

**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 MARCH 31, 2000

OR

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

For the transition period from _____ to _____ .

Commission file number 000-24487

MIPS Technologies, Inc.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

77-0322161
(I.R.S. Employer
Identification Number)

1225 CHARLESTON ROAD, MOUNTAIN VIEW, CA 94043-1353

(Address of principal executive offices)

Registrant's telephone number, including area code: **(650) 567-5000**

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

As of May 1, 2000, the number of outstanding shares of the Registrant's Class A common stock was 13,363,325. The number of outstanding shares of the Registrant's Class B common stock as of May 1, 2000, was 25,069,759, all of which are beneficially owned by Silicon Graphics, Inc.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

**MIPS TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)**

	<u>March 31, 2000</u> (unaudited)	<u>June 30, 1999</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$79,120	\$49,916
Accounts receivable	7,488	425
Prepaid expenses and other current assets	3,394	2,989
Total current assets	<u>90,002</u>	<u>53,330</u>
Equipment and furniture, net	5,908	5,123
Other assets	848	936
	<u>\$96,758</u>	<u>\$59,389</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 3,877	\$10,028
Accrued liabilities	16,307	8,265
Total current liabilities	<u>20,184</u>	<u>18,293</u>
Deferred revenue	375	375
Stockholders' equity:		
Common stock	38	37
Additional paid-in capital	152,427	138,880
Accumulated deficit	<u>(76,266)</u>	<u>(98,196)</u>
Total stockholders' equity	<u>76,199</u>	<u>40,721</u>
	<u>\$96,758</u>	<u>\$59,389</u>

See accompanying notes.

MIPS TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)
(In thousands, except per share data)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2000	1999	2000	1999
Revenue:				
Royalties	\$18,149	\$23,274	\$43,620	\$48,127
Contract revenue	8,812	3,400	23,781	5,800
Total revenue	<u>26,961</u>	<u>26,674</u>	<u>67,401</u>	<u>53,927</u>
Costs and expenses:				
Cost of contract revenue	—	—	500	125
Research and development	6,801	5,824	20,054	15,047
Sales and marketing	2,642	1,801	7,011	4,820
General and administrative	1,387	1,718	5,518	4,673
Total costs and expenses	<u>10,830</u>	<u>9,343</u>	<u>33,083</u>	<u>24,665</u>
Operating income	16,131	17,331	34,318	29,262
Interest income and other, net	1,119	469	2,581	908
Income before income taxes	17,250	17,800	36,899	30,170
Provision for income taxes	6,900	7,120	14,809	12,068
Net income	<u>\$10,350</u>	<u>\$10,680</u>	<u>\$22,090</u>	<u>\$18,102</u>
Net income per basic share	<u>\$ 0.27</u>	<u>\$ 0.29</u>	<u>\$ 0.58</u>	<u>\$ 0.49</u>
Net income per diluted share	<u>\$ 0.26</u>	<u>\$ 0.27</u>	<u>\$ 0.55</u>	<u>\$ 0.47</u>
Shares used in computing net income per basic share	<u>38,196</u>	<u>37,277</u>	<u>37,908</u>	<u>37,242</u>
Shares used in computing net income per diluted share	<u>40,437</u>	<u>39,275</u>	<u>39,901</u>	<u>38,584</u>

See accompanying notes.

MIPS TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(In thousands)

	Nine Months Ended	
	March 31,	
	2000	1999
Operating activities:		
Net income	\$22,090	\$18,102
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	1,767	1,393
Other non-cash charges	202	385
Changes in operating assets and liabilities:		
Accounts receivable	(7,063)	(2,873)
Accounts payable	(6,151)	5,347
Other assets and liabilities, net	7,594	3,867
Net cash provided by operating activities	18,439	26,221
Investing activities—capital expenditures	(2,555)	(1,866)
Financing activities:		
Net proceeds from issuance of common stock during initial public offering	—	16,150
Net proceeds from issuance of common stock under stock plans	13,479	—
Net cash provided by financing activities	13,479	16,150
Foreign currency translation adjustment	(159)	(18)
Net increase in cash and cash equivalents	29,204	40,487
Cash and cash equivalents, beginning of period	49,916	45
Cash and cash equivalents, end of period	<u>\$79,120</u>	<u>\$40,532</u>

See accompanying notes.

MIPS TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—UNAUDITED

Note 1. Description of Business and Basis of Presentation

Formation of MIPS Technologies, Inc. MIPS Technologies' predecessor, MIPS Computer Systems, Inc., was founded in 1984 and was engaged in the design and development of RISC processors for the computer systems and embedded markets. Silicon Graphics, Inc. ("Silicon Graphics") adopted the MIPS architecture for its computer systems in 1988 and acquired MIPS Computer Systems, Inc. in 1992. Following the acquisition, Silicon Graphics continued the MIPS processor business through its MIPS Group (a division of Silicon Graphics), which focused primarily on the development of high-performance processors for Silicon Graphics' workstations and servers. In order to increase the focus of the MIPS Group on the design and development of processor applications dedicated to the embedded market, in December 1997, Silicon Graphics initiated a plan to separate the business of the MIPS Group from its other operations. In April 1998, our Board of Directors approved a transaction in which, Silicon Graphics transferred to us the assets and liabilities related to the design and development of processor intellectual property for embedded market applications (the "Separation"). Since the closing of our initial public offering (the "Offering") on July 6, 1998, we have been a majority owned subsidiary of Silicon Graphics.

Basis of Presentation. The unaudited results of operations for the interim periods shown herein are not necessarily indicative of operating results for the entire fiscal year. In the opinion of management, the condensed consolidated financial statements include all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position, results of operations and cash flows for each interim period shown.

The condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") applicable to interim financial information. Certain information and footnote disclosures included in financial statements prepared in accordance with generally accepted accounting principles have been omitted in these interim statements as allowed by such SEC rules and regulations. The balance sheet at June 30, 1999 has been derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. However, we believe that the disclosures are adequate to make the information presented not misleading. The unaudited condensed consolidated financial statements included in this Form 10-Q should be read in conjunction with the audited consolidated financial statements and notes thereto, for the fiscal year ended June 30, 1999, included in our 1999 Annual Report on Form 10-K.

Note 2. Computation of Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2000	1999	2000	1999
Numerator:				
Net income available to common stockholders	\$10,350	\$10,680	\$22,090	\$18,102
Denominator:				
Weighted-average shares of common stock outstanding	38,211	37,292	37,923	37,257
Less: Weighted-average shares subject to repurchase	(15)	(15)	(15)	(15)
Shares used in computing net income per basic share	38,196	37,277	37,908	37,242
Effect of dilutive securities-employee stock options and shares subject to repurchase	2,241	1,998	1,993	1,342
Shares used in computing net income per diluted share	40,437	39,275	39,901	38,584
Net income per basic share	\$ 0.27	\$ 0.29	\$ 0.58	\$ 0.49
Net income per diluted share	\$ 0.26	\$ 0.27	\$ 0.55	\$ 0.47
Potentially dilutive securities excluded from net income per diluted share computation because they are anti-dilutive	—	5	17	2

Note 3. Comprehensive Income

There is no material difference between the reported net income and the comprehensive net income for all the periods presented.

Note 4. Contingencies

On October 28, 1999, we filed suit against Lexra, Inc. in the United States District Court for the Northern District of California for infringement of two United States patents. We have also identified nine additional patents that we believe Lexra may be infringing and we intend to assert claims under these patents as warranted based on our continuing factual investigation.

On November 12, 1999, Lexra, Inc. filed counterclaims against us seeking a declaratory judgment that the two asserted patents are invalid and not infringed. Lexra has also asserted claims for common law unfair competition, intentional interference with business relations, and statutory unfair competition, all purportedly based on the allegation that our claims of patent infringement have been made in bad faith. On December 3, 1999, we filed our answer to Lexra's counterclaims, and denied the substantive allegations made by Lexra.

From time to time, we receive communications from third parties asserting patent or other rights covering our products and technologies. Based upon our evaluation, we may take no action or we may seek to obtain a license. There can be no assurance in any given case that a license will be available on terms we consider reasonable, or that litigation will not ensue.

Management is not aware of any pending disputes including those discussed above that would be likely to have a material adverse effect on our results of operations or financial condition.

Note 5. Related Party Transactions

At March 31, 2000 accounts payable includes approximately \$3.3 million primarily related to fiscal year 2000 estimated net taxes payable to Silicon Graphics under a tax sharing agreement with Silicon Graphics compared to approximately \$8.8 million at June 30, 1999 related to fiscal 1999 net taxes payable which has subsequently been paid to Silicon Graphics. The tax sharing agreement provides that we will make payments to Silicon Graphics, with respect to any period in which we were considered as part of the Silicon Graphics consolidated tax return. The amount of taxes to be paid, subject to certain adjustments, will be determined as though we were to file separate state and local income tax returns. At March 31, 2000, accounts payable also includes approximately \$1,000 payable to Silicon Graphics relating to certain administrative and corporate support services provided by Silicon Graphics on our behalf during the third quarter of fiscal 2000.

Note 6. Recent Accounting Pronouncement

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, referred to as SAB 101. SAB 101 summarizes the SEC staff's views in applying generally accepted accounting principles to revenue recognition. We are currently in the process of evaluating SAB 101 and what effect it may have on our financial statements. Accordingly, we have not determined whether SAB 101 will have a material impact on our financial position or results of operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

You should read the following discussion and analysis together with the unaudited condensed consolidated financial statements and the notes to those statements included elsewhere in this report. Except for the historical information contained in this Quarterly Report on Form 10-Q, this discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those indicated in these forward-looking statements as a result of certain factors, as more fully described under "Factors That May Affect Our Business", and other risks included from time to time in our other Securities and Exchange Commission ("SEC") reports, copies of which are available from us upon request. The forward-looking statements within this Quarterly Report on Form 10-Q are identified by words such as "believes," "anticipates," "expects," "intends," "may" and other similar expressions. However, these words are not the exclusive means of identifying such statements. We undertake no obligation to update any forward-looking statements included in this discussion.

Results of Operations

Revenue. Our revenue consists of royalties and contract revenue earned under contracts with our licensees. We generate royalties from the sale by semiconductor companies of products incorporating our technology. We also receive royalties from Nintendo relating to sales of Nintendo 64 video game players and related cartridges. Royalties may be calculated as a percentage of the revenue received by the seller on sales of such products or on a per unit basis. Contract revenue includes technology license fees and engineering service fees earned primarily under contracts with our semiconductor manufacturing licensees. We receive license fees for the use of technology that we have developed internally and, in some cases, which we have licensed from third parties. Fees related to engineering services, which are performed on a best effort basis, are recognized as revenue when the defined milestones are achieved and collectibility of the milestone payment is probable. The technology we develop is generally licensed to multiple customers.

Total revenue for the third quarter and first nine months of fiscal 2000 increased by \$287,000 to \$27.0 million and increased by \$13.5 million to \$67.4 million, respectively. Royalties for the third quarter and first nine months of fiscal 2000 decreased by \$5.2 million to \$18.1 million and decreased by \$4.5 million to \$43.6 million, respectively. The decrease in royalties for the third quarter was due primarily to lower royalties derived from sales of Nintendo products. The decrease in royalties for the first nine months of fiscal 2000 was due primarily to lower royalties derived from sales of Nintendo products offset in part by higher royalties derived from sales of non-Nintendo products. As the Nintendo 64 video game product line continues further into its life-cycle, we expect that sales of such products and the related royalties we receive will generally trend downward, subject to seasonal fluctuations and to the impact of particular game titles introduced by Nintendo from time to time. Contract revenue for the third quarter and first nine months of fiscal 2000 increased by \$5.4 million to \$8.8 million and increased by \$18.0 million to \$23.8 million, respectively. The increase in both periods was the result of technology license fees from new agreements and engineering service fees earned upon our achievement of defined milestones.

Cost of Contract Revenue. Our cost of contract revenue consists of sublicense fees payable to third parties. We incur an obligation to pay these fees when we sublicense technology to our customers that we have licensed from third parties. Sublicense fees are recorded as cost of contract revenue when the obligation is incurred, which is typically the same period in which the related revenue is recognized.

There was no sublicensing activity during both the third quarter of fiscal 2000 and for the same period in fiscal 1999 and therefore, there was no cost of contract revenue. Cost of contract revenue was \$500,000 in the first nine months of fiscal 2000 compared with \$125,000 for the same period in fiscal 1999. We expect that in future periods cost of contract revenue will be minimal.

Research and Development. Costs incurred with respect to technology we develop internally and engineering services we perform which are not directly related to any particular licensee, license agreement or license fee, are recorded as research and development expense.

Research and development expenses for the third quarter and first nine months of fiscal 2000 were \$6.8 million and \$20.1 million, respectively, compared with research and development expenses of \$5.8 million and \$15.0 million for the comparable periods in fiscal 1999. The increases in research and development expenses of \$1.0 million and \$5.0 million in the third quarter and first nine months of fiscal 2000 compared with the same periods in the prior year were due to the addition of resources to support various project development activities including the addition of 25 employees to the development team during the past twelve months. We expect research and development expenses to increase in the foreseeable future as we continue to develop new designs for the digital consumer products market and the market for embedded processors.

Sales and Marketing, General and Administrative. Sales and marketing and general and administrative expenses for the third quarter and first nine months of fiscal 2000 were \$4.0 million and \$12.5 million, respectively, compared to \$3.5 million and \$9.5 million for the comparable periods in fiscal 1999. The increases in sales and marketing and general and administrative expenses of \$510,000 and \$3.0 million in the third quarter and first nine months of fiscal 2000 compared with the same periods in the prior year were due to additional resources hired to support our licensing activities and protect our intellectual property, and the development of our administrative infrastructure to support our business. We increased our sales and marketing and general and administrative staff to 50 persons as of March 31, 2000, from 39 persons as of March 31, 1999, to support this growth.

Interest Income and Other, Net. For the third quarter and first nine months of fiscal 2000, interest income and other, net was \$1.1 million and \$2.6 million, respectively, compared to interest income and other, net of \$469,000 and \$908,000 for the comparable periods in fiscal 1999. The increase in both periods was primarily due to interest income earned from the investment of cash generated from our operating activities and the net proceeds from issuance of common stock under our stock plans.

Income Taxes. We recorded a provision for income taxes of \$6.9 million and \$14.8 million for the third quarter and first nine months of fiscal 2000, respectively, compared to \$7.1 million and \$12.1 million for the same periods in fiscal 1999 based on the estimated federal and state combined statutory rate of 40% on income before taxes.

Financial Condition

At March 31, 2000, we had cash and cash equivalents of \$79.1 million and total working capital of \$69.8 million.

Our operating activities provided net cash of \$18.4 million for the nine months ended March 31, 2000 compared to \$26.2 million for the comparable period in the prior year. During the nine months ended March 31, 2000, net cash provided by operating activities consisted mainly of net income offset by an increase in accounts receivable and a decrease in accounts payable. The increase in accounts receivable was due to fees owed us under license agreements. The decrease in accounts payable was primarily due to a payment of taxes due to Silicon Graphics for our fiscal 1999 tax liability incurred under the tax sharing agreement with Silicon Graphics.

Net cash used in investing activities was \$2.6 million and \$1.9 million for the nine months ended March 31, 2000 and 1999, respectively. Net cash used in investing activities in both periods represents equipment purchases and licensing of computer aided design tools used in development. Capital expenditures have been, and future expenditures are anticipated to be, primarily for facilities, equipment to support expansion of our operations and licensing of computer aided design tools used in development. We expect that our capital expenditures will increase as our employee base grows.

Net cash provided by financing activities was \$13.5 million for the nine months ended March 31, 2000 compared to \$16.2 million for the comparable period in the prior year. Net cash provided in the current period resulted from the exercise of stock options. Financing activities for the nine months ended March 31, 1999 consisted of \$16.2 million received in connection with the issuance of common stock through our initial public offering, which was completed in July 1998.

Our future liquidity and capital requirements are expected to vary greatly from quarter to quarter, depending on numerous factors, including, among others:

- the cost, timing and success of product development efforts;
- the cost and timing of sales and marketing activities;
- the extent to which our existing and new technologies gain market acceptance;
- the level and timing of contract revenues and royalties;
- competing technological and market developments; and
- the costs of maintaining and enforcing patent claims and other intellectual property rights.

We believe that cash generated by our operations, together with our current cash balance, will be sufficient to meet our projected operating and capital requirements for the foreseeable future. However, we may in the future be required to raise additional funds through public or private financing, strategic relationships or other arrangements. We cannot be certain that any such financing will be available on acceptable terms, or at all, and our failure to raise capital when needed could have a material adverse effect on our business, operating results and financial condition. Additional equity financing may be dilutive to holders of our common stock, and debt financing, if available, may involve restrictive covenants. Moreover, strategic relationships, if necessary to raise additional funds, may require that we relinquish our rights to certain technology. In the event that Silicon Graphics effects a tax-free distribution of its interest in us, our ability to issue shares of our common stock in connection with an acquisition or in a public or private offering during the 30 months following such distribution will be limited under the terms of a distribution tax indemnification agreement which we have entered into with Silicon Graphics.

Factors That May Affect Our Business

Factors negatively affecting sales of Nintendo 64 video game players and related cartridges could materially and adversely affect us. Royalties from Nintendo and NEC relating to Nintendo 64 video game players and related cartridges for the third quarter and first nine months of fiscal 2000 were 58% and 54% respectively, of our total revenue compared to 81% and 78% for the comparable periods in fiscal 1999. We anticipate that royalties related to sales of Nintendo 64 video game cartridges will continue to represent a substantial portion of our total revenue for the next one to two years. Accordingly, declining sales of Nintendo 64 video game cartridges could have a material adverse effect on our results of operations and financial condition. The market for home entertainment products is competitive and the introduction of new products or technologies, as well as shifting consumer preferences, could negatively impact the amount and timing of sales of Nintendo 64 video game players and related cartridges.

We must diversify our sources of revenue to offset the decline in revenue we derive from sales of Nintendo video game products. The next generation Nintendo video game system will not incorporate any of our technology. Our ability to diversify our sources of revenue is still uncertain and will depend on whether our processors and related designs are selected for design (“design wins”) into a broader range of digital consumer products and business equipment. Our ability to achieve design wins is subject to several risks and uncertainties, including:

- the potentially limited opportunities for design wins with respect to certain digital consumer products, such as video game products, due to a limited number of product manufacturers and the length of product life cycles;
- the risk that the performance, functionality, price and power characteristics of our designs may not satisfy those that are critical to specific digital consumer product applications; and
- our limited research and development and sales and marketing experience in our target markets due to our previous focus on the development of high performance processors for Silicon Graphics’ workstations and servers.

Even if our technology is incorporated into new products, we cannot be certain that any such products will ultimately be brought to market, achieve commercial acceptance or generate meaningful royalties for us.

Factors that negatively affect our semiconductor company licensees could adversely affect our business. A significant portion of our total revenue has been derived from a limited number of semiconductor companies. Accordingly, factors negatively affecting a particular licensee could adversely affect our results of operations and financial condition if such licensee accounts for a significant portion of our revenue at the time. We are subject to many risks beyond our control that influence the success of our licensees, including, for example, the highly competitive environment in which they operate, the market for their products, their engineering capabilities and their financial and other resources.

Revenues from our top two semiconductor company licensees represented an aggregate of 23% and 17% of total revenue for the third quarter and first nine months of fiscal 2000, respectively, compared to 11% and 14% for the comparable periods in fiscal 1999. We expect that this revenue concentration will continue in the future, although the identity of the particular licensees that will account for this revenue concentration may vary from period to period depending on the addition or expiration of contracts, the nature and timing of payments due under our contracts and the volumes and prices at which our licensees sell products incorporating our technology.

We depend on semiconductor companies and digital consumer product manufacturers to adopt our technology and use it in the products they sell. The adoption and continued use of our technology by semiconductor companies and digital consumer product manufacturers is important to our continued success. We face numerous risks in obtaining agreements with semiconductor companies and digital consumer product manufacturers on terms consistent with our business model, including:

- the lengthy and expensive process of building a relationship with a potential licensee;
- the fact that we may compete with the internal design teams of semiconductor companies and digital consumer product manufacturers;
- the potential difficulties in persuading large semiconductor companies and digital consumer product manufacturers to work with us, to rely on us for critical technology, and to disclose to us proprietary manufacturing technology; and
- the potential difficulties in persuading potential licensees to bear certain development costs associated with our technology and to produce embedded processors using our technology.

We cannot assure you that we will be able to maintain our current relationships or establish new relationships with additional licensees, and any failure by us to do so could have a material adverse effect on our business.

Moreover, we are subject to risks beyond our control that influence the success or failure of a particular semiconductor company or digital consumer product manufacturer, including:

- the competition it faces and the market acceptance of its products;
- its engineering, marketing and management capabilities and the technical challenges unrelated to our technology that it faces in developing its products; and
- its financial and other resources.

None of our current licensees are obligated to license new or future generations of our processor designs. In addition, because we do not control the business practices of our licensees, we do not influence the degree to which our licensees promote our technology or set the prices at which the products incorporating our technology are sold to digital consumer product manufacturers.

Our separation from Silicon Graphics may negatively affect certain of our existing licensee relationships, insofar as Silicon Graphics was a factor in establishing and maintaining the relationship or in negotiating the financial and other terms of our contracts with such licensees (due to, for example, Silicon Graphics' status as a customer of such licensees).

Our quarterly financial results are subject to significant fluctuations, which could adversely affect our stock price. Our quarterly financial results may vary significantly due to a number of factors, many of which are outside of our control. In addition, our revenue components are difficult to predict and may fluctuate significantly from period to period. Because our expenses are largely independent of our revenue in any particular period, it is difficult to accurately forecast our operating results. Our operating expenses are based, in part, on anticipated future revenue and a high percentage of our expenses are fixed in the short term. As a result, if our revenue is below expectations in any quarter, the adverse effect may be magnified by our inability to adjust spending in a timely manner to compensate for the revenue shortfall.

In light of the foregoing, we believe that quarter-to-quarter comparisons of our revenue and operating results may not be a good indication of our future performance. In addition, it is possible that in some future periods our results of operations may be below the expectations of public market analysts and investors. In this event, the price of our Class A common stock may fall.

Factors that could cause our revenue and operating results to vary from quarter to quarter include:

- the demand for and average selling prices of semiconductor products that incorporate our technology;
- the financial terms of our contractual arrangements with our semiconductor licensees, which may provide for significant up-front payments or payments based on the achievement of certain milestones;
- the relative mix of contract revenue and royalties;
- competitive pressures resulting in lower contract revenue or royalty rates;
- our ability to develop, introduce and market new processor intellectual property;
- the establishment or loss of licensing relationships with semiconductor companies or digital consumer product manufacturers;
- the timing of new products and product enhancements by us and our competitors;

- changes in development schedules, research and development expenditure levels and product support by us and digital consumer product manufacturers;
- seasonal fluctuations; and
- general economic and market conditions.

We are dependent on the emerging market for digital consumer products and consumer acceptance of the products that incorporate our technology. The digital consumer products industry is presently the primary market for our processor, core and related designs. The market for digital consumer products is relatively new and emerging, and our success will depend largely on the level of consumer interest in digital consumer products, many of which have only recently been introduced to the market. In addition, the timing and amount of royalties we receive will depend on consumer acceptance of the products that incorporate our technology. We cannot assure you that any products that incorporate our technology will achieve commercial acceptance or generate meaningful royalties for us.

Our dependence on the digital consumer products industry involves several risks and uncertainties, including:

- changes in consumer requirements and preferences;
- the introduction of products by our competitors embodying new technologies or features; and
- the current lack of open industry standards for hardware and software in the digital consumer products industry.

If we are unable to develop enhancements and new generations of our intellectual property, our ability to achieve design wins may be adversely affected. Our future success will depend on our ability to develop enhancements and new generations of our processors, cores and other intellectual property that satisfy the requirements of specific product applications and introduce these new technologies to the marketplace in a timely manner. If our development efforts are not successful or are significantly delayed, or if the characteristics of our processor and related designs are not compatible with the requirements of specific product applications, our ability to achieve design wins may be limited. Our failure to achieve a sufficient number of design wins could have a material adverse effect on our business, results of operations and financial condition.

Technical innovations of the type critical to our success are inherently complex and involve several risks, including:

- our ability to anticipate and timely respond to changes in the requirements of digital consumer product and business equipment manufacturers;
- our ability to anticipate and timely respond to changes in semiconductor manufacturing processes;
- changing consumer preferences in the digital consumer products market;
- the emergence of new standards in the semiconductor, digital consumer product or business equipment industries;
- the significant investment that is often required before commercial viability is determined; and
- the introduction by our competitors of products embodying new technologies or features.

Any failure by us to adequately address these risks could render our existing processor, core and related designs obsolete and could have a material adverse effect on our business, results of operations and financial condition. In addition, we cannot assure you that we will have the financial and other resources necessary to develop processor, core and related designs in the future, or that any enhancements or new generations of the technology that we develop will generate revenue in excess of the costs of development.

Our intellectual property may be misappropriated or subject to claims of infringement. We attempt to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as licensing agreements and employee and third-party nondisclosure and assignment agreements. Our failure to obtain or maintain adequate protection of our intellectual property rights for any reason could have a material adverse effect on our business, results of operations and financial condition.

Policing the unauthorized use of our intellectual property is difficult, and we cannot be certain that the steps we have taken will prevent the misappropriation or unauthorized use of our technologies, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. In addition, we cannot be certain that we will be able to prevent other parties from designing and marketing unauthorized MIPS-based products or that others will not independently develop or otherwise acquire the same or substantially equivalent technologies as ours. Moreover, our cross licensing arrangements, in which we license certain of our patents but do not generally transfer know-how or other proprietary information, may facilitate the ability of our cross-licensees, either alone or in conjunction with others, to develop competitive products and designs.

We cannot assure you that any of our patent applications will be approved or that any of the patents that we own will not be challenged, invalidated or circumvented by others or be of sufficient scope or strength to provide us with any meaningful protection or commercial advantage. Significant litigation regarding intellectual property rights exists in our industry. We cannot be certain that third parties will not make a claim of infringement against us or against our semiconductor company licensees or digital consumer product manufacturers in connection with their use of our technology. Any claims, even those without merit, could be time consuming to defend, result in costly litigation and/or require us to enter into royalty or licensing agreements. These royalty or licensing agreements, if required, may not be available to us on acceptable terms or at all. A successful claim of infringement against us or one of our semiconductor manufacturing licensees in connection with its use of our technology could adversely affect our business.

If we fail to compete effectively in the market for embedded processors, our business will be adversely affected. Competition in the market for embedded processors is intense. We believe that the principal competitive factors in our industry are performance, functionality, price, customizability and power consumption. We cannot assure you that we will be able to compete successfully or that competitive pressures will not materially and adversely affect our business, results of operations and financial condition. We compete with other designers and developers of processors and cores, as well as semiconductor companies whose product lines include processors for embedded and non-embedded applications. In addition, we may face competition from the producers of unauthorized MIPS-based clones and non-RISC based technology designs.

To remain competitive, we must also differentiate our processors, cores and related designs from those available or under development by the internal design groups of semiconductor companies, including some of our current and prospective licensees. Many of these internal design groups have substantial programming and design resources and are part of larger organizations with substantial financial and marketing resources. These internal design groups may develop products that compete directly with ours or may actively seek to license their own technology to third party semiconductor companies.

Many of our existing competitors, as well as a number of potential new competitors, has longer operating histories, greater brand recognition, larger customer bases as well as greater financial and marketing resources than we do. This may allow them to respond more quickly than we can to new or emerging technologies and changes in customer requirements. It may also allow them to devote greater resources than we can to the development and promotion of their technologies and products. In addition, we may face competition from non-RISC based technology designs.

We may not be able to recruit and retain the personnel to succeed. Our future success depends to a significant extent on the continued contributions of our key management, technical, sales and marketing personnel, many of whom are highly skilled and difficult to replace. We do not have employment agreements with any of our officers or key employees. We intend to hire additional highly skilled personnel, particularly technical personnel, for our anticipated research and development activities. Competition for qualified personnel, particularly those with significant experience in the semiconductor and processor design industries, is intense. The loss of the services of any of our key personnel or our inability to attract and retain qualified personnel in the future could have a material adverse effect on our business, results of operations and financial condition. In particular, our ability to hire and retain qualified engineering personnel is essential to meet our business goals.

We have potential conflicts of interest with Silicon Graphics, which could be resolved in a manner that adversely affects us. Conflicts of interest may arise between us and Silicon Graphics in a number of areas relating to our past and ongoing relationships, including:

- potential competitive business activities;
- indemnification arrangements, including with respect to the separation of our business from that of Silicon Graphics and the recapitalization;
- potential acquisitions or financing transactions;
- sales or other dispositions by Silicon Graphics of shares of our common stock, including through the exercise of its registration rights or in a tax-free distribution to its stockholders;
- the exercise by Silicon Graphics of its ability to control our management and affairs; and
- tax and intellectual property matters.

We cannot assure you that any conflicts that may arise between us and Silicon Graphics will be resolved in a manner that does not have a material adverse effect on us, even if such result is not intended by Silicon Graphics. In addition, certain of the agreements that we entered into with Silicon Graphics in connection with the separation of our business from that of Silicon Graphics contain specific procedures for resolving disputes between the two companies with respect to the subject matter of those agreements. We cannot assure you that more favorable results to us would not be obtained under different procedures.

Silicon Graphics does not currently engage in the design and development of processor intellectual property for embedded systems applications. However, our certificate of incorporation provides that Silicon Graphics has no duty to refrain from engaging in the same or similar activities or lines of business as us.

Ownership interests of our directors or officers in the common stock of Silicon Graphics or service as both a director of MIPS Technologies and an officer or employee of Silicon Graphics could create or appear to create potential conflicts of interest when directors and officers are faced with decisions that could have different implications for us and Silicon Graphics. Our certificate of incorporation includes provisions relating to the allocation of business opportunities that may be suitable for both us and Silicon Graphics based on the relationship to the companies of the individual to whom the opportunity is presented and the method by which it was presented.

In May 1998, we entered into a memorandum of understanding with Silicon Graphics, Nintendo Co. Ltd. and ArtX, Inc. in which Nintendo agreed that, in the absence of certain litigation we and Silicon Graphics initiated against ArtX, Inc., Nintendo would refrain from asserting any claims based on its belief that certain disclosures in the registration statement for our initial public offering constituted a breach of the confidentiality obligations contained in our contract with Nintendo. Although we and Silicon Graphics strongly disagree that any such breach has occurred, Nintendo may assert any claims it believes it has against us with respect to the disclosures in such registration statement if Silicon Graphics reasserts its claims against ArtX, Inc.

Our revenue is subject to fluctuations in currency exchange rates. A substantial portion of our revenue has been, and is expected to continue to be, derived from customers outside the United States, primarily in Japan. To date, substantially all of our revenue from international customers has been denominated in U.S. dollars. However, to the extent that the sales by our manufacturing licensees to their customers are denominated in foreign currencies, the royalties we receive on such sales could be subject to fluctuations in currency exchange rates. In addition, if the effective price of the technology we sell to our licensees were to increase due to fluctuations in foreign currency exchange rates, demand for our technology could fall which would, in turn, reduce our royalties. Because we cannot predict the amount of non-U.S. dollar denominated revenue earned by our licensees, we have not historically attempted to mitigate the effect that currency fluctuations may have on our revenue, and we do not presently intend to do so in the future.

We have grown rapidly, and if we are unable to manage this growth, our business will be adversely affected. Our ability to continue to grow successfully requires an effective planning and management process. Since June 30, 1998, we have increased our headcount substantially, from 63 employees at that date to 160 employees at March 31, 2000. This increase includes the addition of 72 research and development employees as well as additional employees in our sales, marketing and administrative staff.

Our growth has placed, and the recruitment and integration of additional employees will continue to place, a strain on our resources. Digital consumer product manufacturers and our semiconductor manufacturing licensees typically require significant engineering support in the design, testing and manufacture of products incorporating our technology. Accordingly, increases in the adoption of our technology can be expected to increase the strain on our personnel, particularly our engineers.

Our separation from Silicon Graphics may affect us in negotiating future licensing arrangements and resolving future intellectual property disputes. We have entered into licensing arrangements with Silicon Graphics with respect to certain of its intellectual property that we use in our business. As a result of the separation, however, we no longer have full access to Silicon Graphics' patents and other intellectual property. In the past, the MIPS Group benefited from its status as a division of Silicon Graphics in its access to the intellectual property of third parties through licensing arrangements or otherwise, and in the negotiation of the financial and other terms of such arrangements. The separation of our business from that of Silicon Graphics could adversely affect our ability to negotiate commercially attractive intellectual property licensing arrangements with third parties in the future. Moreover, in connection with future intellectual property infringement claims, we will not have the benefit of asserting counterclaims based on Silicon Graphics' intellectual property portfolio, nor will we be able to provide licenses to Silicon Graphics' intellectual property in order to resolve such claims.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

A substantial portion of our revenue has been, and is expected to continue to be, derived from customers outside the United States, primarily in Japan. To date, substantially all of our revenue from international customers has been denominated in U.S. dollars. However, to the extent that the sales by our manufacturing licensees to their customers are denominated in foreign currencies, the royalties we receive on such sales could be subject to fluctuations in currency exchange rates. In addition, if the effective price of the technology we sell to our licensees were to increase due to fluctuations in foreign currency exchange rates, demand for our technology could fall which would, in turn, reduce our royalties. Because we cannot predict the amount of non-U.S. dollar denominated revenue that might be earned by our licensees, we have not historically attempted to mitigate the effect that currency fluctuations may have on our revenue, and we do not presently intend to do so in the future.

We are also exposed to interest rate risk on investments of our excess cash. The primary objective of our investment activities is to preserve capital. To achieve this objective and minimize the exposure due to adverse shifts in interest rates, we invest in high quality short-term maturity commercial paper and money market funds operated by reputable financial institutions in the United States. Due to the nature of our investments, we believe that we do not have a material interest rate risk exposure.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 28, 1999, we filed suit against Lexra, Inc. in the United States District Court for the Northern District of California for infringement of two United States patents. We have also identified nine additional patents that we believe Lexra may be infringing and intend to assert claims under these patents as warranted based on our continuing factual investigation.

On November 12, 1999, Lexra, Inc. filed counterclaims against us seeking a declaratory judgment that the two asserted patents are invalid and not infringed. Lexra has also asserted claims for common law unfair competition, intentional interference with business relations, and statutory unfair competition, all purportedly based on the allegation that our claims of patent infringement have been made in bad faith. On December 3, 1999, we filed our answer to Lexra's counterclaims, and denied the substantive allegations made by Lexra.

Our management is not aware of any pending disputes including that discussed above that would be likely to have a material adverse effect on our business, results of operations or financial condition.

From time to time, we receive communications from third parties asserting patent or other rights covering our products and technologies. Based upon our evaluation, we may take no action or we may seek to obtain a license. There can be no assurance in any given case that a license will be available on terms we consider reasonable, or that litigation will not ensue. In addition, from time to time, we evaluate possible infringement claims against third parties and may assert such claims, if appropriate.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

27.1 Financial Data Schedule.

(b) Reports on Form 8-K.

None.

ITEMS 2, 3, 4 AND 5 ARE NOT APPLICABLE AND HAVE BEEN OMITTED.

