PROSPECT CAPITAL CORP
Form 497
July 20, 2015
Prospect Capital Corporation
Prospect Capital InterNotes®
4.750% Senior Notes due 2020 (the "2020 Notes")
5.250% Senior Notes due 2022 (the "2022 Notes"
and together with the 2020 Notes, the "Notes")

Filed under Rule 497, Registration Statement No. 333-198505
Pricing Supplement Nos. 369 and 370 — Dated Monday, July 20, 2015
(To: Prospectus Dated November 4, 2014, and Prospectus Supplement Dated May 8, 2015)

CUSIP Number	ISIN Number	Principal Amount	Selling Price	Gross Concession	Net Proceeds	Coupon Type	Coupon Rate	Coupon Frequency	Maturity Date	1st C Date
74348YRF0	US74348YRF06	$2,429,000.00	100.000%	1.250%	$2,398,637.50	Fixed	4.750%	Semi-Annual	7/15/2020	1/15/

Redemption Information: Callable at 100.000% on 7/15/2016 and every coupon date thereafter.

CUSIP Number	ISIN Number	Principal Amount	Selling Price	Gross Concession	Net Proceeds	Coupon Type	Coupon Rate	Coupon Frequency	Maturity Date	1st C Date
74348YRG8	US74348YRG88	$2,531,000.00	100.000%	1.750%	$2,486,707.50	Fixed	5.250%	Semi-Annual	1/15/2022	1/15/

Redemption Information: Callable at 100.000% on 7/15/2016 and every coupon date thereafter.
Trade Date: Monday, July 20, 2015 @ 12:00 PM ET
Settle Date: Thursday, July 23, 2015
Minimum Denomination/Increments: $1,000.00/$1,000.00
Initial trades settle flat and clear SDFS: DTC Book Entry only
The Notes will be issued pursuant to the Indenture, dated as of February 16, 2012, as amended and supplemented by that certain Three Hundred Sixty-Ninth Supplemental Indenture and Three Hundred Seventieth Supplemental Indenture, respectively, each dated as of July 23, 2015.
The date from which interest shall accrue on the Notes is Thursday, July 23, 2015. The "Interest Payment Dates" for the Notes shall be July 15 and January 15 of each year, commencing January 15, 2016; the interest payable on any Interest Payment Date, will be paid to the Person in whose name the Notes (or one or more predecessor Notes) is registered at the close of business on the Regular Record Date (as defined in the Indenture) for such interest, which shall be June 1 or December 1, as the case may be, next preceding such Interest Payment Date.
The Notes will be redeemable in whole or in part at any time or from time to time, at the option of Prospect Capital Corporation, on or after July 15, 2016 at a redemption price of $1,000 per Notes plus accrued and unpaid interest payments otherwise payable for the then-current semi-annual interest period accrued to, but excluding, the date fixed for redemption and upon not less than 30 days nor more that 60 days prior notice to the noteholder and the trustee, as described in the prospectus.
Prospect Capital Corporation is a financial services company that lends to and invests in middle market, privately-held companies. We are organized as an externally-managed, non-diversified closed-end management investment company that has elected to be treated as a business development company under the Investment Company Act of 1940. Prospect Capital Management L.P. manages our investments and Prospect Administration LLC provides the administrative services necessary for us to operate.
This preliminary pricing supplement relates only to the securities described in the accompanying prospectus supplement and prospectus, is only a summary of changes and should be read together with the accompanying prospectus supplement and prospectus, including among other things the section entitled "Risk Factors" beginning on page S-9 of such prospectus supplement and page 10 of such prospectus. This preliminary pricing supplement and the accompanying prospectus supplement and prospectus contain important information you should know before

investing in our securities. Please read it before you invest and keep it for future reference. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission, or the "SEC." This information is available free of charge by contacting us at 10 East 40th Street, 42nd Floor, New York, NY 10016 or by telephone at (212) 448-0702. The SEC maintains a website at www.sec.gov where such information is available without charge upon written or oral request. Our internet website address is www.prospectstreet.com. Information contained on our website is not incorporated by reference into this prospectus supplement or the accompanying prospectus and you should not consider information contained on our website to be part of this prospectus supplement or the accompanying prospectus.

Neither the SEC nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this preliminary pricing supplement. Any representation to the contrary is a criminal offense.

Obligations of Prospect Capital Corporation and any subsidiary of Prospect Capital Corporation are not guaranteed by the full faith and credit of the United States of America. Neither Prospect Capital Corporation nor any subsidiary of Prospect Capital Corporation is a government-sponsored enterprise or an instrumentality of the United States of America.

InterNotes® is a registered trademark of Incapital Holdings LLC.

Recent Developments:

On May 13, 2015, we made an investment of $44.6 million to purchase 81.48% of the subordinated notes in Mountain View CLO IX Ltd. in a co-investment transaction with Priority Income Fund, Inc., a closed-end fund managed by an affiliate of Prospect Capital Management L.P.

On May 15, 2015, we redeemed $100.0 million aggregate principal amount of our 6.95% unsecured notes. We recognized approximately $2.6 million of realized loss as a result of the call.

On May 22, 2015, Blue Coat Systems, Inc. repaid the $11.0 million loan receivable to us.

On May 28, 2015, we made a $15.0 million follow-on first lien senior secured debt investment in Traeger Pellet Grills LLC in connection with a delayed purchase price payment.

On June 2, 2015, we sold 100% of the outstanding principal balance of the senior secured Term Loan A investment in Fleetwash, Inc. for $24.1 million. There was no gain or loss realized on the sale.

On June 5, 2015, we made an investment of $15.1 million to purchase 50.07% of the subordinated notes in HarbourView CLO VII, Ltd. in a co-investment transaction with Priority Income Fund, Inc., a closed-end fund managed by an affiliate of Prospect Capital Management L.P.

On June 8, 2015, we sold an additional 10% of the total outstanding principal balance of the senior secured Term Loan A investment in Trinity Services Group, Inc. for $9.9 million. There was no gain or loss realized on the sale.

On June 9, 2015, we provided additional debt and equity financing to support the recapitalization of Edmentum, Inc. As part of the recapitalization, we exchanged 100% of the $50.0 million second lien term loan to Edmentum, Inc. for $26.4 million of junior PIK notes and 370,964.14 Class A common equity units representing 37.1% equity ownership in Edmentum Ultimate Holdings, LLC. In addition, we invested $5.9 million in senior PIK notes issued by Edmentum Ultimate Holdings, LLC. We also funded $4.9 million as part of a second lien revolving credit facility to Edmentum, Inc.

On June 12, 2015, we made a $37.5 million follow-on second lien senior secured debt investment in Capstone Logistics Acquisition, Inc., to support an acquisition.

On June 12, 2015, we made a second lien secured investment of $5.0 million to support the recapitalization of Royal Holdings, Inc., a manufacturer of high-value specialty adhesives and sealants. As part of the recapitalization, on June 22, 2015, we received repayment of the $20.0 million loan previously outstanding from Royal Adhesives and Sealants, LLC, a wholly-owned subsidiary of Royal Holdings, Inc.

On June 19, 2015, we made a $10.0 million second lien secured investment in Apollo Security Services Borrower, LLC to support the simultaneous acquisitions of two providers of alarm monitoring services in the U.S.

On June 22, 2015, IDQ Holdings, Inc. repaid the $12.5 million loan receivable to us.

On June 22, 2015, we sold 26.85% of the outstanding principal balance of the senior secured Term Loan A investment in PrimeSport, Inc. for $20.0 million. There was no gain or loss realized on the sale.

On June 22, 2015, we sold an additional 20% of the total outstanding principal balance of the senior secured Term Loan A investment in Trinity Services Group, Inc. for $19.8 million. There was no gain or loss realized on the sale.

On June 23, 2015, we made a $10.0 million second lien secured investment in PlayPower, Inc., a global designer and manufacturer of commercial playgrounds as well as indoor and outdoor recreational equipment.

On June 25, 2015, Deltek, Inc. repaid the $12.0 million loan receivable to us.

On June 26, 2015, we made a $21.4 million follow-on first lien senior secured debt investment in Global Employment Solutions, Inc. to support an acquisition.

On June 26, 2015, we made an investment of $16.9 million to purchase 56.52% of the subordinated notes in Jefferson Mill CLO Ltd. in a co-investment transaction with Priority Income Fund, Inc., a closed-end fund managed by an affiliate of Prospect Capital Management L.P.

On June 30, 2015, we provided $58.5 million of first lien senior secured financing, of which $44.0 million was funded at closing, to BAART Programs, Inc., an operator of outpatient opioid treatment service clinics.

On July 1, 2015, we provided $31.0 million of first lien senior secured financing, of which $30.2 million was funded at closing, to inome, Inc., an online information commerce company.

On July 8, 2015, we sold 27.45% of the outstanding principal balance of the senior secured Term Loan A investment in InterDent, Inc. for $34.4 million. There was no gain or loss realized on the sale.

During the period from May 21, 2015 through July 16, 2015, we issued $29.0 million aggregate principal amount of our Prospect Capital InterNotes® for net proceeds of $28.5 million.
During the period from May 9, 2015 through July 20, 2015, our wholly-owned subsidiary Prospect Small Business Lending, LLC purchased $25.5 million of whole loans from On Deck Capital, Inc., an online small business lender.
During the period from May 9, 2015 through July 20, 2015, we made eight follow-on investments in National Property REIT Corp. ("NPRC") totaling $61.5 million to support the online consumer lending initiative. We invested $15.4 million of equity through NPH Property Holdings, LLC and $46.1 million of debt directly to ACL Loan Holdings, Inc., a wholly-owned subsidiary of NPRC.

Legal Matters:
In the opinion of Joseph Ferraro, General Counsel of Prospect Administration, administrator for Prospect Capital Corporation, a Maryland corporation (the "Company"), the certificates evidencing the Notes (the "Note Certificates") constitute the valid and binding obligations of the Company, entitled to the benefits of the Indenture and enforceable against the Company in accordance with their terms under the laws of the State of New York subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally, concepts of reasonableness and equitable principles of general applicability (including, without limitation, concepts of good faith, fair dealing and the lack of bad faith), provided that such counsel expresses no opinion as to the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law on the conclusions expressed above. This opinion is given as of the date hereof and is limited to the law of the State of New York as in effect on the date hereof. In addition, this opinion is subject to the same assumptions and qualifications stated in the letter of Skadden, Arps, Slate, Meagher & Flom, LLP dated March 8, 2012, filed as Exhibit (l)(5) to the Company's registration statement on Form N-2 (File No. 333-176637) and to the further assumptions that (i) the Note Certificates have been duly authorized by all requisite corporate action on the part of the Company and duly executed by the Company under Maryland law, and (ii) they were duly authenticated by the Trustee and issued and delivered by the Company against payment therefor in accordance with the terms of the Fourth Amended and Restated Selling Agent Agreement and the Indenture. Capitalized terms used in this paragraph without definition have the meanings ascribed to them in the accompanying prospectus supplement.

Prospect Capital Corporation
10 East 40th Street, 42nd Floor
New York, New York 10016

In the opinion of Venable LLP, as Maryland counsel to the Company, (i) the execution and delivery by the Company of the Indenture, dated as of February 16, 2012, as supplemented through the Three Hundred Sixty-Ninth Supplemental Indenture, between the Company and American Stock Transfer & Trust Company, and the Three Hundred Seventieth Supplemental Indenture, between the Company and American Stock Transfer & Trust Company, and the global notes representing the Notes issued pursuant to such Supplemental Indentures, and the performance by the Company of its obligations thereunder, have been duly authorized by the Company and (ii) the issuance of the Notes has been duly authorized by the Company. This opinion is given to the Company as of July 20, 2015 and is limited to the laws of the State of Maryland as in effect on July 20, 2015. In addition, this opinion is subject to the same assumptions, qualifications and limitations stated in the opinion letter to the Company of Venable LLP, dated March 8, 2012, filed as Exhibit (l)(4) to the Company's Registration Statement on Form N-2 (File No. 333-176637). Capitalized terms used in this paragraph without definition have the meanings ascribed to them in the accompanying prospectus supplement.

Very truly yours,
/s/ Venable LLP

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Filed pursuant to Rule 497
File No. 333-198505

PROSPECTUS SUPPLEMENT
(To Prospectus dated November 4, 2014)
Prospect Capital Corporation
Prospect Capital InterNotes®

- We may offer to sell our Prospect Capital InterNotes® from time to time. The specific terms of the notes will be set prior to the time of sale and described in a pricing supplement. You should read this prospectus supplement, the accompanying prospectus and the applicable pricing supplement carefully before you invest. We may offer other debt securities from time to time other than the notes under our Registration Statement or in private placements.
- We may offer the notes to or through agents for resale. The applicable pricing supplement will specify the purchase price, agent discounts and net proceeds of any particular offering of notes. The agents are not required to sell any specific amount of notes but will use their reasonable best efforts to sell the notes. We also may offer the notes directly. We have not set a date for termination of our offering.
- The agents have advised us that from time to time they may purchase and sell notes in the secondary market, but they are not obligated to make a market in the notes and may suspend or completely stop that activity at any time. Unless otherwise specified in the applicable pricing supplement, we do not intend to list the notes on any stock exchange.

Investing in the notes involves certain risks, including those described in the “Risk Factors” section beginning on page S-9 of this prospectus supplement and page 10 of the accompanying prospectus.

This prospectus supplement and the accompanying prospectus contain important information you should know before investing in our securities. Please read it before you invest and keep it for future reference. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission, or the “SEC.” This information is available free of charge by contacting us at 10 East 40th Street, 42nd Floor, New York, NY 10016 or by telephone at (212) 448-0702. The SEC maintains a website at www.sec.gov where such information is available without charge upon written or oral request. Our internet website address is www.prospectstreet.com. Information contained on our website is not incorporated by reference into this prospectus supplement or the accompanying prospectus and you should not consider information contained on our website to be part of this prospectus supplement or the accompanying prospectus.

Neither the SEC nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this prospectus supplement. Any representation to the contrary is a criminal offense.

Obligations of Prospect Capital Corporation and any subsidiary of Prospect Capital Corporation are not guaranteed by the full faith and credit of the United States of America. Neither Prospect Capital Corporation nor any subsidiary of Prospect Capital Corporation is a government-sponsored enterprise or an instrumentality of the United States of America.

We may sell the notes to or through one or more agents or dealers, including the agents listed below.

Incapital LLC BofA Merrill Lynch Citigroup RBC Capital Markets

Prospectus Supplement dated May 8, 2015.

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FORWARD-LOOKING STATEMENTS

This prospectus supplement and the accompanying prospectus may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the "Exchange Act," which involve substantial risks and uncertainties. Forward-looking statements predict or describe our future operations, business plans, business and investment strategies and portfolio management and the performance of our investments and our investment management business. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about our industry, our beliefs, and our assumptions. Words such as "intends," "intend," "intended," "goal," "estimate," "estimates," "expects," "expect," "expected," "project," "projected," "proje "seeks," "anticipates," "anticipated," "should," "could," "may," "will," "designed to," "foreseeable future," "believe," "believe "scheduled" and variations of these words and similar expressions are intended to identify forward-looking statements. Our actual results or outcomes may differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward looking statements, which speak only as of the date the statement was made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including without limitation:

- our future operating results,
- our business prospects and the prospects of our portfolio companies,
- the impact of investments that we expect to make,
- our contractual arrangements and relationships with third parties,
- the dependence of our future success on the general economy and its impact on the industries in which we invest,
- the ability of our portfolio companies to achieve their objectives,
- difficulty in obtaining financing or raising capital, especially in the current credit and equity environment,
- the level and volatility of prevailing interest rates and credit spreads, magnified by the current turmoil in the credit markets,
- adverse developments in the availability of desirable loan and investment opportunities whether they are due to competition, regulation or otherwise,
- a compression of the yield on our investments and the cost of our liabilities, as well as the level of leverage available to us,
- our regulatory structure and tax treatment, including our ability to operate as a business development company and a regulated investment company,
- the adequacy of our cash resources and working capital,
- the timing of cash flows, if any, from the operations of our portfolio companies,
- the ability of our investment adviser to locate suitable investments for us and to monitor and administer our investments,
- authoritative generally accepted accounting principles or policy changes from such standard-setting bodies as the Financial Accounting Standards Board, the SEC, Internal Revenue Service, the NASDAQ Global Select Market, and other authorities that we are subject to, as well as their counterparts in any foreign jurisdictions where we might do business, and
- the risks, uncertainties and other factors we identify in "Risk Factors" and elsewhere in this prospectus supplement and the accompanying prospectus and in our filings with the SEC.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. Important assumptions include our ability to originate new loans and investments, ability to obtain certain margins and levels of profitability and the availability of additional capital. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus supplement and the accompanying prospectus, respectively, should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in "Risk

Factors" and elsewhere in this prospectus supplement and the accompanying prospectus, respectively. You should not place undue reliance on these forward-looking statements, which apply

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only as of the date of this prospectus supplement or the accompanying prospectus, as applicable. These forward-looking statements do not meet the safe harbor for forward-looking statements pursuant to Section 27A of the Securities Act of 1933, as amended, or the "Securities Act."

You should rely only on the information contained in this prospectus supplement, including any pricing supplement included hereto, and the accompanying prospectus. We have not, and the agent(s) or dealer(s) has not, authorized any other person to provide you with information that is different from that contained in this prospectus supplement, including any pricing supplement included hereto, or the accompanying prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the agents are not, making an offer of these securities in any jurisdiction where the offer is not permitted. You should assume that the information appearing in this prospectus supplement, including any pricing supplement included hereto, and the accompanying prospectus is accurate only as of their respective dates and we assume no obligation to update any such information. Our business, financial condition and results of operations may have changed since those dates. Although we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we any make directly to you or through reports that we have filed with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

This prospectus supplement, including any pricing supplement included hereto, supersedes the accompanying prospectus to the extent it contains information that is different from or in addition to the information in that prospectus.

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PROSPECTUS SUMMARY

This section summarizes the legal and financial terms of the notes that are described in more detail in "Description of Notes" beginning on page S-13. Final terms of any particular notes will be determined at the time of sale and will be contained in the pricing supplement, which will be included with this prospectus supplement, relating to those notes. The terms in that pricing supplement may vary from and supersede the terms contained in this summary and in "Description of Notes." In addition, you should read the more detailed information appearing elsewhere in this prospectus supplement, the accompanying prospectus and in that pricing supplement.

The terms "we," "us," "our" and "Company" refer to Prospect Capital Corporation; "Prospect Capital Management," "Investm Adviser" and "PCM" refer to Prospect Capital Management L.P., formerly Prospect Capital Management LLC; and "Prospect Administration" and the "Administrator" refer to Prospect Administration LLC.

The Company

We are a financial services company that primarily lends to and invests in middle market privately-held companies. We are a closed-end investment company incorporated in Maryland. We have elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940 (the "1940 Act"). As a BDC, we have elected to be treated as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986 (the "Code"). We invest primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, recapitalizations and other purposes. We work with the management teams or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro-forma cash flows.

On May 15, 2007, we formed a wholly-owned subsidiary Prospect Capital Funding LLC ("PCF"), a Delaware limited liability company and a bankruptcy remote special purpose entity, which holds certain of our portfolio loan investments that are used as collateral for the revolving credit facility at PCF. Our wholly-owned subsidiary Prospect Small Business Lending, LLC ("PSBL") was formed on January 27, 2014 and purchases small business whole loans on a recurring basis from online small business loan originators, including OnDeck Capital, Inc. ("OnDeck") and Direct Capital Corporation ("Direct Capital"). On September 30, 2014, we formed a wholly-owned subsidiary Prospect Yield Corporation, LLC ("PYC") and effective October 23, 2014, PYC holds our investments in collateralized loan obligations ("CLOs"). Each of these subsidiaries have been consolidated since operations commenced.

Effective July 1, 2014, we began consolidating certain of our wholly-owned and substantially wholly-owned holding companies formed by us in order to facilitate our investment strategy. The following companies have been included in our consolidated financial statements since July 1, 2014: AMU Holdings Inc.; APH Property Holdings, LLC; Arctic Oilfield Equipment USA, Inc.; CCPI Holdings Inc.; CP Holdings of Delaware LLC; Credit Central Holdings of Delaware, LLC; Energy Solutions Holdings Inc.; First Tower Holdings of Delaware LLC; Harbortouch Holdings of Delaware Inc.; MITY Holdings of Delaware Inc.; Nationwide Acceptance Holdings LLC; NMMB Holdings, Inc.; NPH Property Holdings, LLC; STI Holding, Inc.; UPH Property Holdings, LLC; Valley Electric Holdings I, Inc.; Valley Electric Holdings II, Inc.; and Wolf Energy Holdings Inc. On October 10, 2014, concurrent with the sale of the operating company, our ownership increased to 100% of the outstanding equity of ARRM Services, Inc. which was renamed SB Forging Company, Inc. ("SB Forging"). As such, we began consolidating SB Forging on October 11, 2014. We collectively refer to these entities as the "Consolidated Holding Companies."

We currently have nine origination strategies in which we make investments: (1) lending in private equity sponsored transactions, (2) lending directly to companies not owned by private equity firms, (3) control investments in corporate operating companies, (4) control investments in financial companies, (5) investments in structured credit, (6) real estate investments, (7) investments in syndicated debt, (8) aircraft leasing and (9) online lending. We continue to evaluate other origination strategies in the ordinary course of business with no specific tops-down allocation to any single origination strategy.

Lending in Private Equity Sponsored Transactions – We make loans to companies which are controlled by leading private equity firms. This debt can take the form of first lien, second lien, unitranche or unsecured loans. In making these investments, we look for a diversified customer base, recurring demand for the product or service, barriers to entry, strong historical cash flow and experienced management teams. These loans typically have significant equity subordinate to our loan position. Historically, this strategy has comprised approximately 50%-60% of our business,

but more recently it is less than 50% of our business.

Lending Directly to Companies – We provide debt financing to companies owned by non-private equity firms, the company founder, a management team or a family. Here, in addition to the strengths we look for in a sponsored transaction, we also look for the alignment with the management team with significant invested capital. This strategy often has less competition than the private equity sponsor strategy because such company financing needs are not easily addressed by banks and often

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require more diligence preparation. Direct lending can result in higher returns and lower leverage than sponsor transactions and may include warrants or equity to us. Historically, this strategy has comprised approximately 5%-15% of our business, but more recently it is less than 5% of our business.

Control Investments in Corporate Operating Companies – This strategy involves acquiring controlling stakes in non-financial operating companies. Our investments in these companies are generally structured as a combination of yield-producing debt and equity. We provide certainty of closure to our counterparties, give the seller personal liquidity and generally look for management to continue on in their current roles. This strategy has comprised approximately 10%-15% of our business.

Control Investments in Financial Companies – This strategy involves acquiring controlling stakes in financial companies, including consumer direct lending, sub-prime auto lending and other strategies. Our investments in these companies are generally structured as a combination of yield-producing debt and equity. These investments are often structured in a tax-efficient RIC-compliant partnership, enhancing returns. This strategy has comprised approximately 5%-15% of our business.

Investments in Structured Credit – We make investments in CLOs, generally taking a significant position in the subordinated interests (equity) of the CLOs. The CLOs include a diversified portfolio of broadly syndicated loans and do not have direct exposure to real estate, mortgages, sub-prime debt, or consumer based debt. The CLOs in which we invest are managed by top-tier collateral managers that have been thoroughly diligenced prior to investment. This strategy has comprised approximately 10%-20% of our business.

Real Estate Investments – We make investments in real estate through our three wholly-owned tax-efficient real estate investment trusts (“REITs”), American Property REIT Corp. (“APRC”), National Property REIT Corp. (“NPRC”) and United Property REIT Corp. (“UPRC” and, collectively with APRC and NPRC, “our REITs”). Our real estate investments are in various classes of fully developed and occupied real estate properties that generate current yields. We seek to identify properties that have historically high occupancy and steady cash flow generation. Our REITs partner with established property managers with experience in managing the property type to manage such properties after acquisition. This is a more recent investment strategy that has comprised approximately 5%-10% of our business.

Investments in Syndicated Debt – On an opportunistic basis, we make investments in loans and high yield bonds that have been sold to a syndicate of buyers. Here we look for investments with attractive risk-adjusted returns after we have completed a fundamental credit analysis. These investments are purchased with a long term, buy-and-hold outlook and we look to provide significant structuring input by providing anchoring orders. This strategy has comprised approximately 5%-10% of our business.

Aircraft Leasing – We invest debt as well as equity in aircraft assets subject to commercial leases to credit-worthy airlines across the globe. These investments present attractive return opportunities due to cash flow consistency from long-lived assets coupled with hard asset collateral. We seek to deliver risk-adjusted returns with strong downside protection by analyzing relative value characteristics across the spectrum of aircraft types of all vintages. Our target portfolio includes both in-production and out-of-production jet and turboprop aircraft and engines, operated by airlines across the globe. This strategy comprised approximately 1.5% of our business in the fiscal year ended June 30, 2014 and approximately 1% as of March 31, 2015.

Online Lending – We make investments in loans originated by certain consumer loan and small and medium sized business (“SME”) originators. We purchase each loan in its entirety (i.e., a “whole loan”). The borrowers are consumers and SMEs. The loans are typically serviced by the originators of the loans. This strategy comprised approximately 1% of our business in the fiscal year ended June 30, 2014 and less than 3% as of March 31, 2015.

Typically, we concentrate on making investments in companies with annual revenues of less than $750 million and enterprise values of less than $1 billion. Our typical investment involves a secured loan of less than $250 million. We also acquire controlling interests in companies in conjunction with making secured debt investments in such companies. In most cases, companies in which we invest are privately held at the time we invest in them. We refer to these companies as “target” or “middle market” companies and these investments as “middle market investments.”

We seek to maximize total returns to our investors, including both current yield and equity upside, by applying rigorous credit analysis and asset-based and cash-flow based lending techniques to make and monitor our investments. We are constantly pursuing multiple investment opportunities, including purchases of portfolios from private and

public companies, as well as originations and secondary purchases of particular securities. We also regularly evaluate control investment opportunities in a range of industries, and some of these investments could be material to us. There can be no assurance that we will successfully consummate any investment opportunity we are currently pursuing. If any of these opportunities are consummated, there can be

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no assurance that investors will share our view of valuation or that any assets acquired will not be subject to future write downs, each of which could have an adverse effect on our stock price.

As of March 31, 2015, we had investments in 132 portfolio companies. The aggregate fair value as of March 31, 2015 of investments in these portfolio companies held on that date is approximately $6.6 billion. Our portfolio across all our performing interest-bearing investments had an annualized current yield of 12.4% as of March 31, 2015.

Recent Developments

Investment Transactions

On April 2, 2015, we sold our $74.7 million investment in American Broadband Holding Company. There was no gain or loss realized on the sale.

On April 8, 2015, we sold 60% of the outstanding principal balance of the senior secured Term Loan A investment in Trinity Services Group, Inc. for $59.3 million. There was no gain or loss realized on the sale.

On April 10, 2015, Sandow Media, LLC repaid the $24.4 million loan receivable to us.

On April 15, 2015, we provided $48.5 million of first lien senior secured financing, of which $43.5 million was funded at closing, to USG Intermediate, LLC, an entrepreneur-owned direct marketing company.

On April 16, 2015, Ikaria, Inc. repaid the $20.0 million loan receivable to us.

On April 16, 2015, we made a $10.0 million second lien secured debt investment in SESAC Holdco II LLC, a performance rights organization based in Nashville, Tennessee.

During the period from April 1, 2015 through May 8, 2015, we made three follow-on investments in NPRC totaling $30.0 million to support the online consumer lending initiative. We invested $8.0 million of equity through NPH and $22.0 million of debt directly to ACL Loan Holdings, Inc., a wholly-owned subsidiary of NPRC.

During the period from April 1, 2015 through May 8, 2015, our wholly-owned subsidiary PSBL purchased $14.5 million of small business whole loans from OnDeck.

During the period from April 1, 2015 through May 8, 2015, we sold portions of two of our investments in syndicated debt totaling $20.5 million.

Debt Issuances, Redemptions and Repurchases

On April 10, 2015, we provided notice of our intent to redeem on May 15, 2015 $100.0 million aggregate principal amount of our 6.95% unsecured notes that mature on November 15, 2022. We expect to recognize approximately $2.6 million of realized loss as a result of the call.

On April 11, 2015, we announced the then current conversion rate on the convertible notes that mature on April 15, 2020 (the “2020 Notes”) as 80.6670 shares of common stock per $1,000 principal amount of the 2020 Notes converted, which is equivalent to a conversion price of approximately $12.40.

On April 16, 2015, we announced the then current conversion rate on the convertible notes that mature on October 15, 2017 (the “2017 Notes”) as 87.7516 shares of common stock per $1,000 principal amount of the 2017 Notes converted, which is equivalent to a conversion price of approximately $11.40.

During the period from April 1, 2015 through May 8, 2015, we issued $30.1 million aggregate principal amount of our Prospect Capital InterNotes® for net proceeds of $29.6 million.

Common Stock Issuance

On April 23, 2015, we issued 131,971 shares of our common stock in connection with the dividend reinvestment plan.

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Dividends

On May 6, 2015, we announced the declaration of monthly dividends in the following amounts and with the following dates:

- $0.08333 per share for May 2015 to holders of record on May 29, 2015 with a payment date of June 18, 2015;
- $0.08333 per share for June 2015 to holders of record on June 30, 2015 with a payment date of July 23, 2015;
- $0.08333 per share for July 2015 to holders of record on July 31, 2015 with a payment date of August 20, 2015; and
- $0.08333 per share for August 2015 to holders of record on August 31, 2015 with a payment date of September 17, 2015.

Dispositions of Certain Business Strategies

We previously announced that we intend to unlock value by “spinning off” certain “pure play” business strategies to our shareholders. We desire through these transactions to (i) transform some of the business strategies we have successfully grown and developed into pure play public companies with the potential for increased earnings multiple trading valuations, (ii) allow for continued revenue and earnings growth through more flexible non-business development company formats (which are expected to benefit from not having one or more of the (a) 30% basket, (b) leverage, and (c) control basket constraints with which regulated investment company BDCs must comply), and (iii) free up our 30% basket and leverage capacity for our new originations. The business strategies we intend to enable our shareholders to participate in on a “pure play” basis have grown faster than our overall growth rate in the past few years, with outlets in less constraining structures required to continue this strong growth. We anticipate these non-BDC companies will have tax efficient structures. We initially intend on focusing these efforts on three separate companies consisting of portions of our (i) CLO structured credit business, (ii) online consumer lending business, and (iii) real estate business.

We will likely seek to divest these businesses in conjunction with capital raises for each such business, with the goal of leverage and earnings neutrality for us. The sizes of these dispositions, some of which are expected to be partial rather than complete spin-offs, remain to be determined. The consummation of any of the spin-offs depends upon, among other things, market conditions, regulatory and exchange listing approvals, and sufficient investor interest, and there can be no guarantee that we will consummate any of these spin-offs.

On March 11, 2015, Prospect Yield Corporation, LLC, our wholly-owned subsidiary, filed a registration statement with the SEC in connection with our rights offering disposition of a portion of our CLO structured credit business, and it filed the first amendment to the registration statement on April 17, 2015. We are a selling stockholder under the registraont-variant: normal;">

Preferred stock, $0.01 par value; 20,000 shares authorized; none issued and

outstanding

—

—

Common stock, $0.001 par value; 120,000 shares authorized; 8,171 shares
and 8,068 shares issued and outstanding at June 30, 2018 and
December 31, 2017, respectively

8

8

Additional paid-in capital

232,228

232,026

Accumulated deficit

(223,795

)

(224,688

)

Total stockholders’ equity

8,441

7,346

Total liabilities and stockholders’ equity

$

21,897

$

23,139

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

MOSYS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net revenue				
Product	$4,051	$1,111	$7,755	$2,066
Royalty and other	547	273	1,051	530
Total net revenue	4,598	1,384	8,806	2,596
Cost of net revenue	1,833	732	3,434	1,334
Gross profit	2,765	652	5,372	1,262
Operating expenses				
Research and development	990	2,313	2,041	5,798
Selling, general and administrative	1,250	1,101	2,239	2,415
Restructuring charges	—	1,002	—	1,002
Total operating expenses	2,240	4,416	4,280	9,215
Income (loss) from operations	525	(3,764)	1,092	(7,953)
Interest expense	(206)	(223)	(427)	(447)
Other income (expense), net	(3)	—	—	13
Income (loss) before income taxes	316	(3,987)	665	(8,387)
Income tax provision	1	7	2	12
Net and comprehensive income (loss)	$315	$(3,994)	$663	$(8,399)
Net income (loss) per share				
Basic	$0.04	$(0.60)	$0.08	$(1.26)
Diluted	$0.04	$(0.60)	$0.08	$(1.26)
Shares used in computing net income (loss) per share				
Basic	8,171	6,677	8,151	6,662
Diluted	8,409	6,677	8,378	6,662

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

MOSYS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$663	$(8,399)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	340	389
Stock-based compensation	252	356
Amortization of intangible assets	55	56
Amortization of debt issuance costs	24	22
Accrued interest	403	430
(Gain) loss on disposal of assets	—	—
Changes in assets and liabilities		
Accounts receivable	207	37
Inventories	(528)	403
Prepaid expenses and other assets	920	(653)
Accounts payable	58	(407)
Deferred revenue and other liabilities	(2,592)	763
Net cash used in operating activities	(198)	(7,003)
Cash flows from investing activities:		
Purchases of property and equipment	(25)	—
Proceeds from sales and maturities of marketable securities	—	2,604
Purchases of marketable securities	—	(1,602)
Net cash provided by (used in) investing activities	(25)	1,002
Cash flows from financing activities:		
Issuance costs for sale of common stock	(12)	(22)
Taxes paid to net share settle equity awards	(38)	—
Net cash used in financing activities	(50)	(22)
Net decrease in cash and cash equivalents	(273)	(6,023)
Cash and cash equivalents at beginning of period	3,868	8,766
Cash and cash equivalents at end of period	$3,595	$2,743
Supplemental disclosure:		
Issuance of convertible notes in settlement of accrued interest	$463	$420

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

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MOSYS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. The Company and Summary of Significant Accounting Policies

MoSys, Inc. (the "Company") was incorporated in California in September 1991 and reincorporated in September 2000 in Delaware. The Company's strategy and primary business objective is to be an IP-rich fabless semiconductor company focused on the development and sale of integrated circuit (IC) products. Its Bandwidth Engine ICs combine the Company's proprietary high-density embedded memory with its high-speed 10 gigabits per second and higher interface technology. The Company's future success and ability to achieve and maintain profitability depends on its success in developing a market for its ICs.

The accompanying condensed consolidated financial statements of the Company have been prepared on a basis that assumes that the Company will continue as a going concern and contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business and have been prepared without audit in accordance with the rules and regulations of the Securities and Exchange Commission (SEC).

The condensed consolidated balance sheet as of December 31, 2017 has been derived from the audited consolidated financial statements at that date. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted in accordance with these rules and regulations. The information in this report should be read in conjunction with the Company's consolidated financial statements and notes thereto included in its most recent annual report on Form 10-K filed with the SEC.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly the Company's financial position, results of operations and cash flows for the interim periods presented. The operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or for any other future period.

Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The Company's fiscal year ends on December 31 of each calendar year.

Use of Estimates

The preparation of financial statements in accordance with 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 revenues and expenses recognized during the reported period. Actual results could differ from those estimates.

Cash Equivalents and Investments

The Company invests its excess cash in money market accounts, certificates of deposit, commercial paper, corporate debt, government-sponsored enterprise bonds and municipal bonds and considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Investments with original maturities greater than three months and remaining maturities less than one year are classified as short-term investments. Investments with remaining maturities greater than one year are classified as long-term investments. Management generally determines the appropriate classification of securities at the time of purchase. All securities are classified as available-for-sale. The Company’s available-for-sale short-term investments are carried at fair value, with the unrealized holding gains and losses reported in accumulated other comprehensive loss. Realized gains and losses and declines in the value judged to be other than temporary are included in the other income, net line item in the condensed consolidated statements of operations and comprehensive loss. The cost of securities sold is based on the specific identification method.

Fair Value Measurements

The Company measures the fair value of financial instruments using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

Level 1— Inputs used to measure fair value are unadjusted quoted prices that are available in active markets for the identical assets or liabilities as of the reporting date.

Level 2— Pricing is provided by third party sources of market information obtained through the Company's investment advisors, rather than models. The Company does not adjust for, or apply, any additional assumptions or estimates to the pricing information it receives from advisors. The Company's Level 2 securities may include cash equivalents and available-for-sale securities, which consist primarily of certificates of deposit, corporate debt, and government agency and municipal debt securities from issuers with high-quality credit ratings. The Company's investment advisors obtain pricing data from independent sources, such as Standard & Poor's, Bloomberg and Interactive Data Corporation, and rely on comparable pricing of other securities because the Level 2 securities are not actively traded and have fewer observable transactions. The Company considers this the most reliable information available for the valuation of the securities.

Level 3— Unobservable inputs that are supported by little or no market activity and reflect the use of significant management judgment are used to measure fair value. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions. The determination of fair value for Level 3 investments and other financial instruments involves the most management judgment and subjectivity.

Allowance for Doubtful Accounts

The Company establishes an allowance for doubtful accounts to ensure that its trade receivables balances are not overstated due to uncollectibility. The Company performs ongoing customer credit evaluations within the context of the industry in which it operates and generally does not require collateral from its customers. A specific allowance of up to 100% of the invoice value is provided for any problematic customer balances. Delinquent account balances are written off after management has determined that the likelihood of collection is remote. The Company grants credit only to customers deemed creditworthy in the judgment of management. There was no allowance for doubtful accounts receivable at either June 30, 2018 or December 31, 2017.

Inventories

The Company values its inventories at the lower of cost, which approximates actual cost on a first-in, first-out basis, or net realizable value. The Company records inventory reserves for estimated obsolescence or unmarketable inventories based upon assumptions about future demand and market conditions. Once a reserve is established, it is maintained until the product to which it relates is sold or otherwise disposed of. If actual market conditions are less favorable than those expected by management, additional adjustment to inventory valuation may be required. Charges for obsolete and slow-moving inventories are recorded based upon an analysis of specific identification of obsolete inventory items and quantification of slow moving inventory items. The Company recorded no inventory write-downs during the three or six months ended June 30, 2018 or 2017.

Critical Accounting Policy – Revenue Recognition

The Company generates revenue primarily from sales of IC products and licensing of its IP. Revenues are recognized when control is transferred to customers in amounts that reflect the consideration the Company expects to be entitled to receive in exchange for those goods. Revenue recognition is evaluated through the following five steps: (i) identification of the contract, or contracts, with a customer; (ii) identification of the performance obligations in the contract; (iii) determination of the transaction price; (iv) allocation of the transaction price to the performance obligations in the contract; and (v) recognition of revenue when or as a performance obligation is satisfied.

IC products

Revenue is recognized when performance obligations under the terms of a contract with a customer are satisfied.

The majority of the Company's contracts have a single performance obligation to transfer products. Accordingly, the Company recognizes revenue when title and risk of loss have been transferred to the customer, generally at the time of shipment of products. Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring products and is generally based upon a negotiated, formula, list or fixed price. The Company sells its products both directly to customers and through distributors generally under agreements with payment terms typically less than 60 days.

The Company may record an estimated allowance, at the time of shipment, for future returns and other charges against revenue consistent with the terms of sale.

Royalty and other

The Company’s licensing contracts typically provide for royalties based on the licensee’s use of the Company’s memory technology in its currently shipping commercial products. With the adoption of ASC 606 in January 2018, the Company estimates its royalty revenue in the calendar quarter in which the licensee uses the licensed technology. Payments are generally received in the subsequent quarter.

Contract liabilities – deferred revenue

The Company’s contract liabilities consist of advance customer payments and deferred revenue. The Company classifies advance customer payments and deferred revenue as current or non-current based on the timing of when the Company expects to recognize revenue. For the six months ended June 30, 2018, contract liabilities were in a current position and included in deferred revenue.

During the six months ended June 30, 2018, the Company recognized revenue of $2.6 million that had been included in deferred revenue at December 31, 2017.

See Note 5 for disaggregation of revenue by geography.

Cost of Net Revenue

Cost of net revenue consists primarily of direct and indirect costs of IC product sales and engineering personnel costs directly related to maintenance and support services specified in licensing agreements. Maintenance and support typically include engineering support to assist in the commencement of production of a licensee’s products.

Goodwill

In January 2017, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2017-04, Simplifying the Test for Goodwill Impairment (ASU No. 2017-04), which eliminated step 2, the computation of the implied fair value of goodwill to determine the amount of impairment, from the goodwill impairment test. Under ASU No. 2017-04, the Company determines the amount of goodwill impairment by comparing the fair value of the reporting unit with its carrying amount. To the extent the carrying value of a reporting unit exceeds its fair value, a goodwill impairment charge is recognized. The Company early-adopted ASU No. 2017-04 effective January 1, 2017, because the ASU significantly simplifies the evaluation of goodwill for impairment.

The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. As the Company uses the market approach to determine the step one fair value, the price of its common stock is an important component of the fair value calculation. If the Company’s stock price continues to experience significant price and volume fluctuations, this will impact the fair value of the reporting unit, which can lead to potential impairment in future periods. The Company reviews goodwill for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. The Company first assesses qualitative factors to determine whether it is more-likely-than-not that the fair value of the reporting unit is less than the carrying amount. If the qualitative assessment warrants further analysis, the Company compares the fair value of the reporting unit to its carrying value. The fair value of the reporting unit is determined using the market approach. If the fair value of

the reporting unit exceeds the carrying value of net assets of the reporting unit, goodwill is not impaired. If the carrying value of the reporting unit's goodwill exceeds its fair value, then the Company must record an impairment charge equal to the difference. The Company performed its annual test for goodwill impairment as of September 1, 2017, and performed a subsequent test on June 30, 2018. In both tests, the Company's fair value exceeded its carrying value of net assets and, as such, there was no additional impairment of goodwill.

Per Share Amounts

Basic net income (loss) per share is computed by dividing net income (loss) for the period by the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share gives effect to all potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of incremental shares of common stock issuable upon the exercise of stock options, vesting of stock awards and shares issuable in conjunction with the Company's outstanding senior secured convertible notes.

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Numerator:				
Net income (loss)	$315	$(3,994)	$663	$(8,399)
Denominator:				
Add: weighted-average common shares outstanding	8,171	6,677	8,151	6,662
Total shares: basic	8,171	6,677	8,151	6,662
Add: weighted-average stock options outstanding	81	—	72	—
Add: weighted-average unvested restricted stock units	157	—	155	—
Total shares: diluted	8,409	6,677	8,378	6,662
Net income (loss) per share:				
Basic	$0.04	$(0.60)	$0.08	$(1.26)
Diluted	$0.04	$(0.60)	$0.08	$(1.26)

The following table sets forth securities outstanding which were excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Options outstanding to purchase common stock	144	336	144	659
Employee stock purchase plan	—	—	—	35
Unvested restricted common stock units	—	52	—	11

Convertible debt	2,271	973	2,271	889
Total	2,415	1,361	2,415	1,594

Debt Issuance Costs

Debt issuance costs are capitalized and amortized to interest expense using the effective interest method. Unamortized debt issuance costs are presented in the condensed consolidated balance sheets as a direct deduction from the carrying amount of the related debt liability and accounted for as debt discounts.

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Note 2: Fair Value of Financial Instruments

The estimated fair values of financial instruments outstanding were (in thousands):

	June 30, 2018			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$3,595	$ —	$ —	$3,595

	December 31, 2017			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$3,868	$ —	$ —	$3,868

The following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and investments) (in thousands):

	June 30, 2018			
	Fair Value	Level 1	Level 2	Level 3
Money market funds	$625	$ 625	$ —	$ —

	December 31, 2017			
	Fair Value	Level 1	Level 2	Level 3
Money market funds	$621	$621	$ —	$ —

There were no transfers in or out of Level 1 and Level 2 securities during the three or six months ended June 30, 2018 or 2017.

Note 3. Balance Sheet Detail

	June 30, 2018	December 31, 2017
	(in thousands)	
Inventories:		

Work-in-process	$1,941	$ 1,612
Finished goods	353	154
	$2,294	$ 1,766

Identifiable intangible assets were (dollar amounts in thousands):

	June 30, 2018			
	Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patent license	7	$ 780	$ 724	$ 56

	December 31, 2017			
	Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patent license	7	$ 780	$ 669	$ 111

Amortization expense has been included in research and development expense in the condensed consolidated statements of operations. The remaining estimated aggregate amortization expense is less than $0.1 million and will be recognized in 2018.

Note 4. Commitments and Contingencies

Indemnification

In the ordinary course of business, the Company enters into contractual arrangements under which it may agree to indemnify the counterparties from any losses incurred relating to breach of representations and warranties, failure to perform certain covenants, or claims and losses arising from certain events as outlined within the particular contract, which may include, for example, losses arising from litigation or claims relating to past performance. Such indemnification clauses may not be subject to maximum loss clauses. The Company has also entered into indemnification agreements with its officers and directors. No material amounts were reflected in the Company's condensed consolidated financial statements for the three or six months ended June 30, 2018 or 2017 related to these indemnifications.

The Company has not estimated the maximum potential amount of indemnification liability under these agreements due to the limited history of prior claims and the unique facts and circumstances applicable to each particular agreement. To date, the Company has not made any material payments related to these indemnification agreements.

Legal Matters

In October 2017, Trinity Technologies, Inc. (Trinity), the Company's former sales representative in the San Francisco Bay Area, filed a lawsuit against the Company in the Superior Court of California alleging non-payment of commissions. In April 2018, the Company and Trinity executed a settlement agreement, and Trinity dismissed the lawsuit. Under the terms of the settlement agreement, the Company agreed to pay Trinity for commissions related to both 2017 and 2018. Commissions for the period prior to April 1, 2018 were accrued as of March 31, 2018. Pursuant to the settlement agreement, the Company recorded commission expenses of approximately $250,000 and paid approximately $450,000 in the quarter ended June 30, 2018.

Note 5. Business Segments, Concentration of Credit Risk and Significant Customers

The Company operates in one business segment and uses one measurement of profitability for its business. Net revenue is attributed to the United States and to all foreign countries based on the geographical location of the customer.

The Company recognized revenue from shipment of product and licensing of its technologies to customers by geographical location as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
North America	$3,384	$961	$6,741	$1,783

Japan	1,128	200	1,842	371
Taiwan	73	171	156	340
Rest of world	13	52	67	102
Total net revenue	$4,598	$1,384	$8,806	$2,596

Customers who accounted for at least 10% of total net revenue were:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Customer A	31%	37%	39%	46%
Customer B	24%	14%	12%	14%
Customer C	21%	*%	22%	*%
Customer D	*%	10%	*%	*%
Customer E	*%	10%	*%	12%

* Represents less than 10%

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Two customers accounted for 76% of accounts receivable, net at June 30, 2018. One customer accounted for 63% of accounts receivable, net at December 31, 2017.

Note 6. Income Tax Provision

The Company determines deferred tax assets and liabilities based upon the differences between the financial statement and tax bases of the Company's assets and liabilities using tax rates in effect for the year in which the Company expects the differences to affect taxable income. A valuation allowance is established for any deferred tax assets for which it is more likely than not that all or a portion of the deferred tax assets will not be realized.

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. All tax returns from 2013 to 2017 may be subject to examination by the Internal Revenue Service, California and other states. Returns filed in foreign jurisdictions may be subject to examination for the years 2009 to 2017. As of June 30, 2018, the Company has not recorded any liability for unrecognized tax benefits related to uncertain tax positions.

Note 7. Stock-Based Compensation

The expense relating to stock options is recognized on a straight-line basis over the requisite service period, usually the vesting period, based on the grant-date fair value. The unamortized compensation cost, net of expected forfeitures, as of June 30, 2018 was $0.8 million related to stock options and is expected to be recognized as expense over a weighted-average period of approximately 2.0 years. The expense related to restricted stock units (RSUs) is recognized over a three-to-five year vesting period and is based on the fair value of the underlying stock on the dates of grant. The unamortized compensation cost, net of expected forfeitures, as of June 30, 2018 was $0.3 million related to RSUs and is expected to be recognized as expense over a weighted-average period of approximately 0.6 years.

For the three and six months ended June 30, 2018 and 2017, there were no excess tax benefits associated with the exercise of stock options due to the Company's historical loss positions.

Valuation Assumptions

No stock options were granted during the three months ended June 30, 2018 or 2017. The fair value of the Company's stock options granted for the six months ended June 31, 2018 and 2017 was estimated on the grant dates using the Black-Scholes valuation option-pricing model with the following assumptions:

	Six Months Ended June 30,	
	2018	2017
Risk-free interest rate	2.2 %	1.6 %
Volatility	109.5 %	70.2 %
Expected life (years)	4.0	4.0
Dividend yield	— %	— %

The risk-free interest rate was derived from the Daily Treasury Yield Curve Rates, as published by the U.S. Department of the Treasury as of the grant date for terms equal to the expected terms of the options. The expected volatility was based on the historical volatility of the Company's stock price over the expected term of the options. The expected term of options granted was derived from historical data based on employee exercises and post vesting employment termination behavior. A dividend yield of zero is applied because the Company has never paid dividends, and has no intention to pay dividends in the near future.

The stock based compensation expense recorded is adjusted based on estimated forfeiture rates. An annualized forfeiture rate has been used as a best estimate of future forfeitures based on the Company's historical forfeiture experience. Stock based compensation expense will be adjusted in later periods if the actual forfeiture rate is different from the estimate.

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Common Stock Options and Restricted Stock

A summary of option and RSU activity under the Company's Amended and Restated 2010 Equity Incentive Plan (the Plan) is presented below (in thousands, except exercise price):

	Shares Available for Grant	Awards outstanding Number of Shares	Weighted Average Exercise Prices
Balance at January 1, 2018	231	307	$ 4.81
Additional shares authorized under the Plan	50	—	—
RSUs granted	(60)	—	—
RSUs cancelled and returned to the Plan	1	—	—
Options granted	(40)	40	$ 1.28
Options cancelled and returned to the Plan	2	(2)	$ 23.47
Balance at March 31, 2018	184	345	$ 4.30
Options cancelled and returned to the Plan	1	(1)	$ 9.40
Balance at June 30, 2018	185	344	$ 4.27

A summary of RSU activity under the Plan is presented below (in thousands, except for fair value):

	Number of Shares	Weighted Average Grant-Date Fair Value
Non-vested shares at January 1, 2018	376	$ 1.58
Granted	60	$ 1.16
Vested	(133)	$ 2.11
Cancelled	(1)	$ 0.94
Non-vested shares at June 30, 2018	302	$ 1.27

In the six months ended June 30, 2018, the Company paid approximately $38,000 for employee income taxes related to net-share settlement of vested RSUs.

The total intrinsic value of the RSUs outstanding as of June 30, 2018 was $0.5 million.

The following table summarizes significant ranges of outstanding and exercisable options as of June 30, 2018 (in thousands, except contractual life and exercise price):

	Options Outstanding			Options Exercisable		
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Aggregate Intrinsic value
$0.75 - $1.27	160	5.30	$ 0.75	—	$ —	$ 160
$1.28 - $7.19	51	6.07	$ 2.10	7	$ 5.17	$ 19
$7.20 - $20.49	112	8.01	$ 7.20	70	$ 7.20	$ —
$20.50 - $43.59	19	6.55	$ 20.50	16	$ 20.50	$ —
$44.60 - $46.19	1	4.93	$ 44.60	1	$ 44.60	$ —
$46.20 - $46.20	1	5.64	$ 46.20	1	$ 46.20	$ —
$0.75 - $46.20	344	6.37	$ 4.27	95	$ 9.68	$ 179
Vested and expected to vest	322	6.42	$ 4.45			162
Exercisable	94	7.68	$ 9.68			—

There were no stock options exercised during the six months ended June 30, 2018 or 2017. As of June 30, 2018, the intrinsic value of outstanding stock options was approximately $0.2 million.

Note 8. Convertible Notes

On March 14, 2016, the Company entered into a 10% Senior Secured Convertible Note Purchase Agreement (the “Purchase Agreement”) with the purchasers of $8,000,000 principal amount of 10% Senior Secured Convertible Notes due August 15, 2018 (the “Notes”), at par, in a private placement transaction effected pursuant to an exemption from the registration requirements under the Securities Act of 1933, as amended. Pursuant to an amendment to the Notes and related documents effective February 18, 2018, the interest rate was reduced to 8%, the maturity date of the Notes was extended to August 15, 2019, and the optional conversion price was reduced from $8.50 of Note principal per share of common stock to $4.25 of Note principal per share of common stock. The conversion price is subject to adjustment upon certain events, such as stock splits, reverse stock splits, stock dividends and similar kinds of transactions, as set forth in the Purchase Agreement. Pursuant to a security agreement entered into by the Company, the Notes are secured by a security interest in all of the assets of the Company.

The Notes originally had an interest rate of 10%, but from February 15, 2018, the annual rate of interest is 8%. Accrued interest is payable semi-annually in cash or in kind through the issuance of identical new Notes, or with a combination of the two, at the Company’s option. The Notes are noncallable and nonredeemable by the Company. The Notes are redeemable at the election of the holders if the Company experiences a fundamental change (as defined in the Notes), which generally would occur in the event (i) any person acquires beneficial ownership of shares of common stock of the Company entitling such person to exercise at least 40% of the total voting power of all of the shares of capital stock of the Company entitled to vote generally in elections of directors, (ii) an acquisition of the Company by another person through a merger or consolidation, or the sale, transfer or lease of all or substantially all of the Company’s assets, or (iii) the Company’s current directors cease to constitute a majority of the board of directors of the Company within a 12-month period, disregarding for this purpose any director who voluntarily resigns as a

director or dies while serving as a director. Pursuant to the amendment to the Notes, the redemption price was reduced from 120% to 100% of the principal amount of the Note to be repurchased plus accrued and unpaid interest as of the redemption date.

No holder of a Note is entitled to convert such Note if effective upon the applicable conversion date (i) the holder would have beneficial ownership of more than 9.9% of the voting capital stock of the Company as determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934, as amended, (with exceptions specified in the Purchase Agreement), or (ii) if the shares are being acquired or held with a purpose or effect of changing or influencing control of the Company, or in connection with or as a participant in any transaction having that purpose or effect, as determined in the sole discretion of the board of directors of the Company. There is no required sinking fund for the Notes. The Notes have not been registered for resale, and the holder(s) do not have registration rights.

The Notes restrict the ability of the Company to incur any indebtedness for borrowed money, unless such indebtedness by its terms is expressly subordinated to the Notes in right of payment and to the security interest of the Note holder(s) in respect to the priority and enforcement of any security interest in property of the Company securing such new debt; provided that the Note holder(s) security interest and cash payment rights under the Notes shall be subordinate to a maximum of $5,000,000 of indebtedness for a secured accounts receivable line of credit facility provided to the Company by a bank or institutional lender; and, provided further, that in no event may the amount of indebtedness to which the security interest of the Note holder(s) is subordinated exceed the outstanding balance of accounts receivable less than 90 days old for which the Company has not recorded an allowance for doubtful accounts pledged under such credit facility.

The Notes define an event of default generally as any failure by the Company to pay an amount owed under the Notes when due (subject to cure periods), a default with respect to other indebtedness of the Company resulting in acceleration of such indebtedness, the commencement of bankruptcy or insolvency proceedings, or the cessation of business. If an event of default occurs under the Notes, the holder(s) of a majority-in-interest of the outstanding principal amount of the Notes may declare the outstanding principal amount thereof to be immediately due and payable and pursue all available remedies, including taking possession of the assets of the Company and selling them to pay the amount of debt then due, plus expenses, in accordance with applicable laws and procedures.

The Company incurred debt issuance costs of approximately $0.1 million, which were recorded as a debt discount and are being amortized to interest expense over the repayment period for the original loan using the effective interest rate method. The interest expense related to the debt discount during the three and six months ended June 30, 2018 was approximately $12,000 and $24,000, respectively, and during the three and six months ended June 30, 2017 was approximately $11,000 and $22,000, respectively.

Semi-annual interest payments have been made in each of August 2016, February 2017, August 2017 and February 2018, for approximately $336,000, $420,000, $434,000 and $463,000, respectively, in-kind with the issue of additional notes (Interest Notes) to the Purchasers. The Interest Notes have terms identical to the Notes. As of June 30, 2018, the Notes and Interest Notes could be converted into a maximum of 2,271,338 shares of common stock at $4.25 per share, excluding the effects of future payments of interest in-kind and a beneficial ownership ceiling of 9.9%.

The outstanding convertible notes payable of $9.7 million (excluding unamortized discount of approximately $6,000 as of June 30, 2018) are due in August 2019.

Note 9. Restructuring Charges

In the second quarter of 2017, the Company effected a reduction in its workforce and associated operating expenses, net loss and cash burn. The Company reduced headcount by approximately 60% with the majority of the reductions occurring at its U.S. headquarters facility. As a result of the restructuring, the Company recorded approximately $1.0 million of charges for severance benefits and future obligations under computer-aided design software licenses. In the third quarter of 2017, the Company closed its Japanese branch and Iowa locations and further reduced headcount resulting in additional expenses of approximately $50,000. In the fourth quarter of 2017, the Company terminated its existing headquarters facility lease and incurred lease termination expenses of approximately $270,000.

Expenses related to the restructure are included in the restructuring charges line in the condensed consolidated statements of operations and the remaining liability is included in accrued expenses and other on the condensed consolidated balance sheets consisting of (in thousands):

	Facility	Contractual	Total

	related	obligations and other termination costs	
Balance as of January 1, 2018	$ 89	$ 389	$ 478
Cash payments	(89)	(131)	(220)
Balance as of March 31, 2018	$ —	$ 258	$ 258
Cash payments	—	(86)	(86)
Balance as of June 30, 2018	$ —	$ 172	$ 172

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying condensed consolidated financial statements and notes included in this report. This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which include, without limitation, statements about the market for our technology, our strategy, competition, expected financial performance and capital raising efforts, all information disclosed under Item 3 of this Part I, and other aspects of our business identified in our most recent annual report on Form 10-K filed with the Securities and Exchange Commission on March 12, 2018 and in other reports that we file from time to time with the Securities and Exchange Commission. Any statements about our business, financial results, financial condition and operations contained in this Form 10-Q that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "expects," "intends," "plans," "projects," or similar expressions are intended to identify forward-looking statements. Our actual results could differ materially from those expressed or implied by these forward-looking statements as a result of various factors, including the risk factors described under Item 1A of our annual report on Form 10-K for the year ended December 31, 2017. We undertake no obligation to update publicly any forward-looking statements for any reason, except as required by law, even as new information becomes available or events occur in the future.

Company Overview

Our strategy and primary business objective is to be a profitable fabless semiconductor company focused on the development and sale of integrated circuits, or ICs, for the high-speed cloud networking, communications, security appliance, video, test and monitoring and data center markets. Our solutions deliver time-to-market, performance, power, area and economic benefits for system original equipment manufacturers, or OEMs. Our principal product line and source of substantially all of our revenue is the Bandwidth Engine® product family. Bandwidth Engine ICs combine our proprietary 1T-SRAM® high-density embedded memory, integrated macro functions and high-speed serial interface, or SerDes I/O, with our intelligent access technology and a highly efficient interface protocol. Historically, our primary business was the design, development, marketing, sale and support of differentiated intellectual property, or IP, including embedded memory and high-speed parallel and SerDes I/O used in advanced systems-on-chips, or SoCs. In April 2017, we implemented restructuring initiatives to effect a reduction in our workforce and associated operating expenses, net loss and cash burn. Under these initiatives, we significantly reduced our headcount, closed our international sales offices and relocated and downsized our corporate headquarters. We are now focusing our resources primarily on producing and selling our existing products, and have substantially curtailed new product development. Our second-generation Bandwidth Engine, or Bandwidth Engine 2, products are expected to be our primary revenue source through at least 2019, and to continue to generate significant revenue thereafter. We expect our third generation Bandwidth Engine products, Bandwidth Engine 3, to commence production in late 2018, and begin generating meaningful revenue in late 2019. Despite our limited new product development efforts, we believe our current product portfolio positions us to pursue future growth and maintain profitability. However, we were recently informed by a large customer that it will be phasing out our Bandwidth Engine IC products over the next 24 months. The customer informed us that its decision was not attributable to any dissatisfaction with the our products or performance. We expect to fulfill the customer's remaining commitments and complete shipments of our Bandwidth Engine IC products to this customer in the first half of 2019. The loss of future business with this customer is expected to result in a material reduction in our revenue outlook beginning in the fourth quarter of 2018. We continue to seek opportunities to sell existing products, license our technology and obtain third-party funding for new product development efforts. Our future success and ability to achieve and maintain profitability are dependent on the marketing and sales of our IC products into cloud networking, communications, security appliances, monitoring and test, data center, video, and other markets requiring high-bandwidth memory access.

Accounting Change

On January 1, 2018, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 606, Revenue from Contracts with Customers (ASC 606) using the modified retrospective (cumulative effect) transition method Under this transition method, results for reporting periods beginning January 1, 2018 or later are presented under ASC 606, while prior period results continue to be reported in accordance with previous guidance. The cumulative effect of the initial application of ASC 606 was recognized as an adjustment to accumulated deficit of $0.2 million as of January 1, 2018. Overall, the adoption of ASC 606 did not have a material impact on the condensed consolidated balance sheet as of June 30, 2018, the statement of operations and comprehensive income for the three or six months ended June 30, 2018 and statement of cash flows for the six months ended June 30, 2018. ASC 606 also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from

customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. As described below, the analysis of contracts under ASC 606 supports the recognition of revenue at a point in time, resulting in revenue recognition timing that is materially consistent with our historical practice of recognizing product revenue when title and risk of loss pass to the customer.

Sources of Revenue

Product. Product revenue is generally recognized at the time of shipment to our customers. An estimated allowance may be recorded, at the time of shipment, for future returns and other charges against revenue consistent with the terms of sale.

Royalty and other. Our licensing contracts typically provide for royalties based on the licensee's use of our memory technology in their currently shipping commercial products. With the adoption of ASC 606 in January 2018, we estimate royalty revenue in the period in which the licensee uses the licensed technology. Payments are received in the following period.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis we make these estimates based on our historical experience and on assumptions that we consider reasonable under the circumstances. Actual results may differ from these estimates, and reported results could differ under different assumptions or conditions. Our significant accounting policies and estimates are disclosed in Note 1 of the "Notes to Consolidated Financial Statements" in our Annual Report on Form 10-K for the year ended December 31, 2017. As of June 30, 2018, there have been no material changes to our significant accounting policies and estimates, except that we adopted ASC 606, Revenue from Contracts with Customers, effective January 1, 2018, as discussed in Note 1 to the Condensed Consolidated Financial Statements.

Results of Operations

Net Revenue.

	June 30,		Change	
	2018	2017	2017 to 2018	
	(dollar amounts in thousands)			
Product -three months ended	$4,051	$1,111	$2,940	265%
Percentage of total net revenue	88 %	80 %		
Product -six months ended	$7,755	$2,066	$5,689	275%
Percentage of total net revenue	88 %	80 %		

Product revenue increased for the three and six months ended June 30, 2018 compared with the same periods of 2017 primarily due to higher shipment volumes of our Bandwidth Engine products, as well as higher average selling prices.

	June 30,		Change 2017 to	
	2018	2017	2018	
	(dollar amounts in thousands)			
Royalty and other -three months ended	$547	$273	$274	100%
Percentage of total net revenue	12 %	20 %		
Royalty and other -six months ended	$1,051	$530	$521	98 %
Percentage of total net revenue	12 %	20 %		

Royalty revenue and other includes revenues generated from licensing agreements. The increases in royalty and other revenue was primarily due to non-recurring license and engineering services for a development project, which was substantially completed during the six months ended June 30, 2018 and for which cash was collected in 2017. These increases were partially offset by decreases in royalties due to lower shipment volumes by licensees whose products incorporate our licensed IP. We expect royalty and other revenues to decrease for the remainder of 2018 due to the recognition of revenue related to a non-recurring development project.

Cost of Net Revenue and Gross Profit.

	June 30,		Change	
	2018	2017	2017 to 2018	
	(dollar amounts in thousands)			
Cost of net revenue -three months ended	$1,833	$732	$1,101	150%
Percentage of total net revenue	40 %	53 %		
Cost of net revenue -six months ended	$3,434	$1,334	$2,100	157%
Percentage of total net revenue	39 %	51 %		

	June 30,		Change	
	2018	2017	2017 to 2018	
	(dollar amounts in thousands)			
Gross profit -three months ended	$2,765	$652	$2,113	324%
Percentage of total net revenue	60 %	47 %		
Gross profit -six months ended	$5,372	$1,262	$4,110	326%
Percentage of total net revenue	61 %	49 %		

Cost of net revenue is primarily comprised of direct and indirect costs related to the sale of IC products.

Cost of net revenue increased for the three and six months ended June 30, 2018 compared with the same periods of 2017 primarily due to increased IC product shipment volumes.

Gross profit increased for the three and six months ended June 30, 2018, compared with the same periods of 2017, primarily due to the increase in gross profit from increased product shipments and reduced manufacturing costs, as well as non-recurring license and engineering services fees for a development project, partially offset by lower royalty revenue, which has no corresponding costs.

	June 30,		Change	
	2018	2017	2017 to 2018	
	(dollar amounts in thousands)			
Gross profit - product -three months ended	$2,218	$379	$1,839	485%
Percentage of total net revenue	48 %	27 %		
Gross profit - product -six months ended	$4,321	$732	$3,589	490%
Percentage of total net revenue	49 %	28 %		

Research and Development.

	June 30,		Change
	2018	2017	2017 to 2018

	(dollar amounts in thousands)			
Research and development -three months ended	$990	$2,313	$(1,323)	(57)%
Percentage of total net revenue	22 %	167 %		
Research and development -six months ended	$2,041	$5,798	$(3,757)	(65)%
Percentage of total net revenue	23 %	223 %		

Our research and development expenses include costs related to the development of our IC products and amortization of intangible assets. We expense research and development costs as they are incurred.

The decreases for the three and six months ended June 30, 2018 compared with the same periods in 2017 were primarily due to reduced personnel, product development and qualification, stock-based compensation, and computer-aided design software expenses and facility costs.

We expect research and development expenses to remain at approximately the same levels during each of the remaining quarters of 2018, due primarily to cost-reduction initiatives implemented in 2017 (discussed in Note 9 to the Condensed Consolidated Financial Statements), as we continue to primarily focus our resources on producing and selling our existing products and have substantially limited new product development.

Research and development expenses included stock-based compensation expense of approximately $83,000 and $102,000 for the three months ended June 30, 2018 and 2017, respectively. Research and development expenses included stock-based compensation expense of approximately $89,000 and $211,000 for the six months ended June 30, 2018 and 2017, respectively.

Selling, General and Administrative.

	June 30,		Change 2017 to 2018	
	2018	2017		
	(dollar amounts in thousands)			
SG&A -three months ended	$1,250	$1,101	$149	14%
Percentage of total net revenue	27 %	80 %		
SG&A -six months ended	$2,239	$2,415	$(176)	(7)%
Percentage of total net revenue	25 %	93 %		

Selling, general and administrative, or SG&A, expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, human resources and general management.

The increase for the three months ended June 30, 2018 compared with the same period in 2017 was due to a one-time expense to settle a disputed commissions claim with a terminated sales representative in Q2. The decrease for the six months ended June 30, 2018 compared with the same period in 2017 was primarily due to lower compensation costs. Due to the effects of cost-reduction initiatives implemented in 2017, we expect SG&A expenses to remain at approximately the same levels for the remainder of 2018.

Selling, general and administrative expenses included stock-based compensation expense of $0.1 million for each of the three-month periods ended June 30, 2018 and 2017. Selling, general and administrative expenses included stock-based compensation expense of approximately $0.2 million and $0.1 million for each of the six-month periods ended June 30, 2018 and 2017, respectively.

Interest expense

	June 30,		Change 2017 to 2018	
	2018	2017		
	(dollar amounts in thousands)			
Interest expense - three months ended	$(206)	$(223)	$(17)	(8)%
Percentage of total net revenue	(4)%	(16)%		
Interest expense - six months ended	$(427)	$(447)	$(20)	(4)%
Percentage of total net revenue	(5)%	(17)%		

Interest expense consisted of interest expense on our senior secured convertible notes (the Notes). To date, we have paid all accumulated interest for the Notes in-kind through the issuance of identical new senior secured convertible

notes. See Note 8 to the condensed consolidated financial statements for additional disclosure.

Liquidity and Capital Resources; Changes in Financial Condition

Cash Flows

As of June 30, 2018, we had cash and cash equivalents of $3.6 million and working capital of $4.0 million.

Net cash used in operating activities was $0.2 million for the first six months of 2018, which primarily resulted from $1.9 million in net reductions in assets and liabilities partially offset by net income of $0.7 million, non-cash charges, including stock-based compensation expense of $0.3 million, depreciation and amortization expenses of $0.4 million and accrued interest of $0.4 million. The changes in assets and liabilities primarily related to the timing of customer collections and inventory prepayments and the net change in liabilities.

Net cash used in operating activities was $7.0 million for the first six months of 2017, which primarily resulted from our net loss of $8.4 million, partially offset by $1.4 million due to net changes in assets and liabilities and non-cash charges, including stock-based compensation expense of $0.4 million and depreciation and amortization expenses of

$0.4 million. The changes in assets and liabilities primarily related to accrued restructuring liabilities, accrued interest, which we expect will be settled in-kind, and the timing of payments to vendors.

Net cash used in investing activities during the six months ended June 30, 2018 was for the purchase of operating equipment. Net cash provided by investing activities was $1.0 million for the first six months of 2017, and included net amounts transferred to cash and cash equivalents from investments of $1.0 million, which did not impact our liquidity.

Net cash used in financing activities for the first six months of 2018 consisted of amounts paid for employee income taxes related to net share settlement of vested RSUs and costs incurred in connection with the sale of common stock and warrants to purchase common stock in an equity offering completed in July 2017.

Net cash used in financing activities for the first six months of 2017 consisted primarily of payments of income taxes related to the issuance of common stock upon vesting of restricted stock units.

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

- level of revenue;
- cost, timing and success of technology development efforts;
- inventory levels, timing of product shipments and length of billing and collection cycles;
- fabrication costs, including mask costs, of our ICs, currently under development;
- variations in manufacturing yields, materials costs and other manufacturing risks;
- costs of acquiring other businesses and integrating the acquired operations;
- profitability of our business; and
- whether interest payments on the Notes are paid in cash or, at our election, in-kind through the issuance of new Notes with identical terms for the accrued interest.

Working Capital

We believe our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs over the next 12 months. Our primary capital requirements are to fund working capital, capital expenditures and for general corporate purposes, including the repayment of the Notes, which are due on August 15, 2019. To date, we have made accrued interest payments on the Notes in kind through the issuance of additional identical notes totaling approximately $1.7 million, and, as of June 30, 2018, the principal outstanding under the Notes totaled $9.7 million. If we fail to pay the Notes, including accrued interest, in full when due, the holders of the Notes, acting through their agent, will be entitled to pursue all of their remedies as secured creditors, including taking possession of the collateral securing the Notes and effecting a private sale of some or all of our assets securing the Notes. After the holders of the Notes take such actions, we may not have enough assets to make payments owed to other creditors, to continue operating our business, or distribute any funds to stockholders.

We expect to raise additional capital for working capital and repayment of all or a portion of the Notes, but there can be no assurance that such funding will be available to us on favorable terms, if at all. The failure to raise capital when needed could have a material adverse effect on our business and financial condition. We may not be able to obtain additional financing as needed on acceptable terms, or at all, which may require us to further reduce our operating costs and other expenditures, including reductions of personnel, salaries and capital expenditures. Alternatively, or in addition to such potential measures, we may elect to implement additional cost reduction actions as we may determine are necessary and in our best interests. Any such actions undertaken might limit our opportunities to realize plans for revenue growth and we might not be able to reduce our costs in amounts sufficient to achieve break-even or profitable operations.

If we were to raise additional capital through sales of our equity securities, our stockholders would suffer dilution of their equity ownership. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, prohibit us from paying dividends, repurchasing our stock or making investments, and force us to maintain specified liquidity or other ratios, any of which could harm our business, operating results and financial condition. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- repay the Notes when they are due;
- develop or enhance our products;
- expand our product development and sales and marketing organizations;
- acquire complementary technologies, products or businesses;
- expand operations;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Our failure to do any of these things could seriously harm our ability to execute our business strategy and may force us to curtail our existing operations or research and development plans.

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures. Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based on this evaluation, our management concluded that, as of June 30, 2018, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting. During the first six months of 2018, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. Legal Proceedings

The discussion of legal matters in Note 4 of the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this report under the heading "Legal Matters" is incorporated by reference in response to this Part II, Item 1.

ITEM 1A. Risk Factors

We face many significant risks in our business, some of which are unknown to us and not presently foreseen. These risks could have a material adverse impact on our business, financial condition and results of operations in the future. We have disclosed a number of material risks under Item 1A of our annual report on Form 10-K for the year ended December 31, 2017, which we filed with the SEC on March 12, 2018.

ITEM 5. Other Information

Effective August 8, 2018, Mr. Leonard Perham has resigned as our president and chief executive officer. Mr. Perham will remain a member of our board of directors.

Mr. Daniel Lewis, a member of our board of directors since September 2017, has been appointed our new president and chief executive officer, effective August 8, 2018. Mr. Lewis will remain a member of board of directors, but has resigned from the audit and compensation committees of our board of directors. He has served as the managing member and an owner of GMS Manufacturing Solution LLC, which provides engineering services to manufacturing companies, since 2013. From 2001 to 2013, he served as chief executive officer of View Box Group, LLC, which provides management consulting services to small businesses. Prior to 2001, Mr. Lewis previously served as vice president of worldwide sales at both Xicor, Inc. and Integrated Device Technology, Inc. He has also held various sales and technical positions with Accelerant Networks, Inc. Intel Corporation, Zilog, Inc. and Digital Equipment Corporation. Mr. Lewis holds a B.S. in Electrical Engineering from the University of Michigan.

Mr. Lewis's initial compensation will be an annual salary of $250,000.

ITEM 6. Exhibits

(a) Exhibits

31.1	Rule 13a-14 certification
31.2	Rule 13a-14 certification
32.1	Section 1350 certification
101	The following financial information from MoSys, Inc.’s Quarterly Report on Form 10-Q for the period ended June 30, 2018, filed with the SEC on August 8, 2018, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and six months ended June 30, 2018 and 2017, (ii) the Condensed Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017, (iii) the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2018 and 2017, and (iv) Notes to Condensed Consolidated Financial Statements.

Signatures

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

Dated: August 8, 2018		MOSYS, INC.
	By:	/s/ Leonard Perham Leonard Perham President and Chief Executive Officer
	By:	/s/ James W. Sullivan James W. Sullivan Vice President of Finance and Chief Financial Officer (Principal Financial Officer)