

AMBARELLA INC  
Form 10-Q  
September 08, 2014  
Table of Contents

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

**Form 10-Q**

(Mark One)

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

**For the quarterly period ended July 31, 2014**

**OR**

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

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

**Commission file number: 001-35667**

**AMBARELLA, INC.**

**(Exact name of registrant as specified in its charter)**

**Cayman Islands**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**98-0459628**  
**(I.R.S. Employer**  
**Identification No.)**

**3101 Jay Street**

**Santa Clara, California**  
**(Address of principal executive offices)**

**95054**  
**(Zip Code)**

**(408) 734-8888**

**(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant 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

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

The number of ordinary shares, \$0.00045 par value, of the Registrant, outstanding as of July 31, 2014 was 29,695,783 shares.

**Table of Contents**

**AMBARELLA, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	<b>3</b>
Item 1. <u>Financial Statements</u>	3
<u>Unaudited Condensed Consolidated Balance Sheets at July 31, 2014 and January 31, 2014</u>	3
<u>Unaudited Condensed Consolidated Statements of Operations for the three and six months ended July 31, 2014 and 2013</u>	4
<u>Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended July 31, 2014 and 2013</u>	5
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended July 31, 2014 and 2013</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	28
Item 4. <u>Controls and Procedures</u>	29
<b><u>PART II. OTHER INFORMATION</u></b>	<b>29</b>
Item 1. <u>Legal Proceedings</u>	29
Item 1A. <u>Risk Factors</u>	29
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
Item 6. <u>Exhibits</u>	50
<u>Signatures</u>	51

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. Financial Statements****AMBARELLA, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share data)****(unaudited)**

	<b>July 31, 2014</b>	<b>January 31, 2014</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 128,263	\$ 143,394
Marketable securities	38,265	
Accounts receivable, net	26,833	18,837
Inventories	13,003	10,452
Restricted cash	3	3
Deferred tax assets, current	1,599	1,599
Prepaid expenses and other current assets	2,227	2,951
Total current assets	210,193	177,236
Property and equipment, net	3,080	3,018
Deferred tax assets, non-current	1,375	1,134
Other assets	1,772	1,919
Total assets	\$ 216,420	\$ 183,307
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	14,424	8,321
Accrued liabilities	12,344	11,705
Income taxes payable	706	545
Deferred revenue, current	4,888	4,831
Total current liabilities	32,362	25,402
Deferred revenue, non-current	178	
Other long-term liabilities	1,569	1,544
Total liabilities	34,109	26,946
Commitments and contingencies (Note 11)		
Shareholders' equity:		

Edgar Filing: AMBARELLA INC - Form 10-Q

Preference shares, \$0.00045 par value per share, 20,000,000 shares authorized and no shares issued and outstanding at July 31, 2014 and January 31, 2014, respectively		
Ordinary shares, \$0.00045 par value per share, 200,000,000 shares authorized at July 31, 2014 and January 31, 2014, respectively; 29,695,783 shares issued and outstanding at July 31, 2014; 28,748,513 shares issued and outstanding at January 31, 2014	13	13
Additional paid-in capital	121,686	110,285
Accumulated other comprehensive income (loss)	(21)	
Retained earnings	60,633	46,063
Total shareholders' equity	182,311	156,361
Total liabilities and shareholders' equity	\$ 216,420	\$ 183,307

See accompanying notes to condensed consolidated financial statements.

Table of Contents

## AMBARELLA, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

(unaudited)

	Three Months Ended		Six Months Ended July 31,	
	2014	2013	2014	2013
Revenue	\$ 46,968	\$ 37,710	\$ 87,889	\$ 71,651
Cost of revenue	16,432	14,419	31,757	26,667
<b>Gross profit</b>	<b>30,536</b>	<b>23,291</b>	<b>56,132</b>	<b>44,984</b>
<b>Operating expenses:</b>				
Research and development	13,497	10,974	26,411	22,291
Selling, general and administrative	6,875	5,385	13,630	10,542
Total operating expenses	20,372	16,359	40,041	32,833
Income from operations	10,164	6,932	16,091	12,151
Other income (loss), net	39	(11)	88	(16)
<b>Income before income taxes</b>	<b>10,203</b>	<b>6,921</b>	<b>16,179</b>	<b>12,135</b>
Provision for income taxes	893	667	1,609	1,140
<b>Net income</b>	<b>\$ 9,310</b>	<b>\$ 6,254</b>	<b>\$ 14,570</b>	<b>\$ 10,995</b>
Net income per share attributable to ordinary shareholders:				
Basic	\$ 0.32	\$ 0.23	\$ 0.50	\$ 0.40
Diluted	\$ 0.29	\$ 0.21	\$ 0.46	\$ 0.37
Weighted-average shares used to compute net income per share attributable to ordinary shareholders:				
Basic	29,421,200	27,409,343	29,198,511	27,232,142
Diluted	31,899,501	29,848,676	31,831,489	29,456,374

See accompanying notes to condensed consolidated financial statements.



Table of Contents**AMBARELLA, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(unaudited, in thousands)**

	<b>Three Months Ended July 31</b>		<b>Six Months Ended July 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Net income</b>	\$ 9,310	\$ 6,254	\$ 14,570	\$ 10,995
Other comprehensive income (loss):				
Unrealized gains (losses) on investments	(29)		(21)	
Other comprehensive income (loss), net of tax	(29)		(21)	
<b>Comprehensive income</b>	\$ 9,281	\$ 6,254	\$ 14,549	\$ 10,995

See accompanying notes to condensed consolidated financial statements.



Table of Contents

## AMBARELLA, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	<b>Six Months Ended July 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 14,570	\$ 10,995
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	628	481
Amortization/accretion of marketable securities	265	
Loss on disposal of long-lived assets	4	2
Stock-based compensation	5,823	3,199
Excess income tax benefits associated with stock-based compensation	(416)	(267)
Other non-cash items, net	(2)	
Changes in operating assets and liabilities:		
Accounts receivable	(7,996)	(1,728)
Inventories	(2,551)	(995)
Prepaid expenses and other current assets	973	882
Deferred tax assets	(241)	(196)
Other assets	147	(14)
Accounts payable	6,103	4,388
Accrued liabilities	727	(2,610)
Income taxes payable	577	362
Deferred revenue	235	1,440
Net cash provided by operating activities	18,846	15,939
<b>Cash flows from investing activities:</b>		
Purchase of investments	(41,621)	
Sales of investments	10	
Maturities of investments	2,812	
Net proceeds from disposal of fixed assets		13
Purchase of property and equipment	(678)	(1,293)
Net cash used in investing activities	(39,477)	(1,280)
<b>Cash flows from financing activities:</b>		
Proceeds from exercise of stock options, warrants, and employee stock purchase plan withholding, net of repurchase of stock options	5,084	2,915
Payment for initial public offering cost		(25)
Excess income tax benefits associated with stock-based compensation	416	267
Net cash provided by financing activities	5,500	3,157

Net increase (decrease) in cash and cash equivalents	(15,131)	17,816
Cash and cash equivalents at beginning of period	143,394	100,494
Cash and cash equivalents at end of period	\$ 128,263	\$ 118,310
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for income taxes	\$ 435	\$ 314
<b>Supplemental disclosure of noncash investing activities:</b>		
Increase in accrued liabilities related to non-monetary assets purchases	\$ 37	\$ 9

See accompanying notes to condensed consolidated financial statements.

**Table of Contents**

**AMBARELLA, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Organization and Summary of Significant Accounting Policies**

***Organization***

Ambarella, Inc. (the Company) was incorporated in the Cayman Islands on January 15, 2004. The Company is a developer of semiconductor processing solutions for video that enable high-definition video capture, sharing and display. The Company combines its processor design capabilities with its expertise in video and image processing, algorithms and software to provide a technology platform that is designed to be easily scalable across multiple applications and enable rapid and efficient product development. The Company's system-on-a-chip, or SoC, designs fully integrate high-definition video processing, image processing, audio processing and system functions onto a single chip, delivering exceptional video and image quality, differentiated functionality and low power consumption.

The Company sells its solutions to leading original design manufacturers, or ODMs, and original equipment manufacturers, or OEMs, globally.

***Basis of presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with the instructions to Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, do not include all information and notes normally provided in audited financial statements. The accounting policies are described in the Notes to Consolidated Financial Statements in the Annual Report on Form 10-K for the 2014 fiscal year filed with the SEC on April 4, 2014 (the Form 10-K) and updated, as necessary, in this Form 10-Q. The year-end condensed consolidated balance sheet data presented for comparative purposes was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States (U.S. GAAP). In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of, nor comparable to, the results of operations for any other interim period or for a full fiscal year. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the Form 10-K.

***Basis of Consolidation***

The Company's fiscal year ends on January 31. The condensed consolidated financial statements of the Company and its subsidiaries have been prepared in conformity with U.S. GAAP. All intercompany transactions and balances have been eliminated upon consolidation.

***Use of Estimates***

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and

expense during the reported periods. Actual results could differ from those estimates.

On an ongoing basis, management evaluates its estimates and assumptions, including those related to (i) the collectability of accounts receivable; (ii) write down for excess and obsolete inventories; (iii) the estimated useful lives of long-lived assets; (iv) impairment of long-lived assets and financial instruments; (v) warranty obligations; (vi) the valuation of stock-based compensation and financial instruments; (vii) the probability of performance objectives achievement; (viii) the realization of tax assets and estimates of tax liabilities, including reserves for uncertain tax positions; and (ix) the recognition and disclosure of contingent liabilities. These estimates and assumptions are based on historical experience and on various other factors which the Company believes to be reasonable under the circumstances. The company may engage third-party valuation specialists to assist with estimates related to the valuation of financial instruments and assets associated with various contractual arrangements. Such estimates often require the selection of appropriate valuation methodologies and significant judgment. Actual results could differ from these estimates under different assumptions or circumstances.

---

**Table of Contents**

***Concentration of Risk***

The Company's products are manufactured, assembled and tested by third-party contractors located primarily in Asia. The Company does not have long-term agreements with these contractors. A significant disruption in the operations of one or more of these contractors would impact the production of the Company's products which could have a material adverse effect on its business, financial condition and results of operations.

A substantial portion of the Company's revenue is derived from sales through its logistics provider, Wintech Microelectronics Co., Ltd., or Wintech, which serves as its non-exclusive sales representative in all of Asia other than Japan, and through one large direct ODM customer, Chicony Electronics Co., Ltd., or Chicony. Termination of the relationships with these two customers could result in a temporary or permanent loss of revenue and obligation to repurchase unsold product. Furthermore, any credit issues from these two customers could impair their abilities to make timely payment to the Company. See Note 12 for additional information regarding concentration with these two customers.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, marketable securities and accounts receivable. The Company maintains its cash primarily in checking and money market accounts with reputable financial institutions. Cash deposits held with these financial institutions may exceed the amount of insurance provided on such deposits. The Company has not experienced any material losses on deposits of its cash. The cash equivalents and marketable securities consist primarily of money market funds, commercial paper and debt securities of corporations which management assesses to be high credit quality, in order to limit the exposure of each investment. The Company does not hold or issue financial instruments for trading purposes.

The Company performs ongoing credit evaluations of each of its customers and adjusts credit limits based upon payment history and the customer's credit worthiness. The Company regularly monitors collections and payments from its customers.

***Cash, Cash Equivalents and Marketable Securities***

The Company considers all highly liquid investments with original maturities of less than three months at the time of purchase to be cash equivalents. Investments that are highly liquid with original maturities at the time of purchase greater than three months are considered as marketable securities.

The Company classifies these investments as available-for-sale securities carried at fair value, based on quoted market prices of similar assets, with the unrealized gains or losses reported, net of tax, as a separate component of shareholders' equity and included in accumulated other comprehensive income (loss) in the condensed consolidated balance sheets. The amortization of security premiums and accretion of discounts and the realized gains and losses are both recorded in other income (loss), net in the condensed consolidated statements of operations. The Company reviews its investments for possible other-than-temporary impairments on a regular basis. If any loss on investment is believed to be other-than-temporary, a charge will be recorded and a new cost basis in the investment will be established. In evaluating whether a loss on a security is other-than-temporary, the Company considers the following factors: 1) general market conditions, 2) the duration and extent to which the fair value is less than cost, 3) the Company's intent and ability to hold the investment.

For securities in an unrealized loss position which is deemed to be other-than-temporary, the difference between the security's then-current amortized cost basis and fair value is separated into (i) the amount of the impairment related to the credit loss (i.e., the credit loss component) and (ii) the amount of the impairment related to all other factors (i.e.,

the non-credit loss component). The credit loss component is recognized in earnings. The non-credit loss component is recognized in accumulated other comprehensive loss. Due to the relative short term nature of the investments, there have been no other-than-temporary impairments recorded to date.

### ***Inventories***

The Company records inventories at the lower of cost or market. The cost includes materials and other production costs and is computed using standard cost on a first-in, first-out basis. Inventory reserves are recorded for estimated obsolescence or unmarketable inventories based on forecast of future demand and market conditions. If actual market conditions are less favorable than projected, or if future demand for the Company's products decrease, additional inventory write-downs may be required. Once inventory is written down, a new accounting cost basis has been established and, accordingly, any associated reserve is not reversed until the inventory sold or scrapped. There have been no material inventory losses recognized to date.

### ***Revenue Recognition***

The Company generates revenue from the sales of its SoCs to OEMs or ODMs, either directly or through logistics providers. Revenue from sales directly to OEMs and ODMs is recognized upon shipment provided persuasive evidence of an arrangement exists, legal title to the products and risk of ownership have transferred, the fee is fixed or determinable, and collection of the resulting receivable is reasonably

---

**Table of Contents**

assured. The Company provides its logistics providers with the right to return excess levels of inventory and to future price adjustments. Given the inability to reasonably estimate these price changes and returns, revenue and costs related to shipments to logistics providers are deferred until the Company has received notification from its logistics providers that they have sold the Company's products. Information reported by the Company's logistics providers includes product resale price, quantity and end customer shipment information as well as remaining inventory on hand. At the time of shipment to a logistics provider, the Company records a trade receivable as there is a legally enforceable right to receive payment, reduces inventory for the value of goods shipped as legal title has passed to the logistics provider and defers the related margin as deferred revenue in the consolidated balance sheets. Any price adjustments are recorded as a change to deferred revenue at the time the adjustments are agreed upon.

Arrangements with certain OEM customers provide for pricing that is dependent upon the end products into which the Company's SoCs are used. These arrangements may also entitle the Company to a share of the product margin ultimately realized by the OEM. The minimum guaranteed amount of revenue related to the sale of products subject to these arrangements is recognized when all other elements of revenue recognition are met. Any amounts at the date of shipment invoiced in excess of the minimum guaranteed contract price are deferred until the additional amounts the Company is entitled to are fixed or determinable. Additional amounts earned by the Company resulting from margin sharing arrangements and determination of the end products into which the products are ultimately incorporated are recognized when end customer sales volume is reported to the Company.

The Company sells a limited amount of software under perpetual licenses that include post-contract customer support, or PCS. The Company does not have evidence of fair value for the PCS and, accordingly, license revenue is recognized ratably over the estimated supporting period in accordance with ASC 985, Software Revenue Recognition. The Company also enters into development agreements with certain customers. Revenue is deferred for any amounts billed prior to delivery of development services. However, if the Company retains the intellectual property generated from these development agreements, receipts and costs related to these arrangements are included in research and development expense. The revenue from those licenses and services was not material for the three and six months ended July 31, 2014 and 2013, respectively.

***Cost of Revenue***

Cost of revenue includes cost of materials, cost associated with packaging and assembly, testing and shipping, cost of personnel, stock-based compensation, logistics and quality assurance, warranty cost, royalty expense, write-downs of inventories and allocation of overhead.

***Income Taxes***

The Company records income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in its financial statements or tax returns. In estimating future tax consequences, generally all expected future events other than enactments or changes in the tax law or rates are considered. Valuation allowances are provided when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company applies authoritative guidance for the accounting for uncertainty in income taxes. The guidance requires that tax effects of a position be recognized only if it is more likely than not to be sustained based solely on its technical merits as of the reporting date. Upon estimating the Company's tax positions and tax benefits, the Company considered and evaluated numerous factors, which may require periodic adjustments and which may not reflect the final tax liabilities. The Company adjusts its financial statements to reflect only those tax positions that are more likely than not to be sustained under examination.

As part of the process of preparing consolidated financial statements, the Company is required to estimate its taxes in each of the jurisdictions in which it operates. The Company estimates actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets, which are included in the consolidated balance sheets. In general, deferred tax assets represent future tax benefits to be received when certain expenses previously recognized in the consolidated statements of operations become deductible expenses under applicable income tax laws, or loss or credit carryforwards are utilized.

In assessing whether deferred tax assets may be realized, management considers whether it is more likely than not that some portion or all of deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income.

The Company makes estimates and judgments about its future taxable income based on assumptions that are consistent with its plans and estimates. Should the actual amounts differ from estimates, the amount of valuation allowance could be materially impacted. Any adjustment to the deferred tax asset valuation allowance would be recorded in the income statement for the periods in which the adjustment is determined to be required.



---

**Table of Contents*****Net Income Per Ordinary Share***

The Company applies the two-class method to calculate and present net income per ordinary share. Under the two-class method, net income is allocated between ordinary shares and other participating securities based on their participating rights. Participating securities are defined as securities that may participate in undistributed earnings with ordinary shares, whether that participation is conditioned upon the occurrence of a specified event or not. Basic net income per ordinary share is computed by dividing net income allocable to ordinary shares by the weighted-average number of ordinary shares outstanding for the period. Diluted net income per ordinary share is computed by dividing net income allocable to ordinary shares and income allocable to participating securities, to the extent they are dilutive, by the weighted-average number of ordinary shares outstanding, including the dilutive effects of participating securities plus the dilutive effects of ordinary shares. The Company's potential dilutive ordinary share equivalents consist of incremental ordinary shares issuable upon the exercise of options, upon the issuance of shares pursuant to the Employee Stock Purchase Plan, or ESPP, and upon release of vested restricted stock units.

The Company performs an assessment as to whether instruments granted in stock-based payment transactions are participating securities. Stock-based payment awards that have not yet vested meet the definition of a participating security provided the right to receive the dividend is non-forfeitable and non-contingent. These participating securities should be included in the computation of basic net income per ordinary share under the two-class method. The Company has concluded that its non-vested early-exercised options meet the definition of a participating security and should be included in the computation of basic net income per ordinary share.

***Comprehensive Income (Loss)***

Comprehensive income (loss) includes unrealized gains or losses from available-for-sale securities that are excluded from net income.

***Recent Accounting Pronouncements***

In February 2013, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (AOCI). This new guidance requires that the Company present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, the Company would instead cross reference to the related footnote for additional information. This guidance only impacts disclosures within the Company's consolidated financial statements and notes to the consolidated financial statements and does not result in a change to the accounting treatment of AOCI. This new guidance became effective prospectively for fiscal years, and interim periods with those years, beginning after December 15, 2012. The Company adopted this guidance starting from the first quarter of fiscal year 2014 and the adoption did not have an impact on its financial position, results of operations or disclosures.

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The new guidance requires the netting of unrecognized tax benefits (UTBs) against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Under the new standard, UTBs will be netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the UTBs. The new guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and should be applied prospectively to all unrecognized tax

benefits that exist at the effective date. The Company has adopted this new standard on a prospective basis in the first quarter of fiscal year 2015. The implementation had no material impact on its financial position, results of operations, statement of cash flows or disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The new guidance clarifies the principles and develops a common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards (the IFRS ). Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, an entity shall identify the contract(s) with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the entity satisfies a performance obligation. The new guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The new revenue guidance may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company is currently evaluating the impact of adoption on its financial position, results of operations and disclosures.

**Table of Contents****2. Financial Instruments and Fair Value**

Beginning in fiscal year 2015, the Company invested a portion of its cash primarily in marketable securities that are denominated in United States dollars. The investment portfolio consists of money market funds, commercial paper and debt securities of corporations. All of the investments are classified as available-for-sale securities and reported at fair value in the condensed consolidated balance sheets as follows:

	<b>As of July 31, 2014</b>			<b>Fair Value</b>
	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
	<b>(in thousands)</b>			
Money market funds	\$ 319	\$	\$	\$ 319
Corporate bonds	35,940	7	(28)	35,919
Commercial paper	3,548			3,548
<b>Total cash equivalents and marketable securities</b>	<b>\$ 39,807</b>	<b>\$ 7</b>	<b>\$ (28)</b>	<b>\$ 39,786</b>

	<b>As of July 31, 2014 (in thousands)</b>
Included in cash equivalents	\$ 1,521
Included in marketable securities	38,265
<b>Total cash equivalents and marketable securities</b>	<b>\$ 39,786</b>

The contractual maturities of the investments at July 31, 2014 were as follows:

	<b>As of July 31, 2014 (in thousands)</b>
Due within one year	\$ 31,580
Due within one to two years	8,206
<b>Total cash equivalents and marketable securities</b>	<b>\$ 39,786</b>

The unrealized losses on the available-for-sale securities were caused by fluctuations in market value and interest rates as a result of the economic environment. As the decline in market value was attributable to changes in market conditions and not credit quality, and because the Company neither intended to sell nor was it more likely than not that it will be required to sell these investments prior to a recovery of par value, the Company did not consider these investments to be other-than temporarily impaired as of July 31, 2014.

The following fair value hierarchy is applied for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.

Level 3 Unobservable inputs based on the Company's own assumptions used to measure assets and liabilities at fair value. The inputs require significant management judgment or estimation.

The Company measures the fair value of money market funds using quoted prices in active markets for identical assets and classifies them within Level 1. The fair value of the Company's investments in other debt securities are obtained based on quoted prices for similar asserts in active markets, or model driven valuations using significant inputs derived from or corroborated by observable market data and are classified within Level 2.

**Table of Contents**

The following table presents the fair value of the financial instruments measured on a recurring basis as of July 31, 2014:

	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
	<b>(in thousands)</b>			
Money market funds	\$ 319	\$ 319	\$	\$
Corporate bonds	35,919		35,919	
Commercial paper	3,548		3,548	
Total cash equivalents and marketable securities	\$ 39,786	\$ 319	\$ 39,467	\$

**Table of Contents****3. Inventories**

Inventory at July 31, 2014 and January 31, 2014 consisted of the following:

	<b>July 31, 2014</b>	<b>As of January 31, 2014</b>
	<b>(in thousands)</b>	
Work-in-progress	\$ 9,096	\$ 5,119
Finished goods	3,907	5,333
<b>Total</b>	<b>\$ 13,003</b>	<b>\$ 10,452</b>

**4. Property and Equipment, Net**

Depreciation and amortization expense was approximately \$0.3 million for the three months ended July 31, 2014 and 2013, respectively. Depreciation and amortization expense was approximately \$0.6 million and \$0.5 million for the six months ended July 31, 2014 and 2013, respectively. Property and equipment at July 31, 2014 and January 31, 2014 consisted of the following:

	<b>July 31, 2014</b>	<b>As of January 31, 2014</b>
	<b>(in thousands)</b>	
Computer equipment and software	\$ 5,079	\$ 4,521
Machinery and equipment	2,153	2,114
Furniture and fixtures	450	411
Leasehold improvements	1,189	1,198
	8,871	8,244
Less: accumulated depreciation and amortization	(5,791)	(5,226)
<b>Total property and equipment, net</b>	<b>\$ 3,080</b>	<b>\$ 3,018</b>

**5. Accrued Liabilities**

Accrued liabilities at July 31, 2014 and January 31, 2014 consisted of the following:

	<b>July 31, 2014</b>	<b>As of January 31, 2014</b>
	<b>(in thousands)</b>	
Accrued employee compensation	\$ 7,375	\$ 8,108
Accrued warranty	234	269

Edgar Filing: AMBARELLA INC - Form 10-Q

Accrued rebates	440	270
Accrued product development costs	2,833	1,904
Other accrued liabilities	1,462	1,154
Total accrued liabilities	\$ 12,344	\$ 11,705

**Table of Contents****6. Deferred Revenue and Deferred Cost**

Deferred revenue and related cost at July 31, 2014 and January 31, 2014 consisted of the following:

	<b>July 31, 2014</b>	<b>As of January 31, 2014</b>
	<b>(in thousands)</b>	
Deferred revenue on product shipments	\$ 5,523	\$ 5,174
Deferred revenue from licenses & services	1,007	1,023
Deferred cost of revenue on product shipments	(1,464)	(1,366)
Total deferred revenue, net	\$ 5,066	\$ 4,831

**7. Capital Stock*****Preference shares***

After completion of the Company's initial public offering, or IPO, a total of 20,000,000 preference shares, with a \$0.00045 par value per share, were authorized. There were no preference shares issued and outstanding as of July 31, 2014 and January 31, 2014, respectively.

***Ordinary shares***

At July 31, 2014 and January 31, 2014, a total of 200,000,000 ordinary shares were authorized.

On February 1, 2014, the Company added 1,297,555 ordinary shares to the ordinary shares reserved for issuance under the 2012 Equity Incentive Plan, or EIP, pursuant to an evergreen provision contained in the EIP. Pursuant to such provision, on February 1st of each fiscal year, the number of ordinary shares reserved for issuance under the EIP is automatically increased by a number equal to the lesser of (i) 3,500,000 ordinary shares, (ii) four and one half percent (4.5%) of the aggregate number of ordinary shares outstanding on January 31st of the preceding fiscal year, or (iii) a lesser number of shares that may be determined by the Company's Board of Directors.

On February 1, 2014, the Company added 359,356 ordinary shares to the ordinary shares reserved for issuance under the 2012 Employee Stock Purchase Plan, or ESPP, pursuant to an evergreen provision contained in the ESPP. Pursuant to such provision, on February 1st of each fiscal year, the number of ordinary shares reserved for issuance under the ESPP is automatically increased by a number equal to the lesser of (i) 1,500,000 ordinary shares, (ii) one and one quarter percent (1.25%) of the aggregate number of ordinary shares outstanding on such date, or (iii) an amount determined by the Company's Board of Directors or a duly authorized committee of the Board of Directors.

As of July 31, 2014 and January 31, 2014, the following ordinary shares were reserved for future issuance under the EIP and ESPP:

	<b>July 31, 2014</b>	<b>As of January 31, 2014</b>
--	----------------------	-----------------------------------



Edgar Filing: AMBARELLA INC - Form 10-Q

Shares reserved for options and restricted stock units	6,140,955	5,699,530
Shares reserved for employee stock purchase plan	724,626	456,410

**Table of Contents****8. Stock-based Compensation**

The following table presents the classification of stock-based compensation for the periods indicated:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Stock-based compensation:				
Cost of revenue	\$ 58	\$ 34	\$ 117	\$ 68
Research and development	1,629	900	3,219	1,874
Selling, general and administrative	1,262	659	2,487	1,257
<b>Total stock-based compensation</b>	<b>\$ 2,949</b>	<b>\$ 1,593</b>	<b>\$ 5,823</b>	<b>\$ 3,199</b>

As of July 31, 2014, total unrecognized compensation cost related to unvested stock options and unvested restricted stock units was \$6.2 million and \$15.6 million, respectively, and is expected to be recognized over a weighted-average period of 2.09 years and 2.64 years, respectively. As of January 31, 2014, total unrecognized compensation cost related to unvested stock options and unvested restricted stock units was \$5.8 million and \$17.0 million, respectively, and is expected to be recognized over a weighted-average period of 1.90 years and 2.99 years, respectively.

The following table sets forth the weighted-average assumptions used to estimate the fair value of stock options and employee stock purchase plan awards for the periods indicated:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Stock Options:				
Volatility	64%	66%	65%	65%
Risk-free interest rate	1.90%	1.25%	1.93%	1.21%
Expected term (years)	6.08	6.05	6.06	6.05
Dividend yield	0%	0%	0%	0%
Employee stock purchase plan awards:				
Volatility			57%	
Risk-free interest rate			0.08%	
Expected term (years)			0.5	
Dividend yield			0%	

The following table summarizes stock option activities for the six months ended July 31, 2014:

Shares	Weighted-Average Exercise Price	Option Outstanding			Aggregate Intrinsic Value (in thousands)
		Weighted-Average Grant-date Fair Value	Total Intrinsic Value of options Exercised	Weighted-Average Remaining Contractual	

			(in thousands)	Term (in years)
Outstanding at January 31, 2014	3,358,706	\$ 6.92		
Granted	151,333	29.26	\$ 17.51	
Exercised	(653,486)	5.72	\$ 15,623	
Forfeited	(31,916)	11.38		
Outstanding at July 31, 2014	2,824,637	8.35		6.10 \$ 57,493
Exercisable at July 31, 2014	2,138,115	6.03		5.43 \$ 48,281
Vested and expected to vest at July 31, 2014	2,783,352	8.20		6.07 \$ 57,051

Exercisable shares include options with early exercise rights. The vested and expected-to-vest options are calculated based on the vesting schedule of each grant as of the reporting date.

The intrinsic value of options outstanding, exercisable and expected-to-vest options are calculated based on the difference between the fair market value of the Company's ordinary shares on the reporting date and the exercise price. The closing price of the Company's ordinary shares was \$28.61 on July 31, 2014, as reported by The NASDAQ Global Market. The intrinsic value of exercised options is calculated based on the difference between the fair market value of the Company's ordinary shares on the exercise date and the exercise price.

**Table of Contents**

The following table summarizes restricted stock unit activities for the six months ended July 31, 2014:

	Shares	Weighted-Average Grant-Date Fair Value
Unvested at January 31, 2014	1,410,089	\$ 14.02
Granted	73,667	29.93
Vested	(202,644)	13.89
Forfeited	(25,902)	13.46
Unvested at July 31, 2014	1,255,210	\$ 14.99

As of July 31, 2014, the aggregate intrinsic value of unvested restricted stock units was \$35.9 million.

***Non-employee Stock-based Compensation***

The fair value of awards granted to non-employees is determined on the grant date and remeasured at the end of each reporting period until such awards vest. The non-employee stock-based compensation expense was not material for the three and six months ended July 31, 2014 and 2013, respectively.

**9. Net Income Per Ordinary Share**

The following table sets forth the computation of basic and diluted net income per ordinary share for the periods indicated:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands, except share and per share data)			
<b>Numerator:</b>				
Net income	\$ 9,310	\$ 6,254	\$ 14,570	\$ 10,995
Less: amount allocable to unvested early exercised options	(2)	(8)	(4)	(17)
Net income allocable to ordinary shareholders - basic	\$ 9,308	\$ 6,246	\$ 14,566	\$ 10,978
Undistributed earnings reallocated to ordinary shareholders		1		1
Net income allocable to ordinary shareholders - diluted	\$ 9,308	\$ 6,247	\$ 14,566	\$ 10,979
<b>Denominator:</b>				

Edgar Filing: AMBARELLA INC - Form 10-Q

Weighted-average ordinary shares outstanding	29,426,935	27,443,622	29,206,936	27,273,376
Less: weighted-average unvested early exercised options subject to repurchase	(5,735)	(34,279)	(8,425)	(41,234)
Weighted-average ordinary shares - basic	29,421,200	27,409,343	29,198,511	27,232,142
Effect of potentially dilutive securities:				
Employee stock options	1,879,067	2,046,623	1,994,912	1,867,695
Restricted stock units	599,234	159,434	627,368	150,541
Employee stock purchase plan		231,278	10,698	201,048
Warrants to purchase ordinary shares		1,998		4,948
Weighted-average ordinary shares - diluted	31,899,501	29,848,676	31,831,489	29,456,374
Net income per ordinary share:				
Basic	\$ 0.32	\$ 0.23	\$ 0.50	\$ 0.40
Diluted	\$ 0.29	\$ 0.21	\$ 0.46	\$ 0.37

Earnings per share (EPS) of ordinary shares is calculated using the two-class method required for participating securities. Net income has been allocated to the ordinary shares and participating securities based on their respective rights to share in net income and weighted-average outstanding during the periods.

**Table of Contents**

The following weighted-average potentially dilutive securities are excluded from the computation of diluted net income per ordinary share as their effect would have been antidilutive:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Options to purchase ordinary shares	193,633	102,707	156,550	246,817
Restricted stock units	52,978		42,167	3,151
Employee stock purchase plan	62,887		47,165	
Early exercised options subject to repurchase	5,735	34,279	8,425	41,234
	315,233	136,986	254,307	291,202

**10. Income Taxes**

The Company reported the following income tax for the periods indicated:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Income tax expense	\$ 893	\$ 667	\$ 1,609	\$ 1,140

The effective tax rate was 8.8% and 9.6% for the three months ended July 31, 2014 and 2013, respectively. The effective tax rate was 9.9% and 9.4% for the six months ended July 31, 2014 and 2013, respectively. The decrease in the tax rate for the three months ended July 31, 2014 compared to the three months ended July 31, 2013 was primarily due to a change in the mix of earnings of various geographic jurisdictions between the two periods. The increase in the tax rate for the six months ended July 31, 2014 compared to the six months ended July 31, 2013 was primarily due to the expiration of the US federal R&D tax credit on December 31, 2013, and the changes in the mix of earnings of various geographic jurisdictions in the fiscal year 2015 as compared to the fiscal year 2014. The quarterly income taxes reflect an estimation of the corresponding fiscal year's annual effective tax rate and include, when applicable, adjustments from discrete tax items.

The Company files federal and state income tax returns in the United States and in various foreign jurisdictions. The tax years 2007 to 2009 and 2011 to 2013 remain open to examination by U.S. federal tax authorities. The tax years 2004 to 2013 remain open to examination by U.S. state tax authorities. The tax years 2010 to 2013 remain open to examination by material foreign tax authorities.

The Company is subject to ongoing tax examinations of its tax returns by the Internal Revenue Service and other tax authorities in various jurisdictions. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. These assessments can require considerable estimates and judgments. As of July 31, 2014, the gross amount of unrecognized tax benefits was approximately \$3.6 million. If the estimates of income tax liabilities prove to be less than the ultimate assessment, then a further charge to expense would be required. If events occur and the payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period in which the Company determines the liabilities are no longer necessary. The Company does not anticipate any material changes to its uncertain tax positions during the next twelve months.

**11. Commitments and Contingencies**

The Company leases its principal facilities and time-based software licenses under operating agreements with various expiration dates through April 2018. Net operating lease expenses for the three months ended July 31, 2014 and 2013 were approximately \$1.5 million and \$1.3 million, respectively. Net operating lease expenses for the six months ended July 31, 2014 and 2013 were approximately \$2.8 million and \$2.4 million, respectively. Future annual minimum lease payments under these operating leases with initial lease terms in excess of one year are as follows:

<b>Fiscal Year</b>	<b>As of July 31, 2014 (in thousands)</b>
2015	2,687
2016	5,079
2017	4,622
2018	1,381
2019	238
Total future annual minimum lease payments	\$ 14,007

**Table of Contents*****Contract Manufacturer Commitments***

The Company's components and products are procured and built by independent contract manufacturers based on sales forecasts. These forecasts include estimates of future demand, historical trends, analysis of sales and marketing activities, and adjustment of overall market conditions. The Company regularly issues purchase orders to independent contract manufacturers which are cancelable only upon the agreement between the Company and the third-party. As of July 31, 2014 and January 31, 2014, total manufacturing purchase commitments were approximately \$18.4 million and \$13.7 million, respectively.

***Indemnification***

The Company, from time to time, in the normal course of business, indemnifies certain vendors with whom it enters into contractual relationships. The Company has agreed to hold the other party harmless against third-party claims in connection with the Company's future products. The Company also indemnifies certain customers against third party claims related to certain intellectual property matters. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of prior indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim. The Company has not made payments under these obligations and no liabilities have been recorded for these obligations on the condensed consolidated balance sheets as of July 31, 2014 and January 31, 2014, respectively.

**12. Segment Reporting**

The Company operates in one reportable segment related to the development and sales of low-power, high-definition video products. The Chief Executive Officer of the Company has been identified as the Chief Operating Decision Maker (the CODM) and manages the Company's operations as a whole and for the purpose of evaluating financial performance and allocating resources, the CODM reviews financial information presented on a consolidated basis accompanied by information of customer and geographic region.

***Geographic Revenue***

The following table sets forth the Company's revenue by geographic region for the periods indicated:

	<b>Three Months Ended July 31,</b>		<b>Six Months Ended July 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			
Hong Kong	\$ 41,999	\$ 33,195	\$ 77,393	\$ 61,969
Asia Pacific	585	446	1,218	702
United States	1,721	1,242	3,868	3,847
North America	1,445	1,071	2,716	2,033
Europe	1,218	1,756	2,694	3,100
Total revenue	\$ 46,968	\$ 37,710	\$ 87,889	\$ 71,651

As of July 31, 2014, substantially all of the Company's long-lived tangible assets were located in the Asia Pacific region.



### ***Major Customers***

The customers representing 10% or more of revenue and accounts receivable were Wintech, the Company's logistics provider, and Chicony, a direct ODM customer, which combined accounted for approximately 88% and 87% of total revenue for the three months ended July 31, 2014 and 2013, respectively, and approximately 87% and 84% of total revenue for the six months ended July 31, 2014 and 2013, respectively. Accounts receivable with these two customers combined accounted for approximately \$23.6 million and \$15.9 million as of July 31, 2014 and January 31, 2014, respectively.

### **13. Related-Party Transactions**

The Company considers an entity to be a related party if it owns more than 10% of the Company's total voting stock at the end of each reporting period or if an officer or employee of an entity also serves on the Company's board of directors or if it is a significant shareholder and has material business transactions with the Company.

In April 2014, the Company added additional software license commitments to its existing software license agreement with Cadence Design Systems, Inc. ( Cadence ). A member of the Company's Board of Directors is also the Chief Executive Officer, President and a Director of Cadence. Under these license commitments, the Company committed to pay an aggregate amount of \$6.9 million payable through January 2017. The Company paid \$0.6 million and \$0.4 million of license fees to Cadence for the three months ended July 31, 2014 and 2013,

**Table of Contents**

respectively. The Company paid \$1.0 million and \$0.9 million of license fees to Cadence for the six months ended July 31, 2014 and 2013, respectively. Operating lease expenses related to these commitments included in research and development cost were approximately \$0.5 million and \$0.4 million for the three months ended July 31, 2014 and 2013, respectively. Operating lease expenses related to these commitments included in research and development cost were approximately \$0.7 million and \$0.9 million for the six months ended July 31, 2014 and 2013, respectively.

In addition to the related party transactions noted above, the Company recognized revenue from sales to Wintech Microelectronics Co., Ltd, or Wintech, the Company's logistics provider. Wintech, along with an affiliate, owned approximately 4.6% of the Company's voting stock as of January 31, 2013, but has sold such stock and is no longer a significant shareholder of the Company as of January 31, 2014. The Company recognized revenue from sales to Wintech of approximately \$30.3 million and \$22.1 million for the three months ended July 31, 2014 and 2013, respectively. The Company recognized revenue from sales to Wintech of approximately \$58.5 million and \$35.5 million for the six months ended July 31, 2014 and 2013, respectively. As of July 31, 2014 and January 31, 2014, the Company had receivables from Wintech of approximately \$12.5 million and \$7.9 million, respectively.

---

**Table of Contents****ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto for the fiscal year ended January 31, 2014 and management's discussion and analysis of our financial condition and results of operations included in our Annual Report on Form 10-K for the 2014 fiscal year filed with the SEC on April 4, 2014.*

*This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, includes a number of forward-looking statements that involve many risks and uncertainties. Forward-looking statements are identified by the use of the words would, could, will, may, expect, believe, should, anticipate, outlook, if, future, intend, plan, estimate, predict, potential, targets, seek or continue and similar words and phrases, including the negatives of these terms, or other variations of these terms, that denote future events. Such statements include, but are not limited to, statements concerning our market opportunity, our ability to develop new solutions, our future financial and operating performance, sales and marketing strategy, investment strategy, research and development, customer and supplier relationships, industry trends, our cash needs and capital requirements, expectations about seasonality, taxes, and operating expenses. These statements reflect our current views with respect to future events and our potential financial performance and are subject to risks and uncertainties that could cause our actual results and financial position to differ materially and adversely from what is projected or implied in any forward-looking statements included in this Quarterly Report on Form 10-Q. These factors include, but are not limited to, the risks described under Item 1A of Part II Risk Factors, Item 2 of Part I Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the SEC. We make these forward-looking statements based upon information available on the date of this Quarterly Report on Form 10-Q, and we have no obligation (and expressly disclaim any such obligation) to update or alter any forward-looking statements, whether as a result of new information or otherwise except as otherwise required by securities regulations.*

**Overview**

We are a leading developer of semiconductor processing solutions for video that enable high-definition, or HD, video capture, sharing and display. We combine our processor design capabilities with our expertise in video and image processing algorithms and software to provide a technology platform that is designed to be easily scalable across multiple applications and enable rapid and efficient product development. Our system-on-a-chip, or SoC, designs fully integrate HD video processing, image processing, audio processing and system functions onto a single chip, delivering exceptional video and image quality, differentiated functionality and low power consumption.

We sell our solutions to leading original design manufacturers, or ODMs, and original equipment manufacturers, or OEMs, globally. We refer to ODMs as our customers and OEMs as our end customers, except as otherwise indicated or as the context otherwise requires. In the camera market, our solutions enable the creation of high-quality video content primarily for wearable sports cameras, automotive aftermarket cameras, and Internet Protocol, or IP, security cameras. In the infrastructure market, our solutions efficiently manage IP video traffic, broadcast encoding, transcoding and IP video delivery applications.

Our sales cycles typically require a significant investment of time and a substantial expenditure of resources before we can realize revenue from the sale of our solutions, if any. Our typical sales cycle consists of a multi-month sales and development process involving our customers' system designers and management along with our sales personnel and software engineers. If successful, this process culminates in a customer's decision to use our solutions in its system,

which we refer to as a design win. Our sales efforts are typically directed to the OEM of the product that will incorporate our video and image processing solution, but the eventual design and incorporation of our SoC into the product may be handled by an ODM on behalf of the OEM. Volume production may begin within six to 18 months after a design win, depending on the complexity of our customer's product and other factors upon which we may have little or no influence. Once one of our solutions has been incorporated into a customer's design, we believe that our solution is likely to remain a component of the customer's product for its life cycle because of the time and expense associated with redesigning a product or substituting an alternative solution. Conversely, a design loss to a competitor will likely preclude any opportunity for future revenue from such customer's product.

***Financial Highlights and Trends***

We recorded revenue of \$47.0 million and \$87.9 million for the three and six months ended July 31, 2014, respectively. This represented increases of 25% and 23% for the three and six months ended July 31, 2014, respectively, as compared to the same periods in fiscal year 2014. The increases were primarily due to higher demand in our IP security market as a result of continuing adoption by new and existing customers of our A5S chip and S2 chip, a 4K Ultra High Definition, or UHD, SoC. Also contributing to higher revenues were shipments of our new A9 chip into the wearable sports camera and the unmanned aerial vehicle or UAV markets. The increases were partially offset by year over year declines in the

---

**Table of Contents**

automotive camera and the infrastructure markets. The decline in the automotive market was primarily due to competitive pressures at the low end market in China and weak economic conditions in Russia. The decreased revenue in the infrastructure market was due to continued weak macro market conditions in the United States and Europe in this industry which has resulted in delayed investment in anticipation of the network upgrade and the new compression technology.

We recorded operating income of \$10.2 million and \$16.1 million for the three and six months ended July 31, 2014, respectively. This represented increases of 47% and 32% for the three and six months ended July 31, 2014, respectively, as compared to the same periods in fiscal year 2014. The increases were primarily due to continuing growth in revenue, higher gross margin from unmanned aerial vehicle or UAV market, as well as efficient control of product cost and operating expenses.

We generated cash flows from operating activities of \$18.8 million for the six months ended July 31, 2014, as compared to \$15.9 million for the six months ended July 31, 2013. The increase was primarily attributable to increased net income, adjusted for increased non-cash stock-based compensation expense, depreciation of fixed assets, and amortization/accretion of securities premiums and discounts. The increase was also attributable to increased liabilities associated with the timing of payments to suppliers. The increase was partially offset by increased accounts receivable associated with the timing of payments from customers, increased inventory purchases to support continuing growth of sales as well as decreased deferred revenue associated with the timing of inventory shipments by our logistics providers.

For the six months ended July 31, 2014, we invested \$40.0 million in high quality, highly liquid debt securities, of which approximately \$1.5 million was recorded as cash equivalents. We hold these investments as available-for-sale securities and mark them to market. As of July 31, 2014, the debt securities had a fair value of approximately \$39.8 million with insignificant unrealized losses caused by fluctuations in market value and interest rates.

***Factors Affecting Our Performance***

*Design Wins.* We closely monitor design wins by customer and end market. We consider design wins to be critical to our future success, although the revenue generated by each design win can vary significantly. Our long-term sales expectations are based on forecasts from customers and internal estimations of customer demand factoring in the expected time to market for end customer products incorporating our solutions and associated revenue potential.

*Pricing, Product Cost and Margin.* Our pricing and margins depend on the volumes and the features of the solutions we provide to our customers. Additionally, we make significant investments in new solutions for both cost improvements and new features that we expect to drive revenue and maintain margins. In general, solutions incorporated into more complex configurations, such as those used in the infrastructure market, have higher prices and higher gross margins as compared to solutions sold into the camera market. Our average selling price, or ASP, can vary by market and application due to market-specific supply and demand, the maturation of products launched in previous years and the launch of new products.

We continually monitor the cost of our solutions. As we rely on third-party manufacturers for the production of our products, we maintain a close relationship with these suppliers to continually monitor production yields, component costs and design efficiencies.

*Shifting Consumer Preferences.* Our revenue is subject to consumer preferences, regarding form factor and functionality, and how those preferences impact the video and image capture electronics that we support. For example, improved smartphone video capture capabilities, and the rapid adoption by consumers, led to the decline of pocket video cameras aimed at the video and image capture market. The current video and image capture market is now characterized by a greater volume of more specialized video and image capture devices that are less likely to be replaced with smartphones, such as wearable sports cameras, automotive aftermarket cameras, and IP security cameras. This increasing specialization of video capture devices has changed our customer base and end markets and has impacted our revenue. In the future, we expect further changes in the market to continue to impact our business performance.

*Continued Concentration of Revenue by End Market.* Historically, our revenue has been significantly concentrated in a small number of end markets. In fiscal year 2010, the majority of our revenue came from the pocket video, camcorder and infrastructure markets. Over the last four years, we have continued to provide solutions for the camcorder and infrastructure markets, but also have expanded our focus to include the wearable sports, automotive aftermarket, and IP security camera markets. We believe our entry into these markets will continue to facilitate revenue growth and customer diversification. While we will continue to expand our end market exposure, such as to non-sports wearable cameras and unmanned aerial vehicles or UAV, we anticipate that sales to a limited number of end markets will continue to account for a significant percentage of our total revenue for the foreseeable future. Our end market concentration may cause our financial performance to fluctuate significantly from period to period based on the success or failure of video capture markets in which we compete. In addition, we derive a significant portion of our revenue from a limited number of ODMs who build products on behalf of a limited number of OEMs and from a limited number of OEMs to whom we ship directly. We believe that our operating results for the foreseeable future will continue to depend on sales to a relatively small number of customers.

**Table of Contents**

*Ability to Capitalize on Connectivity Trend.* Mobile connected devices are ubiquitous today and play an increasingly prominent role in consumers' lives. The constant connectivity provided by these devices has created a demand for connected electronic peripherals such as video and image capture devices. Our ability to capitalize on these trends by supporting our end customers in the development of connected peripherals that seamlessly cooperate with other connected devices and allow consumers to distribute and share video and images with online media platforms is critical for our success. We have added wireless communication functionality into our solutions for wearable sports cameras, automotive aftermarket and IP security cameras. The combination of our compression technology with wireless connectivity enables wireless video streaming and uploading of videos and images to the Internet. Our solutions enable IP security camera systems to stream video content to either cloud infrastructure or connected mobile devices, and our solutions for wearable sports cameras allow consumers to quickly stream or upload video and images to social media platforms.

*Sales Volume.* A typical design win can generate a wide range of sales volumes for our solutions, depending on the end market demand for our customers' products. This can depend on several factors, including the reputation of the end customer, market penetration, product capabilities, size of the end market that the product addresses and our end customers' ability to sell their products. In certain cases, we may provide volume discounts on sales of our solutions, which may be offset by lower manufacturing costs related to higher volumes. In general, our customers with greater market penetration and better branding tend to develop products that generate larger volumes over the product life cycle.

*Customer Product Life Cycle.* We estimate our customers' product life cycles based on the customer, type of product and end market. In general, products launched in the camera market have shorter life cycles than those sold into the infrastructure market. We typically commence commercial shipments from six to 18 months following a design win; however, in some markets, more lengthy product and development cycles are possible, depending on the scope and nature of the project. A portable consumer device typically has a product life cycle of six to 18 months. In the infrastructure market, the product life cycle can range from 24 to 60 months.

**Results of Operations**

The following table sets forth a summary of our statement of operations for the periods indicated:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
	(dollars in thousands)			
Revenue	\$ 46,968	\$ 37,710	\$ 87,889	\$ 71,651
Cost of revenue	16,432	14,419	31,757	26,667
Gross profit	30,536	23,291	56,132	44,984
Operating expenses:				
Research and development	13,497	10,974	26,411	22,291
Selling, general and administrative	6,875	5,385	13,630	10,542
Total operating expenses	20,372	16,359	40,041	32,833
Income from operations	10,164	6,932	16,091	12,151
Other income (loss), net	39	(11)	88	(16)

Edgar Filing: AMBARELLA INC - Form 10-Q

Income before income taxes	10,203	6,921	16,179	12,135
Provision for income taxes	893	667	1,609	1,140
Net income	\$ 9,310	\$ 6,254	\$ 14,570	\$ 10,995



**Table of Contents**

The following table sets forth operating results as a percentage of revenue of each line item for the periods indicated:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Revenue	100%	100%	100%	100%
Cost of revenue	35	38	36	37
Gross profit	65	62	64	63
Operating expenses:				
Research and development	29	29	30	31
Selling, general and administrative	15	14	16	15
Total operating expenses	44	43	46	46
Income from operations	21	19	18	17
Other income (loss), net				
Income before income taxes	21	19	18	17
Provision for income taxes	2	2	2	2
Net income	19%	17%	16%	15%

**Revenue**

We derive substantially all of our revenue from the sale of HD video and image processing SoC solutions to OEMs and ODMs, either directly or through our logistics providers. Our SoC solutions have been used in the camera and infrastructure markets, and we expect these will be the primary markets for our solutions for the foreseeable future. We derive a substantial portion of our revenue from sales made indirectly through our logistics provider, Wintech Microelectronics Co., Ltd., or Wintech, and directly to one large ODM customer, Chicony Electronics Co., Ltd., or Chicony.

We typically experience seasonal fluctuations in our quarterly revenue with our third fiscal quarter normally being the highest revenue quarter. This fluctuation has been driven primarily by increased sales in the camera market as our customers build inventories in preparation for the holiday shopping season. More generally, our average selling prices fluctuate based on the mix of our solutions sold in a period which reflects the impact of both changes in unit sales of existing solutions as well as the introduction and sales of new solutions. Our solutions are typically characterized by a life cycle that begins with higher average selling prices and lower volumes, followed by broader market adoption, higher volumes and average selling prices that are lower than initial levels.

The end markets into which we sell our products have seen significant changes as consumer preferences have evolved in response to new technologies. As a result, the composition of our revenue may differ meaningfully during periods of technology or consumer preference changes. We expect shifts in consumer use of video capture to continue to change over time, as more specialized use cases emerge and video capture continues to proliferate.

**Cost of Revenue and Gross Margin**

Cost of revenue includes the cost of materials such as wafers processed by third-party foundries, costs associated with packaging, assembly and test, and our manufacturing support operations such as logistics, planning and quality assurance. Cost of revenue also includes indirect costs such as warranty, inventory valuation reserves and other general overhead costs.

We expect that our gross margin may fluctuate from period to period as a result of changes in average selling price, product mix and the introduction of new products by us or our competitors. In general, solutions incorporated into more complex configurations, such as those used in the infrastructure market, have higher prices and higher gross margins, as compared to solutions sold into the camera market. As semiconductor products mature and unit volumes sold to customers increase, their average selling prices typically decline. These declines may be paired with improvements in manufacturing yields and lower wafer, packaging and test costs, which offset some of the margin reduction that could result from lower selling prices. We believe that our gross margin will decline in the future as we continue to penetrate the highly competitive camera market and as we launch our solutions into new markets.

### ***Research and Development***

Research and development expense consists primarily of personnel costs, including salaries, stock-based compensation and employee benefits. The expense also includes costs of development incurred in connection with our collaborations with our foundry vendors, costs of licensing intellectual property from third parties for product development, costs of development for software and hardware tools, cost of fabrication of mask sets for prototype products, and allocated depreciation and facility expenses. All research and development costs are expensed as incurred. We expect our research and development expense to increase in absolute dollars as we continue to enhance and expand our product features and offerings.

**Table of Contents*****Selling, General and Administrative***

Selling, general and administrative expense consists primarily of personnel costs, including salaries, stock-based compensation and employee benefits for our sales, marketing, finance, human resources, information technology and administrative personnel. The expense also includes professional service costs related to accounting, tax, legal services, and allocated depreciation and facility expenses. We expect our selling expense to increase in absolute dollars as we expand the size of our sales and marketing organization to support our anticipated growth. We expect our general and administrative expense to increase in absolute dollars and as a percent of revenue as we develop the infrastructure necessary to operate as a public company, which includes increased audit and legal fees, costs to comply with the Sarbanes-Oxley Act of 2002, the rules and regulations applicable to companies listed on The NASDAQ Stock Market, investor relations costs, and higher insurance premiums.

***Other Income (Loss), Net***

Other income (loss), net consists primarily of investment interest income and gains and losses from foreign currency transactions and remeasurements.

***Provision for Income Taxes***

We are incorporated in the Cayman Islands and conduct business in several countries such as the United States, China, Taiwan, Hong Kong, South Korea and Japan, and we are subject to taxation in those jurisdictions. As such, our worldwide operating income is subject to varying tax rates and our effective tax rate is highly dependent upon the geographic distribution of our earnings or losses and the tax laws and regulations in each geographical region. Consequently, we have experienced lower effective tax rates as a substantial percentage of our operations are conducted in lower-tax jurisdictions. If our operational structure was to change in such a manner that would increase the amount of operating income subject to taxation in higher-tax jurisdictions, or if we were to commence operations in jurisdictions assessing relatively higher tax rates, our effective tax rate could fluctuate significantly on a quarterly basis and/or be adversely affected.

***Comparison of the Three and Six Months Ended July 31, 2014 and 2013******Revenue***

	Three Months Ended July 31, Change				Six Months Ended July 31, Change			
	2014	2013	Amount	%	2014	2013	Amount	%
	(dollars in thousands)							
Revenue	\$ 46,968	\$ 37,710	\$ 9,258	25%	\$ 87,889	\$ 71,651	\$ 16,238	23%

Revenue increased for the three and six months ended July 31, 2014 as compared to the same periods in fiscal year 2014 primarily due to higher demand in our IP security market as a result of continuing adoption by new and existing customers of our A5S chip and S2 chip, a 4K Ultra High Definition, or UHD, SoC. Also contributing to higher revenues were shipments of our new A9 chip into the wearable sports camera and the unmanned aerial vehicle or UAV markets. The increases were partially offset by year over year declines in the automotive camera and the infrastructure markets. The decline in the automotive market was primarily due to competitive pressures at the low end market in China and weak economic conditions in Russia. The decreased revenue in the infrastructure market was due to continued weak macro market conditions in the United States and Europe in this industry which has resulted in delayed investment in anticipation of the network upgrade and the new compression technology.

*Cost of Revenue and Gross Margin*

	Three Months Ended July 31, Change				Six Months Ended July 31, Change			
	2014	2013	Amount	%	2014	2013	Amount	%
	(dollars in thousands)							
Cost of revenue	\$ 16,432	\$ 14,419	\$ 2,013	14%	\$ 31,757	\$ 26,667	\$ 5,090	19%
Gross profit	30,536	23,291	7,245	31%	56,132	44,984	11,148	25%
Gross margin	65%	62%		3%	64%	63%		1%

Cost of revenue increased for the three and six months ended July 31, 2014 primarily due to an increase in the number of SoCs sold into the camera markets. The increase was partially offset by cost reductions received from suppliers for certain SoCs due to increased purchase volumes.

**Table of Contents**

Gross margin increased for the three and six months ended July 31, 2014 compared to the same periods in the prior fiscal year primarily due to increased revenues associated with higher gross margin shipments of our S2 and A9 chips into the IP security and UAV markets.

**Table of Contents****Research and Development**

	Three Months Ended July 31, Change				Six Months Ended July 31, Change			
	2014	2013	Amount	%	2014	2013	Amount	%

(dollars in thousands)

Research and development	\$ 13,497	\$ 10,974	\$ 2,523	23%	\$ 26,411	\$ 22,291	\$ 4,120	18%
--------------------------	-----------	-----------	----------	-----	-----------	-----------	----------	-----

Research and development expense increased for the three and six months ended July 31, 2014 primarily due to increases in engineering personnel costs, product development costs and facility allocation costs. Our research and development engineering headcount increased to 352 at July 31, 2014 compared to 342 at July 31, 2013, resulting in increases in salary related expenses of approximately \$0.5 million and \$0.7 million for the three and six months ended July 31, 2014, respectively. In the third quarter of fiscal year 2014, we granted restricted stock units under our annual evergreen program, resulting in increases in stock-based compensation expense of approximately \$0.7 million and \$1.3 million for the three and six months ended July 31, 2014, respectively. Our product development costs increased by approximately \$0.9 million and \$1.2 million for the three and six months ended July 31, 2014, respectively, compared to the same periods in the prior fiscal year resulting from new product development efforts on a number of next generation SoCs. In fiscal year 2014, we entered into a lease agreement for our new headquarters located in Santa Clara, California and implemented a new enterprise resource planning system, resulting in additional facility allocation costs of approximately \$0.3 million and \$0.9 million for the three and six months ended July 31, 2014, respectively.

**Selling, General and Administrative**

	Three Months Ended July 31, Change				Six Months Ended July 31, Change			
	2014	2013	Amount	%	2014	2013	Amount	%

(dollars in thousands)

Selling, general and administrative	\$ 6,875	\$ 5,385	\$ 1,490	28%	\$ 13,630	\$ 10,542	\$ 3,088	29%
-------------------------------------	----------	----------	----------	-----	-----------	-----------	----------	-----

Selling, general and administrative expense increased for the three and six months ended July 31, 2014 primarily due to increased headcount to support our expanding business. Our selling, general and administrative headcount increased to 141 at July 31, 2014 compared to 116 at July 31, 2013, resulting in increases in salary related expenses of approximately \$1.0 million and \$1.7 million for the three and six months ended July 31, 2014, respectively. In the third quarter of fiscal year 2014, we granted restricted stock units under our annual evergreen program, resulting in increases in stock-based compensation expense of approximately \$0.6 million and \$1.2 million for the three and six months ended July 31, 2014, respectively.

**Other Income (Loss), Net**

	Three Months Ended July 31, Change				Six Months Ended July 31, Change			
	2014	2013	Amount	%	2014	2013	Amount	%

(dollars in thousands)

Other income (loss), net	\$ 39	\$ (11)	\$ 50	455%	\$ 88	\$ (16)	\$ 104	650%
--------------------------	-------	---------	-------	------	-------	---------	--------	------

The increases in other income (loss), net, for the three and six months ended July 31, 2014 as compared to the same periods of prior fiscal year were primarily due to approximately \$24,000 and \$64,000, respectively, of net interest income from our investments.

*Provision for Income Taxes*

	Three Months Ended July 31, Change				Six Months Ended July 31, Change			
	2014	2013	Amount	%	2014	2013	Amount	%
	(dollars in thousands)							
Provision for income taxes	\$ 893	\$ 667	\$ 226	34%	\$ 1,609	\$ 1,140	\$ 469	41%
Effective tax rate	8.8%	9.6%		(0.8)%	9.9%	9.4%		0.5%

The effective tax rate decreased for the three months ended July 31, 2014 compared to the same period of last fiscal year primarily due to a change in the mix of earnings between our various geographic jurisdictions in the two periods. The effective tax rate increased for the six months ended July 31, 2014 compared to the six months ended July 31, 2013 primarily due to the expiration of the US federal R&D tax credit on December 31, 2013, and the changes in the mix of earnings of various geographic jurisdictions in fiscal year 2015 as compared to fiscal year 2014.

**Table of Contents****Liquidity and Capital Resources**

We had cash and cash equivalents of \$128.3 million and \$143.4 million as of July 31, 2014 and January 31, 2014, respectively. The reduction in cash and cash equivalents from January 31, 2014 to July 31, 2014 resulted from investments in highly liquid, short-term marketable securities made during the first six months of fiscal year 2015.

***Cash Flows***

The following table summarizes our cash flows for the periods indicated:

	<b>Six Months Ended July 31,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>	
Net cash provided by operating activities	\$ 18,846	\$ 15,939
Net cash used in investing activities	(39,477)	(1,280)
Net cash provided by financing activities	5,500	3,157
Net increase in cash	\$ (15,131)	\$ 17,816

***Net Cash Provided by Operating Activities***

Net cash provided by operating activities increased for the six months ended July 31, 2014 primarily due to increased net income, adjusted for increased non-cash stock-based compensation expense, depreciation of fixed assets, and amortization/accretion of securities premiums and discounts. The increase was also attributable to increased liabilities associated with the timing of payments to suppliers. The increase was partially offset by increased accounts receivable associated with the timing of payments from customers, increased inventory purchases to support continuing growth of sales as well as decreased deferred revenue associated with the timing of inventory shipments by our logistics providers.

***Net Cash Used in Investing Activities***

Net cash used in investing activities increased for the six months ended July 31, 2014 compared to the six months ended July 31, 2013 primarily due to \$41.6 million investments in highly-liquid, short-term marketable securities. The increase was partially offset by \$2.8 million in cash receipts from partial maturities of these investments.

***Net Cash Provided by Financing Activities***

Net cash provided by financing activities increased for the six months ended July 31, 2014 compared to the same period in prior fiscal year primarily due to an additional \$2.2 million in net cash proceeds from option exercises and contributions from employees to the employee stock purchase plan.

***Operating and Capital Expenditure Requirements***

We have generated net income in each quarter beginning with the first quarter of fiscal year 2010, and we have generated cash from operations in each of fiscal years 2009 to 2014 and for the six months ended July 31, 2014. We believe that our anticipated cash generated from operations and our existing cash balances will be sufficient to meet



our anticipated cash requirements through at least the next 12 months. In the future, we expect our operating and capital expenditures to increase as we increase headcount, expand our business activities, implement and enhance our information technology platforms and meet the requirements of the Sarbanes-Oxley Act. We expect our accounts receivable and inventory balances to increase, and could be partially offset by increases in accounts payable, which will result in a greater need for working capital. If our available cash balances are insufficient to satisfy our future liquidity requirements, we may seek to sell equity or convertible debt securities or borrow funds commercially. The sale of equity and convertible debt securities may result in dilution to our shareholders and those securities may have rights senior to those of our ordinary shares. If we raise additional funds through the issuance of convertible debt securities, these securities could contain covenants that would restrict our operations. We may require additional capital beyond our currently anticipated amounts. Additional capital may not be available to us on reasonable terms, or at all.

*Our short- and long-term capital requirements will depend on many factors, including the following:*

our ability to generate cash from operations;

our ability to control our costs;

the emergence of competing or complementary technologies or products;

**Table of Contents**

the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights, or participating in litigation-related activities; and

our acquisition of complementary businesses, products and technologies.

**Contractual Obligations, Commitments and Contingencies**

The following table summarizes our outstanding contractual obligations as of July 31, 2014:

	Payment Due by Period as of July 31, 2014 (in thousands)					
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	All Other
<b>Contractual Obligations</b>						
Facilities under operating leases	\$ 5,885	\$ 897	\$ 3,380	\$ 1,608	\$	\$
Technology license or other obligations under operating leases	8,122	1,791	6,321	10		
Purchase obligations	18,405	18,405				
Uncertain tax liabilities	1,493					1,493
Total	\$ 33,905	\$ 21,093	\$ 9,701	\$ 1,618	\$	\$ 1,493

As of July 31, 2014, we had purchase obligations with our independent contract manufacturers of \$18.4 million.

Uncertain tax liabilities represent our potential liabilities related to uncertain tax positions as of July 31, 2014. We are unable to reasonably estimate the timing of payments in individual years due to uncertainties in the timing of the effective settlement of tax positions.

**Off-Balance Sheet Arrangements**

As of July 31, 2014, we did not engage in any off-balance sheet arrangements, including the use of structured finance, special purpose entities or variable interest entities.

**Recent Authoritative Accounting Guidance**

See Note 1 to our unaudited condensed consolidated financial statements for information regarding recently issued accounting pronouncements.

**Critical Accounting Policies and Significant Management Estimates**

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K for the 2014 fiscal year filed with the SEC on April 4, 2014.

**ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

We had cash, cash equivalents, marketable securities and restricted cash totaling \$166.5 million and \$143.4 million at July 31, 2014 and January 31, 2014, respectively. Our cash and restricted cash consist of cash in standard bank accounts and certificates of deposit. The cash equivalents and marketable securities consist primarily of investments in debt securities. Our cash is held for working capital purposes. We do not enter into investments for trading or speculative purposes.

*Interest Rate Fluctuation Risk*

The primary objectives of our investment activities are to preserve principal, provide liquidity and maximize income without significantly increasing risk. Some of the securities we invest in are subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. To minimize this risk, we maintain our portfolio of short-term investments in a variety of debt securities with high credit quality and highly liquidity. We do not enter into investments for trading or speculative purposes. A 10% change in interest rates will not have a material impact on our future interest income or investment fair value. The risk associated with fluctuating interest rates is limited to our investment portfolio.

---

**Table of Contents***Foreign Currency Risk*

To date, all of our product sales and inventory purchases have been denominated in U.S. dollars. We therefore have not had any foreign currency risk associated with these two activities. The functional currency of all of our entities is the U.S. dollar. Our operations outside of the United States incur operating expenses and hold assets and liabilities denominated in foreign currencies, principally the New Taiwan Dollar and the Chinese Yuan Renminbi. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. However, we believe that the exposure to foreign currency fluctuation from operating expenses is immaterial at this time as the related costs do not constitute a significant portion of our total expenses. As we grow our operations, our exposure to foreign currency risk could become more significant. To date, we have not entered into any foreign currency exchange contracts and currently do not expect to enter into foreign currency exchange contracts for trading or speculative purposes.

**ITEM 4. Controls and Procedures***Evaluation of Disclosure Controls and Procedures*

Our management, with the participation of our Chief Executive Officer (our principal executive officer) and Chief Financial Officer (our principal financial officer), has evaluated the effectiveness of our disclosure controls and procedures as of July 31, 2014. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on such evaluation of our disclosure controls and procedures as of July 31, 2014, our Chief Executive Officer and Chief Financial Officer concluded that as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

*Changes in Internal Control over Financial Reporting*

Other than the implementation of our enterprise resource planning (ERP) system, there were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As of July 31, 2014, we completed the implementation and integration of a new ERP system, which upgrades our information system capabilities and improves our business processes and financial reporting system. The new system is expected to result in enhanced internal controls.

*Limitations on the Effectiveness of Controls*

Because of their inherent limitations, our disclosure controls and procedures and our internal control over financial reporting may not prevent material errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The effectiveness of

our disclosure controls and procedures and our internal control over financial reporting is subject to risks, including that the controls may become inadequate because of changes in conditions or that the degree of compliance with our policies or procedures may deteriorate.

## **PART II OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

We are not engaged in any material legal proceedings at this time.

### **ITEM 1A. Risk Factors**

*Certain factors may have a material adverse effect on our business, financial condition and results of operations. You should consider carefully the risks and uncertainties described below, in addition to other information contained in this Quarterly Report on Form 10-Q, including our unaudited condensed consolidated financial statements and related notes. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that adversely affect our business. If any of the following risks actually occurs, our business, financial condition, results of operations, and future prospects could be materially and adversely affected. In that event, the trading price of our ordinary shares could decline, and you could lose part or all of your investment.*

---

**Table of Contents****Risks Related to Our Business and Our Industry**

***If our customers do not design our solutions into their product offerings, or if our customers' product offerings are not commercially successful, our business would suffer.***

We sell our video and image processing system-on-a-chip, or SoC, solutions to original equipment manufacturers, or OEMs, who include our SoCs in their products, and to original design manufacturers, or ODMs, who include our SoCs in the products that they supply to OEMs. We refer to ODMs as our customers and OEMs as our end customers, except as otherwise indicated or as the context otherwise requires. Our video and image processing SoCs are generally incorporated into our customers' products at the design stage, which is referred to as a design win. As a result, we rely on OEMs to design our solutions into the products that they design and sell. Without these design wins, our business would be harmed. We often incur significant expenditures developing a new SoC solution without any assurance that an OEM will select our solution for design into its own product. Once an OEM designs a competitor's device into its product, it becomes significantly more difficult for us to sell our SoC solutions to that OEM because changing suppliers involves significant cost, time, effort and risk for the OEM. Furthermore, even if an OEM designs one of our SoC solutions into its product, we cannot be assured that the OEM's product will be commercially successful over time or at all or that we will receive or continue to receive any revenue from that OEM. For example, improved smartphone video capture capabilities, and rapid adoption of smartphones by consumers, led to the decline of an entire category of pocket video cameras aimed at the casual video capture market. In fiscal year 2011, pocket video revenue represented approximately 40% of our total revenue. The proliferation of smartphones and their ability to capture high-quality video and still images significantly impacted this market, decreasing pocket video cameras' contribution to approximately zero of our total revenue by fiscal year 2013. If other product categories incorporating our SoC solutions are not commercially successful or experience rapid decline, our revenue and business will suffer.

***We depend on a limited number of customers and end customers for a significant portion of our revenue. If we fail to retain or expand our customer relationships, our revenue could decline.***

We derive a significant portion of our revenue from a limited number of ODMs who build products on behalf of a limited number of OEMs and from a limited number of OEMs to whom we ship directly. We anticipate that this customer concentration will continue for the foreseeable future. For the three months ended July 31, 2014, sales directly and through our logistics providers to our five largest customers collectively accounted for approximately 63% of our total revenue, and sales to our 10 largest customers collectively accounted for approximately 75% of our total revenue. For the six months ended July 31, 2014, sales directly and through our logistics providers to our five largest customers collectively accounted for approximately 56% of our total revenue, and sales to our 10 largest customers collectively accounted for approximately 70% of our total revenue. For the three months ended July 31, 2014, sales to our largest ODM customer accounted for approximately 24% of our total revenue. For the six months ended July 31, 2014, sales to our largest ODM customer accounted for approximately 20% of our total revenue. This ODM customer builds products for several OEM customers as well as for its own brand. We believe that our operating results for the foreseeable future will continue to depend on sales to a relatively small number of customers and end-customers. In the future, these customers may decide not to purchase our SoC solutions at all, may purchase fewer solutions than they did in the past or may alter their purchasing patterns. As substantially all of our sales to date have been made on a purchase order basis, these customers may cancel, change or delay product purchase commitments with little or no notice to us and without penalty and may make our revenue volatile from period to period. For example, our largest OEM end customer in fiscal year 2011, Eastman Kodak Company, or Kodak, closed its camera division in January 2012. The loss of a significant customer could happen again at any time and without notice, and such loss would likely harm our financial condition and results of operations.

In addition, our relationships with some customers may deter other potential customers who compete with these customers from buying our solutions. To attract new customers or retain existing customers, we may have to offer these customers favorable prices on our solutions. In that event, our average selling prices and gross margins would decline. The loss of a key customer, a reduction in sales to any key customer or our inability to attract new customers could seriously impact our revenue and harm our results of operations.

***Our customers may cancel their orders, change production quantities or delay production. If we fail to accurately forecast demand for our solutions, revenue shortfalls, or excess, obsolete or insufficient inventory could result.***

Our customers typically do not provide us with firm, long-term purchase commitments. Substantially all of our sales are made on a purchase order basis, which permits our customers to cancel, change or delay their product purchase commitments with little or no notice to us and without penalty to them. Because production lead times often exceed the amount of time required by our customers to fill their orders, we often must build SoCs in advance of orders, relying on an imperfect demand forecast to project volumes and product mix.

Our SoCs are incorporated into products manufactured by or for our end customers, and as a result, demand for our solutions is influenced by the demand for our customers' products. Our ability to accurately forecast demand can be adversely affected by a number of factors, including inaccurate forecasting by our customers, miscalculations by our customers of their inventory requirements, changes in market conditions, adverse changes in our product order mix and fluctuating demand for our customers' products. Even after an order is received, our customers may cancel these orders or request a decrease in production quantities. Any such cancellation or decrease subjects us to a number of risks, most notably that our projected sales will not materialize on schedule or at all, leading to unanticipated revenue shortfalls and excess or obsolete inventory that we may be unable to sell to other customers.



---

**Table of Contents**

Alternatively, if we are unable to project customer requirements accurately, we may not build enough SoCs, which could lead to delays in product shipments and lost sales opportunities in the near term, as well as force our customers to identify alternative sources, which could affect our ongoing relationships with these customers. We have in the past had customers significantly increase their requested production quantities with little or no advance notice. If we do not fulfill customer demands in a timely manner, our customers may cancel their orders and we may be subject to customer claims for cost of replacement. In addition, the rapid pace of innovation in our industry could render portions of our inventory obsolete. Excess or obsolete inventory levels could result in unexpected expenses or increases in our reserves that could adversely affect our business, operating results and financial condition. In addition, any significant future cancellations or deferrals of product orders could harm our margins, increase our write-offs due to product obsolescence and restrict our ability to fund our operations.

***Our target markets may not grow or develop as we currently expect and are subject to market risks, any of which could harm our business, revenue and operating results.***

To date, our revenue has been attributable to demand for our video and image processing SoCs in the camera and infrastructure markets and the growth of these overall markets. We initially focused on the infrastructure market, and then leveraged our knowledge and experience to design solutions for the camera market. We derive the substantial majority of our revenue from the camera market, and our operating results are increasingly affected by trends in the camera market. These trends include demand for higher resolution, increasing functionality, longer battery life, greater storage and connectivity requirements, while accommodating more sophisticated standards for video compression. We may be unable to predict the timing or development of these markets with accuracy. For example, the proliferation of smartphones having the ability to capture high-quality video and still images has significantly impacted the camera market in a relatively short period of time and continues to impact this market. In the Internet Protocol, or IP, security camera market, a slower than expected adoption rate for digital technology in place of analog solutions could slow the demand for our solutions. If our target markets, such as wearable cameras, automotive aftermarket cameras, IP security cameras, and telepresence cameras, do not grow or develop in ways that we currently expect, demand for our video and image processing SoCs may not materialize as expected and our business and operating results could suffer.

***Fluctuations in our operating results on a quarterly and annual basis could cause the market price of our ordinary shares to decline.***

Our revenue and operating results have fluctuated significantly from period to period in the past and are likely to do so in the future. In particular, our business tends to be seasonal with higher revenue in our third quarter as our customers typically increase their production to meet year-end demand for their products. We may also experience seasonally lower demand in our first quarter in the Asia-based portion of the IP security camera market as a result of industry seasonality and the impact of ODM and OEM factory closures associated with the Chinese New Year holiday. As a result, you should not rely on period-to-period comparisons of our operating results as an indication of our future performance. In future periods, our revenue and results of operations may be below the expectations of analysts and investors, which could cause the market price of our ordinary shares to decline.

Factors that may affect our operating results include:

fluctuations in demand, sales cycles, product mix, and prices for our products;

the forecasting, scheduling, rescheduling or cancellation of orders by our customers;

shifts in consumer preferences and any resultant change in demand for video and image capture devices into which our solutions are incorporated;

changes in the competitive dynamics of our markets, including new entrants or pricing pressures;

delays in our customers' ability to manufacture and ship products that incorporate our solutions caused by internal and external factors beyond our control;

our ability to successfully define, design and release new solutions in a timely manner that meet our customers' needs;

changes in manufacturing costs, including wafer, test and assembly costs, mask costs, manufacturing yields and product quality and reliability;

timely availability of adequate manufacturing capacity from our manufacturing subcontractors;

the timing of product announcements by our competitors or by us;

incurrence of research and development and related new products expenditures;

**Table of Contents**

write-downs of inventory for excess quantities and technological obsolescence;

future accounting pronouncements and changes in accounting policies;

volatility in our share price, which may lead to higher stock-based compensation expense;

general socioeconomic and political conditions in the countries where we operate or where our products are sold or used; and

costs associated with litigation, especially related to intellectual property.

Moreover, the semiconductor industry has historically been cyclical in nature, reflecting overall economic conditions as well as budgeting and buying patterns of consumers. We expect these cyclical conditions to continue. As a result, our quarterly operating results are difficult to predict, even in the near term. Our expense levels are relatively fixed in the short term and are based, in part, on our expectations of future revenue. If revenue levels are below our expectations, we may experience declines in margins and profitability or incur losses.

***Achieving design wins is subject to lengthy competitive selection processes that require us to incur significant costs. Even if we begin a product design, a customer may decide to cancel or change its product plans, resulting in no revenue from such expenditures.***

We are focused on selling our video and image processing solutions to ODMs and OEMs for incorporation into their products at the design stage. These efforts to achieve design wins typically are lengthy, especially in new markets we intend to address, and in any case can require us to both incur design and development costs and dedicate scarce engineering resources in pursuit of a single customer opportunity. We may not prevail in the competitive selection process and, even when we do achieve a design win, we may never generate any revenue despite incurring development expenditures. For example, in the past we had achieved a significant design win and projected substantial future revenue from that end customer as a result of that design win. Subsequently, based on changes in that end customer's assessment of the consumer market, among other factors, the end customer abruptly shut down its business unit with which we achieved the design win, with no notice to us.

These risks are exacerbated by the fact that some of our end customers' products, particularly in the camera market, likely will have short life cycles. Further, even after securing a design win, we have experienced and may again experience delays in generating revenue from our solutions as a result of the lengthy product development cycle typically required, if we generate any revenue at all as a result of any such design win.

Our customers generally take a considerable amount of time to evaluate our solutions. The typical time from early engagement by our sales force to actual product introduction runs from nine to 12 months for the camera market, and 12 to 24 months for the infrastructure market, though it may take longer in new markets we intend to address. The delays inherent in these lengthy sales cycles increase the risk that a customer will decide to cancel, curtail, reduce or delay its product plans, causing us to lose anticipated sales. In addition, any delay or cancellation of a customer's plans could harm our financial results, as we may have incurred significant expense and generated no revenue. Finally, our customers' failure to successfully market and sell their products could reduce demand for our SoC solutions and harm our business, financial condition and results of operations. If we were unable to generate revenue after incurring substantial expenses to develop any of our solutions, our business would suffer.

***The average selling prices of video and image processing solutions in our target markets have historically decreased over time and will likely do so in the future, which could harm our revenue and gross margins.***

Average selling prices of semiconductor products in the markets we serve have historically decreased over time, and we expect such declines to continue to occur for our solutions over time. Our gross margins and financial results will suffer if we are unable to offset reductions in our average selling prices by reducing our costs, developing new or enhanced SoC solutions on a timely basis with higher selling prices or gross margins, or increasing our sales volumes. Additionally, because we do not operate our own manufacturing, assembly or testing facilities, we may not be able to reduce our costs as rapidly as companies that operate their own facilities, and our costs may even increase, which could also reduce our gross margins. In the past, we have reduced the prices of our SoC solutions in anticipation of future competitive pricing pressures, new product introductions by us or our competitors and other factors. Recently, we have experienced competitive pricing pressures at the low ends of the automotive aftermarket camera market and China-based IP security camera market. We expect that we will have to address pricing pressures again in the future, which could require us to reduce the prices of our SoC solutions and harm our operating results.

---

**Table of Contents**

*We expect competition to increase in the future, which could have an adverse effect on our revenue and market share.*

The global semiconductor market in general, and the video and image processing markets in particular, are highly competitive. We compete in different target markets to various degrees on the basis of a number of competitive factors, including our solutions' performance, features, functionality, energy efficiency, size, ease with which our solution may be integrated into our customers' products, customer support, reliability and price, as well as on the basis of our reputation. We expect competition to increase and intensify as more and larger semiconductor companies enter our markets, and as the internal resources of large OEMs grow. Increased competition could result in price pressure, reduced profitability and loss of market share, any of which could harm our business, revenue and operating results.

Our competitors range from large, international companies offering a wide range of semiconductor products to smaller companies specializing in narrow markets. In the wearable sports camera market, our primary competitors are vertically integrated divisions of camera device OEMs, including Sony Corporation and Panasonic Corporation. In the IP security camera market, our primary competitors include HiSilicon Technologies Co., Ltd., Geo Semiconductor, Inc., Grain Media, Inc., and Texas Instruments Incorporated, as well as vertically integrated divisions of IP Security camera device OEMs, including Axis Communications AB, Panasonic and Sony. In the market for automotive aftermarket cameras, we compete against Alpha Imaging Technology Corp., Core Logic, Inc., Novatek Microelectronics Corp. and Sunplus Technology Co. Ltd. Our primary competitors in the infrastructure market include Intel Corporation, Magnum Semiconductor, Inc. and Texas Instruments Incorporated. Certain of our customers and suppliers also have divisions that produce products competitive with ours. We expect competition in our current markets to increase in the future as existing competitors improve or expand their product offerings and as potential new competitors, such as Broadcom Corporation, NVIDIA Corporation, Qualcomm Incorporated and Samsung Electronics Co., Ltd., enter these markets.

Our ability to compete successfully depends on elements both within and outside of our control, including industry and general economic trends. Many of our competitors are substantially larger, have greater financial, technical, marketing, distribution, customer support and other resources, are more established than we are and have significantly better brand recognition and broader product offerings which may enable them to better withstand adverse economic or market conditions in the future. Our ability to compete will depend on a number of factors, including:

our ability to anticipate market and technology trends and successfully develop solutions that meet market needs;

our success in identifying and penetrating new markets, applications and customers;

our ability to understand the price points and performance metrics of competing products in the marketplace;

our solutions' performance and cost-effectiveness relative to that of competing products;

our ability to gain access to leading design tools and product specifications at the same time as our competitors;

our ability to develop and maintain relationships with key OEMs and ODMs;

our products' effective implementation of video processing standards;

our ability to protect our intellectual property;

our ability to expand international operations in a timely and cost-efficient manner;

our ability to deliver products in volume on a timely basis at competitive prices;

our ability to support our customers' incorporation of our solutions into their products; and

our ability to recruit design and application engineers with expertise in image video and image processing technologies and sales and marketing personnel.

Our competitors may also establish cooperative relationships among themselves or with third parties or acquire companies that provide similar products to ours. As a result, new competitors or alliances may emerge that could acquire significant market share. Any of these factors, alone or in combination with others, could harm our business and result in a loss of market share and an increase in pricing pressure.

***We are dependent on sales of a limited number of video and image processing solutions, and a decline in market adoption of these solutions could harm our business.***

From inception through July 31, 2014, our revenue has been generated primarily from the sale of a limited number of high-definition, or HD, video and image processing SoC solutions in the camera and infrastructure markets. Moreover, we currently derive a substantial majority of our revenue from the sale of our SoCs for use in the camera market and we expect to do so for the next several years. As a result, continued market adoption of our SoC solutions in the camera market is critical to our future success. If demand for our SoC solutions were to decline, or demand for products incorporating our solutions declines, does not continue to grow or does not grow as expected, our revenue would decline and our business would be harmed.

---

**Table of Contents**

***If we fail to develop and introduce new or enhanced solutions on a timely basis, our ability to attract and retain customers could be impaired and our competitive position could be harmed.***

We operate in a dynamic environment characterized by rapidly changing technologies and technological obsolescence. To compete successfully, we must design, develop, market and sell enhanced solutions that provide increasingly higher levels of performance and functionality and that meet the cost expectations of our customers. Our existing or future solutions could be rendered obsolete by the introduction of new products by our competitors; convergence of other markets, such as smartphones, with or into the camera market; the market adoption of products based on new or alternative technologies; or the emergence of new industry standards for video compression. In addition, the markets for our solutions are characterized by frequent introduction of next-generation and new products, short product life cycles, increasing demand for added functionality and significant price competition. If we or our customers are unable to manage product transitions in a timely and cost-effective manner, our business and results of operations would suffer.

Our failure to anticipate or timely develop new or enhanced solutions in response to technological shifts could result in decreased revenue and our competitors achieving design wins that we sought. In particular, we may experience difficulties with product design, development of new software, manufacturing, marketing or qualification that could delay or prevent our development, introduction or marketing of new or enhanced solutions. In addition, delays in development could impair our relationships with our customers and negatively impact sales of our solutions under development. Moreover, it is possible that our customers may develop their own product or adopt a competitor's solution for products that they currently buy from us. If we fail to introduce new or enhanced solutions that meet the needs of our customers or penetrate new markets in a timely fashion, we will lose market share and our operating results will be adversely affected.

***If we fail to penetrate new markets, our revenue and financial condition could be harmed.***

In the past several years, a significant amount of our revenue was generated from sales of our products to OEMs and ODMs of high definition, or HD, video cameras and broadcasting infrastructure equipment. Our future revenue growth, if any, will depend in part on our ability to expand within these markets with our video and image processing SoC solutions, particularly for wearable sports cameras, automotive aftermarket cameras, IP security cameras, and to enter new markets such as the non-sports wearable camera market and the UAV market. Each of these markets presents distinct and substantial risks and, in many cases, requires us to develop new software to address the particular requirements of that market. If any of these markets do not develop as we currently anticipate or if we are unable to penetrate them successfully, our revenue could decline.

Some of these markets are primarily served by only a few large, multinational OEMs with substantial negotiating power relative to us and, in some instances, with internal solutions that are competitive to our products. Meeting the technical requirements and securing design wins with any of these companies will require a substantial investment of our time and resources. We cannot assure you that we will secure design wins from these or other companies or that we will achieve meaningful revenue from the sales of our solutions into these markets.

If we fail to penetrate these or other new markets we are targeting, our revenue likely will decrease over time and our financial condition could suffer.

***We do not have long-term supply contracts with our third-party manufacturing vendors, and they may not allocate sufficient capacity to us at reasonable prices to meet future demands for our solutions.***

The semiconductor industry is subject to intense competitive pricing pressure from customers and competitors. Accordingly, any increase in the cost of our solutions, whether by adverse purchase price variances or adverse manufacturing cost variances, will reduce our gross margins and operating profit. We currently do not have long-term supply contracts with most of our primary third-party vendors, and we negotiate pricing with our main vendors on a purchase order-by-purchase order basis. Therefore, they are not obligated to perform services or supply product to us for any specific period, in any specific quantities, or at any specific price, except as may be provided in a particular purchase order. Availability of foundry capacity has in the recent past been limited due to strong demand. The ability of our foundry vendors to provide us with a product, which is sole sourced at each foundry, is limited by their available capacity, existing obligations and technological capabilities. Foundry capacity may not be available when we need it or at reasonable prices. None of our third-party foundry or assembly and test vendors has provided contractual assurances to us that adequate capacity will be available to us to meet our anticipated future demand for our solutions. Our foundry and assembly and test vendors may allocate capacity to the production of other companies products while reducing deliveries to us on short notice. In particular, other companies that are larger and better financed than we are or that have long-term agreements with our foundry or assembly and test vendors may cause our foundry or assembly and test vendors to reallocate capacity to them, decreasing the capacity available to us. Converting or transferring manufacturing from a primary location or supplier to a backup foundry vendor could be expensive and would likely take at least two or more quarters. As we transition to more advanced process nodes beyond 28 nanometer, or nm, we will be increasingly dependent upon Samsung Electronics Co., Ltd., or Samsung, Taiwan Semiconductor Manufacturing Co., Ltd., or TSMC, who are two of the only a few foundries currently available for certain advanced process technologies that we may utilize.



---

**Table of Contents**

If, in the future, we enter into arrangements with suppliers that include additional fees to expedite delivery, nonrefundable deposits or loans in exchange for capacity commitments or commitments to purchase specified quantities over extended periods, such arrangements may be costly, reduce our financial flexibility and be on terms unfavorable to us, if we are able to secure such arrangements at all. Moreover, if we are able to secure foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties could harm our financial results. To date, we have not entered into any such arrangements with our suppliers. If we need additional foundry or assembly and test subcontractors because of increased demand or the inability to obtain timely and adequate deliveries from our current vendors, we may not be able to do so cost-effectively, if at all.

***A substantial portion of our revenue is processed through a single logistics provider and the loss of this logistics provider may cause disruptions in our shipments, which may adversely affect our operations and financial condition.***

We sell most of our solutions through a single logistics provider, Wintech Microelectronics Co., Ltd., or Wintech, which serves as our non-exclusive sales representative in all of Asia other than Japan. Approximately 65% and 59% of our revenue was derived from sales through Wintech for the three months ended July 31, 2014 and 2013, respectively. Approximately 67% and 50% of our revenue was derived from sales through Wintech for the six months ended July 31, 2014 and 2013, respectively. We anticipate that a significant portion of our revenue will continue to be derived from sales through Wintech in the foreseeable future. Our current agreement with Wintech is effective until September 2015, unless it is terminated earlier by either party for any or no reason with 90 days written notice or by failure of the breaching party to cure a material breach within 30 days following written notice of such material breach by the non-breaching party. Our agreement with Wintech will automatically renew for additional successive 12-month terms unless at least 60 days before the end of the then-current term either party provides written notice to the other party that it elects not to renew the agreement. Termination of the relationship with Wintech, either by us or by Wintech, could result in a temporary or permanent loss of revenue. We may not be successful in finding suitable alternative logistics providers on satisfactory terms, or at all, and this could adversely affect our ability to effectively sell our solutions in certain geographical locations or to certain end customers. Additionally, if we terminate our relationship with Wintech, we may be obligated to repurchase unsold product, which could be difficult or impossible to sell to other end customers. Furthermore, Wintech, or any successor or other logistics providers we do business with, may face issues obtaining credit, which could impair their ability to make timely payments to us.

***Deterioration of the financial conditions of our customers could adversely affect our operating results.***

Deterioration of the financial condition of our logistics providers or customers could adversely impact our collection of accounts receivable. We regularly review the collectability and creditworthiness of our logistics providers and customers to determine an appropriate allowance for doubtful receivables. Based on our review of our logistics providers and customers, we currently have no reserve for uncollectible accounts. If our uncollectible accounts, however, were to exceed our current or future allowance for doubtful receivables, our operating results would be negatively impacted.

***If we do not sustain our growth rate, we may not be able to execute our business plan and our operating results could suffer.***

We have experienced significant growth in a short period of time. Our revenue increased from \$21.5 million in fiscal year 2008 to \$157.6 million in fiscal year 2014, including growth rates of 30% and 24% in the last two fiscal years. We may not achieve similar growth rates in future periods. You should not rely on our revenue growth, gross margins or operating results for any prior quarterly or annual periods as an indication of our future operating performance. If we are unable to maintain adequate revenue growth, our financial results could suffer and our stock price could

decline.

***If we are unable to manage any future growth, we may not be able to execute our business plan and our operating results could suffer.***

Our business has grown rapidly. Our future operating results depend to a large extent on our ability to successfully manage any expansion and growth, including the challenges of managing a company with headquarters in the United States and the majority of its employees in Asia. To manage our growth successfully and handle the responsibilities of being a public company, we believe we must effectively, among other things:

recruit, hire, train and manage additional qualified engineers for our research and development activities, particularly in our offices in Asia and especially for the positions of semiconductor design and systems and applications engineering;

add additional sales and business development personnel;

add additional finance and accounting personnel;

---

**Table of Contents**

implement and improve our administrative, financial and operational systems, procedures and controls;  
and

enhance our information technology support for enterprise resource planning and design engineering  
by adapting and expanding our systems and tool capabilities, and properly training new hires as to their  
use.

We are increasing our investment in research and development and other functions to grow our business. We are likely to incur the costs associated with these increased investments earlier than some of the anticipated benefits, and the return on these investments, if any, may be lower, may develop more slowly than we expect or may not materialize.

If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities or develop new solutions, and we may fail to satisfy customer product or support requirements, maintain product quality, execute our business plan or respond to competitive pressures.

***We may have difficulty accurately predicting our future revenue and appropriately budgeting our expenses.***

The rapidly evolving nature of the markets in which we sell our solutions, combined with substantial uncertainty concerning how these markets may develop and other factors beyond our control, limits our ability to accurately forecast quarterly or annual revenue. In addition, because we record a significant portion of our revenue from sales when we have received notification from our logistics providers that they have sold our products, some of the revenue we record in a quarter may be derived from sales of products shipped to our logistics providers during previous quarters. This revenue recognition methodology limits our ability to forecast quarterly or annual revenue accurately. We are currently expanding our staffing and increasing our expenditures in anticipation of future revenue growth. If our revenue does not increase as anticipated, we could incur significant losses due to our higher expense levels if we are not able to decrease our expenses in a timely manner to offset any shortfall in future revenue.

***While we intend to continue to invest in research and development, we may be unable to make the substantial investments that are required to remain competitive in our business.***

The semiconductor industry requires substantial investment in research and development in order to bring to market new and enhanced solutions. Our research and development expense was \$13.5 million and \$11.0 million for the three months ended July 31, 2014 and 2013, respectively. Our research and development expense was \$26.4 million and \$22.3 million for the six months ended July 31, 2014 and 2013, respectively. We expect to increase our research and development expenditures as compared to prior periods as part of our strategy of focusing on the development of innovative and sustainable video and image processing solutions. We do not know whether we will have sufficient resources to maintain the level of investment in research and development required to remain competitive. For example, development in the latest process nodes, such as 14 or 16 nm, can cost significantly more than required to develop in 28 nm. This added cost could prevent us from being able to maintain a technology advantage over larger competitors that have significantly more resources to invest in research and development. In addition, we cannot assure you that the technologies which are the focus of our research and development expenditures will become commercially successful or generate any revenue.

***We may experience difficulties demonstrating the value to customers of newer, higher priced and higher margin solutions if they believe existing solutions are adequate to meet end customer expectations.***

As we develop and introduce new solutions, we face the risk that customers may not value or be willing to bear the cost of incorporating these newer solutions into their products, particularly if they believe their customers are satisfied with current solutions. Regardless of the improved features or superior performance of the newer solutions, customers may be unwilling to adopt our new solutions due to design or pricing constraints. Owing to the extensive time and resources that we invest in developing new solutions, if we are unable to sell customers new generations of our solutions, our revenue could decline and our business, financial condition, operating results and cash flows could be negatively affected.

***The complexity of our solutions could result in unforeseen delays or expenses from undetected defects, errors or bugs in hardware or software which could reduce the market adoption of our new solutions, damage our reputation with current or prospective customers and adversely affect our operating costs.***

Highly complex SoC solutions such as ours frequently contain defects, errors and bugs when they are first introduced or as new versions are released. We have in the past and may in the future experience these defects, errors and bugs. If any of our solutions have reliability, quality or compatibility problems, we may not be able to successfully correct these problems in a timely manner or at all. In addition, if any of our proprietary features contain defects, errors or bugs when first introduced or as new versions of our solutions are released, we may be unable to timely correct these problems. Consequently, our reputation may be damaged and customers may be reluctant to buy our solutions, which could

---

**Table of Contents**

harm our ability to retain existing customers and attract new customers, and could adversely affect our financial results. In addition, these defects, errors or bugs could interrupt or delay sales to our customers. If any of these problems are not found until after we have commenced commercial production of a new product, we may incur significant additional development costs and product recall, repair or replacement costs. These problems may also result in claims against us by our customers or others.

***The loss of any of our key personnel could seriously harm our business, and our failure to attract or retain qualified management, engineering, sales and marketing talent could impair our ability to grow our business.***

We believe our future success depends in large part upon the continuing services of the members of our senior management team and various engineering and other technical personnel. If one or more of our senior executives or other key personnel are unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all, our business may be disrupted, and our financial condition and results of operations may be materially and adversely affected. In addition, if any member of our senior management team or any of our other key personnel joins a competitor or forms a competing company, we may experience material disruption of our operations and development plans and lose customers, know-how and key professionals and staff members, and we may incur increased operating expenses as the attention of other senior executives is diverted to recruit replacements for key personnel. Our industry is characterized by high demand and intense competition for talent, and the pool of qualified candidates is very limited. While we plan to continue to recruit software and system engineers with expertise in video processing technologies, primarily in Taiwan and China, we may not be successful in attracting, retaining and motivating sufficient numbers of technical and engineering personnel to support our anticipated growth. The competition for qualified engineering personnel in our industry, and particularly in Asia, is very intense. If we are unable to hire, train and retain qualified engineering personnel in a timely manner, our ability to grow our business will be impaired. In addition, if we are unable to retain our existing engineering personnel, our ability to maintain or grow our revenue will be adversely affected.

***Camera manufacturers incorporate components supplied by multiple third parties, and a supply shortage or delay in delivery of these components could delay orders for our solutions by our customers.***

Our customers purchase components used in the manufacture of their cameras from various sources of supply, often involving several specialized components, including lenses and sensors. Any supply shortage or delay in delivery by third-party component suppliers, or a third-party supplier's cessation or shut down of its business, may prevent or delay production of our customers' products. In addition, replacement or substitute components may not be available on commercially reasonable terms, or at all. As a result of delays in delivery or supply shortages of third-party components, orders for our solutions may be delayed or canceled and our business may be harmed. Similarly, errors or defects within a camera system or in the manner in which the various components interact could prevent or delay production of our customers' products, which could harm our business.

***We outsource our wafer fabrication, assembly and testing operations to third parties, and if these parties fail to produce and deliver our products according to requested demands in specification, quantity, cost and time, our reputation, customer relationships and operating results could suffer.***

We rely on third parties for substantially all of our manufacturing operations, including wafer fabrication, assembly and testing. Currently, the majority of our SoCs are supplied by Samsung in South Korea, from whom we have the option to purchase both fully assembled and tested products as well as tested die in wafer form for assembly. Samsung subcontracts the assembly and initial testing of the assembled chips it supplies to us to Signetics Corporation and STATS ChipPAC Ltd. In the case of purchases of tested die from Samsung, we contract the assembly to Advanced Semiconductor Engineering, Inc., or ASE. We also have products supplied by Global UniChip Corporation, or GUC,

in Taiwan, from whom we purchase fully assembled and tested products. The wafers used by GUC in the assembly of our products are manufactured by TSMC in Taiwan. The assembly is done by GUC subcontracted assembly suppliers ASE, and Powertech Technology Inc, or PTI. Final testing of all of our products is handled by King Yuan Electronics Co., Ltd. or Sigurd Corporation under the supervision of our engineers. We depend on these third parties to supply us with material of a requested quantity in a timely manner that meets our standards for yield, cost and manufacturing quality. We do not have any long-term supply agreements with any of our manufacturing suppliers. If one or more of these vendors terminates its relationship with us, or if we encounter any problems with our manufacturing supply chain, our ability to ship our solutions to our customers on time and in the quantity required would be adversely affected, which in turn could cause an unanticipated decline in our sales and damage our customer relationships.

***If our foundry vendors do not achieve satisfactory yields or quality, our reputation and customer relationships could be harmed.***

The fabrication of our video and image processing SoC solutions is a complex and technically demanding process. Minor deviations in the manufacturing process can cause substantial decreases in yields, and in some cases, cause production to be suspended. Our foundry vendors, from time to time, experience manufacturing defects and reduced manufacturing yields, including in the fabrication of our SoCs. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundry vendors could result in lower than anticipated manufacturing yields or unacceptable performance of our SoCs. Many of these problems are difficult to detect at an early stage of

---

**Table of Contents**

the manufacturing process and may be time consuming and expensive to correct. Poor yields from our foundry vendors, or defects, integration issues or other performance problems in our solutions, could cause us significant customer relations and business reputation problems, harm our financial results and give rise to financial or other damages to our customers. Our customers might consequently seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

Each of our SoC solutions is manufactured at a single location. If we experience manufacturing problems at a particular location, we would be required to transfer manufacturing to a new location or supplier. Converting or transferring manufacturing from a primary location or supplier to a backup fabrication facility could be expensive and could take two or more quarters. During such a transition, we would be required to meet customer demand from our then-existing inventory, as well as any partially finished goods that could be modified to the required product specifications. We do not seek to maintain sufficient inventory to address a lengthy transition period because we believe it is uneconomical to keep more than minimal inventory on hand. As a result, we may not be able to meet customer needs during such a transition, which could delay shipments, cause production delays, result in a decline in our sales and damage our customer relationships.

***We may experience difficulties in transitioning to new wafer fabrication process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased costs.***

We aim to use the most advanced manufacturing process technology appropriate for our products that is available from our third-party foundries. As a result, we periodically evaluate the benefits of migrating our solutions to smaller geometry process technologies in order to improve performance and reduce costs. We believe this strategy will help us remain competitive. These ongoing efforts require us from time to time to modify the manufacturing processes for our products and to redesign some products, which in turn may result in delays in product deliveries. We may face difficulties, delays and increased expense as we transition our products to new processes, such as 14nm or 16nm process nodes, and potentially to new foundries. We depend on Samsung and TSMC, as the principal foundries for our products, to transition to new processes successfully. We cannot assure you that Samsung or TSMC will be able to effectively manage such transitions or that we will be able to maintain our relationship with Samsung or TSMC or develop relationships with new foundries. Moreover, as we transition to more advanced process nodes beyond 28nm, we will be increasingly dependent upon Samsung and TSMC, who are two of the only a few foundries currently available for certain advanced process technologies. If we or our foundry vendors experience significant delays in transitioning to smaller geometries or fail to efficiently implement transitions, we could experience reduced manufacturing yields, delays in product deliveries and increased costs, all of which could harm our relationships with our customers and our operating results. As new processes become more prevalent, we expect to continue to integrate greater levels of functionality, as well as more end-customer and third-party intellectual property, into our solutions. We may not be able to achieve higher levels of design integration or deliver new integrated solutions on a timely basis.

***We rely on third-party vendors to supply software development tools to us for the development of our new products, and we may be unable to obtain the tools necessary to develop or enhance new or existing products.***

We rely on third-party software development tools to assist us in the design, simulation and verification of new products or product enhancements. To bring new products or product enhancements to market in a timely manner, or at all, we need software development tools that are sophisticated enough or technologically advanced enough to complete our design, simulations and verifications. In the future, the design requirements necessary to meet consumer demands for more features and greater functionality from our solutions may exceed the capabilities of available software development tools. Unavailability of software development tools may result in our missing design cycles or

losing design wins, either of which could result in a loss of market share or negatively impact our operating results.

Because of the importance of software development tools to the development and enhancement of our solutions, our relationships with leaders in the computer-aided design industry, including Cadence Design Systems, Inc., Mentor Graphics Corporation and Synopsys, Inc., are critical to us. We have invested significant resources to develop relationships with these industry leaders. We believe that utilizing next-generation development tools to design, simulate and verify our products will help us remain at the forefront of the video compression market, and develop solutions that utilize leading-edge technology on a rapid basis. If these relationships are not successful, we may be unable to develop new products or product enhancements in a timely manner, which could result in a loss of market share, a decrease in revenue or negatively impact our operating results.

***Our failure to adequately protect our intellectual property rights could impair our ability to compete effectively or defend ourselves from litigation, which could harm our business, financial condition and results of operations.***

Our success depends, in part, on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark and trade secret laws, as well as confidentiality and non-disclosure agreements and other contractual protections, to protect our proprietary technologies and know-how, all of which offer only limited protection. The steps we have taken to protect our intellectual property rights may not be adequate to prevent misappropriation of our proprietary information or infringement of our intellectual property rights, and our ability to prevent such misappropriation or infringement is uncertain, particularly in countries outside of the United States. As of July 31, 2014, we had thirty-seven issued and allowed patents in the United States plus eighteen additional continuation patents, three issued patents in China, one



---

**Table of Contents**

issued patent in Japan and twenty-five pending and provisional patent applications in the United States. Even if the pending patent applications are granted, the rights granted to us may not be meaningful or provide us with any commercial advantage. For example, these patents could be opposed, contested, circumvented, designed around by our competitors or be declared invalid or unenforceable in judicial or administrative proceedings. The failure of our patents to adequately protect our technology might make it easier for our competitors to offer similar products or technologies. Our foreign patent protection is generally not as comprehensive as our U.S. patent protection and may not protect our intellectual property in some countries where our products are sold or may be sold in the future. Many U.S.-based companies have encountered substantial intellectual property infringement in foreign countries, including countries where we sell products. Even if foreign patents are granted, effective enforcement in foreign countries may not be available. For example, the legal environment relating to intellectual property protection in China is relatively weak, often making it difficult to create and enforce such rights. We may not be able to effectively protect our intellectual property rights in China or elsewhere. If such an impermissible use of our intellectual property or trade secrets were to occur, our ability to sell our solutions at competitive prices may be adversely affected and our business, financial condition, operating results and cash flows could be materially and adversely affected.

The legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain and evolving. We cannot assure you that others will not develop or patent similar or superior technologies, products or services, or that our patents, trademarks and other intellectual property will not be challenged, invalidated or circumvented by others.

Unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for doing so, which could harm our business. Monitoring unauthorized use of our intellectual property is difficult and costly. Although we are not aware of any unauthorized use of our intellectual property in the past, it is possible that unauthorized use of our intellectual property may have occurred or may occur without our knowledge. We cannot assure you that the steps we have taken will prevent unauthorized use of our intellectual property. Our failure to effectively protect our intellectual property could reduce the value of our technology in licensing arrangements or in cross-licensing negotiations.

We may in the future need to initiate infringement claims or litigation in order to try to protect our intellectual property rights. Litigation, whether we are a plaintiff or a defendant, can be expensive, time-consuming and may divert the efforts of our technical staff and management, which could harm our business, whether or not such litigation results in a determination favorable to us. Litigation also puts our patents at risk of being invalidated or interpreted narrowly and our patent applications at risk of not issuing. Additionally, any enforcement of our patents or other intellectual property may provoke third parties to assert counterclaims against us. If we are unable to protect our proprietary rights or if third parties independently develop or gain access to our or similar technologies, our business, revenue, reputation and competitive position could be harmed.

***Third parties' assertions of infringement of their intellectual property rights could result in our having to incur significant costs and cause our operating results to suffer.***

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights and positions, which has resulted in protracted and expensive litigation for many companies. Certain of our customers have received and, particularly as a public company, we expect that in the future we may receive, communications from others alleging our infringement of their patents, trade secrets or other intellectual property rights. In addition, certain of our end customers have been the subject of lawsuits alleging infringement of intellectual property rights by products incorporating our solutions, including the assertion that the alleged infringement may be attributable, at least in part, to our technology. Lawsuits resulting from such allegations could subject us to significant liability for damages and invalidate our proprietary rights, though this has not occurred to date. Any potential intellectual property

litigation also could force us to do one or more of the following:

stop selling products or using technology that contain the allegedly infringing intellectual property;

lose the opportunity to license our technology to others or to collect royalty payments based upon successful protection and assertion of our intellectual property against others;

incur significant legal expenses;

pay substantial damages to the party whose intellectual property rights we may be found to be infringing;

redesign those products that contain the allegedly infringing intellectual property; or

attempt to obtain a license to the relevant intellectual property from third parties, which may not be available on reasonable terms or at all.

Any significant impairment of our intellectual property rights from any litigation we face could harm our business and our ability to compete.

---

**Table of Contents**

***Any potential dispute involving our patents or other intellectual property could affect our customers, which could trigger our indemnification obligations to them and result in substantial expense to us.***

In any potential dispute involving our patents or other intellectual property, our customers could also become the target of litigation. Certain of our customers have received notices from third parties claiming to have patent rights in certain technology and inviting our customers to license this technology, and certain of our end customers have been the subject of lawsuits alleging infringement of patents by products incorporating our solutions, including the assertion that the alleged infringement may be attributable, at least in part, to our technology. Because we indemnify our customers for intellectual property claims made against them for products incorporating our technology, any litigation could trigger technical support and indemnification obligations under some of our license agreements, which could result in substantial expense to us. Although we have not incurred indemnity expenses related to intellectual property claims to date, we anticipate that we will receive requests for indemnity in the future pursuant to our license agreements with our customers. In addition, other customers or end customers with whom we do not have formal agreements requiring us to indemnify them may ask us to indemnify them if a claim is made as a condition to awarding future design wins to us. Because some of our ODMs and OEMs are larger than we are and have greater resources than we do, they may be more likely to be the target of an infringement claim by third parties than we would be, which could increase our chances of becoming involved in a future lawsuit. Although we have not yet been subject to such claims, if any such claims were to succeed, we might be forced to pay damages on behalf of our ODMs or OEMs that could increase our expenses, disrupt our ability to sell our solutions and reduce our revenue. In addition to the time and expense required for us to supply support or indemnification to our customers, any such litigation could severely disrupt or shut down the business of our customers, which in turn could hurt our relations with our customers and cause the sale of our products to decrease.

***A breach of our security systems may have a material adverse effect on our business.***

Our security systems are designed to maintain the physical security of our facilities and protect our customers, suppliers and employees confidential information. Accidental or willful security breaches or other unauthorized access by third parties to our facilities or our information systems or the existence of computer viruses in our data or software could expose us to a risk of information loss and misappropriation of proprietary and confidential information. Any theft or misuse of this information could result in, among other things, unfavorable publicity, damage to our reputation, difficulty in marketing our products, allegations by our customers that we have not performed our contractual obligations, litigation by affected parties and possible financial obligations for liabilities and damages related to the theft or misuse of this information, any of which could have a material adverse effect on our business, financial condition, our reputation, and our relationships with our customers and partners. We also rely on a number of third-party cloud-based service providers of corporate infrastructure services relating to, among other things, human resources, electronic communication services and some finance functions, and we are, of necessity, dependent on the security systems of these providers. Any security breaches or other unauthorized access by third parties to the systems of our cloud-based service providers or the existence of computer viruses in their data or software could expose us to a risk of information loss and misappropriation of confidential information. Since the techniques used to obtain unauthorized access or to sabotage systems change frequently and are often not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures.

***We rely on third parties to provide services and technology necessary for the operation of our business. Any failure of one or more of our vendors, suppliers or licensors to provide such services or technology could harm our business.***

We rely on third-party vendors to provide critical services, including, among other things, services related to accounting, human resources, information technology and network monitoring that we cannot or do not create or

provide ourselves. We depend on these vendors to ensure that our corporate infrastructure will consistently meet our business requirements. The ability of these third-party vendors to successfully provide reliable and high-quality services is subject to technical and operational uncertainties that are beyond our control. While we may be entitled to damages if our vendors fail to perform under their agreements with us, our agreements with these vendors limit the amount of damages we may receive. In addition, we do not know whether we will be able to collect on any award of damages or that these damages would be sufficient to cover the actual costs we would incur as a result of any vendor's failure to perform under its agreement with us. Upon expiration or termination of any of our agreements with third-party vendors, we may not be able to replace the services provided to us in a timely manner or on terms and conditions, including service levels and cost, that are favorable to us, and a transition from one vendor to another vendor could subject us to operational delays and inefficiencies until the transition is complete.

Additionally, we incorporate third-party technology into some of our products, and we may do so in future products. The operation of our products could be impaired if errors occur in the third-party technology we use. It may be more difficult for us to correct any errors in a timely manner, if at all, because the development and maintenance of the technology is not within our control. We cannot assure you that these third parties will continue to make their technology, or improvements to the technology, available to us, or that they will continue to support and maintain their technology. Further, due to the limited number of vendors of some types of technology, it may be difficult to obtain new licenses or replace existing technology. Any impairment of the technology of or our relationship with these third parties could harm our business.

---

**Table of Contents**

***Failure to comply with the U.S. Foreign Corrupt Practices Act, or FCPA, and similar laws associated with our activities outside of the United States could subject us to penalties and other adverse consequences.***

We face significant risks if we fail to comply with the FCPA and other anti-corruption laws that prohibit improper payments or offers of payment to foreign governments and political parties by us for the purpose of obtaining or retaining business. In many foreign countries, particularly in countries with developing economies, it may be a local custom that businesses operating in such countries engage in business practices that are prohibited by the FCPA or other applicable laws and regulations. We are in the early stages of implementing our FCPA compliance program and cannot assure you that all of our employees and agents, as well as those companies to which we outsource certain of our business operations, will not take actions in violation of our policies and applicable law, for which we may be ultimately held responsible. Any violation of the FCPA or other applicable anti-corruption laws could result in severe criminal or civil sanctions and, in the case of the FCPA, suspension or debarment from U.S. government contracting, which could have a material and adverse effect on our reputation, business, financial condition, operating results and cash flows.

***We, our customers and third-party contractors are subject to increasingly complex environmental regulations and compliance with these regulations may delay or interrupt our operations and adversely affect our business.***

We face increasing complexity in our procurement, design, and research and development operations as a result of requirements relating to the materials composition of our products, including the European Union's (EU's) Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directive, which restricts the content of lead and certain other hazardous substances in specified electronic products put on the market in the EU and similar Chinese legislation relating to marking of electronic products which became effective in March 2007. Failure to comply with these and similar laws and regulations could subject us to fines, penalties, civil or criminal sanctions, contract damage claims, and take-back of non-compliant products, which could harm our business, reputation and operating results. The passage of similar requirements in additional jurisdictions or the tightening of these standards in jurisdictions where our products are already subject to such requirements could cause us to incur significant expenditures to make our products compliant with new requirements, or could limit the markets into which we may sell our products.

Some of our operations, as well as the operations of our contract manufacturers and foundry vendors and other suppliers, are also regulated under various other federal, state, local, foreign and international environmental laws and requirements, including those governing, among other matters, the management, disposal, handling, use, labeling of, and exposure to hazardous substances, and the discharge of pollutants into the air and water. Liability under environmental laws can be joint and several and without regard to comparative fault. We cannot assure you that violations of these laws will not occur in the future, as a result of human error, accident, equipment failure or other causes. Environmental laws and regulations have increasingly become more stringent over time. We expect that our products and operations will be affected by new environmental requirements on an ongoing basis, which will likely result in additional costs, which could adversely affect our business.

Our failure to comply with present and future environmental, health and safety laws could cause us to incur substantial costs, result in civil or criminal fines and penalties and decreased revenue, which could adversely affect our operating results. Failure by our foundry vendors or other suppliers to comply with applicable environmental laws and requirements could cause disruptions and delays in our product shipments, which could adversely affect our relations with our ODMs and OEMs and adversely affect our business and results of operations.

***New regulations related to conflict minerals may force us to incur additional expenses, may make our supply chain more complex and may result in damage to our reputation with customers.***

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, the Securities and Exchange Commission has adopted new requirements for companies that use certain minerals and metals, known as conflict minerals, in their products, whether or not these products are manufactured by third parties. These requirements require companies to diligence, disclose and report whether or not such minerals originate from the Democratic Republic of Congo and adjoining countries. The implementation of these new requirements could adversely affect the sourcing, availability and pricing of minerals used in the manufacture of semiconductor devices, including our products. In addition, we have incurred, and will continue to incur, additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. Since our supply chain is complex, we may not be able to sufficiently verify the origins for these minerals and metals used in our products through the due diligence procedures that we implement, which may harm our reputation. In such event, we may also face difficulties in satisfying customers who require that all of the components of our products are certified as conflict mineral free.

***We are subject to warranty and product liability claims and to product recalls.***

From time to time, we are subject to warranty claims that may require us to make significant expenditures to defend these claims or pay damage awards. In the future, we may also be subject to product liability claims resulting from failure of our solutions. In the event of a

---

**Table of Contents**

warranty claim, we may also incur costs if we compensate the affected customer. We maintain product liability insurance, but this insurance is limited in amount and subject to significant deductibles. There is no guarantee that our insurance will be available or adequate to protect against all claims. We also may incur costs and expenses relating to a recall of one of our customers' products containing one of our devices. The process of identifying a recalled product in consumer devices that have been widely distributed may be lengthy and require significant resources, and we may incur significant replacement costs, contract damage claims from our customers and reputational harm. Costs or payments made in connection with warranty and product liability claims and product recalls could harm our financial condition and results of operations.

***Rapidly changing industry standards could make our video and image processing solutions obsolete, which would cause our operating results to suffer.***

We design our video and image processing solutions to conform to video compression standards, including MPEG-2 and H.264, set by industry standards setting bodies such as ITU-T Video Coding Experts Group and the ISO/IEC Moving Picture Experts Group. Generally, our solutions comprise only a part of a camera or broadcast infrastructure equipment device. All components of these devices must uniformly comply with industry standards in order to operate efficiently together. We depend on companies that provide other components of the devices to support prevailing industry standards. Many of these companies are significantly larger and more influential in driving industry standards than we are. Some industry standards may not be widely adopted or implemented uniformly, and competing standards may emerge that may be preferred by our customers or by consumers. If our customers or the suppliers that provide other device components adopt new or competing industry standards with which our solutions are not compatible, or if the industry groups fail to adopt standards with which our solutions are compatible, our existing solutions would become less desirable to our customers. As a result, our sales would suffer, and we could be required to make significant expenditures to develop new SoC solutions. In addition, existing standards may be challenged as infringing upon the intellectual property rights of other companies or may be superseded by new innovations or standards.

Products for communications applications are based on industry standards that are continually evolving. Our ability to compete in the future will depend on our ability to identify and ensure compliance with these evolving industry standards, including any new video compression standards. The emergence of new industry standards could render our solutions incompatible with products developed by other suppliers. As a result, we could be required to invest significant time and effort and to incur significant expense to redesign our solutions to ensure compliance with relevant standards. If our solutions are not in compliance with prevailing industry standards for a significant period of time, we could miss opportunities to achieve crucial design wins, which could harm our business.

***We are subject to the cyclical nature of the semiconductor industry.***

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence, price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry experienced a significant downturn during the recent global recession. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. Any future downturns could harm our business and operating results. Furthermore, any significant upturn in the semiconductor industry could result in increased competition for access to third-party foundry and assembly capacity. We are dependent on the availability of this capacity to manufacture and assemble our SoC solutions. None of our third-party foundry or assembly contractors has provided assurances that adequate capacity will be available to us in the future.

***The use of open source software in our products, processes and technology may expose us to additional risks and compromise our proprietary intellectual property.***

Our products, processes and technology sometimes utilize and incorporate software that is subject to an open source license. Open source software is typically freely accessible, usable and modifiable. Certain open source software licenses, such as the GNU General Public License, require a user who intends to distribute the open source software as a component of the user's software to disclose publicly part or all of the source code to the user's software. In addition, certain open source software licenses require the user of such software to make any derivative works of the open source code available to others on terms unfavorable to us or at no cost. This can subject previously proprietary software to open source license terms.

While we monitor the use of open source software in our products, processes and technology and try to ensure that no open source software is used in such a way as to require us to disclose the source code to the related product, processes or technology when we do not wish to do so, such use could inadvertently occur. Additionally, if a third-party software provider has incorporated certain types of open source software into software we license from such third-party for our products, processes or technology, we could, under certain circumstances, be required to disclose the source code to our products, processes or technology. This could harm our intellectual property position and our business, results of operations and financial condition.



**Table of Contents**

*Some of our operations and a significant portion of our customers and our subcontractors are located outside of the United States, which subjects us to additional risks, including increased complexity and costs of managing international operations and geopolitical instability.*

We have research and development design centers and business development offices in China, Japan, South Korea and Taiwan, and we expect to continue to conduct business with companies that are located outside the United States, particularly in Asia. Even customers of ours that are based in the United States often use contract manufacturers based in Asia to manufacture their products, and these contract manufacturers typically purchase products directly from us. As a result of our international focus, we face numerous challenges and risks, including:

increased complexity and costs of managing international operations;

longer and more difficult collection of receivables;

difficulties in enforcing contracts generally;

geopolitical and economic instability and military conflicts;

limited protection of our intellectual property and other assets;

compliance with local laws and regulations and unanticipated changes in local laws and regulations, including tax laws and regulations;

trade and foreign exchange restrictions and higher tariffs;

travel restrictions;

timing and availability of import and export licenses and other governmental approvals, permits and licenses, including export classification requirements;

foreign currency exchange fluctuations relating to our international operating activities;

restrictions imposed by the U.S. government on our ability to do business with certain companies or in certain countries as a result of international political conflicts;

transportation delays and other consequences of limited local infrastructure, and disruptions, such as large scale outages or interruptions of service from utilities or telecommunications providers;

difficulties in staffing international operations;

heightened risk of terrorist acts;

local business and cultural factors that differ from our normal standards and practices;

differing employment practices and labor relations;

regional health issues and natural disasters; and

work stoppages.

***Our third-party contractors and their suppliers are concentrated in South Korea, Taiwan and Japan, a region subject to earthquakes and other natural disasters. Any disruption to the operations of these contractors could cause significant delays in the production or shipment of our products.***

The majority of our products are manufactured by or receive components from third-party contractors located in South Korea, Taiwan and Japan. The risk of an earthquake or tsunami in South Korea, Taiwan, Japan and elsewhere in the Pacific Rim region is significant due to the proximity of major earthquake fault lines. For example, in December 2006 a major earthquake occurred in Taiwan and in March 2011 a major earthquake and tsunami occurred in Japan. Although we are not aware of any significant damage suffered by our third-party contractors as a result of such natural disasters, the occurrence of additional earthquakes or other natural disasters could result in the disruption of our foundry vendor or assembly and test capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling or testing from the affected contractor to another third-party vendor. We may not be able to obtain alternate capacity on favorable terms, or at all.

---

**Table of Contents*****If our operations are interrupted, our business and reputation could suffer.***

Our operations and those of our manufacturers are vulnerable to interruption caused by technical breakdowns, computer hardware and software malfunctions, software viruses, infrastructure failures, fires, earthquakes, floods, power losses, telecommunications failures, terrorist attacks, wars, Internet failures and other events beyond our control. Any disruption in our services or operations could result in a reduction in revenue or a claim for substantial damages against us, regardless of whether we are responsible for that failure. We rely on our computer equipment, database storage facilities and other office equipment, which are located primarily in the seismically active San Francisco Bay Area and Taiwan. If we suffer a significant database or network facility outage, our business could experience disruption until we fully implement our back-up systems.

***We are an emerging growth company, and we cannot be certain if the reduced reporting requirements applicable to emerging growth companies will make our ordinary shares less attractive to investors.***

We are an emerging growth company, as defined in the Jumpstart Our Business Startups Act, (the JOBS Act), enacted in April 2012. For as long as we continue to be an emerging growth company, we may take advantage of exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies, including not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, (the Sarbanes-Oxley Act), reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. We will cease to be an emerging growth company, as defined in the JOBS Act, at the end of this fiscal year. We cannot predict if investors will find our ordinary shares less attractive because we may rely on these exemptions. If some investors find our ordinary shares less attractive as a result, there may be a less active trading market for our ordinary shares and our stock price may be more volatile.

Under the JOBS Act, emerging growth companies can also delay adopting new or revised accounting standards until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

***Our management has limited public company experience. As a result of becoming a public company, we are subject to additional regulatory compliance requirements, including Section 404 of the Sarbanes-Oxley Act of 2002, and if we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.***

We became a public company on October 10, 2012 and have and will continue to incur significant legal, accounting and other expenses that we did not incur as a private company. The individuals who constitute our management team have limited experience managing a publicly traded company, and limited experience complying with the increasingly complex and changing laws pertaining to public companies. Our management team and other personnel will need to devote a substantial amount of time to compliance, and we may not effectively or efficiently manage our transition into a public company.

Rules and regulations such as the Sarbanes-Oxley Act have increased our legal and finance compliance costs and made some activities more time consuming and costly. For example, Section 404 of the Sarbanes-Oxley Act requires that our management report on, and our independent auditors attest to, the effectiveness of our internal control structure and procedures for financial reporting. Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Section 404 compliance may divert internal resources and will take a

significant amount of time and effort to complete. We may not be able to successfully complete the procedures and certification and attestation requirements of Section 404 by the time we will be required to do so. In addition, these Sarbanes-Oxley Act requirements may be modified, supplemented or amended from time to time. Implementing these changes may take a significant amount of time and may require specific compliance training of our personnel. In the future, we may discover areas of our internal controls that need improvement. If our auditors or we discover a material weakness or significant deficiency, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price. Any inability to provide reliable financial reports or prevent fraud could harm our business. We may not be able to effectively and timely implement necessary control changes and employee training to ensure continued compliance with the Sarbanes-Oxley Act and other regulatory and reporting requirements. Our recent growth rate could present challenges to maintain the internal control and disclosure control standards applicable to public companies. If we fail to successfully complete the procedures and certification and attestation requirements of Section 404, or if in the future our Chief Executive Officer, Chief Financial Officer or independent registered public accounting firm determines that our internal controls over financial reporting are not effective as defined under Section 404, we could be subject to sanctions or investigations by The NASDAQ Stock Market, the

## **Table of Contents**

Securities and Exchange Commission, or SEC, or other regulatory authorities. Furthermore, investor perceptions of our company may suffer, and this could cause a decline in the market price of our ordinary shares. We cannot assure you that we will be able to fully comply with the requirements of the Sarbanes-Oxley Act or that management or our auditors will conclude that our internal controls are effective in future periods. Irrespective of compliance with Section 404, any failure of our internal controls could have a material adverse effect on our stated results of operations and harm our reputation.

***If we fail to hire additional finance personnel, strengthen our financial reporting systems and infrastructure, and effectively use our enterprise resource planning system, we may not be able to timely and accurately report our financial results or comply with the requirements of being a public company, including compliance with the Sarbanes-Oxley Act and SEC reporting requirements, which in turn would significantly harm our reputation and our business.***

We intend to hire additional accounting and finance personnel with system implementation experience and Sarbanes-Oxley Act compliance expertise. Any inability to recruit and retain such finance personnel would have an adverse impact on our ability to accurately and timely prepare our financial statements. We may be unable to locate and hire qualified professionals with requisite technical and public company experience when and as needed. In addition, new employees will require time and training to learn our business and operating processes and procedures. If our finance and accounting organization is unable for any reason to respond adequately to the increased demands that will result from being a public company, the quality and timeliness of our financial reporting may suffer, which could result in the identification of material weaknesses in our internal controls. Any consequences resulting from inaccuracies or delays in our reported financial statements could cause the trading price of our ordinary shares to decline and could harm our business, operating results and financial condition.

If we fail to strengthen our financial reporting systems, infrastructure and internal control over financial reporting to meet the demands that will be placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act, we may be unable to report our financial results timely and accurately and prevent fraud. We expect to incur significant expense and devote substantial management effort toward ensuring compliance with Section 404.

We recently completed implementing a new enterprise resource planning, or ERP, system. This project has required and may continue to require investment of capital and human resources, the re-engineering of processes of our business and the attention of many employees who would otherwise be focused on other aspects of our business. Any deficiencies in the design and implementation of the new ERP system could result in potentially much higher costs than we had incurred and could adversely affect our ability to develop and launch solutions, provide services, fulfill contractual obligations, file reports with the SEC in a timely manner, otherwise operate our business or otherwise impact our controls environment. Any of these consequences could have an adverse effect on our results of operations and financial condition.

***Changes to financial accounting standards may affect our results of operations and could cause us to change our business practices.***

We prepare our consolidated financial statements to conform to generally accepted accounting principles, or GAAP, in the United States. These accounting principles are subject to interpretation by the American Institute of Certified Public Accountants, the SEC and various bodies formed to interpret and create accounting rules and regulations. Changes in those accounting rules can have a significant effect on our financial results and may affect our reporting of transactions completed before a change is announced. Changes to those rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

***The complexity of calculating our tax provision may result in errors that could result in restatements of our financial statements.***

We are incorporated in the Cayman Islands and our operations are subject to income and transaction taxes in the United States, China, Hong Kong, Japan, South Korea, Taiwan and other jurisdictions in which we do business. Due to the complexity associated with the calculation of our tax provision, we have hired independent tax advisors to assist us. If we or our independent tax advisors fail to resolve or fully understand certain issues, there may be errors that could result in us having to restate our financial statements. Restatements are generally costly and could adversely impact our results of operations or have a negative impact on the trading price of our ordinary shares.

***Changes in effective tax rates or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.***

Our future effective tax rates could be adversely affected if earnings are lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof. In addition, our income tax returns are subject to continuous examination by the Internal Revenue Service, or IRS, and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. We cannot assure you that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

---

**Table of Contents**

***Unfavorable tax law changes, an unfavorable governmental review of our tax returns, changes in our geographical earnings mix or imposition of withholding taxes on repatriated earnings could adversely affect our effective tax rate and our operating results.***

Our operations are subject to certain taxes, such as income and transaction taxes, in the Cayman Islands, the United States, China, Hong Kong, Japan, South Korea, Taiwan and other jurisdictions in which we do business. A change in the tax laws in the jurisdictions in which we do business, including an increase in tax rates or an adverse change in the treatment of an item of income or expense, possibly with retroactive effect, could result in a material increase in the amount of taxes we incur. In particular, past proposals have been made to change certain U.S. tax laws relating to foreign entities with U.S. connections, which may include us. For example, previously proposed legislation has considered treating certain foreign corporations as U.S. domestic corporations (and therefore taxable on all of their worldwide income) if the management and control of the foreign corporation occurs, directly or indirectly, primarily within the United States. If such legislation were enacted, we could, depending on the precise form, be subject to U.S. taxation notwithstanding our domicile outside the United States. In addition, the U.S. government has proposed various other changes to the U.S. international tax system, certain of which could adversely impact foreign-based multinational corporate groups, and increased enforcement of U.S. international tax laws. Although none of these proposed U.S. tax law changes has yet been enacted, and they may never be enacted in their current forms, it is possible that these or other changes in the U.S. tax laws could significantly increase our U.S. income tax liability in the future.

We are subject to periodic audits or other reviews by tax authorities in the jurisdictions in which we conduct our activities. Any such audit, examination or review requires management's time, diverts internal resources and, in the event of an unfavorable outcome, may result in additional tax liabilities or other adjustments to our historical results.

Because we conduct operations in multiple jurisdictions, our effective tax rate is influenced by the amounts of income and expense attributed to each such jurisdiction. If such amounts were to change so as to increase the amounts of our net income subject to taxation in higher-tax jurisdictions, or if we were to commence operations in jurisdictions assessing relatively higher tax rates, our effective tax rate could be adversely affected. In addition, we may determine that it is advisable from time to time to repatriate earnings from subsidiaries under circumstances that could give rise to imposition of potentially significant withholding taxes by the jurisdictions in which such amounts were earned, without our receiving the benefit of any offsetting tax credits, which could also adversely impact our effective tax rate.

***We may be classified as a passive foreign investment company which could result in adverse U.S. federal income tax consequences for U.S. holders of our ordinary shares.***

Based on the current and anticipated valuation of our assets and the composition of our income and assets, we do not expect to be considered a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for our 2014 fiscal year or the foreseeable future. However, a separate determination must be made at the close of each taxable year as to whether we are a PFIC for that taxable year, and we cannot assure you that we will not be a PFIC for our 2015 fiscal year or any future taxable year. Under current law, a non-U.S. corporation will be considered a PFIC for any taxable year if either (a) at least 75% of its gross income is passive income or (b) at least 50% of the value of its assets, generally based on an average of the quarterly values of the assets during a taxable year, is attributable to assets that produce or are held for the production of passive income. PFIC status depends on the composition of our assets and income and the value of our assets (which may be based in part on the value of our ordinary shares which may fluctuate), including, among others, a pro rata portion of the income and assets of each subsidiary in which we own, directly or indirectly, at least 25% by value of the subsidiary's equity interests, from time to time. Because we currently hold, and expect to continue to hold, a substantial amount of cash or cash equivalents, and because the calculation of the value of our assets may be based in part on the value of our ordinary shares which



may fluctuate after this offering and may fluctuate considerably given that market prices of technology companies historically often have been volatile, we may be a PFIC for any taxable year. If we were treated as a PFIC for any taxable year during which a U.S. holder held ordinary shares, certain adverse U.S. federal income tax consequences could apply for such U.S. holder.

***Fluctuations in exchange rates between and among the currencies of the countries in which we do business may adversely affect our operating results.***

Our sales have been historically denominated in U.S. dollars. An increase in the value of the U.S. dollar relative to the currencies of the countries in which our end customers operate could impair the ability of our end customers to cost-effectively integrate our SoCs into their devices which may materially affect the demand for our solutions and cause these end customers to reduce their orders, which would adversely affect our revenue and business. We may experience foreign exchange gains or losses due to the volatility of other currencies compared to the U.S. dollar. A significant portion of our solutions are sold to camera manufacturers located outside the United States, primarily in Asia. Sales to customers in Asia accounted for approximately 91% and 89% of our revenue for the three and six months ended July 31, 2014, respectively. Because most of our end customers or their ODM manufacturers are located in Asia, we anticipate that a majority of our future revenue will continue to come from sales to that region. Although a large percentage of our sales are made to customers in Asia, we believe that a significant number of the products designed by these customers and incorporating our SoCs are then sold to consumers globally.

---

**Table of Contents**

A significant number of our employees are located in Asia, principally Taiwan and China. Therefore, a portion of our payroll as well as certain other operating expenses are paid in currencies other than the U.S. dollar, such as the New Taiwan Dollar and the Chinese Yuan Renminbi. Our operating results are denominated in U.S. dollars and the difference in exchange rates in one period compared to another may directly impact period-to-period comparisons of our operating results. Furthermore, currency exchange rates have been especially volatile in the recent past and these currency fluctuations may make it difficult for us to predict our operating results.

We have not implemented any hedging strategies to mitigate risks related to the impact of fluctuations in currency exchange rates. Even if we were to implement hedging strategies, not every exposure can be hedged and, where hedges are put in place based on expected foreign exchange exposure, they are based on forecasts which may vary or which may later prove to have been inaccurate. Failure to hedge successfully or anticipate currency risks accurately could adversely affect our operating results.

***We may make acquisitions in the future that could disrupt our business, cause dilution to our shareholders, reduce our financial resources and harm our business.***

In the future, we may acquire other businesses, products or technologies. We have not made any acquisitions to date and do not have any agreements or commitments for any specific acquisition at this time. Our ability to make and successfully integrate acquisitions is unproven. If we complete acquisitions, we may not strengthen our competitive position or achieve our goals in a timely manner, or at all, and these acquisitions may be viewed negatively by our customers, financial markets or investors. In addition, any acquisitions we make could lead to difficulties in integrating personnel, technologies and operations from the acquired businesses and in retaining and motivating key personnel from these businesses. Acquisitions may disrupt our ongoing operations, divert management from their primary responsibilities, subject us to additional liabilities, increase our expenses and adversely impact our business, operating results, financial condition and cash flows. Acquisitions may also reduce our cash available for operations and other uses, and could also result in an increase in amortization expense related to identifiable assets acquired, potentially dilutive issuances of equity securities or the incurrence of debt, any of which could harm our business.

***We cannot predict our future capital needs, and we may not be able to obtain additional financing to fund our operations.***

We may need to raise additional funds in the future. Any required additional financing may not be available on terms acceptable to us, or at all. If we raise additional funds by issuing equity securities or convertible debt, investors may experience significant dilution of their ownership interest, and the newly-issued securities may have rights senior to those of the holders of our ordinary shares. If we raise additional funds by obtaining loans from third parties, the terms of those financing arrangements may include negative covenants or other restrictions on our business that could impair our operational flexibility and would also require us to incur interest expense. If additional financing is not available when required or is not available on acceptable terms, we may have to scale back our operations or limit our production activities, and we may not be able to expand our business, develop or enhance our products, take advantage of business opportunities or respond to competitive pressures which could result in lower revenue and reduce the competitiveness of our products.

***Our marketable securities portfolio could experience a decline in market value, which could materially and adversely affect our financial results.***

As of July 31, 2014, we had approximately \$40.0 million investments in securities. The investments consisted primarily of money market funds, commercial paper and debt securities of corporations which are focused on the preservation of our capital. We currently do not use derivative financial instruments to adjust our investment portfolio

risk or income profile.

These investments, as well as any cash deposited in bank accounts, are subject to general credit, liquidity, market and interest rate risks, which may be exacerbated by unusual events, such as the eurozone crisis and the U.S. debt ceiling crisis, which have affected various sectors of the financial markets and led to global credit and liquidity issues. Over the past several years, the volatility and disruption in the global credit market reached unprecedented levels. If the global credit market deteriorates, our investment portfolio may be impacted and some or all of our investments may experience other-than-temporary impairment which could adversely impact our financial results and position.

### **Risks Related to Ownership of Our Ordinary Shares**

*The market price of our ordinary shares may be volatile, which could cause the value of your investment to decline.*

Since our initial public offering in October 2012, the market price of our ordinary shares has been highly volatile. The trading price of our ordinary shares is likely to remain volatile and could be subject to wide fluctuations in price in response to various factors, some of which are beyond our control. These factors include:

changes in financial estimates, including our ability to meet our future revenue and operating profit or loss projections;

fluctuations in our operating results or those of other semiconductor or comparable companies;

**Table of Contents**

fluctuations in the economic performance or market valuations of companies perceived by investors to be comparable to us;

economic developments in the semiconductor industry as a whole;

general economic conditions and slow or negative growth of related markets;

announcements by us or our competitors of acquisitions, new products, significant contracts or orders, commercial relationships or capital commitments;

our ability to develop and market new and enhanced solutions on a timely basis;

commencement of or our involvement in litigation;

disruption to our operations;

any major change in our board of directors or management;

political or social conditions in the markets where we sell our products;

changes in governmental regulations; and

changes in earnings estimates or recommendations by securities analysts.

In addition, the stock market in general, and the market for semiconductor and other technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may cause the market price of our ordinary shares to decrease, regardless of our actual operating performance. These trading price fluctuations may also make it more difficult for us to use our ordinary shares as a means to make acquisitions or to use options to purchase our ordinary shares to attract and retain employees. If the market price of our ordinary shares declines, you may not realize any return on your investment in us and may lose some or all of your investment. In addition, in the past, following periods of volatility in the overall market and the market price of a company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

***If securities analysts or industry analysts downgrade our ordinary shares, publish negative research or reports or fail to publish reports about our business, our stock price and trading volume could decline.***

The trading market for our ordinary shares will be influenced by the research and reports that industry or securities analysts publish about us, our business and our market. If one or more analysts adversely changes their recommendation regarding our stock or our competitors' stock, our stock price would likely decline. If one or more analysts cease coverage of us or fail to regularly publish reports on us, we could lose visibility in the financial markets which in turn could cause our stock price or trading volume to decline.

***Our actual operating results may differ significantly from our guidance and investor expectations, which would likely cause our stock price to decline.***

From time to time, we may release guidance in our earnings releases, earnings conference calls or otherwise, regarding our future performance that represent our management's estimates as of the date of release. If given, this guidance, which will include forward-looking statements, will be based on projections prepared by our management. Projections are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. The principal reason that we expect to release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. With or without our guidance, analysts and other investors may publish expectations regarding our business, financial performance and results of operations. We do not accept any responsibility for any projections or reports published by any such third persons.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of the guidance furnished by us will not materialize or will vary significantly from actual results. If our actual performance does not meet or exceed our guidance or investor expectations, the trading price of our ordinary shares is likely to decline.

***The price of our ordinary shares could decrease as a result of shares being sold in the market.***

Sales of a substantial number of our ordinary shares in the public market, or the perception that these sales might occur, could cause the market price of our ordinary shares to decline. Certain holders of our ordinary shares are entitled to rights with respect to registration of such

**Table of Contents**

shares under the Securities Act pursuant to a registration rights agreement between such holders and us. If such holders, by exercising their registration rights, sell a large number of shares, the market price for our ordinary shares could be adversely affected. If we file a registration statement for the purpose of selling additional shares to raise capital and are required to include shares held by these holders pursuant to the exercise of their registration rights, our ability to raise capital may be impaired.

We filed registration statements on Form S-8 under the Securities Act to register shares for issuance under our 2004 Stock Plan, 2012 Equity Incentive Plan and 2012 Employee Stock Purchase Plan. Our 2012 Equity Incentive Plan and 2012 Employee Stock Purchase Plan provide for automatic increases in the shares reserved for issuance under these plans which could result in additional dilution to our shareholders. These shares can be freely sold in the public market upon issuance and vesting, subject to restrictions provided under the terms of the applicable plan and/or the option agreements entered into with option holders.

We may also issue ordinary shares or securities convertible into ordinary shares from time to time in connection with a financing, acquisition or otherwise. Any such issuance could result in substantial dilution to our existing shareholders and cause the trading price of our stock to decline.

***A limited number of shareholders will have the ability to influence the outcome of director elections and other matters requiring shareholder approval.***

As of July 31, 2014, our executive officers and directors and their affiliates beneficially own, in the aggregate, approximately 7.0% of our outstanding ordinary shares. These shareholders, if they acted together, could exert substantial influence over matters requiring approval by our shareholders, including electing directors, adopting new compensation plans and approving mergers, acquisitions or other business combination transactions. This concentration of ownership may discourage, delay or prevent a change of control of our company, which could deprive our shareholders of an opportunity to receive a premium for their stock as part of a sale of our company and might reduce our stock price. These actions may be taken even if they are opposed by our other shareholders.

***We do not intend to pay dividends on our ordinary shares and, consequently, a shareholder's ability to achieve a return on its investment will depend on appreciation in the price of our ordinary shares.***

We have never declared or paid any cash dividends on our ordinary shares and do not currently intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. Therefore, shareholders are not likely to receive any dividends on their ordinary shares for the foreseeable future and the success of an investment in our ordinary shares will depend upon any future appreciation in their value. There is no guarantee that our ordinary shares will appreciate in value or even maintain the price at which our shareholders have purchased their shares. Investors seeking cash dividends should not purchase our ordinary shares.

***Provisions of our memorandum and articles of association and Cayman Islands corporate law may discourage or prevent an acquisition of us which could adversely affect the value of our ordinary shares.***

Provisions of our memorandum and articles of association and Cayman Islands law may have the effect of delaying or preventing a change of control or changes in our management. These provisions include the following:

the division of our board of directors into three classes;

Edgar Filing: AMBARELLA INC - Form 10-Q

the right of our board of directors to elect a director to fill a vacancy created by the expansion of our board of directors or due to the resignation or departure of an existing board member;

prohibition of cumulative voting in the election of directors which would otherwise allow less than a majority of shareholders to elect director candidates;

the requirement for the advance notice of nominations for election to our board of directors or for proposing matters that can be acted upon at a shareholders meeting;

the ability of our board of directors to issue, without shareholder approval, such amounts of preference shares as the board of directors deems necessary and appropriate with terms set by our board of directors, which rights could be senior to those of our ordinary shares;

the elimination of the rights of shareholders to call a special meeting of shareholders and to take action by written consent in lieu of a meeting; and

the required approval of a special resolution of the shareholders, being a two-thirds vote of shares held by shareholders present and voting at a shareholder meeting, to alter or amend the provisions of our post-offering memorandum and articles of association.

---

**Table of Contents**

***Holders of our ordinary shares may face difficulties in protecting their interests because we are incorporated under Cayman Islands law.***

Our corporate affairs are governed by our amended and restated memorandum and articles of association, by the Companies Law (as the same may be supplemented or amended from time to time) of the Cayman Islands and by the common law of the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as under statutes or judicial precedent in existence in jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities laws than the U.S. and provides significantly less protection to investors. There is no legislation specifically dedicated to the rights of investors in securities and thus no statutorily defined private cause of action specific to investors such as those provided under the Securities Act of 1933 or the Securities Exchange Act of 1934 of the U.S. In addition, shareholders of Cayman Islands companies may not have standing to initiate shareholder derivative actions in U.S. federal courts. Therefore, you may have more difficulty in protecting your interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States due to the comparatively less developed nature of Cayman Islands law in this area.

Shareholders of Cayman Islands exempted companies, such as our company, have no general rights under Cayman Islands law to inspect corporate records and accounts or to obtain copies of lists of shareholders of the company. Our directors have discretion under our articles of association to determine whether or not, and under what conditions, our corporate records may be inspected by our shareholders, but are not obliged to make them available to our shareholders. This may make it more difficult for you to obtain the information needed to establish any facts necessary for a shareholder motion or to solicit proxies from other shareholders in connection with a proxy contest.

Subject to limited exceptions, under Cayman Islands law, a minority shareholder may not bring a derivative action against the board of directors.

***Holders of our ordinary shares may have difficulty obtaining or enforcing a judgment against us because we are incorporated under the laws of the Cayman Islands.***

It may be difficult or impossible for you to bring an action against us in the Cayman Islands if you believe your rights have been infringed under U.S. securities laws. There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the courts of the Cayman Islands will in certain circumstances recognize and enforce a non-penal judgment of a foreign court of competent jurisdiction without retrial on the merits. While there is no binding authority on this point, this is likely to include, in certain circumstances, a non-penal judgment of a United States court imposing a monetary award based on the civil liability provisions of the U.S. federal securities laws. The Grand Court of the Cayman Islands may stay proceedings if concurrent proceedings are being brought elsewhere. There is uncertainty as to whether the Grand Court of the Cayman Islands would recognize or enforce judgments of United States courts obtained against us predicated upon the civil liability provisions of the securities laws of the United States or any state thereof and whether the Grand Court of the Cayman Islands would hear original actions brought in the Cayman Islands against us predicated upon the securities laws of the United States or any state thereof.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

***ITEM 6. Exhibits***



The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report.

**Table of Contents**

**Signatures**

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

Date: September 8, 2014

**AMBARELLA, INC.**

By: **/s/ Feng-Ming Wang**  
**Feng-Ming Wang**  
**President and Chief Executive Officer**

Date: September 8, 2014

By: **/s/ George Laplante**  
**George Laplante**  
**Chief Financial Officer**

**Table of Contents**

<b>Exhibit</b>	
<b>Number</b>	<b>Description</b>
3.1(1)	Amended and Restated Memorandum of Association and Second Amended and Restated Articles of Association of the Registrant.
31.1	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1*	Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Schema Linkbase Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Labels Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

(1) Incorporated by reference to the Registrant's registration statement on Form S-1 (No. 333-174838) Amendment No. 3 as filed with the Securities and Exchange Commission on September 12, 2012.

\* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 hereto are deemed to accompany this Form 10-Q and will not be deemed filed for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference. In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections.