dollar from German Marks for these entities as a result of the manner in which these entities are now managed and operated. Foreign currency exchange gains and losses resulting from the remeasurement of financial statements not denominated in U.S. dollars of Microtune KG and its subsidiaries into U.S. Dollars are recognized currently in the statement of operations as a component of foreign currency gains and losses.

Income Taxes

Prior to our combination with Microtune KG, the Company had not recognized any provision for income taxes. For U.S. federal income tax purposes, at December 31, 2000, the Company had a net operating loss carryforward of approximately $26.0 million and an unused research and development credit carryforward of approximately $1.0 million, which begins to expire in 2011. Due to the uncertainty of our ability to utilize these deferred tax assets, they have been fully reserved.

The benefit for the three and six months ended June 30, 2001, and the provision for the three and six months ended June 30, 2000, consists of foreign income taxes and U.S. state franchise taxes. Effective January 1, 2001, the German government reduced tax rates of retained earnings, previously 40%, and earnings distributed as a dividend, previously 30%, to a flat rate of 25%. The impact of this change on deferred income taxes was recorded in the third quarter of 2000 when the law was inacted.

Liquidity and Capital Resources

Prior to our combination with Microtune KG, we funded our operations primarily through the issuance of convertible preferred stock which generated net cash proceeds of approximately $44.2 million. On August 4, 2000, we issued 4.6 million common stock shares in our initial public offering that raised net proceeds of approximately $66.8 million. As of June 30, 2001, we had net working capital of $80.6 million, including $71.1 million of cash and cash equivalents.

At June 30, 2001, Microtune KG had a credit agreement with a bank that provides for borrowings of up to $0.9 million. The agreement is cancelable upon notification by the bank. Borrowings under this agreement bear interest at a rate determined from time to time by the bank. The rate was 7.25% at June 30, 2001. At June 30, 2001, no borrowings were outstanding under this credit agreement.

Investments in property and equipment were $6.4 million and $6.5 million in the six months ended June 30, 2001 and 2000, respectively. We expect capital expenditures to remain consistent with the levels experienced in 2000. Other uses of cash include the funding of operating activities, which were $0.5 million and $4.7 million in the six months ended June 30, 2001 and 2000, respectively.

We believe that our current cash balance will provide adequate liquidity to fund our operations and meet our other cash requirements for at least the next 24 months. However, we may find it necessary or we may choose to seek additional financing if our investment plans change or if industry or market conditions are favorable for a particular type of financing. We cannot be sure that financing will be available on reasonable

terms, or at all, when and if required. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders will be reduced.

Item 3. Qualitative and Quantitative Disclosure About Market Risk

The following discusses our exposure to market risk related to changes in interest rates, equity prices and foreign currency exchange rates. This discussion contains forward looking statements that are subject to risks and uncertainties. Actual results could vary materially as a result of a number of factors including those set forth in the "Factors Affecting Future Operating Results and Stock Price" section.

Following our combination with Temic, we now transact both sales and purchases in multiple foreign currencies, including Euros, German Marks and Philippine Pesos. Due to the volatile nature of the currency markets, there is a potential risk of foreign currency translation losses, as well as gains. We currently do not use derivative financial instruments to hedge our balance sheet exposures against future movements in exchange rates. However, we are consistently evaluating our exchange risk management strategy, including changes in our organizational structure and other capital structuring techniques to manage our currency risk.

Our net investment in foreign subsidiaries, translated into U.S. dollars using exchange rates at June 30, 2001 was $58.8 million. A potential loss in the value of this net investment resulting from a hypothetical 10% adverse change in foreign exchange rates would be approximately $5.9 million.

On January 1, 1999, 11 European Union member states (Germany, France, the Netherlands, Austria, Italy, Spain, Finland, Ireland, Belgium, Portugal and Luxembourg) adopted the Euro as their common national currency. Until January 1, 2002, either the Euro or a participating country's national currency will be accepted as legal tender. Beginning on January 1, 2002, Euro-denominated bills and coins will be issued, and by July 1, 2002, only the Euro will be accepted as legal tender. We do not expect future balance sheets, statements of operations or statements of cash flows to be materially impacted by the Euro conversion.

Factors Affecting Future Operating Results and Stock Price

This report contains forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward looking statements as a result of certain factors, including those set forth below and elsewhere in this report.

If we are unable to migrate our customers over time from our modules using discrete components to our RF silicon products or our modules that incorporate our RF silicon products, our operating results could be harmed.

Currently, most of our revenues are from the sale of our tuner modules using discrete, third-party components. Our future success will depend on our ability to successfully migrate our customers from our modules that use discrete components to our RF silicon products, or MicroModules containing the MicroTuner and other silicon products, by convincing leading equipment manufacturers to select these products for design into their own products. If we are not able to convince these manufacturers to incorporate our silicon products our operating results could be harmed.

We have not completed our integration with Microtune KG's operations and we may be unable to do so effectively.

We combined with Microtune KG in January, 2000 and we are still in the process of integrating Microtune KG's German and Philippines operations with ours. Integrating operations of two ongoing businesses can be difficult especially when they are located in different countries. In addition to integrating the operational aspects of our two companies, we will also face challenges coordinating and consolidating our financial reporting functions. For example, our accounting functions utilize different software programs, and

Microtune KG's consolidated financial statements have historically been prepared based on German generally accepted accounting principles. We may not be able to complete this integration on a timely and cost-effective basis.

We are dependent upon third parties, some of which compete with us, for the supply of components for our module manufacturing. Our failure to obtain components for our module manufacturing would seriously harm our ability to ship modules to our customers in a timely manner.

Many of the components for our modules are sole-sourced, meaning that we are dependent upon one supplier for a specific component. At times we have experienced significant difficulties in obtaining an adequate supply of components necessary for our manufacturing operations, which have on occasion prevented us from delivering radio frequency products to our customers in a timely manner. For example, in 2000, we did not receive our expected allocation of components from several significant sole-source suppliers which constrained our ability to meet customer demand. We may experience similar shortages of components in the future.

We usually do not have long-term supply agreements with our suppliers and instead obtain components on a purchase order basis. Our suppliers typically have no obligation to supply products to us for any specific period, in any specific quantity or at any specific price, except as set forth in a particular purchase order. Our requirements often represent a small portion of the total production capacity of our suppliers, and our suppliers may reallocate capacity to other customers even during periods of high demand for our radio frequency products. In addition, some of our suppliers offer or may offer products that compete with our radio frequency products. As a result, these suppliers may preferentially allocate their components to in-house or third party manufacturers, rather than us.

If our suppliers were to become unable or unwilling to continue manufacturing or supplying the components that we utilize in our radio frequency products, our business would be seriously harmed. As a result, we would have to identify and qualify substitute suppliers or design around the component. This would be time-consuming and difficult, and may result in unforeseen manufacturing and operations problems. This may also require our customers to requalify our parts for their products, which may be a lengthy process. The loss of a significant supplier or the inability of a supplier to meet performance and quality specifications or delivery schedules could impede our ability to meet customer demand for timeliness, performance and quality, which could harm our reputation and our business.

If we are unable to develop and introduce new radio frequency products successfully and in a cost-effective and timely manner or to achieve market acceptance of our new products, our operating results would be substantially harmed.

Our future success will depend on our ability to develop new radio frequency products for existing and new markets, introduce these products in a cost-effective and timely manner, meet customer specifications and convince leading equipment manufacturers to select these products for design into their own new products. Our quarterly results in the past have been, and are expected in the future to continue to be, dependent on the introduction and market acceptance of a relatively small number of new products and the timely completion and delivery of those products to our customers. For example, we believe that market acceptance of our radio frequency integrated circuits for the cable modem market will be limited until the time that we introduce radio frequency integrated circuits with the power requirements that conform to the evolving specifications of some cable modem manufacturers.

The development of new radio frequency products is highly complex, and from time to time we have experienced delays in completing the development and introduction of new products. In addition, some of our new product development efforts are focused on producing silicon products utilizing architectures and technologies with which we have no experience, and delivering performance characteristics such as low power consumption at levels that we have not previously achieved. If we are not able to develop and

introduce these new products successfully and in a cost-effective and timely manner, we will not be able to successfully penetrate all of our target markets and our operating results would be substantially harmed.

We face intense competition in the broadband communications and radio frequency tuner markets, which could reduce our market share in existing markets and affect our ability to enter new markets.

The broadband communications and radio frequency markets are intensely competitive. We expect competition to continue to increase in the future as industry standards become well known and as other competitors enter our target markets. We compete with, or may in the future compete with, a number of major domestic and international suppliers of integrated circuit and system modules in the cable modem, PC/TV, set-top box, cable telephony, digital TV and automotive markets. We compete primarily with tuner manufacturers such as Alps, Panasonic, Philips Electronics, Samsung and Thomson, and with semiconductor companies such as Anadigics, Analog Devices, Broadcom and Maxim, and potentially with companies such as Conexant and Silicon Wave. This competition has resulted and may continue to result in declining average selling prices for our radio frequency products.

Many of our current and potential competitors have advantages over us, including:

- longer operating histories and presence in key markets;
- greater name recognition;
- access to larger customer bases;
- significantly greater financial, sales and marketing, manufacturing, distribution, technical and other resources; and
- relationships with potential customers as a result of the sales of other components, which relationships our competitors can leverage into sales of products competitive with our radio frequency products.

As a result, our competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements and may be able to devote greater resources to the development, promotion and sale of their products.

Consolidation by industry participants, including in some cases, acquisitions of some of our customers or suppliers by our competitors, or vice versa, could create entities with increased market share, customer base, technology and marketing expertise in markets in which we compete. In fact, some of our suppliers offer or may offer products that compete with our radio frequency products. These developments may significantly and adversely affect our current markets, the markets we are seeking to serve and our ability to compete successfully in those markets, thereby harming our results from operations.

If we do not anticipate and adapt to evolving industry standards in the radio frequency tuner and broadband communications markets, or if industry standards develop more slowly than expected, our products could become obsolete and we could lose market share.

Products for broadband communications applications generally are based on industry standards that are continuously evolving. In some cases, the development of these standards takes longer than was originally anticipated. We have directed our development toward producing radio frequency products that comply with the evolving standards. The slowness of the development of a standard in our target markets has resulted in slower deployment of new technologies, which may harm our ability to sell our radio frequency products, or the continued use of proprietary technologies. The continued delay in the development of the standards could result in fewer manufacturers purchasing our radio frequency products in favor of continuing to use the proprietary technologies designed by our competitors. Either of the aforementioned effects would result in diminished revenues and consequently harm our business. Further, if new industry standards emerge, our products or our customers' products could become unmarketable or obsolete. We may also have to incur substantial unanticipated costs to comply with these new standards.

Our ability to adapt to changes and to anticipate future standards and the rate of adoption and acceptance of those standards is a significant factor in maintaining or improving our competitive position and prospects for growth. Our inability to anticipate the evolving standards in the broadband communications market and, in particular, in the radio frequency market, or to develop and introduce new products successfully into these markets could result in diminished revenues and consequently harm our business.

The average selling price of our products will likely decrease over time. If the selling price reductions are greater than we expect, our operating results will be harmed.

Historically, the average selling price of our products has decreased over the products' lives. In addition, as the markets for radio frequency integrated circuit products and transceivers mature, we believe that it is likely that the average unit prices of our radio frequency products will decrease in response to competitive pricing pressures, increased sales discounts and new product introductions. To offset these decreases, we rely primarily on achieving yield improvements and other cost reductions for existing products and on introducing new products that can often be sold at higher average selling prices.

Although, we will seek to increase the sales of our higher margin products, our sales, product and process development efforts may not be successful. Our new products or processes may not achieve market acceptance. To the extent we are unable to reduce cost and emphasis on higher margin products does not occur, our results of operations would suffer.

We expect our quarterly operating results to fluctuate.

Our quarterly results of operations have fluctuated in the past and may fluctuate significantly in the future due to a number of factors, many of which are not in our control. These factors include:

- timing, cancellation and rescheduling of significant customer orders which result in revenues being shifted from one quarter to another;
- ability of our customers to procure the necessary components for their end-products that utilize our radio frequency tuners to conduct their operations as planned for any quarter;
- pricing concessions on volume sales to particular customers for established time frames;
- slowdown in customer demand and related industry-wide buildup of inventories;
- our inability to predict our customers' demand for our products;
- changes in our product and customer mix between quarters; and
- quality problems with our radio frequency tuners that result in

significant returns.

We believe that transitioning our silicon products to higher performance process technologies will be important to our future competitive position. If we fail to make this transition efficiently, our competitive position could be seriously harmed.

We continually evaluate the benefits, on a product-by-product basis, of migrating to higher performance process technologies in order to produce more efficient and higher performance integrated circuits. We believe this migration is required to remain competitive. Other companies in the industry have experienced difficulty in migrating to new process technologies and, consequently, have suffered reduced yields, delays in product deliveries and increased expense levels. We may experience similar difficulties.

Moreover, we are dependent on our relationships with foundries to successfully migrate to higher performance processes. Our foundry suppliers may not make higher performance process technologies available to us on a timely or cost-effective basis, if at all. If our foundry suppliers do not make higher performance process technologies available to us on a timely or cost-effective basis or if we experience difficulties in migrating to these advanced processes, our competitive position and business prospects could be seriously harmed.

Because we depend on a few significant customers for a substantial portion of our revenues, the loss of a key customer could seriously harm our business.

We have derived a substantial portion of our revenues from sales to a relatively small number of customers. As a result, the loss of any significant customer could significantly harm our revenues. Sales to DaimlerChrysler accounted for approximately 24% of consolidated net revenues for the six months ended June 30, 2001. Sales to DaimlerChrysler, Motorola/General Instruments, Askey and Panasonic accounted for approximately 29%, 13%, 11% and 11%, respectively, of consolidated net revenues for the three months ended June 30, 2001. Sales to our twenty largest customers, including sales to their respective manufacturing subcontractors, accounted for approximately 94% of total sales for the three months ended June 30, 2001. We believe that our future operating results will continue to depend on the success of our largest customers and on our ability to sell existing and new products to these customers in significant quantities. The loss of a key customer or a reduction in our sales to any key customer could harm our revenues and consequently our financial condition.

If we are unable to continue to sell existing and new products to our key customers in significant quantities or to attract new significant customers, our future operating results could be harmed.

We may not be able to maintain or increase sales to our key customers or to attract new significant customers for a variety of reasons, including the following:

- most of our customers can stop purchasing our radio frequency products with limited notice to us without incurring any significant contractual penalty;
- most of our customers typically buy our radio frequency tuners through a purchase order, which does not require them to purchase a minimum amount of our radio frequency tuners;
- many of our customers and potential customers have pre-existing relationships with our current or potential competitors, which may affect their decision to purchase our radio frequency tuners;
- some of our customers or potential customers offer or may offer products

that compete with our radio frequency tuners; and

. our longstanding relationships with some of our larger customers may also deter other potential customers who compete with these customers from buying our radio frequency products.

If we do not maintain or increase sales to existing customers or attract significant new customers, our revenues would diminish and consequently our business would be harmed.

The sales cycle for our radio frequency products is long, and we may incur substantial non-recoverable expenses and devote significant resources to sales that may not occur when anticipated or at all.

Our customers typically conduct significant evaluation, testing, implementation and acceptance procedures before they purchase our radio frequency products. As a result, we may expend significant financial and other resources to develop customer relationships before we recognize any revenues from these relationships, and we may never recognize any revenues from these efforts. Our customers' evaluation processes are frequently lengthy and may range from three months to one year or more. In many situations, our customers design their products to specifically incorporate our radio frequency products, and our radio frequency products must be designed to meet their stringent specifications. This process can be complex and may require significant engineering, as well as sales, marketing and management efforts on our part. This process becomes more complex as we simultaneously qualify our products with multiple customers.

Uncertainties involving the ordering and shipment of our radio frequency products could harm our business.

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Our sales are typically made pursuant to individual purchase orders, and we generally do not have long-term supply arrangements with our customers. Our sales orders typically provide that our customers may cancel orders until 90 days prior to the shipping date and may reschedule shipments up to 30 days prior to the shipping date; however, in the past, we have permitted customers to cancel orders less than 90 days before the expected date of shipment, in many cases with little or no penalty. Moreover, we routinely manufacture or purchase inventory based on estimates of customer demand for our radio frequency products, which demand is difficult to predict. The cancellation or deferral of product orders, the return of previously sold products or overproduction due to the failure of anticipated orders to materialize could result in our holding excess or obsolete inventory that could substantially harm our business, financial condition and results of operations. In addition, our inability to produce and ship radio frequency products to our customers in a timely manner could harm our reputation and damage our relationships with our customers.

We customize a substantial portion of our radio frequency products to address our customers' specific radio frequency needs. If we do not sell our customer-specific products in large volumes, we may be unable to cover our fixed costs or may be left with substantial unsaleable inventory.

We manufacture a substantial portion of our radio frequency products to address the needs of individual customers. Frequent product introductions by systems manufacturers make our future success dependent on our ability to select development projects that will result in sufficient volumes to enable us to achieve manufacturing efficiencies. Because customer-specific radio frequency products are developed for unique applications, we expect that some of our current and future customer-specific radio frequency products may never be produced in volume and may impair our ability to cover our fixed manufacturing costs. In addition, if our customers fail to purchase these customized radio frequency products from us, we risk having substantial unsaleable inventory. If substantial unsaleable inventory occurs, our financial condition would be harmed.

Other technologies for the broadband communications market will compete with some of our target markets. If these technologies prove to be more reliable, faster or less expensive or become more popular, the demand for our radio frequency products and our revenues may decrease.

Some of our target markets, such as cable modem and cable telephony services, are competing with a variety of different non-radio frequency based broadband communications technologies, including digital subscriber line technology. Many of these technologies will compete effectively with cable modem and cable telephony services. If any of these competing technologies are more reliable, faster or less expensive, reach more customers or have other advantages over radio frequency based broadband technology, the demand for our radio frequency products and our revenues may decrease.

We depend on the continued growth of the broadband communications market generally, and the radio frequency product market specifically, for our success.

We derive a substantial portion of our revenues from sales of radio frequency products for broadband communication applications, in particular, the cable modem market. These markets are characterized by the following:

- intense competition;
- rapid technological change; and
- short product life cycles, especially in the consumer electronics markets.

Although the broadband communications market, in general, has grown rapidly in the last few years, it may not continue to grow or a significant slowdown in this market may occur. In particular, the set-top box, cable modem and cable telephony markets may not grow at a rate sufficient for us to achieve profitability or at all. Because of the uncertainty of the level of competition and the strength of competitors in the broadband communications market, the unproven technology of many products addressing this market and the short life

cycles of many consumer products, it is difficult to predict the potential size and future growth rate of the radio frequency product market. In addition, the broadband communications market is transitioning from analog to digital, as well as expanding to new services, including internet access, cable telephony and interactive television. The future growth of the radio frequency product market is partially dependent upon the market acceptance of products and technologies addressing the broadband communications market, and we cannot assure you that the radio frequency technologies upon which our products are based will be accepted by the market. If the demand for radio frequency products is not as great as we expect, we may not be able to generate sufficient revenues to become successful.

The semiconductor industry is cyclical. If there is a sustained upturn in the semiconductor market, there could be a resulting increased demand for foundry services, significantly increasing prices and reducing product availability.

The semiconductor industry periodically experiences increased demand and production capacity constraints. An increased demand for semiconductors could substantially increase the cost of producing our radio frequency products, in particular, our integrated circuit products, and consequently reduce our profit margins. As a result, we may experience substantial period-to-period fluctuations in future results of operations due to general semiconductor industry conditions.

We primarily depend on a single third-party wafer foundry to manufacture all of our integrated circuit products, which reduces our control over the integrated circuit manufacturing process.

We do not own or operate a semiconductor fabrication facility. We primarily rely on IBM, an outside foundry, to produce most of our integrated circuit radio frequency products, although we are in the process of qualifying x-FAB for manufacturing our newer integrated circuit products. We do not have a long-term supply agreement with IBM and instead obtain manufacturing services on a purchase order basis. IBM has no obligation to supply products to us for any specific period, in any specific quantity or at any specific price, except as set forth in a particular purchase order. Our requirements represent a small portion of the total production capacity of this foundry, and IBM may reallocate capacity to other customers even during periods of high demand for our integrated circuits. If IBM were to become unable or unwilling to continue manufacturing our integrated circuits, our business would be seriously harmed. As a result, we would have to identify and qualify substitute foundries, which would be time consuming and difficult, resulting in unforeseen manufacturing and operations problems. In addition, if competition for foundry capacity increases, our product costs may increase, and we may be required to pay significant amounts to secure access to manufacturing services. If we do not qualify or receive supplies from additional foundries, including x-FAB, we may be exposed to increased risk of capacity shortages due to our dependence on IBM.

We depend on a single third-party subcontractor for integrated circuit packaging which reduces our control over the integrated circuit packaging process

Our integrated circuit products are packaged by a sole independent subcontractor, Amkor, using facilities located in South Korea. We do not have long-term agreements with Amkor and typically obtain services from them on a purchase order basis. Our reliance on Amkor involves risks such as reduced control over delivery schedules, quality assurance and costs. These risks could result in product shortages or increase our costs of packaging our products. If Amkor is unable or unwilling to continue to provide packaging services of acceptable quality, at acceptable costs and in a timely manner, our business would be seriously harmed. We would also have to identify and qualify substitute subcontractors, which could be time consuming and difficult and may result in unforeseen operations problems.

We may be unable to integrate operations that we may acquire in the future.

From time to time, we expect to continue to evaluate acquisitions and may make additional acquisitions in the future. Our acquisition of Microtune KG was our first acquisition of a business.

Accordingly, we have limited organizational experience in acquiring and integrating businesses, and we will need to develop the relevant skills if we are to be successful in realizing the benefits of any future acquisitions. If in the future we acquire technologies or businesses, we could have difficulty integrating acquired technology into our product offerings or integrating our technology with an acquired company's products. We could also have difficulty coordinating and integrating overall business strategies, controls, procedures and policies, as well as sales and marketing and research and development efforts. Assimilating employees into our corporate culture and coordinating operations across geographically dispersed locations could prove to be difficult or time consuming. Moreover, we currently do not know and cannot predict the accounting treatment of any future acquisition, in part because we cannot be certain what accounting regulations, conventions or interpretations may prevail in the future. These difficulties could disrupt our ongoing business, distract our management and employees and increase our expenses. Furthermore, we may have to incur debt or issue equity securities to pay for any future acquisitions, and those issuances could be dilutive to our existing stockholders.

Our inability to generate revenues from international sales could harm our financial results.

For the six months ended June 30, 2001, 50% of our net revenues were from sales outside of North America. We plan to increase our international sales activities by hiring additional international sales personnel. Our international sales will be limited if we cannot do so. Even if we are able to expand our international operations, we may not succeed in maintaining or increasing international market demand for our products.

Currency fluctuations related to our international operations could harm our financial results.

A significant portion of our international revenues and expenses are denominated in foreign currencies. Accordingly, in the past, we have experienced significant fluctuations in our financial results due to changing exchange rates rather than operational changes. We expect currency fluctuations to continue, which may significantly impact our financial results in the future. We may choose to engage in currency hedging activities to reduce these fluctuations.

Our international operations, including our operations in Germany, the Philippines, Hong Kong, Taiwan and Korea, may be negatively affected by actions taken or events that occur in countries over which we have no control.

We currently have facilities and suppliers located outside of the U.S., including research and development operations in Ingolstadt, Germany, and two manufacturing facilities in Manila, Philippines, and sales offices in Hong Kong, Taiwan and Korea. As a result, our operations are affected by the local conditions in those countries, as well as actions taken by the governments of those countries. For example, if the Philippines government enacts restrictive laws or regulations, or increases taxes paid by manufacturing operations in that country, the cost of manufacturing our products in Manila could increase substantially, causing a decrease in our gross margins and profitability. In addition, if the U.S. imposes significant import restrictions on our products, our ability to import our products into the U.S. from our international manufacturing and packaging facilities could be diminished or eliminated. Local economic and political instability in areas in the Far East, in particular in the Philippines where there has been political instability in the past, could result in unpleasant or intolerable conditions for our workers, and ultimately could result in a shutdown of our facilities in that country.

International operations that we may initiate or acquire in the future may subject us to additional business risks, including political instability, and changing or conflicting laws, regulations and tax schemes.

We may acquire or open additional international operations in Europe and the Pacific Rim region. International expansion or acquisitions, and any subsequent international operations, could be affected by the

local conditions in those countries, as well as actions taken by the governments of those countries. To expand our operations internationally, we will have to comply with the laws and regulations of each country in which we conduct business. For example, if a foreign government enacts restrictive laws or regulations, or increases taxes paid by manufacturing operations in that country, the cost of manufacturing our products in that country could increase substantially, causing a decrease in our gross margins and profitability. We cannot assure you that we will be successful in obtaining the necessary regulatory approval, or in complying with applicable regulations in those countries or, if such approvals are obtained or such regulations are complied with, that we will be able to continue to comply with these regulations.

Our success could be jeopardized if key personnel leave.

Our future success depends largely upon the continued service of our executive officers and other key management and technical personnel. Our success also depends on our ability to continue to attract, retain and motivate qualified personnel. Our personnel represent a significant asset as the source of our technological and product innovations. The competition for qualified personnel is intense in the radio frequency silicon and radio frequency systems industries. We cannot assure you that we will be able to continue to attract and retain qualified management, technical and other personnel necessary for the design, development, manufacture and sale of our radio frequency products. We may have difficulty attracting and retaining key personnel particularly during periods of poor operating performance. The loss of the services of one or more of our key employees or our inability to attract, retain and motivate qualified personnel could harm our business.

Our manufacturing operations could be jeopardized and our production decreased if our labor union causes labor slowdowns or shutdowns at our union facility.

One of our manufacturing facilities is covered by union representation. This facility currently manufactures a significant portion of our tuner module products. If we experience labor slowdowns or shutdowns at this facility due to actions by the labor union, our manufacturing output, and consequently our revenues, could be diminished.

We must manage our growth.

If we fail to manage our growth, our reputation and results of operations could be harmed. Since June 30, 2000, our total number of employees has grown from 142 to 173 as of June 30, 2001, excluding manufacturing personnel in Manila, Philippines. In addition, as of June 30, 2001, we had 1,157 manufacturing personnel, in the Philippines. The resulting growth has placed, and is expected to continue to place, significant demands on our personnel, management and other resources. We must continue to improve our operational, financial and management information systems to keep pace with the growth of our business.

Our business may be harmed if we fail to protect our proprietary technology.

We rely on a combination of patents, trademarks, copyrights, trade secret laws, confidentiality procedures and licensing arrangements to protect our intellectual property rights. We currently have patents issued and pending in the U.S. and in foreign countries. We intend to seek further U.S and international patents on our technology. We cannot be certain that patents will be issued from any of our pending applications or that patents will be issued in all countries where our products can be sold or that any claims will be allowed from pending applications or will be of sufficient scope or strength to provide meaningful protection or any commercial advantage. Our competitors may also be able to design around our patents. The laws of some countries in which our products are or may be developed, manufactured or sold, including various countries in Asia, may not protect our products or intellectual property rights to the same extent as do the laws of the U.S., increasing the possibility of piracy of our technology and products. Although we intend to vigorously defend our intellectual property rights, we may not be able to prevent misappropriation of our technology. Our competitors may also independently develop technologies that are substantially equivalent or superior to our technology.

Our ability to sell our radio frequency products may suffer if any outstanding claims of intellectual property infringement against us or one of our customers is valid or if any other third party claims that we or our customers infringe on their intellectual property or if any of our issued patents are proven to be invalid.

The electronics industry is characterized by vigorous protection and pursuit of intellectual property rights or positions, which have resulted in significant and often protracted and expensive litigation. In addition, our customers may be subject to infringement claims for products incorporating our radio frequency products. If any claims of infringement are made against any of our customers, our customers may seek to involve us in the infringement claim and request indemnification from us. For example, we could be notified of a claim against one of our customers for which the customer would make a claim for indemnification from us. If the claim resulted in an adverse result for our customer, it may reduce or completely eliminate marketing of its infringing product, which would decrease sales of our radio frequency tuners to this customer. Further, if our customer prevailed in its claim for indemnification against us, or if we were found to infringe on any other third- party intellectual property, we could be required to:

- pay substantial damages such as a royalties on our historical and future product sales;
- indemnify our customers for their legal fees and damages paid;
- stop manufacturing, using and selling the infringing products;
- expend significant resources to develop non-infringing technology;
- discontinue the use of some of our processes; or
- obtain licenses to the technology.

We may be unsuccessful in developing noninfringing products or negotiating licenses upon reasonable terms, or at all. These problems might not be resolved in time to avoid harming our results of operations.

Furthermore, we have initiated, and may initiate in the future, claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. On January 24, 2001, we filed a lawsuit alleging patent infringement in the United States Court for the Eastern District of Texas, Sherman Division, against Broadcom Corporation. The lawsuit is in the initial phases of discovery. Any current or future litigation by or against us or one of our customers could result in significant expense and divert the efforts of our technical personnel and management, whether or not the litigation results in a favorable determination.

The products of our customers are subject to governmental regulation.

Governmental regulation could place constraints on our customers and consequently minimize our customers' need or desire for our radio frequency products. The Federal Communications Commission, or FCC, has broad jurisdiction over several of our target markets in the U.S. Similar governmental agencies regulate our target markets in other countries. Although our products are not directly subject to current regulations of the FCC or any other federal or state communications regulatory agency, much of the equipment into which our products are incorporated is subject to direct government regulation. Accordingly, the effects of regulation on our customers or the industries in which they operate may, in turn, impede sales of our products. For example, it is possible that demand for our radio frequency products will decrease if equipment incorporating our products fails to comply with FCC emissions specifications.

Part II Other Information

Item 1. Legal Proceedings

From time to time, we may be involved in litigation relating to claims arising out of our ordinary course of business. We are not currently a party to any material litigation, except as described below.

On January 24, 2001, we filed a lawsuit alleging patent infringement in the United States Court for the Eastern District of Texas, Sherman Division, against Broadcom Corporation. The lawsuit alleges that Broadcom Corporation's BCM 3415 microchip infringes our U.S. patent no. 5,737,035. In our compliant, we are seeking monetary damages resulting from the alleged infringement as well as injunctive relief precluding Broadcom Corporation from taking any further action which infringes our 5,737,035 patent. The lawsuit is still at an early stage.

Item 2. Changes In Securities and Use of Proceeds

From the time of receipt through June 30, 2001, we have applied our net proceeds from the offerings toward funding capital expenditures. Net cash used from our stock offerings for capital expenditures totaled $11.9 million through June 30, 2001. The Company is currently investing the remainder of the proceeds in interest bearing, investment grade securities for future use.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders.

At our Annual Meeting of the Stockholders held on April 26, 2001 in Plano, Texas, our stockholders voted on the following matters.

1. The election of class 1 directors to serve for a term of three years that expires upon the 2004 annual meeting of stockholders or until their successors are duly elected and qualified. The nominees of the Board of Directors were elected.

	For	Against Withhe
Douglas J. Bartek	33,166,620	856,
Harvey B. (Berry) Cash	33,885,605	137,
Walter S. Ciciora	33,887,215	135,

2. <u>To ratify the appointment of Ernst & Young LLP as the Company's independent auditors for the year ended December 31, 2001. The appointment of Ernst & Young LLP was ratified.</u>

	For	Against or Withheld
Ratification of Ernst & Young LLP as independent auditors	33,577,065	445,625

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Item 5. Other Information

Not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

(b) Reports on Form 8-K

There were no Form 8-K's filed during the quarter ended June 30, 2001.

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Signatures

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

Date: August 14, 2001

/s/ Everett (Buddy) Rogers

Everett (Buddy) Rogers
Chief Financial Officer and Vice President
of Finance and Administration
(Principal Financial and Accounting Officer)

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