

EMCORE CORP  
Form 10-Q  
August 17, 2009

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

FORM 10-Q

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

For the quarterly period ended: June 30, 2009

Commission File Number: 0-22175

EMCORE Corporation  
(Exact name of Registrant as specified in its charter)

New Jersey  
(State or other jurisdiction of incorporation or organization)

22-2746503  
(IRS Employer Identification No.)

10420 Research Road SE, Albuquerque, NM 87123  
(Address of principal executive offices) (Zip Code)

(505) 332-5000  
(Registrant's telephone number, including area code)

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

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

☐ Large accelerated filer ☒ Accelerated filer ☐  
Non-accelerated filer ☐ Smaller reporting company

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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 shares outstanding of the registrant's no par value common stock as of August 11, 2009 was 80,704,650.

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EMCORE Corporation  
FORM 10-Q  
For the Quarterly Period Ended June 30, 2009  
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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## EMCORE CORPORATION

## Condensed Consolidated Statements of Operations and Comprehensive Loss

For the three and nine months ended June 30, 2009 and 2008

(in thousands, except loss per share)

(unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2009	2008	2009	2008
Product revenue	\$ 37,190	\$ 72,027	\$ 129,076	\$ 169,713
Service revenue	1,299	3,475	6,753	8,955
Total revenue	38,489	75,502	135,829	178,668
Cost of product revenue	39,880	60,727	138,666	143,439
Cost of service revenue	1,037	1,129	5,007	4,832
Total cost of revenue	40,917	61,856	143,673	148,271
Gross (loss) profit	(2,428)	13,646	(7,844)	30,397
Operating expenses:				
Selling, general, and administrative	10,914	13,906	35,039	36,032
Research and development	5,654	11,382	20,655	28,132
Impairments	27,000	-	60,781	-
Total operating expenses	43,568	25,288	116,475	64,164
Operating loss	(45,996)	(11,642)	(124,319)	(33,767)
Other (income) expense:				
Interest income	(3)	(124)	(83)	(778)
Interest expense	105	-	443	1,580
Impairment of investment	-	-	366	-
Loss from conversion of subordinated notes	-	-	-	4,658
Stock-based expense from tolled options	-	-	-	4,316
Gain from sale of investments	-	(3,692)	(3,144)	(3,692)
Loss on disposal of equipment	-	-	-	86
Foreign exchange (gain) loss	(745)	(104)	635	(302)
Total other (income) expense	(643)	(3,920)	(1,783)	5,868
Net loss	\$ (45,353)	\$ (7,722)	\$ (122,536)	\$ (39,635)
Foreign exchange translation adjustment	(131)	82	353	(5)
Comprehensive loss	\$ (45,484)	\$ (7,640)	\$ (122,183)	\$ (39,640)

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Per share data:

Basic and diluted per share data:

Net loss	\$ (0.57)	\$ (0.10)	\$ (1.56)	\$ (0.62)
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Weighted-average number of basic and  
diluted shares outstanding

79,700	76,582	78,632	64,155
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The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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EMCORE CORPORATION  
Condensed Consolidated Balance Sheets  
As of June 30, 2009 and September 30, 2008  
(In thousands)  
(unaudited)

	June 30, 2009	September 30, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 9,386	\$ 18,227
Restricted cash	366	1,854
Available-for-sale securities	1,400	2,679
Accounts receivable, net of allowance of \$7,320 and \$2,377, respectively	41,892	60,313
Inventory, net	39,503	64,617
Prepaid expenses and other current assets	4,424	7,100
 Total current assets	 96,971	 154,790
 Property, plant, and equipment, net	 57,695	 83,278
Goodwill	20,384	52,227
Other intangible assets, net	13,539	28,033
Investments in unconsolidated affiliates	-	8,240
Available-for-sale securities, non-current	-	1,400
Long-term restricted cash	163	569
Other non-current assets, net	802	741
 Total assets	 \$ 189,554	 \$ 329,278
 <b>LIABILITIES and SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Line of credit	\$ 4,984	\$ -
Short-term debt	889	-
Accounts payable	21,861	52,266
Accrued expenses and other current liabilities	23,909	23,290
 Total liabilities	 51,643	 75,556
 Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, \$0.0001 par, 5,882 shares authorized, no shares outstanding	-	-
Common stock, no par value, 200,000 shares authorized, 80,647 shares issued and 80,488 outstanding at June 30, 2009; 77,920 shares issued and 77,761 shares outstanding at September 30, 2008	686,392	680,020
Accumulated deficit	(547,300)	(424,764)
Accumulated other comprehensive income	902	549
	(2,083)	(2,083)

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Treasury stock, at cost; 159 shares as of June 30, 2009 and  
September 30, 2008

Total shareholders' equity	137,911	253,722
Total liabilities and shareholders' equity	\$ 189,554	\$ 329,278

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

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EMCORE CORPORATION  
Condensed Consolidated Statements of Cash Flows  
For the nine months ended June 30, 2009 and 2008  
(in thousands)  
(unaudited)

	Nine Months Ended June 30,	
	2009	2008
Cash flows from operating activities:		
Net loss	\$ (122,536)	\$ (39,635)
Adjustments to reconcile net loss to net cash used for operating activities:		
Impairments	60,781	-
Stock-based compensation expense	4,975	8,705
Depreciation and amortization expense	12,862	8,992
Provision for obsolete and excess inventory	14,934	2,427
Provision for doubtful accounts	4,818	167
Provision for losses on firm commitments	6,524	-
Impairment of investment	366	-
Loss on disposal of equipment	152	86
Compensatory stock issuances	438	1,648
Gain from sale of investments	(3,144)	(3,692)
Reduction of note receivable due for services received	-	390
Accretion of loss from convertible subordinated notes	-	41
Loss from convertible subordinated notes	-	1,169
Total non-cash adjustments	102,706	19,933
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	13,472	(30,135)
Inventory	10,201	8,132
Prepaid expenses and other current assets	2,577	(1,674)
Other assets	(684)	(542)
Accounts payable	(30,494)	14,066
Accrued expenses and other current liabilities	(5,761)	(6,004)
Total change in operating assets and liabilities	(10,689)	(16,157)
Net cash used in operating activities	(30,519)	(35,859)
Cash flows from investing activities:		
Purchase of plant and equipment	(1,182)	(15,028)
Proceeds from insurance recovery on equipment	-	1,189
Proceeds from sale of unconsolidated affiliates	11,017	6,540
Investment in unconsolidated affiliates	-	(1,503)
Purchase of business	-	(75,779)
Proceeds from (funding of) restricted cash	1,893	(874)
Purchase of available-for-sale securities	-	(7,000)
Sale of available-for-sale securities	2,679	32,806
Net cash provided by (used in) investing activities	14,407	(59,649)



EMCORE CORPORATION  
Condensed Consolidated Statements of Cash Flows - continued  
For the nine months ended June 30, 2009 and 2008  
(in thousands)  
(unaudited)

	Nine Months Ended June 30,	
	2009	2008
Cash flows from financing activities:		
Proceeds from borrowings from credit facility	\$ 88,771	\$ -
Payments on borrowings from credit facility	(83,787)	-
Proceeds from borrowing - long-term and short-term debt	911	-
Payments on borrowings - long-term and short-term debt	(22)	-
Proceeds from private placement of common stock and warrants,		
net of issuance costs	-	93,692
Payments on capital lease obligations	-	(11)
Proceeds from exercise of stock options	32	6,960
Proceeds from employee stock purchase plan	894	723
Net cash provided by financing activities	6,799	101,364
Effect of foreign currency	472	176
Net (decrease) increase in cash and cash equivalents	(8,841)	6,032
Cash and cash equivalents, beginning of period	18,227	12,151
Cash and cash equivalents, end of period	\$ 9,386	\$ 18,183
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for interest	\$ 511	\$ 3,314
Cash paid for income taxes	\$ -	\$ -
NON-CASH DISCLOSURE		
Issuance of common stock for purchase of business	1,183	36,085
Issuance of common stock for conversion of subordinated notes	-	85,428

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



EMCORE Corporation  
Notes to Condensed Consolidated Financial Statements  
(unaudited)

NOTE 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of EMCORE Corporation and its subsidiaries (the “Company” or “EMCORE”). All intercompany accounts and transactions have been eliminated in consolidation.

These statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim information, and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for annual financial statements. In the opinion of management, the interim financial statements reflect all normal adjustments that are necessary to provide a fair presentation of the financial results for the interim periods presented. Operating results for interim periods are not necessarily indicative of results that may be expected for an entire fiscal year. The condensed consolidated balance sheet as of September 30, 2008 has been derived from the audited consolidated financial statements as of such date. For a more complete understanding of the Company’s financial position, operating results, risk factors and other matters, please refer to the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2008.

We have evaluated subsequent events, as defined by Statement of Financial Accounting Standards (SFAS) No. 165, Subsequent Events, through the date that the financial statements were issued on August 17, 2009.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management of the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, as of the date of the financial statements, and the reported amounts of revenue and expenses during the reported period. The accounting estimates that require our most significant, difficult, and subjective judgments include the valuation of inventory, goodwill, intangible assets, and stock-based compensation and the assessment of recovery of long-lived assets.

Management develops estimates based on historical experience and on various assumptions about the future that are believed to be reasonable based on the best information available. The Company’s reported financial position or results of operations may be materially different under changed conditions or when using different estimates and assumptions, particularly with respect to significant accounting policies. In the event that estimates or assumptions prove to differ from actual results, adjustments are made in subsequent periods to reflect more current information.

Earnings (Loss) Per Share

Earnings (loss) per share (“EPS”) are calculated by dividing net earnings (loss) applicable to common stock by the weighted average number of common stock shares outstanding for the period. For the three and nine months ended June 30, 2009, stock options representing 8,005,209 and 7,757,597 shares of common stock, respectively, and 1,400,003 warrants for both periods were excluded from the computation of diluted earnings per share since the

Company incurred a net loss for these periods and any effect would have been anti-dilutive. For the three and nine months ended June 30, 2008, stock options representing 3,800,327 and 5,134,376 shares of common stock, respectively, and 1,400,003 warrants for both periods were excluded from the computation of diluted earnings per share since the Company incurred a net loss for these periods and any effect would have been anti-dilutive.

#### Impairment of Long-lived Assets

During the three months ended June 30, 2009, the Company performed an evaluation of its Fiber Optics segment assets for impairment. The impairment test was triggered by a determination that it was more likely than not that certain assets would be sold or otherwise disposed of before the end of their previously estimated useful lives. As a result of the evaluation, it was determined that an impairment existed, and a charge of \$27.0 million was recorded to write down the long-lived assets to estimated fair value, which was determined based on a combination of guideline public company comparisons and discounted estimated future cash flows.

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The current adverse economic conditions had a significant negative effect on the Company's assessment of the fair value of the Fiber Optics segment assets. The impairment charge primarily resulted from the combined effect of the current slowdown in product orders and lower pricing exacerbated by currently high discount rates used in estimating fair values and the effects of recent declines in market values of debt and equity securities of comparable public companies. This impairment charge in combination with other non-cash charges will not cause the Company to be in default under any of its financial covenants associated with its credit facility nor will it have a material adverse impact on the Company's liquidity position or cash flows.

See Note 9, Goodwill and Intangible Assets, for more information on the impairment charges recorded by the Company in response to unfavorable macroeconomic conditions.

### Liquidity Matters

The Company incurred a net loss of \$122.5 million for the nine months ended June 30, 2009, which included a non-cash impairment charge of \$60.8 million related to the write-down of fixed assets, goodwill and intangible assets associated with the Company's Fiber Optics segment. The Company's operating results for future periods are subject to numerous uncertainties and it is uncertain if the Company will be able to reduce or eliminate its net losses for the foreseeable future. Although total revenue has increased sequentially over the past several years, the Company has not been able to sustain historical revenue growth rates in 2009 due to material adverse changes in market and economic conditions. If management is not able to increase revenue and/or manage operating expenses in line with revenue forecasts, the Company may not be able to achieve profitability.

As of June 30, 2009, cash, cash equivalents, and restricted cash totaled approximately \$9.9 million and working capital totaled \$45.3 million. Historically, the Company has consumed cash from operations. During the nine months ended June 30, 2009, it consumed approximately \$30.5 million in cash from operations.

These matters raise substantial doubt about the Company's ability to continue as a going concern.

### Management Actions and Plans

Historically, management has addressed liquidity requirements through a series of cost reduction initiatives, capital markets transactions and the sale of assets. Management anticipates that the recession in the United States and internationally may continue to impose formidable challenges for the Company's businesses in the near term. Recently, the Company amended the terms of its asset-backed revolving credit facility with Bank of America that included the granting of waivers for prior covenant violations. Although the total amount of available credit under the credit facility has been reduced from \$25 million at September 30, 2008 to \$14 million, the amendments addressed a modification of the borrowing base calculation which generally has resulted in higher borrowing capacity against any given schedule of accounts receivable. The Company has also continued to take steps to lower costs and to conserve and generate cash. Over the past year, management has implemented a series of measures and continues to evaluate opportunities intended to align the Company's cost structure with its current revenue forecasts which has included several workforce reductions, salary reductions, the elimination of executive and employee merit increases, and the elimination or reduction of certain discretionary expenses.

With respect to measures taken to generate cash, the Company sold its minority ownership positions in Entech Solar, Inc. and Lightron Corporation earlier in the fiscal year. The Company has also significantly lowered its quarterly capital expenditures and improved the management of its working capital. During the third fiscal quarter, the Company lowered its net inventory by approximately 17% and achieved positive operating income within the

Company's space solar business.

In addition, the Company continues to pursue and evaluate a number of capital raising alternatives including debt and/or equity financings, product joint-venture opportunities and the potential sale of certain assets.

#### Conclusion

These initiatives are intended to conserve or generate cash in response to the deterioration in the global economy so that we can be assured of adequate liquidity through the next twelve months. However, the full effect of many of these actions may not be realized until late in calendar year 2009, even if they are successfully implemented. We are committed to exploring all of the initiatives discussed above but there is no assurance that capital market conditions will improve within that time frame. Our ability to continue as a going concern is substantially dependent on the successful execution of many of the actions referred to above. The accompanying condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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Since cash generated from operations and cash on hand are not sufficient to satisfy the Company's liquidity requirements, we will seek to raise additional cash through equity financing, additional debt, asset sales or a combination thereof. Due to the unpredictable nature of the capital markets, additional funding may not be available when needed, or on terms acceptable to us. If adequate funds are not available or not available on acceptable terms, our ability to continue to fund expansion, develop and enhance products and services, or otherwise respond to competitive pressures may be severely limited. Such a limitation could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flow.

## Restatements

The Company identified an error in the classification of service and product revenues and related costs of revenue in the condensed consolidated statements of operations for the quarters ended in fiscal 2008. The following table reflects the effects of the restatement on the condensed consolidated statements of operations for the quarter and nine-month period ended June 30, 2008. These misclassifications did not have an impact on the Company's consolidated gross profit, operating loss, or net loss.

(in thousands)	Three Months Ended June 30, 2008			Nine Months Ended June 30, 2008		
	As previously reported	Adjustment	As restated	As previously reported	Adjustment	As restated
Product revenue	\$ 71,934	\$ 93	\$ 72,027	\$ 164,695	\$ 5,018	\$ 169,713
Service revenue	3,568	(93)	3,475	13,973	(5,018)	8,955
Total revenue	75,502	-	75,502	178,668	-	178,668
Cost of product revenue	61,767	(1,040)	60,727	139,212	4,227	143,439
Cost of service revenue	89	1,040	1,129	9,059	(4,227)	4,832
Total cost of revenue	61,856	-	61,856	148,271	-	148,271
Gross profit	\$ 13,646	\$ -	\$ 13,646	\$ 30,397	\$ -	\$ 30,397

The Company also identified errors in the condensed consolidated statements of cash flows for the quarters ended in fiscal 2008. In particular, provision for obsolete and excess inventory was not appropriately classified as a reconciling item to reconcile net loss to net cash used for operating activities. In addition, certain other assets and accounts receivable were improperly classified as reconciling items to reconcile net loss to net cash used for operating activities. The following table reflects the effects of the restatement on the condensed consolidated statements of cash flows for the nine-month period ended June 30, 2008. These misclassifications did not have an impact on net cash used in operating activities.

	June 30, 2008		
	As previously reported	Adjustment	As restated
Adjustments to reconcile net loss to net cash used for operating activities:			

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Depreciation and amortization expense	\$ 9,509	\$ (517)	\$ 8,992
Provision for obsolete and excess inventory	-	2,427	2,427
Provision for doubtful accounts	204	(37)	167
Total non-cash adjustments	18,061	1,873	19,933
Changes in operating assets and liabilities, net of effect of acquisitions:			
Accounts receivable	(30,172)	37	(30,135)
Inventory	10,559	(2,427)	8,132
Other assets	(1,059)	517	(542)
Total change in operating assets and liabilities	(14,284)	(1,873)	(16,157)
Net cash used in operating activities	(35,859)	-	(35,859)

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NOTE 2. Recent Accounting Pronouncements

SFAS 141(R) - In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") 141(R), Business Combinations. This statement replaces SFAS 141, Business Combinations, and requires an acquirer to recognize the assets acquired, the liabilities assumed, including those arising from contractual contingencies, any contingent consideration, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement. SFAS 141(R) also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141(R)). In addition, SFAS 141(R)'s requirement to measure the noncontrolling interest in the acquiree at fair value will result in recognizing the goodwill attributable to the noncontrolling interest in addition to that attributable to the acquirer. SFAS 141(R) amends SFAS No. 109, Accounting for Income Taxes, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. It also amends SFAS 142, Goodwill and Other Intangible Assets, to, among other things, provide guidance on the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Management is currently assessing the potential impact that the adoption of SFAS 141(R) could have on the Company's financial statements in fiscal 2010.

SFAS 160 - In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS 160 amends Accounting Research Bulletin 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. Management is currently assessing the potential impact that the adoption of SFAS 160 could have on the Company's financial statements in fiscal 2010.

SFAS 168 - In June 2009, the FASB issued SFAS 168, FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, which replaces SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS 168 establishes the FASB Accounting Standards Codification as the sole source of authoritative accounting principles recognized by the FASB to be applied by all nongovernmental entities in the preparation of financial statements in conformity with GAAP. SFAS 168 is prospectively effective for financial statements for fiscal years ending on or after September 15, 2009, and interim periods within those fiscal years. The adoption of SFAS 168 on October 1, 2009 will not impact the Company's results of operations or financial condition, but it will affect the reference of accounting pronouncements in future disclosures.

FSP 142-3 - In April 2008, the FASB issued FSP No. 142-3, Determination of the Useful Life of Intangible Assets. FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, Goodwill and Other Intangible Assets and the period of expected cash flows used to measure the fair value of intangible assets under FASB Statement No. 141, Business Combinations. FSP 142-3 is effective for financial statements issued for fiscal

years beginning after December 15, 2008, and interim periods within those fiscal years. Management is currently assessing the potential impact that the adoption of FSP 142-3 could have on the Company's financial statements in fiscal 2010.

FSP APB 14-1 - In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). FSP APB 14-1 requires the proceeds from the issuance of such convertible debt instruments to be allocated between a liability component (issued at a discount) and an equity component. The resulting debt discount is amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. The change in accounting treatment is effective for the Company beginning in fiscal 2010, and will be applied retrospectively to prior periods. Management is currently assessing the potential impact that the adoption of FSP APB 14-1 could have on the Company's financial statements in fiscal 2010.

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## Recently Adopted Accounting Pronouncement:

SFAS 165 - In June 2009, the FASB issued SFAS 165, Subsequent Events, to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. In particular, SFAS 165 sets forth: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is prospectively effective for financial statements issued for interim or annual periods ending after June 15, 2009. The adoption of SFAS 165 on June 30, 2009 did not impact the Company's results of operations or financial condition. See Note 1, Basis of Presentation, for related footnote disclosure.

## NOTE 3. Equity

## Stock Options

The Company provides long-term incentives to eligible officers, directors, and employees in the form of stock options. Most of the stock options vest and become exercisable over four to five years and have a contractual life of ten years. The Company maintains two stock option plans: the 1995 Incentive and Non-Statutory Stock Option Plan ("1995 Plan") and the 2000 Stock Option Plan ("2000 Plan" and, together with the 1995 Plan, the "Option Plans"). The 1995 Plan authorizes the grant of options up to 2,744,118 shares of the Company's common stock. On April 30, 2009, the Company's shareholders approved an increase in the number of shares reserved for issuance under the 2000 Plan from 12,850,000 to 15,850,000 shares of the Company's common stock. As of June 30, 2009, no options were available for issuance under the 1995 Plan and 4,100,776 options were available for issuance under the 2000 Plan. Certain options under the Option Plans are intended to qualify as incentive stock options pursuant to Section 422A of the Internal Revenue Code. The Company issues new shares of common stock to satisfy the issuance of shares under this stock-based compensation plan.

The following table summarizes the activity under the Option Plans for the nine months ended June 30, 2009:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)
Outstanding as of September 30, 2008	8,929,453	\$ 6.57	8.22
Granted	615,439	1.25	
Exercised	(10,675)	3.02	
Forfeited	(902,539)	7.19	
Cancelled	(526,673)	4.51	
Outstanding as of June 30, 2009	8,105,005	\$ 6.28	7.53
Exercisable as of June 30, 2009	3,747,079	\$ 5.81	6.26

As of June 30, 2009 there was approximately \$9.0 million of total unrecognized compensation expense related to non-vested stock-based compensation arrangements granted under the Option Plans. This expense is expected to be recognized over an estimated weighted average life of 2.9 years.

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Intrinsic value for stock options represents the “in-the-money” portion or the positive variance between a stock option’s exercise price and the underlying stock price. There were no stock options exercised during the three months ended June 30, 2009. The total intrinsic value related to stock options exercised during the nine months ended June 30, 2009 was approximately \$10,000. The total intrinsic value related to stock options exercised during the three and nine months ended June 30, 2008 was approximately \$0.3 million and \$11.5 million, respectively. There was no intrinsic value related to fully vested and expected to vest stock options as of June 30, 2009 and no intrinsic value related to exercisable stock options as of June 30, 2009.

Exercise Price of Stock Options	Number Outstanding	Number of Stock Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Life (years)	Weighted- Average Exercise Price	Number Exercisable	Weighted- Average Exercise Price
>=\$1.00 to <\$5.00	2,326,974	6.21	\$ 2.89	1,625,748	\$ 2.96
>=\$5.00 to <\$10.00	5,643,111	8.17	7.40	2,024,211	7.41
>\$10.00	134,920	3.71	17.74	97,120	20.18
TOTAL	8,105,005	7.53	\$ 6.28	3,747,079	\$ 5.81

Stock-based compensation expense is measured at the stock option grant date, based on the fair value of the award, over the requisite service period. As required by SFAS 123(R), Share-Based Payment (revised 2004), management has made an estimate of expected forfeitures and is recognizing compensation expense only for those equity awards expected to vest.

The effect of recording stock-based compensation expense during the three and nine months ended June 30, 2009 and 2008 was as follows:

(in thousands, except per share data)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2009	2008	2009	2008
Stock-based compensation expense by award type:				
Employee stock options	\$ 1,072	\$ 1,555	\$ 4,413	\$ 4,035
Employee stock purchase plan	206	186	562	354
Former employee stock options tolled	-	-	-	4,316
Total stock-based compensation expense	\$ 1,278	\$ 1,741	\$ 4,975	\$ 8,705
Net effect on net loss per basic and diluted share	\$ (0.02)	\$ (0.02)	\$ (0.06)	\$ (0.14)

#### Tolled Stock Options

Under the terms of the Company’s stock option agreements issued under the Option Plans, employees that have vested and exercisable stock options have 90 days subsequent to the date of their termination to exercise their stock

options. In November 2006, the Company announced that it was suspending its reliance on previously issued financial statements, which in turn caused the Company's Form S-8 registration statements for shares of common stock issuable under the Option Plans not to be available. Therefore, employees and terminated employees were precluded from exercising stock options until the Company became compliant with its SEC filings and the registration of the stock option shares was once again effective (the "Blackout Period"). In April 2007, the Company's Board of Directors approved a stock option grant "modification" for terminated employees by extending the normal 90-day exercise period after date of termination to a date after which the Blackout Period was lifted. The Company communicated the terms of the stock option grant modification with its terminated employees in November 2007. The Company's Board of Directors approved an extension of the stock option expiration date equal to the number of calendar days during the Blackout Period before such stock option would have otherwise expired (the "Tolling Period"). Terminated employees were able to exercise their vested stock options beginning on the first day after the lifting of the Blackout Period for a period equal to the Tolling Period. Approximately 50 terminated employees were impacted by this modification. All tolled stock options were either exercised or expired by January 29, 2008.

To account for a stock option grant modification, when the rights conveyed by a stock-based compensation award are no longer dependent on the holder being an employee, the award ceases to be accounted for under SFAS 123(R) and becomes subject to the recognition and measurement requirements of EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, which results in liability classification and measurement of the award. On the date of modification, stock options that receive extended exercise terms are initially measured at fair value and expensed as if the stock options awards were new grants. Subsequent changes in fair value are reported in earnings and disclosed in the financial statements as long as the stock options remain classified as liabilities.

During the three months ended December 31, 2007, the Company incurred a non-cash expense of \$4.4 million associated with the modification of stock options issued to terminated employees which was calculated using the Black-Scholes option valuation model. The modified stock options were 100% vested at the time of grant with an estimated life of no greater than 90 days. When the stock options classified as liabilities were ultimately settled in stock, any gains or losses on those stock options were included in additional paid-in capital. For unexercised stock options that ultimately expired, the liability was relieved with an offset to income included in current earnings, which totaled approximately \$58,000 in January 2008.

Since these modified stock options were issued to terminated employees of the Company, and therefore no services were required to receive this grant and no contractual obligation existed at the Company to issue these modified stock options, the Company concluded it was more appropriate to classify this non-cash expense within "other income and expense" in the Company's statement of operations.

#### Tender Offer

As a result of the Company's previously announced voluntary inquiry into its historical stock option granting practices, which was concluded in 2007, the Company determined that an incorrect grant date was used in the granting of certain stock options. As a result, certain stock options were determined to be granted at an exercise price below the fair market value of the Company's common stock as of the correct measurement grant date. Consequently, employees holding these stock options faced a potential tax liability under Section 409A of the Internal Revenue Code and similar sections of certain state tax codes, unless remedial action was taken to adjust the exercise price of these stock options prior to December 31, 2008.

In November 2008, the Company announced that it had commenced a tender offer for 164,088 stock options outstanding under its 2000 Plan which was held by 91 of its then current non-officer employees. Under the terms of the tender offer, employees holding such stock options were given the opportunity to amend these options to increase the exercise price to a higher price that is equal to the fair market value on the date which has been determined to be

the correct date of issuance for these stock options in return for a cash payment for each tendered stock option equal to the difference between the original exercise price and the new exercise price. The tender offer remained open until 11:59 p.m. Mountain Time on December 17, 2008. As a result of the tender offer, a total of 163,838 stock options were tendered, approximately \$44,000 in cash payments were paid in January 2009, and the non-cash stock-based SFAS 123(R) expense due to the modification of stock options was determined to be immaterial. Further details regarding the tender can be obtained from the filing on Schedule TO which the Company filed on December 18, 2008 with the SEC.

#### Valuation Assumptions

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option valuation model and the straight-line attribution approach using the following weighted-average assumptions. The option-pricing model requires the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. The weighted-average grant date fair value of stock options granted during the three and nine months ended June 30, 2009 was \$1.30 and \$1.25, respectively. The weighted-average grant date fair value of stock options granted during the three and nine months ended June 30, 2008 was \$8.23 and \$7.79, respectively.

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Black-Scholes Weighted-Average  
Assumptions

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Stock Options:				
Expected dividend yield	-%	-%	-%	-%
Expected stock price volatility	147.7			