

DIVX INC

FORM 10-Q (Quarterly Report)

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Address	4780 EASTGATE MALL SAN DIEGO, CA 92121
Telephone	858-882-0600
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Symbol	DIVX
SIC Code	7371 - Computer Programming Services
Industry	Software & Programming
Sector	Technology
Fiscal Year	12/31

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

FORM 10-Q

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from _____ to _____.

Commission File Number 001-33029

DivX, Inc.

(Exact name of Registrant as specified in its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

33-0921758
(I.R.S. Employer Identification Number)

4780 Eastgate Mall
San Diego, California 92121
(Address of Principal Executive Offices, including Zip Code)

(858) 882-0600
(Registrant's Telephone Number, Including Area Code)

N/A
(Former name, former address and former fiscal year if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934):

Yes No

The number of shares of the Registrant's Common Stock outstanding as of July 30, 2009 was 32,673,576.

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PART I — FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

DIVX, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	June 30, 2009 (unaudited)	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 23,206	\$ 43,442
Short-term investments	112,728	73,897
Accounts receivable, net of allowance of \$547 and \$929 at June 30, 2009 and December 31, 2008, respectively	1,654	7,263
Income tax receivable	2,124	185
Prepaid expenses	5,672	3,465
Deferred tax assets, current	2,360	1,841
Other current assets	1,041	1,082
Total current assets	148,785	131,175
Property and equipment, net	2,860	3,811
Long-term investments	4,087	17,968
Deferred tax assets, long-term	10,263	10,547
Purchased intangible assets, net	9,907	10,968
Goodwill	10,390	10,358
Other assets	7,774	8,574
Total assets	<u>\$194,066</u>	<u>\$ 193,401</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 783	\$ 1,319
Accrued liabilities	2,263	2,353
Accrued compensation and benefits	2,394	3,153
Accrued format approval fee	1,375	1,333
Accrued patent royalties	688	681
Income taxes payable	410	389
Deferred revenue, current	4,980	6,185
Total current liabilities	12,893	15,413
Deferred tax liability	1,564	1,559
Deferred revenue, long-term	1,497	769
Accrued format approval fee, long-term	1,427	1,383
Other long-term liability	500	177
Total liabilities	17,881	19,301
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 10,000 shares authorized at June 30, 2009 and December 31, 2008; no shares issued and outstanding at June 30, 2009 and December 31, 2008	—	—
Common stock, \$0.001 par value, 200,000 shares authorized at June 30, 2009 and December 31, 2008; 32,667 and 32,461 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	32	32
Additional paid-in capital	173,211	167,684
Accumulated other comprehensive loss	(601)	(950)
Retained earnings	3,543	7,334
Total stockholders' equity	176,185	174,100
Total liabilities and stockholders' equity	<u>\$194,066</u>	<u>\$ 193,401</u>

See accompanying notes.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net revenues:				
Technology licensing	\$13,725	\$16,410	\$32,331	\$35,488
Media and other distribution and services	1,509	4,909	1,580	10,853
Total net revenues	<u>15,234</u>	<u>21,319</u>	<u>33,911</u>	<u>46,341</u>
Cost of revenues:				
Cost of technology licensing	2,165	956	4,576	1,992
Cost of media and other distribution and services	136	186	312	358
Total cost of revenues	<u>2,301</u>	<u>1,142</u>	<u>4,888</u>	<u>2,350</u>
Gross profit	12,933	20,177	29,023	43,991
Operating expenses:				
Selling, general and administrative(1)	11,875	12,573	24,584	28,550
Product development(1)	4,633	5,366	9,334	10,791
Impairment of acquired intangibles	—	250	—	1,250
Total operating expenses	<u>16,508</u>	<u>18,189</u>	<u>33,918</u>	<u>40,591</u>
Income (loss) from operations	(3,575)	1,988	(4,895)	3,400
Interest income and expense, net	432	1,110	1,026	2,767
Other income (expense), net	529	(15)	139	502
Income (loss) before income taxes	(2,614)	3,083	(3,730)	6,669
Income tax provision (benefit)	(255)	1,406	61	2,511
Net income (loss)	<u>\$ (2,359)</u>	<u>\$ 1,677</u>	<u>\$ (3,791)</u>	<u>\$ 4,158</u>
Net income (loss) per share:				
Basic	<u>\$ (0.07)</u>	<u>\$ 0.05</u>	<u>\$ (0.12)</u>	<u>\$ 0.12</u>
Diluted	<u>\$ (0.07)</u>	<u>\$ 0.05</u>	<u>\$ (0.12)</u>	<u>\$ 0.12</u>
Shares used to compute basic net income (loss) per share	<u>32,589</u>	<u>32,399</u>	<u>32,532</u>	<u>33,548</u>
Shares used to compute diluted net income (loss) per share	<u>32,589</u>	<u>32,907</u>	<u>32,532</u>	<u>34,132</u>

(1) Includes share-based compensation as follows:

Selling, general and administrative	\$ 1,831	\$ 1,852	\$ 3,713	\$ 3,370
Product development	524	574	841	1,063

See accompanying notes.

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DIVX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Six months ended	
	June 30,	
	2009	2008
	(unaudited)	
Cash flows from operating activities:		
Net income (loss)	\$ (3,791)	\$ 4,158
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,005	2,340
Accretion of interest expense	87	—
Deferred taxes	223	(2,738)
Impairment of acquired intangibles	—	1,250
Impairment of long lived assets	—	350
Net recoveries from uncollectible account receivables	(272)	(166)
Share-based compensation	4,554	4,433
Amortization of discount on investments	341	(448)
Excess tax benefit from stock options exercised	(448)	(12)
Foreign currency transaction gain	26	(486)
Unrealized loss on auction rate securities	(141)	—
Changes in operating assets and liabilities:		
Accounts receivable	5,889	(5,013)
Income taxes payable (receivable)	(1,918)	—
Prepaid expenses and other assets	(1,844)	2,604
Accounts payable	(352)	(1,664)
Accrued liabilities	(1,043)	(3,709)
Deferred rent	257	(276)
Deferred revenue	(523)	1,769
Net cash provided by operating activities	4,050	2,392
Cash flows from investing activities:		
Purchase of investments	(78,613)	(69,359)
Proceeds from sales and maturities of investments	53,803	105,790
Purchase of property and equipment	(258)	(1,288)
Payment on format approval agreement obligation	(200)	(1,000)
Cash paid in Veatros acquisition	—	(1,750)
Cash paid in Main Concept acquisition	(97)	(1,205)
Net cash (used in) provided by investing activities	(25,365)	31,188
Cash flows from financing activities:		
Proceeds from exercise of stock options	22	122
Proceeds from shares issued under the employee stock purchase plan	503	584
Excess tax benefit from exercise of stock options	448	12
Repurchase of common stock	—	(19,994)
Repurchase of unvested stock	(13)	(16)
Payments on notes payable and capital lease obligations	—	(90)
Net cash provided by (used in) financing activities	960	(19,382)
Effect of exchange rate changes on cash	119	55
Net (decrease) increase in cash and cash equivalents	(20,236)	14,253
Cash and cash equivalents at beginning of period	43,442	14,532
Cash and cash equivalents at end of period	\$ 23,206	\$ 28,785

See accompanying notes.

DIVX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS—CONTINUED
(In thousands)

Supplemental disclosure of non-cash investing and financing activities		
Issuance of warrants in connection with format approval agreement	\$ —	\$ 87
Supplemental disclosure:		
Cash paid for income taxes	<u>\$1,769</u>	<u>\$4,871</u>
Cash paid for interest	<u>\$ —</u>	<u>\$ 3</u>

See accompanying notes.

DIVX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1—Background and Basis of Presentation

Basis of Presentation

The accompanying consolidated balance sheet as of June 30, 2009, the consolidated statements of operations for the three and six months ended June 30, 2009 and 2008 and the consolidated statements of cash flows for the six months ended June 30, 2009 and 2008 are unaudited. The unaudited consolidated balance sheet as of June 30, 2009 is presented with amounts derived from the audited consolidated balance sheet as of December 31, 2008. These statements should be read in conjunction with the audited consolidated financial statements and related notes, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, or the Annual Report.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in the Annual Report, and include all adjustments (consisting of normal recurring accruals) necessary for the fair presentation of the Company's financial information for the periods presented. The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the year as a whole.

Subsequent Events Evaluation

The Company evaluated all events or transactions that occurred after June 30, 2009 up through August 5, 2009, the date these financial statements were issued.

Use of Estimates

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

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162* (SFAS No. 168). SFAS No. 168 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP in the United States. SFAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect the adoption of SFAS No. 168 to have a material impact on the Company's consolidated results of operations or financial condition.

Effective this quarter, the Company adopted SFAS No. 165, *Subsequent Events* (SFAS No. 165). SFAS No. 165 requires entities to disclose the date through which they have evaluated subsequent events and whether the date is the release of their financial statements or the date they are ready to be released. SFAS No. 165 is effective for interim and annual periods ended after June 15, 2009. The adoption of SFAS No. 165 did not have a material impact on the Company's consolidated results of operations or financial condition.

Effective this quarter, the Company adopted FASB Staff Position (FSP) FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 amends FAS No. 157, *Fair Value Measurements*, and provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased and also includes guidance on identifying circumstances that indicate a transaction is not orderly for fair value measurements. FSP FAS 157-4 shall be applied prospectively with retrospective application not permitted. This FSP was effective for interim and annual periods ended after June 15, 2009. The adoption of FSP FAS 157-4 did not have a material impact on the Company's consolidated results of operations or financial condition.

Effective this quarter, the Company adopted FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2 and FAS 124-2). This FSP amends FAS 115 and FAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations* and EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*, to make the other-than-temporary impairments guidance more operational and to improve the presentation of other-than-temporary

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impairments in the financial statements. This FSP will replace the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired debt security until recovery of its cost basis with a requirement that management assert it does not have the intent to sell the security before recovery of its cost basis. This FSP requires increased disclosure about the credit and noncredit components of impaired debt securities that are not expected to be sold, as well as increased disclosures regarding expected cash flows, credit losses and an aging of securities with unrealized losses. FSP FAS 115-2 and FAS 124-2 are effective for interim and annual periods ended after June 15, 2009. The adoption of FSP FAS 115-2 and FAS 124-2 did not have a material impact on the Company's consolidated results of operations or financial condition, other than the presentation of additional disclosures about the Company's interim financial statements.

Effective this quarter, the Company adopted FSP SFAS 107-1 and Accounting Principles Board Opinion (APB) 28-1, *Interim Disclosure about Fair Value of Financial Instruments* (FSP 107-1 and APB 28-1). FSP 107-1 and APB 28-1 require interim disclosures regarding the fair values of financial instruments that are within the scope of FASB No. 107, *Disclosures about the Fair Value of Financial Instruments*. Additionally, FSP 107-1 and APB 28-1 requires disclosure of the methods and significant assumptions used to estimate the fair value of financial instruments on an interim basis as well as changes of the methods and significant assumptions from prior periods. FSP 107-1 and APB 28-1 does not change the accounting treatment for these financial instruments and was effective for interim reporting periods ended after June 15, 2009. The adoption of FSP 107-1 and APB 28-1 did not have a material impact on the Company's consolidated results of operations or financial condition.

Note 2—Earnings Per Share

Basic earnings per share, or EPS, excludes dilution and is computed by dividing net income or loss attributable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Potentially dilutive securities are excluded from the diluted EPS computation in loss periods and when their exercise price is greater than the market price as their effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted EPS for the three and six months ended June 30, 2009 and 2008 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Numerator:				
Net income (loss)	\$ (2,359)	\$ 1,677	\$ (3,791)	\$ 4,158
Denominator:				
Weighted average common shares outstanding (basic)	32,589	32,399	32,532	33,548
Common equivalent shares from restricted stock awards	—	40	—	29
Common equivalent shares from common stock warrants	—	50	—	54
Common equivalent shares from options to purchase common stock and unvested shares of common stock subject to repurchase	—	418	—	501
Weighted average shares of common stock outstanding (diluted)	32,589	32,907	32,532	34,132
Basic earnings (loss) per share	\$ (0.07)	\$ 0.05	\$ (0.12)	\$ 0.12
Diluted earnings (loss) per share	\$ (0.07)	\$ 0.05	\$ (0.12)	\$ 0.12

Potentially dilutive securities, which are not included in the calculation of diluted net income per share because to do so would be anti-dilutive, are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Options to purchase common stock	5,596	3,470	5,350	2,830
Common stock warrants	545	150	545	150
Restricted stock awards	258	—	269	—
Total	6,399	3,620	6,164	2,980

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Note 3—Investments

The following table summarizes investments by security type as of June 30, 2009 and December 31, 2008 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2009				
Commercial paper	\$ 2,492	\$ —	\$ (1)	\$ 2,491
Auction rate securities and put option	14,256	—	—	14,256
Corporate bonds	32,991	113	(38)	33,066
U.S. government agency notes	62,771	145	(1)	62,915
Total short-term investments	112,510	258	(40)	112,728
Auction rate securities - long-term investments	4,480	—	(393)	4,087
Total investments	<u>\$116,990</u>	<u>\$ 258</u>	<u>\$ (433)</u>	<u>\$116,815</u>
December 31, 2008				
Commercial paper	\$ 6,201	\$ 1	\$ (16)	\$ 6,186
Corporate bonds	31,531	43	(90)	31,484
U.S. government agency notes	35,990	237	—	36,227
Total short-term investments	73,722	281	(106)	73,897
Auction rate securities and put option - long-term investments	18,665	—	(697)	17,968
Total investments	<u>\$ 92,387</u>	<u>\$ 281</u>	<u>\$ (803)</u>	<u>\$ 91,865</u>

The following table summarizes the contractual maturities of the Company's investments as of June 30, 2009 (in thousands):

Less than one year	\$ 84,140
Due in one to five years	28,588
Due after five years	4,087
	<u>\$116,815</u>

Realized gains and losses on investments are included in interest income and expense, net, in the accompanying consolidated statements of operations. During the three and six months ended June 30, 2009, the Company recorded realized gains of \$14,000 and \$28,000, respectively, on the sale of investments. During the three and six months ended June 30, 2008, the Company recorded no realized gains or losses on its investments. As of June 30, 2009 and December 31, 2008, net unrealized losses of \$175,000 and \$522,000, respectively, were included in accumulated other comprehensive loss in the accompanying consolidated balance sheets.

The majority of the gross unrealized losses as of June 30, 2009 were primarily due to the illiquidity of municipal bonds with an auction reset feature (ARS) held by the Company. The gross unrealized losses on the commercial paper and corporate bonds were the result of overall market risk aversion, lack of demand for securities that are non-government guaranteed and the relative widening of credit spreads relative to the U.S. Treasuries. The Company believes that it will be able to collect all principal and interest amounts due at maturity given the high credit quality of these investments. Since the decline in the market value of these investments is attributable to changes in market conditions and not credit quality, and since the Company has the ability and intent to hold those investments until a recovery of par value, which may be maturity, the Company does not consider these investments to be other-than temporarily impaired as of June 30, 2009.

The Company's short-term investments consist primarily of ARS, commercial paper, corporate bonds and U.S. government agency notes. The Company's long-term investments consist primarily of ARS. ARS are long-term variable rate bonds tied to short-term interest rates. After the initial issuance of the securities, the interest rate on the securities is reset periodically, at intervals established at the time of issuance (primarily every 27 to 34 days), based on market demand for a reset period. ARS were bought and sold in the marketplace through a competitive bidding process often referred to as a "Dutch auction." If there was insufficient interest in the securities at the time of an auction, the auction may not be completed and the rates may be reset to predetermined "penalty" or "maximum" rates. Prior to 2008, the Company classified all ARS as short-term investments. In February 2008, auctions began to fail for these securities and each auction since then has failed. As of June 30, 2009, the Company held \$18.8 million par value ARS, all of

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which have experienced failed auctions since February 2008. The underlying assets of the securities consisted of student loans and municipal bonds, of which \$17.2 million were guaranteed by the U.S. government and the remaining \$1.6 million were privately insured. All of these ARS have credit ratings of AAA, except one rated AA1 and two rated A3, by a rating agency. These ARS have contractual maturity dates ranging from 2030 to 2047. The Company is receiving the underlying cash flows on all of its ARS. The principal associated with failed auctions is not expected to be accessible until a successful auction occurs, the issuer redeems the securities, a buyer is found outside of the auction process or the underlying securities mature.

In November 2008, the Company accepted an offer (the Right), from UBS AG (UBS), entitling it to sell at par value ARS originally purchased by the Company from UBS at any time during a two-year period from June 30, 2010 through July 2, 2012. As of June 30, 2009, the Company held \$14.3 million par value ARS purchased from UBS. Although the Company expects to sell its ARS under the Right, if the Right is not exercised before July 2, 2012 it will expire and UBS will have no further rights or obligation to buy the Company's ARS. The Company's Right to sell the ARS to UBS commencing June 30, 2010 represents a put option for a payment equal to the par value of the ARS. As such, the Company's ARS from UBS have been classified as short-term investments as of June 30, 2009. Because the Right is non-transferable and cannot be attached to the ARS if they are sold to another entity other than UBS, it represents a freestanding instrument between the Company and UBS. The Company elected the fair value option under SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115* and, in December 2008, transferred the UBS ARS from available-for-sale to trading securities and, accordingly, recognized the unrealized losses previously recorded in accumulated other comprehensive (loss) income in earnings at the election date. The transfer from available-for-sale to trading securities was a one-time election as allowed under SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*. The changes in fair value of the Right and the UBS ARS are recorded in other income (expense), net in the consolidated statements of operations.

For non-UBS ARS, the Company is unable to predict if these funds will become available before their maturity dates and as a result the Company has classified these ARS as long-term investments as of June 30, 2009.

Fair Value Measurements

The Company measures its financial assets at fair value on a recurring basis. The fair value of these financial assets was determined based on the following three levels of inputs in accordance with SFAS No. 157, *Fair Value Measurements*, (SFAS No. 157) of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In accordance with SFAS No. 157, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of June 30, 2009 (in thousands):

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash equivalents:				
Money market funds	\$ 20,549	\$ 20,549	\$ —	\$ —
Short-term investments:				
Put option on auction rate securities	1,672	—	—	1,672
Commercial paper	2,491	2,491	—	—
Auction rate securities	12,584	—	—	12,584
Corporate bonds	33,066	33,066	—	—
Government	62,915	62,915	—	—
Long-term investments:				
Auction rate securities	4,087	—	—	4,087
Total financial assets	<u>\$137,364</u>	<u>\$119,021</u>	<u>\$ —</u>	<u>\$18,343</u>

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Level 3 assets consist of ARS whose underlying assets are student loans which are substantially backed by the federal government. Since the auctions for these securities have continued to fail since February 2008, these investments are not currently trading and therefore do not have readily determinable market value. Accordingly, the estimated fair value of the ARS no longer approximates par value. The Company has valued the ARS and the associated put option described above using a discounted cash flow model based on Level 3 assumptions. The assumptions used in valuing the ARS and the put option include estimates of interest rates, timing and amount of cash flows, credit and liquidity premiums, expected holding periods of the ARS, loan rates relating to the UBS Rights offering and bearer risk associated with UBS's financial ability to repurchase the ARS beginning June 30, 2010, in each case based on data available to the Company as of June 30, 2009.

The Company also holds ARS with a total par value of \$4.5 million which are not subject to the put option with UBS. The Company has the ability and intent to hold these investments for a period of time sufficient to allow for anticipated recovery in market value or final settlement at the underlying par value, as the Company believes that the credit ratings and credit support of the security issuers indicate that they have the ability to settle the securities at par value. As such, the Company records changes in the fair value of these ARS investments in accumulated other comprehensive loss.

The following table provides a reconciliation for all assets measured at fair value using significant unobservable inputs (Level 3) for the six months ended June 30, 2009 (in thousands):

	Fair Value Measurements at Reporting Date Using Significant Unobservable Inputs (Level 3)	
	Put Option	ARS
Balance at January 1, 2009	\$ 2,311	\$ 15,657
Redemption of ARS investments	—	(70)
Total gains or (losses):		
Included in accumulated other comprehensive loss	—	305
Included in net income (loss)	(639)	779
Balance at June 30, 2009	<u>\$ 1,672</u>	<u>\$ 16,671</u>

Note 4—Share-Based Compensation Expense

The Company records share-based compensation expense in accordance with SFAS No. 123 (revised 2004), *Share-based Payment* (SFAS No. 123R), which requires companies to measure all employee share-based compensation awards using a fair value method and record such expense in the consolidated financial statements.

Total share-based compensation expense for the three and six months ended June 30, 2009 and 2008 is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Selling, general and administrative	\$ 1,831	\$ 1,852	\$ 3,713	\$ 3,370
Product development	524	574	841	1,063
Totals	<u>\$ 2,355</u>	<u>\$ 2,426</u>	<u>\$ 4,554</u>	<u>\$ 4,433</u>

The Company recorded \$2.4 million in share-based compensation expenses during each of the three months ended June 30, 2009 and 2008, and recorded \$4.6 million and \$4.4 million in share-based compensation expenses during the six months ended June 30, 2009 and 2008, respectively. In addition, for the six months ended June 30, 2009 and 2008, \$448,000 and \$12,000, respectively, was presented as financing activities to reflect the incremental tax benefits from stock options exercised in those periods. At June 30, 2009, total unrecognized estimated compensation costs related to unvested stock options granted prior to that date was \$19.3 million, which is expected to be recognized over a weighted-average period of 2.9 years. At June 30, 2009, total unrecognized estimated compensation costs related to non-vested restricted stock awards granted prior to that date was \$1.7 million, which is expected to be recognized over a period of 2.7 years.

Restricted Stock

During the three and six months ended June 30, 2009, approximately 22,000 shares and 44,000 shares, respectively, of the Company's common stock vested and were released pursuant to outstanding restricted stock awards. As of June 30, 2009, the Company had 241,000 shares of common stock subject to restricted stock awards outstanding.

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Stock Options

During the three and six months ended June 30, 2009, the Company granted stock options to purchase approximately 1.0 million shares and 1.2 million shares, respectively, of its common stock. During the three and six months ended June 30, 2009, stock options to purchase approximately 23,000 shares and 40,000 shares, respectively, of common stock were exercised and options to purchase 134,000 shares and 364,000 shares, respectively, of common stock were forfeited or expired. As of June 30, 2009, the Company had outstanding options to purchase approximately 5.9 million shares of common stock.

Warrants

No warrants were exercised during the three and six months ended June 30, 2009. As of June 30, 2009, there were fully vested warrants outstanding to purchase 545,000 shares of the Company's common stock.

Note 5—Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). Deferred income tax assets or liabilities are recognized based on the temporary differences between financial statement and income tax basis of assets and liabilities using enacted tax rates in effect for the years in which the differences are expected to reverse. Deferred income tax expenses or credits are based on the changes in the deferred income tax assets or liabilities from period to period. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized. The Company also determines its tax contingencies in accordance with SFAS No. 5, *Accounting for Contingencies*. The Company records estimated tax liabilities to the extent the contingencies are probable and can be reasonably estimated.

The Company accounts for uncertain tax positions in accordance with FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 prescribes a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods and income tax disclosures. It is the Company's practice to include interest and penalties that relate to income tax matters as a component of income tax provision.

The Company recorded an income tax benefit for the three months ended June 30, 2009 of \$255,000, or 10% of pre-tax loss, compared to an income tax provision of \$1.4 million, or 45.6% of pre-tax income for the three months ended June 30, 2008. The income tax provision for the six months ended June 30, 2009 was \$61,000, or 2% of pre-tax loss, compared to an income tax provision of approximately \$2.5 million, or 38% of pre-tax income for the six months ended June 30, 2008. The income tax provision recorded during the six months ended June 30, 2009 included discrete items of approximately \$1.2 million. These discrete items included approximately \$750,000 recorded during the first quarter of 2009 relating to a decrease to certain deferred tax assets as a result of a California tax law change that was enacted in February 2009. This change allows an elective single sales factor for state apportionment for taxable years beginning on or after January 1, 2011. The Company expects to benefit from the California single sales factor election for apportioning income for years 2011 and beyond. As a result of its anticipated election of the single sales factor, in accordance with SFAS No. 109, the Company has re-measured its deferred tax assets taking into account the reversal pattern and the expected California tax rate under the elective single sales factor. The discrete items also included an increase to income tax provision of approximately \$460,000 relating to the write-off of deferred tax assets associated with cancelled stock options recorded during the three months ended June 30, 2009. Excluding these discrete items, the Company's effective tax rate for the three and six months ended June 30, 2009 was approximately 27% and 31%, respectively, which compares to approximately 46% and 38% for the three and six months ended June 30, 2008, respectively.

The difference between the Company's effective tax rate and the 35% U.S. federal statutory rate for the three and six month period ended June 30, 2009 was primarily due to permanent differences, partially offset by research and development credits and the impact of the discrete items. The difference between the Company's effective tax rate and the 35% U.S. federal statutory rate for the three and six month period ended June 30, 2008 was primarily due to state income taxes and permanent differences, partially offset by research and development credits.

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The Company files federal, state and foreign income tax returns in jurisdictions with varying statutes of limitations. Due to net operating loss and research and development credit carryovers from earlier years, the Company is subject to income tax examination by tax authorities from inception to date.

Note 6—Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Net income (loss)	\$ (2,359)	\$ 1,677	\$(3,791)	\$ 4,158
Unrealized gain (loss) on investments	124	(535)	339	(1,310)
Unrealized gain on foreign currency translation	844	11	10	1,379
Total comprehensive income (loss)	<u>\$ (1,391)</u>	<u>\$ 1,153</u>	<u>\$(3,442)</u>	<u>\$ 4,227</u>

Note 7—Business Acquisitions and Combinations

Veatros

In July 2007, the Company acquired all of the assets of Veatros, L.L.C. (Veatros), a limited liability company engaged in real-time digital video processing for the purposes of producing enhanced video search and discovery services. At the time of acquisition, the operations of Veatros had been wound down and no development projects were in-process. The acquisition was accounted for as an acquisition of assets in accordance with Emerging Issues Task Force Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*. The total purchase price for the acquisition was up to \$4.3 million comprised of an initial upfront cash payment of \$2.0 million, which the Company made in July 2007, and subsequent cash payments of \$2.3 million upon the achievement of certain technology related milestones. The Company did not acquire any tangible assets or assume any liabilities as a result of the acquisition. The Company allocated the cash payments of \$4.3 million to one identifiable intangible asset, a patented technology license. The asset is being amortized over the useful life of the patented technology license, or approximately eight years.

In February 2008, subsequent to the asset purchase, the Company's board of directors approved the shut-down of Stage6, the Company's online video community service. As a significant portion of the benefit from the acquired patented technology license was originally to be derived from Stage6 future activities, the Company evaluated the intangible asset for impairment as of December 31, 2008 in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, based on the projected benefits solely attributable to the Company's core consumer electronics business. Based on the Company's revised forecasts excluding the Stage6 future activities and discounting the cash flows attributable to the Company's core consumer electronics business, the Company concluded that the carrying amount of the asset was not fully recoverable and an impairment charge equal to approximately \$3.0 million was recorded in 2007 in the consolidated statements of operations, as the acquired patented technology license was considered to have a recoverable value of approximately \$60,000. During 2008, technology milestones equal to \$1.3 million in the aggregate were achieved and paid. As these technology milestones were attributable to Stage6, the milestones were not considered to be recoverable and as a result, the Company recorded an impairment charge of \$1.3 million in the consolidated statements of income during 2008. All milestones had been achieved and the Company had no remaining liability related to the acquisition of Veatros as of December 31, 2008.

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Note 8—Legal Matters

On October 22, 2007, following the filing of the Company's declaratory relief action which was subsequently dismissed, Universal Music Group, Inc. (UMG), filed a lawsuit against the Company in the Central District of California. UMG's suit alleges copyright infringement and seeks monetary damages related to the Company's operation of the Stage6 online video community service, which was shut down on February 29, 2008. The Company believes it has meritorious defenses to UMG's claims and will assert them vigorously, but litigation is inherently uncertain and there can be no guarantee that the Company will prevail or that the litigation will not have material adverse consequences for the Company. An unfavorable resolution of these proceedings could materially affect the Company's future operating results or financial conditions in particular periods. No amounts have been accrued for this litigation as of June 30, 2009.

On November 11, 2008, Yahoo! Inc (Yahoo!) informed the Company that it intended to breach the two-year License and Distribution Agreement (Distribution Agreement) entered into between the Company and Yahoo! on September 27, 2007 and to discontinue making payments required under the Distribution Agreement. As a result, in November 2008, the Company filed a lawsuit in California Superior Court in Santa Clara County seeking damages from Yahoo! and specific performance under the Distribution Agreement. As the Company considered the potential receipt of damages from Yahoo! to be a gain contingency, no amounts have been recorded as of June 30, 2009.

The Company is also involved in various legal proceedings from time to time arising from the normal course of business activities, including commercial, employment and other matters. In its opinion, resolution of any of its legal matters is not expected to have a material adverse effect on the Company's operating results or financial condition. However, it is possible that an unfavorable resolution of one or more such proceedings could materially affect the Company's future operating results or financial condition in a particular period.

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

You should read the following discussion and analysis of our financial condition and results of our operations in conjunction with our consolidated financial statements and the notes to those statements included elsewhere in this Quarterly Report on Form 10-Q, as well as our audited consolidated financial statements and notes to those statements as of and for the year ended December 31, 2008 included in our Annual Report on Form 10-K filed with the SEC. This discussion contains forward-looking statements reflecting our current expectations that involve risks and uncertainties. Our actual results and the timing of events may differ materially from those contained in these forward-looking statements due to a number of factors, including those discussed in the section entitled "Risk Factors," and elsewhere in this Quarterly Report on Form 10-Q.

Overview

We create products and services designed to improve the experience of media. Our long-term goal is to allow creators to have the ability to capture their content in the DivX format using any device or software of their choosing and to allow consumers of such content to playback and interact with it on any device or platform.

The first step toward our goal was to build and release a high-quality video compression-decompression software library, or codec, to enable distribution of media across the Internet and through recordable media. As a result, we created the DivX codec, which has been actively sought out and downloaded by consumers hundreds of millions of times. These downloads include those for which we receive revenue as well as free downloads, such as limited-time trial versions, and downloads provided as upgrades to existing end users of our products. After the significant grass-roots adoption of our codec, the next steps toward our goal was to license similar technology to consumer hardware device manufacturers and certify their products to ensure the interoperable support of DivX-encoded content. In January 2009, we took another step forward by releasing to consumers and licensing to hardware device manufacturers a version of our technology built around a new codec, the DivX Plus codec. DivX Plus technology offers enhancements over prior versions of our codecs for certain implementations, including for high definition and mobile content. DivX Certified hardware devices have been shipped worldwide by our customers, who include major consumer video hardware original equipment manufacturers, or OEMs. We are entitled to receive a royalty and/or license fee for DivX Certified devices that our customers ship. In addition to technology licensing to consumer hardware device manufacturers, we currently generate revenue from software licensing and related support, advertising and content distribution.

Complementing our organic growth, in November 2007 we acquired MainConcept AG, or MainConcept, a leading provider of H.264 and other high-quality video codecs and technologies for the broadcast, film, consumer electronics and computer software markets. MainConcept solutions are optimized for various platforms including PCs, set-top boxes, portable media players and mobile phones. Through integration, we expect to realize additional opportunities both in our core markets and in related emerging markets that will help continue to advance our long-term goals.

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Our next steps, which we have begun working toward, are to bring together the millions of DivX consumers with content creators both large and small to build communities around media, including through the development and licensing of media distribution platforms and services for the Internet and consumer electronics devices. We are optimistic about the future and believe the opportunities for DivX are only beginning to be realized.

Sources of revenues

We have four revenue streams. Three of these revenue streams are derived from our technologies, including technology licensing to manufacturers of consumer hardware devices, licensing to independent software vendors and consumers, and providing services related to content distribution over the Internet. Additionally, we derive revenues from advertising and distributing third-party products on our website.

Our technology licensing revenues from consumer hardware device manufacturers comprise the majority of our total revenues and are derived primarily from royalties and/or license fees received from original equipment manufacturers, although related revenues are derived from other members of the consumer hardware device supply chain. We license our technologies to original equipment manufacturers, allowing them to build support of DivX technologies into their consumer hardware devices. In the majority of cases, original equipment manufacturers pay us a per unit fee for each DivX Certified device they sell. Our license agreements with original equipment manufacturers typically range from one to two years, and may include the payment of initial fees, volume-based royalties and minimum guaranteed volume levels. To ensure high-quality support of the DivX media format in finished consumer products, we also license our technologies to companies who create the major components in consumer hardware devices. These companies include integrated circuit manufacturers who supply integrated circuits, and original design manufacturers who create reference designs, for DVD players, digital televisions, mobile phones, and the other consumer hardware devices distributed by our licensee original equipment manufacturers. Because royalties are generated by the shipment volumes of our consumer hardware device customers, and because sales by consumer hardware device manufacturers are highly seasonal, we expect revenues relating to consumer hardware devices to be highly seasonal, with our second quarter revenues in any given calendar year being generally lower than any other quarter in that calendar year.

We license our technologies to independent software vendors that incorporate our technologies into software applications for computers and other consumer hardware devices. An independent software vendor typically pays us an initial license fee, in addition to per-unit royalties based on the number of products sold that include our technology. We also license our technologies directly to consumers through several software bundles. We make certain software bundles available free of charge from our website. These bundles incorporate a version of our codec technology and allow consumers to play and create content in the DivX format. We also make available from our website an enhanced version of our free software bundles, including additional features that increase the quality and control of DivX media playback and creation. These enhanced versions are available free of charge for a limited trial period, which is generally 15 days. At the end of the trial period, our users are invited to purchase a license to one or more components of the enhanced bundle by making a one time payment to us. If they choose not to do so, they still enjoy playback and creation functionality equivalent to our free software bundle. We believe that downloads of this software benefit our business both directly and indirectly. Our business benefits directly from increased revenues when the user downloads a for-pay version. Our business benefits indirectly when free or trial versions are downloaded, as we believe such downloads increase our installed base and therefore the demand for consumer hardware devices that contain our technologies.

We derive revenue from advertisements or third party software applications that we embed in or include with the software packages we offer to consumers. In March 2009, we entered into a new promotion and distribution agreement with Google. Pursuant to this new agreement, we have agreed to distribute Google products, including Google's new web browser, Google Chrome, and the Google Toolbar for Internet Explorer, with our software products and Google has agreed to pay us fees based on successful activations of these products. Pursuant to the terms of the agreement with Google, this agreement expires on February 28, 2011, or upon the achievement of a maximum distribution commitment, however the agreement may be extended for up to two years beyond the original term at Google's option.

We derive revenue by acting as an application service provider for third party owners of digital video content. We provide encoding, content storage and distribution services to these third parties in exchange for a percentage of the revenue they receive from sales of digital content to consumers. We also derive revenues by encoding third-party content into the DivX format to allow such content to be delivered more efficiently via the Internet. Revenues for content distribution and other services have declined slightly for each of the last three years. We record revenue related to content distribution arrangements with consumer hardware OEMs who pay us a fee for each copy of DivX-encoded content that is encoded on physical media and bundled with their consumer hardware products.

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Cost of revenues

Our cost of revenues consists primarily of license fees payable to providers of intellectual property that is included in our technologies. Generally, royalties are due to our third-party intellectual property providers periodically, based on when certain of our products are sold, subject to contractually agreed-upon limits. To a much lesser extent, cost of revenues also includes depreciation on certain computing equipment and related software, the compensation of related employees, Internet connectivity costs, third-party payment processing fees and related overhead. Although this may not be the case in the future, and although we have experienced some variability to our cost of revenue structure in the past, in general our costs of revenues have not been highly variable with revenue volumes. As a result, we generally expect our overall gross margins to fluctuate with revenues.

Selling, general and administrative

The majority of selling, general and administrative expenses consists of employee compensation costs. Selling, general and administrative expense also includes marketing expenses, business travel costs, trade show costs, outside consulting fees and related overhead. Our headcount for selling, general, and administrative related personnel, including employees and outside contractors decreased by 23 from 189 as of June 30, 2008 to 166 as of June 30, 2009, primarily due to the reduction in our work force that we implemented in December 2008. If the need arises, we may hire additional employees or outside contractors for our selling, general and administrative staff and may increase our selling, general and administrative budget to meet future needs.

Product development

The majority of product development expense consists of employee compensation for personnel responsible for the development of new technologies and products. Our headcount for product development related personnel, including employees and outside contractors increased by 13 from 155 as of June 30, 2008 to 168 as of June 30, 2009, primarily to support our development efforts at MainConcept. Product development expense also includes depreciation of computer and related equipment, software license fees and related overhead. If the need arises, we may hire additional employees to meet our business needs. If permanent employees are not available for hire, we may use outside contractors to fulfill our labor needs when and as required to accomplish our operating goals.

Critical accounting policies

This discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements in accordance with GAAP requires us to use accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expenses during a fiscal period. We consider an accounting policy to be critical if it is important to our financial condition and results of operations, and if it requires significant judgment and estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our Board of Directors, and the audit committee has reviewed our related disclosures. Although we believe that our judgments and estimates are appropriate and reasonable, actual results may differ from those estimates.

Our critical accounting policies are described in the notes to the audited consolidated financial statements as of and for the year ended December 31, 2008 included in our Annual Report on Form 10-K filed with the SEC.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*, or SFAS No. 168. SFAS No.168 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP in the United States. SFAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We do not expect the adoption of SFAS No. 168 to have a material impact on our consolidated results of operations or financial condition.

Results of Operations

The following table presents our results of operations as a percentage of total net revenues for the periods indicated:

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	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
	(unaudited)		(unaudited)	
Net revenues:				
Technology licensing	90%	77%	95%	77%
Media and other distribution and services	10	23	5	23
Total net revenues	100	100	100	100
Cost of revenues:				
Cost of technology licensing	14	4	13	4
Cost of media and other distribution and services	1	1	1	1
Total cost of revenues	15	5	14	5
Gross profit	85	95	86	95
Operating expenses:				
Selling, general and administrative(1)	78	59	72	62
Product development(1)	30	25	28	23
Impairment of acquired intangibles	—	1	—	3
Total operating expenses	108	85	100	88
Income (loss) from operations	(23)	10	(14)	7
Interest income and expense, net	3	5	3	6
Other income (expense), net	3	—	—	1
Income (loss) before income taxes	(17)	15	(11)	14
Income tax provision (benefit)	(2)	7	—	5
Net income (loss)	(15)%	8%	(11)%	9%

(1) The following table presents details of total stock-based compensation expense included in each functional line item in the unaudited consolidated statements of operations above:

Selling, general and administrative	12%	9%	11%	7%
Product development	3	3	2	2

Net Revenues

The following table summarizes and analyzes the revenues we earned for the three and six months ended June 30, 2009 and 2008 (in thousands):

	Three Months Ended		Change		Six Months Ended		Change	
	June 30,	June 30,	\$	%	June 30,	June 30,	\$	%
	2009	2008			2009	2008		
Net revenues:								
Technology licensing								
Consumer hardware devices	\$10,740	\$13,411	\$(2,671)	(20)%	\$24,448	\$30,201	\$(5,753)	(19)%
<i>% of total net revenues</i>	70 %	63 %			72 %	65 %		
Software	2,985	2,999	(14)	0	7,883	5,287	2,596	49
<i>% of total net revenues</i>	20 %	14 %			23 %	12 %		
Total technology licensing	13,725	16,410	(2,685)	(16)	32,331	35,488	(3,157)	(9)
<i>% of total net revenues</i>	90 %	77 %			95 %	77 %		
Advertising and third-party product distribution	1,389	4,735	(3,346)	(71)	1,390	10,533	(9,143)	(87)
<i>% of total net revenues</i>	9 %	22 %			4 %	22 %		
Content distribution and related services	120	174	(54)	(31)	190	320	(130)	(41)%
<i>% of total net revenues</i>	1 %	1 %			1 %	1 %		
Total net revenues	\$15,234	\$21,319	\$(6,085)	(29)%	\$33,911	\$46,341	\$(12,430)	(27)%

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Technology licensing—consumer hardware devices: The \$2.7 million, or 20%, decrease in net revenues from technology licensing to consumer hardware device manufacturers from the three months ended June 30, 2008 to the three months ended June 30, 2009, and the \$5.8 million, or 19% decrease in net revenues from technology licensing to consumer hardware device manufacturers from the six months ended June 30, 2008 to the six months ended June 30, 2009 resulted primarily from a decrease in net royalty revenues associated with decreased shipped-unit volumes of devices that incorporate our technologies reported to us by our licensee partners.

Technology licensing—software : Software licensing revenue from the three months ended June 30, 2008 to the three months ended June 30, 2009, remained consistent at approximately \$3.0 million. The \$2.6 million, or 49%, increase in software licensing revenue from the six months ended June 30, 2008 to the six months ended June 30, 2009 was primarily due to a \$2.0 million increase from software development and licensing revenues from licensing customers, and approximately \$600,000 of additional revenue recognized upon early termination of the support period over which revenue is being recognized on a prior version of our website software as a result of our launch of a new version of our website software in January 2009.

Advertising and third-party product distribution: The \$3.3 million, or 71%, decrease in advertising and third-party product distribution revenue from the three months ended June 30, 2008 to the three months ended June 30, 2009, and the \$9.1 million, or 87%, decrease in advertising and third-party product distribution revenue from the six months ended June 30, 2008 to the six months ended June 30, 2009 resulted primarily from the loss of revenue under our advertising services agreement with Yahoo!. Revenue from the three and six months ended June 30, 2008 included \$4.7 million and \$10.3 million, respectively, of revenue from Yahoo! pursuant to our prior agreement, under which Yahoo! paid us fees based on the number of certain distributions or installations of the Yahoo! software by consumers. In November 2008, Yahoo! notified us that they intended to breach this two-year advertising services agreement and would discontinue making payments required under the agreement. As a result, no revenue from Yahoo! was recorded during the six months ended June 30, 2009. As we consider the potential receipt of damages from Yahoo! to be a gain contingency, no amounts have been recorded as of June 30, 2009. On March 9, 2009, we entered into a promotion and distribution agreement with Google, Inc., or Google, pursuant to which we agreed to distribute Google's products with our software offerings. Google has agreed to pay us fees under the agreement based on successful activations of Google's products. Distribution revenue pursuant to the agreement, starting with Google's new browser, Chrome, commenced during the three months ended June 30, 2009, during which revenue was \$1.3 million.

Content distribution and related services: The \$54,000, or 31%, decrease in content distribution and related services revenue from the three months ended June 30, 2008 to the three months ended June 30, 2009, and the \$130,000, or 41%, decrease in content distribution and related services revenue from the six months ended June 30, 2008 to the six months ended June 30, 2009 primarily reflects a decrease in sales by our Open Video System, or OVS, customers and in encoding revenues. Our OVS is a complete hosted service that allows content creators to deliver high-quality DivX video content over the Internet. We use our OVS to provide content and service providers with encoding services, content storage and distribution services, and use of our DivX media format and digital rights management technology. Using our OVS, a content service provider can launch its own web store and sell content online.

Gross profit

The following table shows the gross profit earned on each of our revenue streams for the three and six months ended June 30, 2009 and 2008 in absolute dollars and as a percentage of related revenues (in thousands):

	Three months ended June 30,		Change		Six months ended June 30,		Change	
	2009	2008	\$	%	2009	2008	\$	%
Gross profit								
Technology licensing	\$11,559	\$15,454	\$(3,895)	(25)%	\$27,754	\$33,496	\$ (5,742)	(17)%
<i>Gross margin %</i>	84 %	94 %			86 %	94 %		
Advertising and third-party distribution	1,305	4,685	(3,380)	(72)	1,203	10,440	(9,237)	(88)
<i>Gross margin %</i>	94 %	99 %			87 %	99 %		
Content distribution and related services	69	38	31	82	66	55	11	20
<i>Gross margin %</i>	57 %	22 %			35 %	17 %		
Total gross profit	<u>\$12,933</u>	<u>\$20,177</u>	<u>\$(7,244)</u>	<u>(36)%</u>	<u>\$29,023</u>	<u>\$43,991</u>	<u>\$(14,968)</u>	<u>(34)%</u>
<i>Gross margin %</i>	85 %	95 %			86 %	95 %		

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Technology licensing : The decrease in our technology licensing gross profit and the associated decrease in gross margin of \$3.9 million, or 25%, from the three months ended June 30, 2008 to the three months ended June 30, 2009, and \$5.7 million, or 17%, from the six months ended June 30, 2008 and the six months ended June 30, 2009 were due primarily to a decrease in our technology licensing revenue and the impact of our H.264 license cost of approximately \$1.3 million and \$2.5 million, respectively, associated with the launch of the new version of our website software during the first quarter of 2009.

Advertising and third-party distribution : The decrease in our advertising and third-party distribution gross profit and the associated gross margin of \$3.4 million, or 72%, from the three months ended June 30, 2008 to the three months ended June 30, 2009, and \$9.2 million or 88% from the six months ended June 30, 2008 to June 30, 2009 were primarily due to loss in toolbar revenue under our advertising services agreement with Yahoo!, offset during the three months ended June 30, 2009 by revenue under our agreement with Google.

Content distribution and related services : Our content distribution and related services gross margin increased \$31,000, or 82% from the three months ended June 30, 2008 to the three months ended June 30, 2009 and \$11,000, or 20%, from the six months ended June 30, 2008 to the six months ended June 30, 2009, primarily due to a decrease in Internet connectivity costs resulting from a change in service providers.

Operating expenses

The following table summarizes and analyzes our operating expenses for the three and six months ended June 30, 2009 and 2008 (in thousands):

	Three months ended June 30,		Change		Six months ended June 30,		Change	
	2009	2008	\$	%	2009	2008	\$	%
Operating expenses:								
Selling, general and administrative	\$11,875	\$12,573	\$ (698)	(6)%	\$24,584	\$28,550	\$(3,966)	(14)%
<i>% of total net revenues</i>	78 %	59 %			72 %	62 %		
Product development	4,633	5,366	(733)	(14)%	9,334	10,791	(1,457)	(13)%
<i>% of total net revenues</i>	30 %	25 %			28 %	23 %		
Impairment of acquired intangibles	—	250	(250)	(100)%	—	1,250	(1,250)	(100)%
<i>% of total net revenues</i>	—	1 %			—	3 %		
Total operating expenses	<u>\$16,508</u>	<u>\$18,189</u>	<u>\$(1,681)</u>	<u>(9)%</u>	<u>\$33,918</u>	<u>\$40,591</u>	<u>\$(6,673)</u>	<u>(16)%</u>

Selling, general and administrative : The \$700,000, or 6%, decrease in selling, general and administrative expenses from the three months ended June 30, 2008 to the three months ended June 30, 2009, was primarily due to a decrease of approximately \$600,000 in compensation and benefits expense primarily as a result of a reduction in our workforce that we implemented in December 2008, a decrease in travel expense of \$300,000, and a decrease in facility costs of \$300,000. These decreases were partially offset by increases in professional services, primarily legal expense, of \$500,000, and marketing and promotion expenses of \$100,000.

The \$4.0 million, or 14% decrease in selling, general and administrative expenses from the six months ended June 30, 2008 to the six months ended June 30, 2009, primarily included: (1) a \$1.6 million decrease in Internet connectivity related costs primarily associated with the shut-down of our online video community service, Stage6, on February 29, 2008; (2) a decrease of \$1.0 million in travel expenses, (3) a decrease of approximately \$500,000 for office and equipment rental expenses, (4) a decrease of approximately \$300,000 for marketing and promotion expenses, (5) a \$900,000 decrease in compensation and benefits expense, partially due to our shut-down of Stage6 and the reduction in our workforce that we implemented in December 2008; and (6) a decrease of approximately \$100,000 in other miscellaneous expenses. These decreases were partially offset by an increase of approximately \$800,000 in professional service expenses, primarily legal service expenses, and an increase of approximately \$300,000 in share-based compensation expenses.

Product development : The \$700,000, or 14%, decrease in product development expenses from the three months ended June 30, 2008 to the three months ended June 30, 2009 was primarily due to a decrease of approximately \$600,000 in compensation and benefits as a result of our shut-down of Stage6 and the reduction in our workforce that we implemented in December 2008, and a decrease of approximately \$50,000 in share-based compensation expenses.

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The \$1.5 million, or 13%, decrease in product development expenses from the six months ended June 30, 2008 to the six months ended June 30, 2009 was primarily due to a decrease of approximately \$1.1 million in compensation and benefits as a result of our shut-down of Stage6 and the reduction in our workforce that we implemented in December 2008, and a decrease of approximately \$200,000 in share-based compensation expenses.

Impairment of acquired intangibles : In the three and six months ended June 30, 2008 we recorded an impairment charge of \$250,000 and \$1.3 million, respectively related to the patented technology license intangible asset acquired in connection with our acquisition of Veatros in July 2007. The asset was fully impaired during 2008 and no impairment charges were recorded in the three and six months ended June 30, 2009.

Interest income and expense, net : We reported net interest income of approximately \$400,000 for the three months ended June 30, 2009 compared to \$1.1 million for the three months ended June 30, 2008 and for the six months ended June 30, 2009, we reported approximately \$1.0 million of net interest income compared to \$2.8 million for the six months ended June 30, 2008. The decreases are reflective of lower interest rates compared to the same period in the prior year.

Other income (expense), net : We recorded approximately \$500,000 of other income for the three months ended June 30, 2009 as compared to approximately \$15,000 of other expense for the same period in 2008. For the six months ended June 30, 2009, we recorded other income of approximately \$100,000 compared to approximately \$500,000 of other income for the six months ended June 30, 2008. The fluctuations in other income (expenses), net were primarily due to foreign exchange fluctuations on our Euro-based intercompany receivable balance.

Income tax provision : We recorded an income tax benefit of \$255,000 for the three months ended June 30, 2009, based upon a 10% effective tax rate, compared to a provision of \$1.4 million for the three months ended June 30, 2008 based upon a 46% effective tax rate. For the six months ended June 30, 2009, we recorded a provision for income taxes of \$61,000, based on a 2% effective tax rate, compared to \$2.5 million, or 38% effective tax rate for the six month ended June 30, 2008. The income tax provision recorded during the six months ended June 30, 2009 included discrete items of approximately \$1.2 million. These discrete items are made up of approximately \$750,000 relating to a decrease to certain deferred tax assets as a result of a California tax law change that was enacted in February 2009 and recorded during the first quarter of 2009. This change allows an elective single sales factor for state apportionment for taxable years beginning on or after January 1, 2011. We expect to benefit from the California single sales factor election for apportioning income for years 2011 and beyond. As a result of its anticipated election of the single sales factor, in accordance with SFAS No. 109, we have re-measured our deferred tax assets taking into account the reversal pattern and the expected California tax rate under the elective single sales factor. The discrete items also include an increase to income tax provision of approximately \$460,000 relating to the write-off of deferred tax assets associated with cancelled stock options recorded during the six months ended June 30, 2009. Excluding these discrete items, our effective tax rate for the three and six months ended June 30, 2009 was approximately 27% and 31%, respectively, which compares to approximately 46% and 38% for the three and six months ended June 30, 2008, respectively.

The difference between our effective tax rate and the 35% U.S. federal statutory rate for the three and six month period ended June 30, 2009 was primarily due to permanent differences, partially offset by research and development credits and the impact of the discrete items. The difference between our effective tax rate and the 35% U.S. federal statutory rate for the three and six month period ended June 30, 2008 was primarily due to state income taxes and permanent differences, partially offset by research and development credits.

The effective tax rate for the three and six months ended June 30, 2009 is based upon our estimated fiscal 2009 income before income taxes. To the extent the estimate of fiscal 2009 income before income taxes changes, our provision for income taxes will change as well. The effective tax rate for the full year 2009 is expected to be approximately 32%, excluding any discrete items.

Liquidity and capital resources

The following table presents data regarding our liquidity and capital resources (in thousands):

	June 30, 2009	December 31, 2008
Cash, cash equivalents and short-term investments	\$135,934	\$ 117,339
Working capital	135,892	115,762
Total assets	194,066	193,401

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Cash Flows (in thousands):

	Six Months Ended June 30,	
	2009	2008
Net cash provided by operating activities	\$ 4,050	\$ 1,392
Net cash (used in) provided by investing activities	(25,365)	32,188
Net cash provided by (used in) financing activities	960	(19,382)
Effect of exchange rate changes on cash	119	55
Net (decrease) increase in cash and cash equivalents	(20,236)	14,253
Cash and cash equivalents at beginning of period	43,442	14,532
Cash and cash equivalents at end of period	<u>\$ 23,206</u>	<u>\$ 28,785</u>

Cash provided by operating activities : The \$4.1 million of cash provided by operating activities for the six months ended June 30, 2009 was primarily due to a decrease in accounts receivable of \$5.9 million, non-cash share-based compensation of \$4.6 million, and non-cash depreciation and amortization expenses of \$3.0 million, partially offset by net loss of \$3.8 million, an increase in prepaid and other assets of \$1.8 million, an increase in income taxes receivable of \$1.9 million, a decrease in accrued liabilities of \$1.0 million, and a decrease in deferred revenue of approximately \$500,000.

The \$1.4 million of cash provided by operating activities for the six months ended June 30, 2008 was primarily due to net income of \$4.2 million, non-cash share-based compensation of \$4.4 million, and non-cash depreciation and amortization expenses of \$2.3 million, offset by a \$5.2 million increase in accounts receivable, a \$2.7 million increase in deferred tax, and changes in other working capital accounts, primarily decreases in accounts payable and accrued liabilities.

Cash (used in) provided by investing activities: The \$25.4 million of cash used in investing activities for the six months ended June 30, 2009 was due to purchases of investments of \$78.6 million, offset by sales and maturities of investments of \$53.8 million.

The \$32.2 million provided by investing activities for the six months ended June 30, 2008 was primarily due to \$105.8 million in proceeds from sales and maturities of investments offset by \$69.4 million in purchases of investments, \$1.8 million of cash paid for the Veatros acquisition, \$1.3 million in purchases of property and equipment and \$1.2 million of milestone payments made for the MainConcept acquisition.

Cash provided by (used in) financing activities : The \$960,000 cash provided by financing activities for the six months ended June 30, 2009 was primarily due to the proceeds of \$500,000 from shares issued under the employee stock purchase plan, and \$400,000 from the excess tax benefit from the exercise of stock options.

The \$19.4 million net cash used in financing activities for the six months ended June 30, 2008 was primarily due to the \$20.0 million used in the repurchase of our common stock offset by approximately \$700,000 in proceeds from the exercise of stock options and shares issued under the employee stock purchase plan.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and rates. We are exposed to market risk primarily in the area of changes in United States interest rates and foreign currency exchange rates as measured against the U.S. dollar. These exposures are directly related to our normal operating and funding activities. We have not used derivative financial or commodity instruments or engaged in hedging activities.

Interest Rate Risk

All of our fixed income investments are classified as available-for-sale and are therefore reported on the balance sheet at market value. The fair values of our cash equivalents and investments are subject to change as a result of changes in market interest rates and investment risk related to the issuers' credit worthiness. To minimize these risks, we maintain an investment portfolio of various holdings, types and maturities. We have established guidelines relative to diversification and maturities that attempt to maintain safety and liquidity. These guidelines are periodically reviewed and modified, if necessary. We do not utilize financial contracts to manage our exposure in our investment portfolio to changes in interest rates. At June 30, 2009, we had \$140.0 million in cash, cash equivalents, short-term and long-term investments, all of which are stated at fair value. Changes in market interest rates would not be expected to have a material impact on the fair value of \$23.2 million of our cash and cash equivalents at June 30, 2009, as these

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consisted of securities with maturities of less than three months. The weighted-average maturity of our investments excluding auction rate securities as of June 30, 2009 was approximately six months. A 100 basis point increase or decrease in interest rates over a six month period from those in effect at June 30, 2009 would, however, decrease or increase, respectively, the remaining \$116.8 million of our investments by approximately \$700,000. While changes in interest rates may affect the fair value of our investment portfolio, any gains or losses will not be recognized in our consolidated statements of operations until the investment is sold or if the reduction in fair value was determined to be other than temporary.

At June 30, 2009, we held approximately \$4.5 million of municipal bond investments in par value, classified as long-term assets, with an auction reset feature, or auction rate securities, or ARS, whose underlying assets are student loans which are substantially backed by the federal government. Since February 2008, these auctions have failed and therefore continue to be illiquid and we will not be able to access these funds until a future auction of these investments is successful or a buyer is found outside of the auction process. As a result, our ability to liquidate our investment and fully recover the carrying value of our investment in the near term may be limited or may not exist. If the issuers are unable to successfully close future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments.

In November 2008, we accepted an offer, from UBS AG, or UBS, entitling us to sell at par value ARS originally purchased from UBS at any time during a two-year period from June 30, 2010 through July 2, 2012. If UBS has insufficient funding to buy back the ARS and the auction process continues to fail, then we may incur further losses on the carrying value of the ARS.

We believe that, based on our total cash and investments position and our expected operating cash flows, we are able to hold these securities until there is a recovery in the auctions market, which may be at final maturity. As a result, we do not anticipate that the current illiquidity of these ARS will have a material effect on our cash requirement or working capital.

Foreign Currency Exchange Rate Risk

MainConcept generates revenues and incurs costs which are denominated in local currencies. As exchange rates vary, these results when translated into U.S. dollars may vary from expectations and may adversely impact overall expected results.

Additionally, at June 30, 2009, we had a receivable balance denominated in Euros due from MainConcept. Our outstanding receivable balance is translated into U.S. dollars for financial reporting purposes, with unrealized gains and losses included as a component of other income (expense), net. A 100 basis point increase or decrease in foreign currency exchange rates over a three month period from those in effect at June 30, 2009 would not materially impact our financial position, results of operations and cash flows. During the six months ended June 30, 2009, we recorded approximately \$26,000 of foreign currency losses related to our foreign currency receivable denominated in Euros in other income (expense), net on our consolidated statements of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures: We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Securities and Exchange Commission Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting. There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

On October 22, 2007, following the filing of our declaratory relief action which was subsequently dismissed, UMG filed a lawsuit against us in the Central District of California. UMG's suit alleges copyright infringement and seeks monetary damages related to our operation of the Stage6 online video community service, which we shut down on February 29, 2008. We believe we have meritorious defenses to UMG's claims and will assert them vigorously. Still, litigation is inherently uncertain and there can be no guarantee that we will prevail or that the litigation will not have material adverse consequences for us; an unfavorable resolution of these proceedings could materially affect our future operating results or financial conditions in particular periods.

On November 11, 2008, Yahoo! informed us that it intended to breach the two-year License and Distribution Agreement, the Distribution Agreement, entered into between Yahoo! and us on September 27, 2007 and to discontinue making payments required under the Distribution Agreement. As a result, in November 2008, we filed a lawsuit in California Superior Court in Santa Clara County seeking damages from Yahoo! and specific performance under the Distribution Agreement. As we consider the potential receipt of damages from Yahoo! to be a gain contingency, no amounts have been recorded as of June 30, 2009.

We are also involved in various legal proceedings from time to time arising from the normal course of business activities, including commercial, employment and other matters. In our opinion, resolution of these proceedings is not expected to have a material adverse effect on our operating results or financial condition. However, it is possible that an unfavorable resolution of one or more such proceedings could materially affect our future operating results or financial condition in a particular period.

Item 1A. Risk Factors

Before you decide to invest or maintain an interest in our common stock, you should consider carefully the risks described below, together with the other information contained in this Quarterly Report on Form 10-Q. We believe the risks described below are the risks that are material to us as of the date of this Quarterly Report on Form 10-Q. If any of the following risks comes to fruition, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock could decline and you may lose all or part of your investment.

The risk factors set forth below with an asterisk () next to the title are new risk factors or risk factors containing changes, including any material changes, from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the Securities and Exchange Commission.*

Risks Related to our Business

Our business and prospects depend on the strength of our brand, and if we do not maintain and strengthen our brand, we may be unable to maintain or expand our business.

Maintaining and strengthening the "DivX" brand is critical to maintaining and expanding our business, as well as to our ability to enter into new markets for our technologies and products. If we fail to promote and maintain the DivX brand successfully, our ability to sustain and expand our business and enter into new markets will suffer. Maintaining and strengthening our brand will depend heavily on our ability to continue to develop and provide innovative and high-quality technologies and products for consumers, content owners, consumer hardware device manufacturers and software vendors. Moreover, because we engage in relatively little direct brand advertising, the promotion of our brand depends, among other things, upon hardware device manufacturing partners displaying our trademarks on their products. If these partners choose for any reason not to display our trademarks on their products, or if our partners use our trademarks incorrectly or in an unauthorized manner, the strength of our brand may be diluted or our ability to maintain or increase our brand awareness may be harmed. In addition, if we fail to maintain high-quality standards for products that incorporate our technologies through the quality-control certification process that we require of our licensees, or if we take other steps to commercialize our products and services that our customers or potential customers reject, the strength of our brand could be adversely affected. Further, unauthorized third parties may use our brand in ways that may dilute or undermine its strength.

****We do not expect sales of DVD players to continue to grow as quickly as they have in the past. To the extent that sales of DVD players level off or decline, or alternative technologies in which we do not participate replace DVDs as a dominant medium for consumer video entertainment, our licensing revenue will be adversely affected.***

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Growth in our revenue over the past several years has been the result, in large part, of the rapid growth in sales of red-laser DVD players incorporating our technologies. For the six months ended June 30, 2009, 2008 and 2007, we derived approximately 72%, 65% and 70%, respectively, of our total net revenues from technology licensing to consumer hardware device manufacturers, a majority of which are derived from sales of red-laser DVD players incorporating our technologies. However, as the markets for DVD players mature, we do not expect sales of red-laser DVD players to continue to grow as quickly as they have in the past. To the extent that sales of red-laser DVD players level off or decline, our licensing revenue will be adversely affected. In addition, if new technologies are developed for use with DVDs or new technologies are developed that substantially compete with or replace red-laser DVDs as a dominant medium for consumer video entertainment such as high definition DVD or Blu-ray Disc, and if we are unable to develop and successfully market technologies that are incorporated into or compatible with such new technologies, our ability to generate revenues will be adversely affected.

If we are unable to penetrate existing markets or adapt or develop technologies and products for new markets, our business prospects could be limited.

We expect that our future success will depend, in part, upon our ability to successfully penetrate existing markets for digital media technologies, including:

- DVD players;
- DVD recorders;
- network connected DVD players;
- high definition DVD players;
- portable media players;
- digital still cameras;
- digital camcorders;
- mobile handsets;
- digital media software applications;
- digital TVs;
- home media centers;
- set-top boxes; and
- video game consoles.

To date, we have penetrated only some of these markets, including the markets for DVD players, network connected DVD players, high definition DVD players, portable media players, digital still cameras, digital TVs, mobile handsets, digital media software applications, set-top boxes, and video game consoles. Our success depends upon our ability to further penetrate these markets, some of which we have only penetrated to a limited extent, and to successfully penetrate those markets in which we currently have no presence. Demand for our technologies in any of these developing markets may not grow or develop, and a sufficiently broad base of consumers and professionals may not adopt or continue to use our technologies. In addition, our ability to generate revenue from these markets may be limited to the extent that service providers in these markets choose to provide competitive technologies and entertainment at little or no cost. Because of our limited experience in certain of these markets, we may not be able to adequately adapt our business and our technologies to the needs of consumers and licensees in these markets.

****We face significant competition in various markets, and if we are unable to compete successfully, our ability to generate revenues from our business will suffer.***

We face significant competition in the digital media markets in which we operate. We believe that our most significant competitive threat comes from companies that have the collective financial, technical and other resources to develop the technologies, services, products and partnerships necessary to create a digital media ecosystem that can compete with the DivX ecosystem. Those potential competitors currently include Adobe Systems, Apple Computer, Google, Microsoft, News Corporation, Sony and Yahoo!.

We also compete with companies that offer products or services that compete with specific aspects of our digital media ecosystem. For example, our digital rights management technology competes with technologies from companies such as Apple Computer, ContentGuard, Intertrust Technologies, Microsoft, Nagra Audio, NDS Group and 4C Entity, as well as the internal development

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efforts of certain of our licensees. Similarly, content distribution providers, such as Amazon.com, Apple Computer, CinemaNow, a subsidiary of Sonic Solutions, Google, Joost, MovieLink, a subsidiary of Blockbuster Inc., MySpace.com, a subsidiary of News Corporation, Netflix, Yahoo!, YouTube, a subsidiary of Google, Hulu, LLC and subscription entertainment services and cable and satellite providers compete with our content distribution services.

Our proprietary technologies also compete with other video compression technologies, including other implementations of MPEG-4 or implementations of H.264/AVC. In addition, a number of companies such as Adobe Systems, Apple Computer, Atome, Google, Microsoft, On2 Technologies and RealNetworks offer video formats that compete with our proprietary video format.

We also face competition from subscription entertainment services, cable and satellite providers, DVDs and other emerging technologies and products related to content distribution. Our content distribution platforms and services face significant competition from services, such as peer-to-peer and content aggregator services, which allow consumers to directly access an expansive array of content without securing licenses from content providers.

Some of our current or future competitors may have significantly greater financial, technical, marketing and other resources than we do, may enjoy greater brand recognition than we do, or may have more experience or advantages than we have in the markets in which they compete. For example, companies such as Amazon.com, Apple Computer, Google, Microsoft, Sony, Yahoo! and Adobe Systems may have competitive advantages over us because of their greater size and resources and the strength of their respective brand names. In addition, some of our current or potential competitors, such as Apple Computer, Dolby Laboratories, Microsoft and Sony, may be able to offer integrated system solutions in certain markets for entertainment technologies, including audio, video and rights management technologies related to personal computers or the Internet, which could make competing products and technologies that we develop unnecessary. By offering an integrated system solution, these potential competitors also may be able to offer competing products and technologies at lower prices than our products and technologies. Further, many of the consumer hardware and software products that include our technologies also include technologies developed by our competitors. As a result, we must continue to invest significant resources in product development in order to enhance our technologies and our existing products and introduce new high-quality technologies and products to meet the wide variety of such competitive pressures. Our ability to generate revenues from our business will suffer if we fail to do so successfully.

****We are dependent on the sale by our licensees of consumer hardware and software products that incorporate our technologies. Our top 10 licensees by revenue accounted for approximately 64% of our total net revenues during the six months ended June 30, 2009, and a reduction in revenues from those licensees or a loss of one or more of our key licensees would adversely affect our licensing revenue.***

We derive most of our revenue from the licensing of our technologies to consumer hardware device manufacturers, software vendors and consumers. We derived 95% and 77% of our total net revenues from licensing our technology during the six months ended June 30, 2009 and 2008, respectively. One or a small number of our licensees generally represents a significant percentage of our technology licensing revenues. For example, in the six months ended June 30, 2009, Sony, Philips and Samsung accounted for approximately 13%, 9% and 12% of our total net revenues, respectively, and our top 10 licensees by revenue accounted for approximately 64% of our total net revenues. Our technology licensing revenues are particularly dependent upon our relationships with consumer hardware device manufacturers. We cannot control consumer hardware device manufacturers' and software developers' product development or commercialization efforts or predict their success. Our license agreements typically require manufacturers of consumer hardware devices and software vendors to pay us a specified royalty for every shipped consumer hardware or software product that incorporates our technologies, but many of these agreements do not require these manufacturers to guarantee us a minimum royalty in any given period. Accordingly, if our licensees sell fewer products incorporating our technologies, or otherwise face significant economic difficulties, our licensing revenues will be adversely affected. Additionally, certain of our license agreements provide for specific royalties based on our estimations of the volumes of certain units consumer hardware device manufacturers are likely to ship during a given term; if our estimates are too low, the actual per-unit revenues received may be lower than expected. Our license agreements are generally for two years or less in duration, and a significant number of these agreements expire in any given quarter. Upon expiration of their license agreements, manufacturers and software developers may not renew their agreements or may elect not to enter into new agreements with us on terms as favorable as our current agreements.

****Our March 2009 promotion and distribution agreement with Google may not prove to be an adequate replacement for our September 2007 agreement with Yahoo!.***

Pursuant to our September 2007 agreement with Yahoo!, we agreed to distribute a version of Internet Explorer browser optimized for Yahoo! and a co-branded version of the Yahoo! Toolbar with our software products and Yahoo! agreed to pay us fees based on the number of certain distributions or installations of the Yahoo! software. In November 2008, Yahoo! notified us that it intended to breach the two-year advertising services agreement and would discontinue making payments required under the

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agreement. As a result, we filed a lawsuit in California Superior Court seeking damages from Yahoo! and specific performance under the agreement. In March 2009, we entered into a new agreement with Google, pursuant to which we distribute Google products, including its new web browser, Google Chrome, and the Google Toolbar for Internet Explorer, with our software products and Google pays us fees based on successful activations of these products. Revenue under the Google agreement was lower for the three months ended June 30, 2009 than the revenue earned under the Yahoo! agreement during the corresponding period in 2008, and future revenue under the Google agreement may be less than we currently anticipate. Also, if Google's products do not prove to be as popular among consumers as we anticipate, if our products decline in popularity among consumers, or if Google's products quickly reach market saturation, we may experience a decrease in revenue under our agreement with Google.

The success of our business depends on the availability of premium video content in the DivX format.

To date, only four Hollywood motion picture studios have agreed to make certain video content available in the DivX media format. If we, and/or our consumer electronics partners or retail partners, fail to implement certain technological safeguards mandated under those deals, such format approval agreements may be suspended or terminated, either of which could negatively impact our business. The implementation of these changes could potentially be viewed negatively by consumers and as a result our business could suffer. Additionally, the distribution of such DivX-formatted video content is dependent on third party retailers' willingness to enter into distribution deals with one or more of our studio partners and DivX and ultimately upon the willingness of consumers to purchase such content from such third party retailers. Finally, our business success depends upon our ability to reach agreement with other major motion picture studios to make their content available in the DivX media format. In the event that we fail to reach agreement with such studios, the DivX format may become less compelling to consumers and to retailers and potentially to consumer electronics licensees of DivX.

The success of our business depends on the interoperability of our technologies with consumer hardware devices.

To be successful we design our digital media platform to interoperate effectively with a variety of consumer hardware devices, including personal computers, DVD players, DVD recorders, network connected DVD players, high definition DVD players, digital still cameras, digital camcorders, portable media players, digital TVs, home media centers, set-top boxes, video game consoles, and mobile handsets. We depend on significant cooperation with manufacturers of these devices and the components integrated into these devices, as well as software providers that create the operating systems for such devices, to incorporate our technologies into their product offerings and ensure consistent playback of DivX-encoded files. Currently, a limited number of devices are designed to support our technologies. If we are unsuccessful in causing component manufacturers, device manufacturers and software providers to integrate our technologies into their product offerings, our technologies may become less accessible to consumers, which would adversely affect our revenue potential.

If we fail to develop and deliver innovative technologies and products in response to changes in our industry, including changes in consumer tastes or trends, our revenues could decline.

The markets for our technologies and products are characterized by rapid change and technological evolution. We will need to expend considerable resources on product development in the future to continue to design and deliver enduring and innovative technologies and products. Despite our efforts, we may not be able to develop and effectively market new technologies and products that adequately or competitively address the needs of the changing marketplace. In addition, we may not correctly identify new or changing market trends at an early enough stage to capitalize on market opportunities. At times such changes can be dramatic. Our future success depends to a great extent on our ability to develop and deliver innovative technologies that are widely adopted in response to changes in our industry and that are compatible with the technologies or products introduced by other participants in our industry. If we fail to deliver innovative technologies, we may be unable to meet changes in consumer tastes or trends, which could decrease our revenues.

Our licensing revenue depends in large part upon integrated circuit manufacturers incorporating our technologies into their products for sale to our consumer hardware device manufacturer licensees and if our technologies are not incorporated in these integrated circuits or fewer integrated circuits are sold that incorporate our technologies, our revenues will be adversely affected.

Our licensing revenue from consumer hardware device manufacturers depends in large part upon the availability of integrated circuits that incorporate our technologies. Integrated circuit manufacturers incorporate our technologies into their products, which are then incorporated into consumer hardware devices. We do not manufacture integrated circuits, but rather depend on integrated circuit manufacturers to develop, produce and sell these products to licensed consumer hardware device manufacturers. We do not control the integrated circuit manufacturers' decision whether or not to incorporate our technologies into their products, and we do not control their product development or commercialization efforts. If we fail to develop new technologies that adequately or competitively address the needs of the changing marketplace, integrated circuit manufacturers may not be willing to implement our technologies into their products. The process utilized by integrated circuit manufacturers to design, develop, produce and sell their products is generally 12 to 18 months in duration. As a result, if an integrated circuit manufacturer is unwilling or unable to implement our

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technologies into an integrated circuit that it is producing, we may experience significant delays in generating revenue while we wait for that manufacturer to begin development of a new integrated circuit that may incorporate our technologies. In addition, while the design cycles utilized by integrated circuit manufacturers are typically long, the life cycles of our technologies tend to be short as a result of the rapidly changing technology environment in which we operate. If integrated circuit manufacturers are unable or unwilling to implement technologies we develop into their products, or if they sell fewer products incorporating our technologies, our revenues will be adversely affected. In addition, if integrated circuit manufacturers incorporate our technology in new ways that make reporting or tracking more difficult, it could adversely affect our ability to collect revenues.

****Our business is dependent in part on technologies we license from third parties, and these license rights may be inadequate for our business.***

Certain of our technologies and products are dependent in part on the licensing and incorporation of technologies from third parties. For example, we have entered into license agreements with MPEG LA pursuant to which we have acquired rights to use in our technologies and products certain MPEG-4 and AVC intellectual property licensed to MPEG LA. Our licensing agreements with MPEG LA grant us sublicenses only to the rights in the relevant intellectual property licensed to MPEG LA. There are other parties who have competing rights to MPEG-4 and AVC intellectual property, and to the extent that the rights of such other parties conflict with or are superior to the rights licensed to MPEG LA, our rights to utilize MPEG-4 or AVC technology in our technologies and products could be challenged. Our license agreement with MPEG LA, under its MPEG-4 Part 2 Visual Patent Portfolio will expire on December 31, 2013. Our license agreement with MPEG LA, under its MPEG-4 Part 10, or AVC, Patent Portfolio will expire on December 31, 2010. MPEG LA has the right to renew each of these license agreements for successive terms of five years, upon notice to us.

If the technology we license fails to perform as expected, if key licensors do not continue to support their technology or intellectual property because the licensor has gone out of business or otherwise, if a licensor determines not to renew a license agreement upon expiration or if it is determined that any of our licensors are not entitled to license to us any of the technologies or intellectual property that are subject to our current license agreements, then we may incur substantial costs in replacing the licensed technologies or intellectual property or fall behind in our development schedule while we search for a replacement. In addition, replacement technology may not be available for license on commercially reasonable terms, or at all.

In addition, our agreements with licensors generally require us to give them the right to audit our calculations of royalties payable to them. If a licensor challenges the basis of our calculations, the amount of royalties we have to pay them could increase. Any royalties paid as a result of a successful challenge would increase our expenses and could impair our ability to continue to use and re-license technologies or intellectual property from that licensor.

We rely on our licensees to accurately prepare royalty reports for our determination of licensing revenues, and if these reports are inaccurate, our revenues may be under- or over-stated and our forecasts and budgets may be incorrect.

Our licensing revenues are generated primarily from consumer hardware device manufacturers and software vendors who license our technologies and incorporate them into their products. Under these arrangements, these licensees typically pay us a specified royalty for every consumer hardware or software product they ship that incorporates our technologies. We rely on our licensees to accurately report the number of units shipped. We calculate our license fees, prepare our financial reports, projections and budgets, and direct our sales and technology development efforts based in part on these reports. However, it is often difficult for us to independently determine whether or not our licensees are reporting shipments accurately. This is especially true with respect to software incorporating our technologies because software can be copied relatively easily and we often do not have ways to readily determine how many copies have been made. Licensees in specific countries, including China, have a history of underreporting or failing to report shipments of their products that incorporate our technologies. Most of our license agreements permit us to audit our licensees' records, but audits are generally expensive and time consuming. We have initiated, and intend to initiate, audits with certain of our licensees to determine whether their shipment reports for past periods were accurate. Such audits could harm our relationships with our licensees or may result in the cancellation or termination of our agreements with such licensees. In addition, the license agreements that we have entered into with most of our licensees impose restrictions on our audit rights, such as limitations on the number of audits we may conduct. To the extent that our licensees understate or fail to report the number of products incorporating our technologies that they ship, we will not collect and recognize revenue to which we are entitled. Alternatively, we have experienced limited instances in which a customer has notified us that it previously reported and paid royalties on units in excess of what the customer actually shipped. In such cases, the customer requested, and we granted, a credit for the excess royalties paid. If a similar event occurs in the future, we may be required to record the credit as a reduction in revenue in the period in which it is granted, and such a reduction could be material.

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Current credit and financial market conditions could delay, or prevent consumers from purchasing products incorporating our licensed technology, which could continue to adversely affect our business, financial condition and results of operations.

Our operations and performance depend significantly on worldwide economic conditions. Uncertainty about current global economic conditions pose a risk as consumers may postpone spending and our licensees may postpone producing products incorporating our technology in response to tighter credit and negative financial news, which could have a material negative effect on demand for our products. These and other economic factors have impacted our results and may have a significant impact on our financial condition and operating results in the future.

The current financial turmoil affecting the banking system and financial markets and the possibility that additional financial institutions may consolidate or go out of business has resulted in a tightening in the credit markets, a low level of liquidity in many financial markets, and extreme volatility in fixed income, credit, currency and equity markets. There could be a number of follow-on effects from the credit crisis on our business, including the insolvency of our licensees or their key suppliers or the inability of our licensees to obtain credit to finance development and/or manufacture products that incorporate our technology. In addition, due to the recent tightening of credit markets and concerns regarding the availability of credit, the markets for consumer hardware and software products in which our technologies are incorporated may be negatively affected and consumers may be delayed in obtaining, or may not be able to obtain, necessary credit for their purchases of the consumer hardware and software products that incorporate our technologies, which could in turn result in reduction in shipments by our licensees. Such reductions would adversely affect our licensing and other revenue. If conditions become more severe or continue longer than we anticipate, our forecasted demand may not materialize to the levels we require to achieve our anticipated financial results, which could in turn have a material adverse effect on our revenue, profitability and the market price of our stock.

Any development delays or cost overruns may affect our ability to respond to technological changes, competitive developments or customer requirements and expose us to other adverse consequences.

We have experienced development delays and cost overruns in our development efforts in the past and we may encounter such problems in the future. Delays and cost overruns could affect our ability to respond to technological changes, competitive developments or customer requirements. Also, our technologies and products may contain undetected errors that could cause increased development costs, loss of revenue, adverse publicity, reduced market acceptance of our technologies and products or lawsuits by participants in the consumer hardware or software industries or consumers.

****We conduct a substantial portion of our business outside North America and, as a result, we face diverse risks related to engaging in international business.***

We have offices in ten foreign countries as well as sales staff in others, and we are dedicating a significant portion of our sales efforts in countries outside North America. We are dependent on international sales for a substantial amount of our total revenues. For the six months ended June 30, 2009, 2008 and 2007, our net revenue outside North America comprised 86%, 73% and 74%, respectively, of our total revenues. We expect that international sales will continue to represent a substantial portion of our revenues for the foreseeable future. These future international revenues will depend to a large extent on the continued use and expansion of our technologies in entertainment industries worldwide. Increased worldwide use of our technologies is also an important factor in our future growth.

We are subject to the risks of conducting business internationally, including:

- our ability to enforce our contractual and intellectual property rights, especially in those foreign countries that do not respect and protect intellectual property rights to the same extent that the United States does, which increases the risk of unauthorized and uncompensated use of our technology;
- United States and foreign government trade restrictions, including those that may impose restrictions on importation of programming, technology or components to or from the United States;
- foreign government taxes, regulations and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the United States, and foreign tax and other laws limiting our ability to repatriate funds to the United States;
- foreign labor laws, regulations and restrictions;
- changes in diplomatic and trade relationships;
- difficulty in staffing and managing foreign operations;
- fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;

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- political instability, natural disasters, war and/or events of terrorism; and
- the strength of international economies.

We face risks with respect to conducting business in China due to China's historically limited recognition and enforcement of intellectual property and contractual rights.

We currently have direct license relationships with dozens of consumer hardware device manufacturers located in China. In addition, a number of the OEMs that license our technologies utilize captive or third-party manufacturing facilities located in China. We expect this to continue in the future as consumer hardware device manufacturing in China continues to increase due to its lower manufacturing cost structure as compared to other industrialized countries. As a result, we face many risks in China, in large part due to China's historically limited recognition and enforcement of contractual and intellectual property rights. In particular, we have experienced, and expect to continue to experience, problems with China-based consumer hardware device manufacturers underreporting or failing to report shipments of their products that incorporate our technologies, or incorporating our technologies or trademarks into their products without our authorization or without paying us licensing fees. We may also experience difficulty enforcing our intellectual property rights in China, where intellectual property rights are not as respected as they are in the United States, Japan and Europe. Unauthorized use of our technologies and intellectual property rights may dilute or undermine the strength of our brand. Further, if we are not able to adequately monitor the use of our technologies by China-based consumer hardware device manufacturers, or enforce our intellectual property rights in China, our revenue potential could be adversely affected.

Pricing pressures on the consumer hardware device manufacturers and software vendors who incorporate our technologies into their products could limit the licensing fees we charge for our technologies and adversely affect our revenues.

The markets for the consumer hardware and software products in which our technologies are incorporated are intensely competitive and price sensitive. For example, retail prices for consumer hardware devices that include our digital media platform, such as DVD players, have decreased significantly in recent years, and we expect prices to continue to decrease for the foreseeable future. In response, consumer hardware device manufacturers and software vendors have sought to reduce their product costs, which can result in downward pressure on the licensing fees we charge our licensees who incorporate our technologies into the consumer hardware and software products that they sell. In addition, we have experienced erosion in the average royalty we can charge for specific versions of our technologies to our OEM partners since the release of these technologies. To maintain higher overall per unit royalties, we must continue to introduce new, more highly functional versions of our products for which we can charge a higher royalty. Any inability to introduce such products in the future or other declines in the royalties we charge would adversely affect our revenues.

Digital video technologies could be treated as a commodity in the future, which could expose us to significant pricing pressure.

We believe that the success we have had licensing our digital video technologies to consumer hardware device manufacturers and software vendors is due, in part, to the strength of our brand and the perception that our technologies provide a high-quality video solution. However, as applications that incorporate digital video technologies become increasingly prevalent, we expect more competitors to enter this field with other solutions. Furthermore, to the extent that competitors' solutions are perceived, accurately or not, to provide the same or greater advantages as our technologies, at a lower or comparable price, there is a risk that video encoding and decoding technologies such as ours will be treated as commodities, exposing us to significant pricing pressure.

Current and future government standards or standards-setting organizations may limit our business opportunities.

Various national governments have adopted or are in the process of adopting standards for digital television broadcasts, including cable and satellite broadcasts. In the event national governments adopt similar standards for video codecs used in consumer hardware devices, software products or Internet applications, our technology may be excluded from such standards. We have not made any efforts to have our technologies adopted as standards by any national governments, nor do we currently expect that our technologies will be adopted as standards by any national government in the future. If national governments adopt standards that exclude our technologies, we will be required to redesign our technologies to comply with such government standards to allow our products to be utilized in those countries. Costs or potential delays in the development of our technologies and products to comply with such government standards could significantly increase our expenses. In addition, standards-setting organizations are adopting or establishing formal technology standards for use in a wide range of consumer hardware devices, software products and Internet applications. We do not typically participate in standards-setting organizations, nor do we typically seek to have our technologies adopted as industry standards. As such, participants in the consumer hardware or software industries or consumers may elect not to purchase our technologies because they have not been adopted by standards-setting organizations or if a competing technology is adopted as an industry standard.

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Our business may depend in part upon our ability to provide effective digital rights management technology.

Our business may depend in part upon our ability to provide effective digital rights management technology that controls access to digital content that addresses, among other things, content providers' concerns over piracy. We cannot be certain that we can continue to develop, license or acquire such technology, or that content licensors, consumer hardware device manufacturers or consumers will accept such technology. In addition, consumers may be unwilling to accept the use of digital rights management technology that limits their use of content, especially with large amounts of free content readily available. We may need to license digital rights management technology from third parties to support our technologies and products. Such technology may not be available to us on reasonable terms, or at all. If digital rights management technology is not effective, is perceived as not effective or is compromised by third parties, or if laws are enacted that require digital rights management technology to allow consumers to convert content stored in a protected format into an unprotected format, content providers may not be willing to encode their content using our products and consumer hardware device manufacturers may not be willing to include our technologies in their products.

We have offered and we expect to continue to offer some of our products and technologies for reduced prices or free of charge, and we may not realize the benefits of this marketing strategy.

We have offered and expect to continue to offer some of our products and technologies to consumers for reduced prices or free of charge as part of our overall strategy of developing a digital media ecosystem and promoting additional penetration of our products and technologies into the markets in which we compete. If we offer such products and technologies at reduced prices or free of charge, we will forego all or a portion of the revenue from licensing these products, and we may not realize the intended benefits of this marketing strategy.

Our online video communities and distribution services and platforms are rapidly evolving and may not prove viable.

Online video distribution is a relatively new enterprise, and successful business models for delivering digital media over the Internet are not fully tested. We have not scaled any of our distribution or community services or platforms to a material size. We may fail to develop a viable business model that properly monetizes our technology platforms for online video communities.

****We may experience changes in the size of our organization, and we may experience difficulties in managing growth or contraction.***

As of June 30, 2009 we had approximately 300 full-time employees. We may need to expand or contract our managerial, operational, financial and other resources to manage our business, including our relationships with key customers and licensees. Our current facilities and systems may not be the correct size to support this future growth or contraction. We may require additional office space to accommodate our growth. Additional office space may not be available on commercially reasonable terms and may result in a disruption of our corporate culture. Our need to effectively manage our operations, growth and various projects requires that we continue to improve our operational, financial and management controls, reporting systems and procedures and to attract and retain sufficient numbers of talented employees. We may be unable to successfully implement these tasks on a larger scale, which could prevent us from executing our business strategy.

We may experience changes in our senior management which may disrupt our operations.

We may experience disruptions in our operations as a result of changes in our senior management and as the new members of our management team become acclimated to their roles and to our company in general. If we experience any of these disruptions or a loss of management attention to our core business, our operating results could be adversely affected.

Our business, in particular our content distribution offerings and community forums, will suffer if our systems or networks fail, become unavailable or perform poorly so that current or potential users do not have adequate access to our online products and websites.

Our ability to provide our online offerings will depend on the continued operation of our information systems and networks. As our user traffic increases and our products become more complex, we will need more computing power. We have spent, and may again spend, substantial amounts to purchase or lease data centers and equipment and to upgrade our technology and network infrastructure to handle increased traffic on our website and to introduce new technologies and products. These expansions may be expensive and complex and could result in inefficiencies or operational failures. If we do not implement these expansions successfully, or if we experience inefficiencies and operational failures during the implementation, the quality of our technologies and products and our users' experience could decline. This could damage our reputation and lead us to lose current and potential users, advertisers and content providers.

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In addition, significant or repeated reductions in the performance, reliability or availability of our information systems and network infrastructure could harm our ability to provide our content distribution offerings and advertising platforms. We could experience failures in our systems and networks from our failure to adequately maintain and enhance these systems and networks, natural disasters and similar events, power failures, intentional actions to disrupt our systems and networks and many other causes. The vulnerability of our computer and communications infrastructure is increased because it is largely located at facilities in San Diego, California, an area that is at heightened risk of earthquake, wildfires and flood. We are vulnerable to terrorist attacks, fires, power loss, telecommunications failures, computer viruses, computer denial of service attacks or other attempts to harm our systems. Moreover, much of our facilities are located near the landing path of a military base and are subject to risks related to falling debris and aircraft crashes. We do not currently have fully redundant systems or a formal disaster recovery plan, and we may not have adequate business interruption insurance to compensate us for losses that may occur from a system outage.

Any failure or interruption of the services provided by bandwidth providers, data centers or other key third parties could subject our business to disruption and additional costs and damage our reputation.

We rely on third-party vendors, including data center and bandwidth providers for network access or co-location services that are essential to our business. Any interruption in these services, including any failure to handle current or higher volumes of use, could subject our business to disruption and additional costs and significantly harm our reputation. Our systems are also heavily reliant on the availability of electricity, which also comes from third-party providers. The cost of electricity has risen in recent years with the rising costs of fuel. If the cost of electricity continues to increase, such increased costs could significantly increase our expenses. In addition, if we were to experience a major power outage, it could result in a significant disruption of our business.

Our network is subject to security risks that could harm our reputation and expose us to litigation or liability.

Online commerce and communications depend on the ability to transmit confidential or proprietary information securely over private and public networks. Any compromise of our ability to transmit and store such information and data securely, and any costs associated with preventing or eliminating such problems, could impair our ability to distribute technologies and products or collect revenue, threaten the proprietary or confidential nature of our technology, harm our reputation and expose us to litigation or liability. We also may be required to expend significant capital or other resources to protect against the threat of security breaches or hacker attacks or to alleviate problems caused by such breaches or attacks. Any successful attack or breach of our security could hurt consumer demand for our technologies and products and expose us to consumer class action lawsuits and other liabilities. In addition, our vulnerability to security risks may affect our ability to maintain effective internal controls over financial reporting as contemplated by Section 404 of the Sarbanes-Oxley Act of 2002.

It is not yet clear how laws designed to protect children that use the Internet may be interpreted and enforced, and whether new similar laws will be enacted in the future which may apply to our business in ways that may subject us to potential liability.

The Children's Online Privacy Protection Act imposes civil and criminal penalties on persons collecting personal information from children under the age of 13. We do not knowingly distribute harmful materials to minors, direct our websites or services to children under the age of 13, or collect personal information from children under the age of 13. However, we are not able to control the ways in which consumers use our technology, and our technology may be used for purposes that violate this or other similar laws. The manner in which such laws may be interpreted and enforced cannot be fully determined, and future legislation similar to this law could subject us to potential liability if we were deemed to be non-compliant with such rules and regulations.

We may be subject to market risk and legal liability in connection with the data collection capabilities of our various online services.

Many components of our online services include interactive components that by their very nature require communication between a client and server to operate. To provide better consumer experiences and to operate effectively, we collect certain information from users. Our collection and use of such information may be subject to United States state and federal privacy and data collection laws and regulations, as well as foreign laws such as the EU Data Protection Directive. We post an extensive privacy policy concerning the collection, use and disclosure of user data, including that involved in interactions between our client and server products. Because of the evolving nature of our business and applicable law, our privacy policy may now or in the future fail to comply with applicable law. Any failure by us to comply with our posted privacy policy, any failure by us to conform our privacy policy to changing aspects of our business or applicable law, or any existing or new legislation regarding privacy issues could impact the market for our online video community service, technologies and products and subject us to fines, litigation or other liability.

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Improper conduct by users could subject us to claims and compliance costs.

The terms of use and end-user license agreements for our products and services prohibit a broad range of unlawful or undesirable conduct. However, we are unable to block access in all instances to users who are determined to gain access to our products or services for improper motives. Claims may be threatened or brought against us using various legal theories based on the nature and content of information or media that may be created, posted online or generated by our users or the use of our technology. This risk includes actions by our users to copy or distribute third-party content. Investigating and defending any of these types of claims could be expensive, even if the claims do not ultimately result in liability. In addition, we may incur substantial costs to enforce our terms of use or end-user license agreements and to exclude certain users of our services or products who violate such terms of use or end-user license agreements, or who otherwise engage in unlawful or undesirable conduct.

We may be subject to legal liability for the provision of third-party products, services, content or advertising.

We have entered into, and expect to continue to enter into, arrangements for third-party products, services, content or advertising to be offered in connection with our various content distribution offerings. Certain of these arrangements involve enabling the distribution of digital content owned by third parties, which may subject us to third party claims related to such products, services, content or advertising, including defamation, violation of privacy laws, misappropriation of publicity rights, violation of United States federal CAN-SPAM legislation, and infringement of intellectual property rights. We require users of our services to agree to terms of use that prohibit, among other things, the posting of content that violates third party intellectual property rights, or that is obscene, hateful or defamatory. We have implemented procedures to enforce such terms of use on certain of our services, including taking down content that violates our terms of use for which we have received notification, or that we are aware of, and/or blocking access by, or terminating the accounts of, users determined to be repeat violators of our terms of use. Despite these measures, we cannot guarantee that such unauthorized content will not exist on our services, that these procedures will reduce our liability with respect to such unauthorized third party conduct or content, or that we will be able to resolve any disputes that may arise with content providers or users regarding such conduct or content. Our agreements with these parties may not adequately protect us from these potential liabilities. Investigating and defending any of these types of claims is expensive, even if the claims do not result in liability. If any of these claims results in liability, we could be required to pay damages or other penalties.

We may be subject to assessment of sales taxes and other taxes for our licensing of technology or sale of products.

We do not currently directly collect sales taxes or other taxes on the licensing of our technology, the sale of our products over the Internet, or our distribution of content. Although we have evaluated the tax requirements of certain major tax jurisdictions with respect to the licensing of our technology or the sale of our products over the Internet, in the past we have licensed or sold, and in the future we may license or sell, our technologies or products to consumers located in jurisdictions where we have not evaluated the tax consequences of such license or sale. We would incur substantial costs if one or more taxing jurisdictions required us to collect sales or other taxes from past licenses of technology or sales or distributions of our products or content over the Internet, particularly because we would be unable to go back to customers to collect sales, value added or other taxes for past licenses, sales or distributions and would likely have to pay such taxes out of our own funds. Certain of our licensing agreements require our partners to pay taxes to applicable taxing jurisdictions as a result of the sale of products that incorporate our technologies. If our licensees fail to pay such taxes, we may become liable for the payment of such taxes.

We also intend to sell content over the Internet to consumers throughout the world in conjunction with certain of our service offerings. We intend to comply with applicable tax requirements of certain major tax jurisdictions with respect to such sales. However, we may sell content to consumers located in jurisdictions where we have not evaluated the tax consequences of such sale. If we fail to comply with tax requirements of tax jurisdictions in which we sell content online, we may become liable for substantial costs or penalties.

Inflation and other unfavorable economic conditions may adversely affect our revenues, margins and profitability.

Our consumer software products, as well as the consumer hardware device and software products that contain our technologies, are discretionary purchases for consumers. Consumers are generally more willing to make discretionary purchases during favorable economic conditions. As a result of inflation or other unfavorable economic conditions, including higher interest rates, increased taxation, higher consumer debt levels and lower availability of consumer credit, consumers' purchases of discretionary items may decline, which could adversely affect our revenues. In addition, while inflation historically has not had a material effect on our

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operating results, we may experience inflationary conditions in our cost base due to changes in foreign currency exchange rates that reduce the purchasing power of the United States dollar, increases in selling, general and administrative expenses, reduced interest rates for our cash positions, and other factors. These inflationary conditions may harm our margins and profitability if we are unable to increase our license, advertising and content distribution fees or reduce our costs sufficiently to offset the effects of inflation in our cost base. Our attempts to offset the effects of inflation and cost increases through controlling our expenses, passing cost increases on to our licensees, advertisers and partners or any other method may not succeed.

Failure to comply with applicable current and future government regulations could limit our ability to license our technologies, sell our products or distribute content, and expose us to additional costs and liabilities.

Our operations and business practices are subject to federal, state and local government laws and regulations, as well as international laws and regulations, including those relating to import or export of technology and software, distribution or censorship of content, use of encryption or other digital rights management software and consumer and other safety-related compliance for electronic equipment. Any failure by us to comply with the laws and regulations applicable to us or our technologies, products or our distribution of content could result in our inability to license those technologies, sell those products, or distribute content, additional costs to redesign technologies, products or our methods for distribution of content to meet such laws and regulations, fines or other administrative, civil or criminal liability or actions by the agencies charged with enforcing compliance and, possibly, damages awarded to persons claiming injury as the result of our non-compliance. Changes in or enactment of new statutes, rules or regulations applicable to us could have a material adverse effect on our business.

If we lose the services of key members of our senior management team, we may not be able to execute our business strategy.

Our future success depends in large part upon the continued services of key members of our senior management team. All of our executive officers and key employees are at-will employees, and we do not maintain any key person life insurance policies. The loss of our management or key personnel could seriously harm our ability to execute our business strategy. We also may have to incur significant costs in identifying, hiring, training and retaining replacements for key employees.

We rely on highly skilled personnel, and if we are unable to retain or motivate key personnel or hire qualified personnel, we may not be able to maintain our operations or grow effectively.

Our performance is largely dependent on the talents and efforts of highly skilled individuals. These individuals have acquired specialized knowledge and skills with respect to us and our operations. Our employment relationship with each of these individuals is on an at-will basis and can be terminated at any time. If any of these individuals or a group of individuals were to terminate their employment unexpectedly, we could face substantial difficulty in hiring qualified successors and could experience a loss in productivity while any such successor obtains the necessary training and experience.

Our future success depends on our continuing ability to identify, hire, develop, motivate and retain highly skilled personnel for all areas of our organization. In this regard, if we are unable to hire and train a sufficient number of qualified employees for any reason, we may not be able to implement our current initiatives or grow effectively. We have in the past maintained a rigorous, highly selective and time-consuming hiring process. We believe that our approach to hiring has significantly contributed to our success to date. However, our highly selective hiring process has made it more difficult for us to hire a sufficient number of qualified employees, and, as we grow, our hiring process may prevent us from hiring the personnel we need in a timely manner. Moreover, the cost of living in the San Diego area, where our corporate headquarters are located, has been an impediment to attracting new employees in the past, and we expect that this will continue to impair our ability to attract and retain employees in the future. If we do not succeed in attracting qualified personnel and retaining and motivating existing personnel, our ability to execute our business strategy may suffer.

****Our recent acquisitions, as well as any companies or technologies we may acquire in the future, could prove difficult to integrate and may result in unexpected costs and disruptions to our business.***

In November 2007, we acquired all of the outstanding shares of MainConcept GmbH, or MainConcept, a leading provider of audio and video codecs and software development kits to the broadcast, film and consumer markets. We expect to continue to evaluate possible additional acquisitions of technologies and businesses on an ongoing basis. Our recent acquisitions, as well as acquisitions in which we may engage in the future, entail numerous operational and financial risks including certain of the following risks:

- exposure to unknown liabilities;
- disruption of our business and diversion of our management's time and attention to developing acquired products or technologies;

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- incurrence of substantial debt or dilutive issuances of securities to pay for acquisitions;
- higher than expected acquisition and integration costs;
- increased amortization expenses;
- difficulty and cost in combining the operations and personnel of any acquired businesses with our operations and personnel;
- impairment of relationships with key suppliers or customers of any acquired businesses due to changes in management and ownership; and
- inability to retain key employees of any acquired businesses.

We have limited experience in identifying new acquisition targets, successfully completing acquisitions and integrating any acquired products, businesses or technologies into our current infrastructure. Moreover, in the future we may devote resources to potential acquisitions that are never completed or that fail to realize any of their anticipated benefits.

We may not realize the benefits we expect from the acquisition of MainConcept.

The integration of MainConcept's technology may be time consuming and expensive, and may disrupt our business. We will need to overcome significant challenges to realize any benefits or synergies from this transaction. These challenges include the timely, efficient and successful execution of a number of post-transaction integration activities, including:

- integrating MainConcept's technology;
- entering markets in which we have limited or no prior experience;
- successfully completing the development of MainConcept's technologies;
- developing commercial products based on those technologies;
- retaining and assimilating the key personnel of MainConcept;
- attracting additional customers for products based on MainConcept's technologies;
- implementing and maintaining uniform standards, controls, processes, procedures, policies, accounting systems and information systems; and
- managing expenses of any potential legal liability of MainConcept.

In particular, we may encounter difficulties successfully integrating our operations, technologies, services and personnel with those of MainConcept, and our financial and management resources may be diverted from our existing operations. For example, as a result of our acquisition of MainConcept we have additional offices in Germany, Russia and Japan. Maintaining offices in multiple countries could create a strain on our ability to effectively manage our operations and personnel. In addition, the process of integrating operations and technology could cause an interruption of, or loss of momentum in, the activities of one or more of our businesses and the loss of key personnel. The delays or difficulties encountered in connection with the integration of MainConcept's technologies could have an adverse effect on our business, results of operations or financial condition. We may not succeed in addressing these risks or any other problems encountered in connection with this transaction. Our inability to successfully integrate the technology and personnel of MainConcept, or any significant delay in achieving integration, including regulatory approval delays, could have a material adverse effect on us and, as a result, on the market price of our common stock.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity and teamwork fostered by our culture.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and teamwork. As our organization grows and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

Risks related to our finances

Our quarterly operating results and stock price may fluctuate significantly.

We expect our operating results to be subject to quarterly fluctuations. The revenues we generate and our operating results and the market price of our common stock will be affected by numerous factors, including:

- demand for our technologies and products;

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- introduction, enhancement and market acceptance of technologies and products by us and our competitors;
- price reductions by us or our competitors or changes in how technologies and products are priced;
- the mix of technologies and products offered by us and our competitors;
- the mix of distribution channels through which our technologies and products are licensed and sold;
- our ability to successfully generate revenues from advertising and content distribution;
- the mix of international and United States revenues attributable to our technologies and products;
- costs of intellectual property protection and any litigation;
- timing of payments received by us pursuant to our licensing agreements;
- our ability to hire and retain qualified personnel;
- growth in the use of the Internet; and
- general economic conditions.

As a result of the variances in quarterly volumes reported by our consumer hardware device manufacturing customers, we expect our revenues to be subject to seasonality, with our second quarter revenues expected to be lower than the revenues we derive in our other quarters. In addition, a substantial majority of our quarterly revenues are based on actual shipment of products incorporating our technologies in that quarter, and not on contractually agreed upon minimum revenue commitments. Because the shipping of products by our consumer hardware and independent software vendor partners are outside our control and difficult to predict, our ability to accurately forecast quarterly revenue is substantially limited. Quarterly fluctuations in our operating results may, in turn, cause the price of our stock to fluctuate substantially. We believe that quarterly comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of our future performance.

We may not generate sufficient revenue to be profitable on a quarterly or annual basis in the future.

We may not generate sufficient revenue to be profitable on a quarterly or annual basis in the future. In addition, we devote significant resources to developing and enhancing our technology and to selling, marketing and obtaining content for our technologies and products. We expect our operating expenses to increase, as we, among other things:

- develop and grow our community and content distribution platform initiatives;
- expand our domestic and international sales and marketing activities;
- increase our product development efforts to advance our existing technologies and products and develop new technologies and products;
- hire additional personnel;
- upgrade our operational and financial systems, procedures and controls and continued compliance with Section 404 of the Sarbanes-Oxley Act; and
- continue to assume the responsibilities of being a public company.

We may require additional capital, and raising additional funds by issuing securities, debt financing or through strategic alliances or licensing arrangements may cause dilution to existing stockholders, restrict our operations or require us to relinquish proprietary rights.

We may raise additional funds through public or private equity offerings, debt financings, strategic alliances or licensing arrangements. To the extent that we raise additional capital by issuing equity securities, our existing stockholders' ownership will be diluted. Any debt financing we enter into may involve covenants that restrict our operations. These restrictive covenants may include limitations on additional borrowing, specific restrictions on the use of our assets as well as prohibitions on our ability to create liens, pay dividends, redeem our stock or make investments. In addition, if we raise additional funds through strategic alliances or licensing arrangements, it may be necessary to relinquish potentially valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us.

****Our investments in auction rate securities may not provide us a liquid source of cash.***

As of June 30, 2009, we held approximately \$18.8 million par value of auction-rate securities (\$18.3 million estimated fair value). During the three months ended June 30, 2008 and 2009, \$1.3 million and \$70,000, respectively, worth of the Company's auction-rate securities were redeemed. All other auction-rate security instruments in our portfolio have failed at auctions since February 2008, and we may not be able to sell these securities in a timely manner to meet a liquidity need. In the event that we are unable to sell the underlying securities at or above our carrying value, or at all, these securities may not provide us a liquid source of cash in the future.

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Risks related to our intellectual property

We and our licensees are, and may in the future be, subject to intellectual property rights claims, which are costly to defend, could require us to pay damages and could limit our ability to use certain technologies or content in the future.

Companies in the technology and entertainment industries own large numbers of patents, copyrights, trademarks and trade secrets and they frequently make claims and commence litigation based on allegations of infringement or other violations of intellectual property rights, including those relating to digital media standards such as MPEG-4, H.264, MP3 and AAC or relating to video or music content. We have faced such claims in the past, we currently face such claims, and we expect to face similar claims in the future. For instance, we have been contacted by third parties such as AT&T and LG (one of our most significant customers in consumer hardware technology licensing) regarding the licensing of certain patents characterized by such parties as being essential to the MPEG-4 visual standard or other standards. Regardless of the merits of such claims any disputes with third parties over intellectual property rights could materially and adversely impact our business, including by resulting in the loss of management time and attention to our core business, or reducing the willingness of licensees to incorporate our technologies into their products. We have also received notices that various third parties have, on occasion, contacted certain of our licensees alleging that products incorporating our technology require a license under certain patents which they purport to own or have rights in. Our licensees have faced claims such as these in the past, currently face such claims, and may face similar claims in the future. Regardless of the merits of these allegations, this type of contact could materially impact our business by reducing our ability to generate revenue and drive adoption of our technologies and it could also materially impact our relationships with our licensees and their desires to implement DivX technologies. In the event we determine that we need to obtain a license from any third party, we cannot guarantee that we would be able to obtain such license on commercially reasonable terms, if at all. We may be required to develop non-infringing alternative technologies, which could be very time consuming and expensive, and there is no guarantee that we would be successful in developing such technologies. We have also been asked by content owners to stop the display or hosting of copyrighted materials by our users or ourselves through our service offerings, including notices provided to us pursuant to the Digital Millennium Copyright Act. Among those content owners who have asked us to remove materials is Universal Music Group, Inc., or UMG, who also asserted claims of copyright infringement against us arising from the operation of Stage6, our online video community service, which we shut down on February 29, 2008. Currently, we are involved in litigation with UMG in the Central District of California, in which UMG has alleged copyright infringement and has sought monetary damages. Moreover, content providers may claim that we are contributorily or vicariously liable for third parties' use of our technology or service offerings to infringe the content providers' copyrights. Users of our services are subject to terms of use that prohibit the posting of content that violates third party intellectual property rights. We have and will promptly respond to legitimate takedown notices or complaints, including but not limited to those submitted pursuant to the Digital Millennium Copyright Act, notifying us that we are providing unauthorized access to copyrighted content by removing such content and/or any links to such content from our websites. Nevertheless, we cannot guarantee that our prompt removal of content, including removal pursuant to the provisions of the Digital Millennium Copyright Act, will prevent disputes with content providers, that infringing content will not exist on our services, or that we will be able to resolve any disputes that may arise with content providers or users regarding such infringing content. Any intellectual property claims, with or without merit, could be time-consuming, expensive to litigate or settle and could divert management resources and attention. An adverse determination could require that we pay damages, block access to certain content, or stop using technologies found to be in violation of a third party's rights, and could prevent us from offering our technologies, products or certain content to others. To avoid these restrictions, we may be required to seek a license for the technology or content from additional third parties. Such licenses may not be available on reasonable terms, could require us to pay significant royalties and may significantly increase our cost of revenues. The technologies or content also may not be available for license to us at all. As a result, we may be required to develop alternative non-infringing technologies, or license alternative content, which could require significant effort and expense. If we cannot license or develop technologies or content for any infringing aspects of our business, we may be forced to limit our technology or content offerings and may be unable to compete effectively with entities that offer such technology or content. In addition, from time to time we engage in disputes regarding the licensing of our intellectual property rights, including matters related to our royalty rates and other terms of our licensing arrangements. These types of disputes can be asserted by our licensees or prospective licensees or by other third parties as part of negotiations with us or in private actions seeking monetary damages or injunctive relief. Any disputes with our licensees or potential licensees or other third parties could harm our reputation and expose us to additional costs and other liabilities.

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****We may be unable to adequately protect the proprietary rights in our technologies and products.***

We have only five issued patents in the United States and two issued patents in foreign jurisdictions, along with exclusive rights to one additional United States patent, and we generally do not rely upon patents to protect our proprietary rights. In addition, our ability to obtain patent protection for our technologies and products will be limited as a result of the incorporation of aspects of MPEG-4, MP3, and other standards-based technologies into our technologies and products. We license such technologies from third party licensors and do not own any patents relating to such technologies. As a result, we do not have the right to defend perceived infringements of patents relating to such technologies. Moreover, the licensors from which we have acquired the right to incorporate MPEG-4 and MP3 technologies into our products are not the exclusive owners of the patents relating to such technologies. As a result, our licensors must coordinate enforcement efforts with the owners of such patents to protect or defend against infringements of patents relating to such technology, which can be expensive, time consuming and difficult. Any significant impairment of the intellectual property rights relating to the MPEG-4 or MP3 technologies we license for use in our technologies and products could reduce the value of such technologies, which could impair our ability to compete.

Our ability to compete partly depends on the superiority, uniqueness and value of our technologies, including both internally developed technology and technology licensed from third parties. To protect our proprietary rights, we rely on a combination of trademark, patent, copyright and trade secret laws, confidentiality agreements with our employees and third parties, and protective contractual provisions. Despite our efforts to protect our intellectual property, any of the following occurrences may reduce the value of our intellectual property:

- our applications for trademarks or patents may not be granted and, if granted, may be challenged or invalidated;
- issued patents, copyrights and trademarks may not provide us with any competitive advantages;
- our efforts to protect our intellectual property rights may not be effective in preventing misappropriation of our technology or dilution of our trademarks;
- our efforts may not prevent the development and design by others of products or technologies similar to or competitive with, or superior to those that we develop; or
- another party may obtain a blocking patent that would force us to either obtain a license or design around the patent to continue to offer the contested feature or service in our technologies.

Legislation may be passed that would require companies to share information about their digital rights management technology to permit interoperability with other systems. If this legislation is enacted, we may be required to reveal our proprietary digital rights management code to competitors. Furthermore, if content must be formatted such that it can be played on a media player other than a DivX Certified player, then the demand for DivX Certified players could decrease.

We may be forced to litigate to defend our intellectual property rights or to defend against claims by third parties against us relating to intellectual property rights.

Disputes regarding the ownership of technologies and rights associated with digital media technologies and online businesses are common and likely to arise in the future. We may be forced to litigate to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of other parties' proprietary rights. Any such litigation could be very costly and could distract our management from focusing on operating our business.

Our ability to maintain and enforce our trademark rights has a large impact on our ability to prevent third party infringement of our brand and technologies.

We generally rely on enforcing our trademark rights to prevent unauthorized use of our brand and technologies. Our ability to prevent unauthorized uses of our brand and technologies would be negatively impacted if our trademark registrations were overturned in the jurisdictions where we do business. Our brand and logo are widely used by consumers and entities, both licensed and unlicensed, in association with digital video compression technology, and if we are not vigilant in preventing unauthorized or improper use of our trademarks, then our trademarks could become generic and we would lose our ability to assert such trademarks against others. We also have trademark applications pending in a number of jurisdictions that may not ultimately be granted, or if granted, may be challenged or invalidated, in which case we would be unable to prevent unauthorized use of our brand and logo in such jurisdiction. We have not filed trademark registrations in all jurisdictions where our brand and logo are used.

Some software we provide may be subject to "open source" licenses, which may restrict how we use or distribute our software or require that we release the source code of certain products subject to those licenses.

Some of the products we support and some of our proprietary technologies incorporate open source software such as open source MP3 codecs that may be subject to the Lesser Gnu Public License or other open source licenses. The Lesser Gnu Public License and

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other open source licenses typically require that source code subject to the license be released or made available to the public. Such open source licenses typically mandate that software developed based on source code that is subject to the open source license, or combined in specific ways with such open source software, become subject to the open source license. We take steps to ensure that proprietary software we do not wish to disclose is not combined with, or does not incorporate, open source software in ways that would require such proprietary software to be subject to an open source license. However, few courts have interpreted the Lesser Gnu Public License or other open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to some uncertainty. We also take steps to disclose any source code for which disclosure is required under an open source license, but it is possible that we have or will make mistakes in doing so, which could negatively impact our brand or our adoption in the community, or could expose us to additional liability. In addition, we rely on multiple software programmers to design our proprietary products and technologies. Although we take steps to ensure that our programmers do not include open source software in products and technologies we intend to keep proprietary, we do not exercise complete control over the development efforts of our programmers and we cannot be certain that our programmers have not incorporated open source software into products and technologies we intend to keep proprietary. In the event that portions of our proprietary technology are determined to be subject to an open source license, or are intentionally released under an open source license, we could be required to publicly release the relevant portions of our source code, which could reduce or eliminate our ability to commercialize our products and technologies. Also, in relying on multiple software programmers to design products and technologies that we intend, or ultimately end up releasing in the open source community, we may discover that one or multiple such programmers have included code or language that would be embarrassing to the company, which could negatively impact our brand or our adoption in the community, or could expose us to additional liability.

Risks related to the securities markets and investment in our common stock

Market volatility may affect our stock price and the value of your investment.

The current turbulence in the U.S. and global financial markets has caused a decline in stock values across all industries. The market price for our common stock has been and is likely to continue to be volatile, in part because our shares have only recently been traded publicly. In addition, the market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot control, including:

- announcements of new products, services or technologies, commercial relationships or other events by us or our competitors;
- regulatory developments in the United States and foreign countries;
- fluctuations in stock market prices and trading volumes of similar companies;
- variations in our quarterly operating results;
- changes in securities analysts' estimates of our financial performance;
- changes in accounting principles;
- sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;
- additions or departures of key personnel; and
- discussion of us or our stock price by the financial press and in online investor communities.

****Shares of our common stock are relatively illiquid.***

The current turbulence in the U.S. and global financial markets could adversely affect our stock price and our ability to raise additional capital through the sale of equity or debt securities. As of July 30, 2009, we had 32,673,576 shares of common stock outstanding, excluding 1,427 shares subject to repurchase. As a result of our relatively small public float, our common stock may be less liquid than the stock of companies with broader public ownership. In addition, in March 2008, our Board of Directors approved a share repurchase program authorizing us to repurchase up to \$20.0 million worth of our outstanding common stock. During the first and second quarters of 2008, we purchased approximately 2.8 million shares of our common stock for a total purchase price of approximately \$20.0 million. As of June 30, 2008, the share repurchase program was complete. These repurchases, as well as any future repurchases of our common stock, reduce our public float and may cause our common stock to become less liquid. A reduction in the liquidity of our common stock, as a result of the recent share repurchase or otherwise, could have a greater impact on the trading price for our shares than would be the case if our public float were larger.

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Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

Provisions in our certificate of incorporation and bylaws may delay or prevent an acquisition of us or a change in our management. These provisions include a classified board of directors, a prohibition on actions by written consent of our stockholders and the ability of our Board of Directors to issue preferred stock without stockholder approval. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us. Although we believe these provisions collectively provide for an opportunity to obtain higher bids by requiring potential acquirors to negotiate with our Board of Directors, they would apply even if an offer were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our Board of Directors, which is responsible for appointing the members of our management.

We do not intend to pay dividends on our common stock.

We have never declared or paid any cash dividend on our capital stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future.

We will incur increased costs as a result of changes in laws and regulations relating to corporate governance matters.

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act and rules adopted by the SEC and by The Nasdaq Stock Market, will result in increased costs to us as we continue to evaluate the implications of these laws and respond to their requirements. The impact of these laws and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors, our board committees or as executive officers. We are presently evaluating and monitoring developments with respect to these laws and regulations and cannot predict or estimate the amount or timing of additional costs we may incur to respond to their requirements.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our ability to operate our business and our stock price.

Ensuring that we have adequate internal financial and accounting controls and procedures in place to help ensure that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. We periodically document, review and, where appropriate, improve our internal controls and procedures for compliance with Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors addressing these assessments. Both we and our independent registered public accounting firm periodically test our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify material weaknesses, significant deficiencies or other areas for further attention or improvement. Our networks are vulnerable to security risks and hacker attacks, which may affect our ability to maintain effective internal controls as contemplated by Section 404. Implementing any appropriate changes to our internal controls may require specific compliance training for our directors, officers and employees, entail substantial costs to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, disclosure regarding our internal controls or investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements may adversely affect our stock price.

****Future sales of our common stock may cause our stock price to decline.***

As of July 30, 2009, there were 32,673,576 shares of our common stock outstanding, excluding 1,427 shares subject to repurchase. Substantially all of these shares are eligible for sale in the public market, although as of July 30, 2009, 1,113,689 of these shares were held by directors, executive officers and other affiliates and will be subject to volume limitations under Rule 144. In addition, as of July 30, 2009, we had outstanding warrants to purchase up to 545,000 shares of common stock that, if exercised, will result in these additional shares becoming available for sale. A large portion of these shares and warrants are held by a small number of persons and investment funds. Sales by these stockholders or warrant holders of a substantial number of shares could significantly reduce the market price of our common stock. Moreover, the holders of 783,061 shares of common stock at July 30, 2009 have rights, subject to some conditions, to require us to file registration statements covering the shares they currently hold or to include these shares in registration statements that we may file for ourselves or other stockholders. Additionally, the current turbulence in the U.S. and global financial markets has caused a decline in stock values across all industries.

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As of July 30, 2009, an aggregate of approximately 7,864,837 shares of our common stock were reserved for future issuance under our 2000 Stock Option Plan, or 2000 Plan, our 2006 Equity Incentive Plan, or 2006 Plan, and our 2006 Employee Stock Purchase Plan, or 2006 Purchase Plan and the share reserve under our 2006 Plan and our 2006 Purchase Plan are subject to automatic annual increases in accordance with the terms of the plans. These shares can be freely sold in the public market upon issuance. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock and impede our ability to raise future capital.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Use of Proceeds

Our initial public offering of common stock was effected through a Registration Statement on Form S-1 (File No. 333-133855) that was declared effective by the SEC on September 21, 2006. The Registration Statement covered the offer and sale by us of 7,461,538 shares of our common stock, which we sold to the public on September 27, 2006 at a price of \$16.00 per share. Our initial public offering resulted in aggregate proceeds to us of approximately \$108.2 million net of underwriting discounts and commissions of approximately \$8.4 million and offering expenses of approximately \$2.8 million.

As of June 30, 2009, the remaining \$62.8 million of proceeds from our initial public offering are invested in auction rate securities, government agency and corporate debt securities and money market funds.

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

We held our 2009 Annual Meeting of Stockholders, or the Annual Meeting, on June 3, 2009. At the Annual Meeting, our stockholders:

1. Elected Class III directors, Fred Gerson, Jerry Murdock and Alex Vieux, to hold office until the 2012 Annual Meeting of Stockholders or until their successors are duly elected and qualified; and
2. Ratified the appointment of Ernst & Young LLP to serve as our independent registered public accounting firm for our fiscal year ending December 31, 2009

At the Annual Meeting, the stockholders voted as follows:

	For	Against/ Withheld	Abstentions	Broker non-votes
1.a. Election of Fred Gerson	24,471,325	1,830,499	Not applicable	—
1.b. Election of Jerry Murdock	23,282,632	3,019,192	Not applicable	—
1.c. Election of Alex Vieux	25,921,818	380,006	Not applicable	—
2. Ratification of Appointment of Ernst & Young LLP as our Registered Independent Public Accountants	24,021,232	2,257,746	22,846	—

Item 6. Exhibits.

Exhibit Number	Description of Document
3.1(1)	Form of Amended and Restated Certificate of Incorporation as currently in effect.
3.2(2)	Form of Amended and Restated Bylaws as currently in effect.
4.1(1)	Form of Common Stock Certificate.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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- (1) Incorporated by reference to the exhibit of the same number to the Company's Registration Statement on Form S-1 (No. 333-133855), originally filed with the SEC on May 5, 2006.
- (2) Filed as an exhibit to the Company's Annual Report on Form 10-K filed with the SEC on March 11, 2009.

SIGNATURE

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

Dated: August 5, 2009

DIVX, INC.

By: /s/ Dan L. Halvorson
Dan L. Halvorson
Executive Vice President and Chief Financial Officer
(Duly authorized officer and principal financial officer)

CERTIFICATION

I, Kevin Hell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of DivX, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's second fiscal quarter in the case of this report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2009

By: /s/ Kevin Hell

Kevin Hell

Chief Executive Officer

CERTIFICATION

I, Dan L. Halvorson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of DivX, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's second fiscal quarter in the case of this report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2009

By: /s/ Dan L. Halvorson

Dan L. Halvorson

Executive Vice President and Chief Financial Officer

**CERTIFICATIONS OF
CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Kevin Hell, Chief Executive Officer of DivX, Inc. (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2009 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Report and results of operations of the Company for the period covered by the Report.

Date: August 5, 2009

I N W I T N E S S W H E R E O F , the undersigned has set his hand hereto as of the date hereof.

By: /s/ Kevin Hell
Kevin Hell
Chief Executive Officer

I, Dan L. Halvorson, Executive Vice President and Chief Financial Officer of DivX, Inc. (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2009 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Report and results of operations of the Company for the period covered by the Report.

Date: August 5, 2009

I N W I T N E S S W H E R E O F , the undersigned has set his hand hereto as of the date hereof.

By: /s/ Dan L. Halvorson
Dan L. Halvorson
Executive Vice President and Chief Financial Officer

A signed original of these certifications has been provided to DivX, Inc. and will be retained by DivX, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

These certifications are being furnished solely to accompany this quarterly report pursuant to 18 U.S.C. Section 1350, and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of DivX, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.