SILICON LABORATORIES INC
Form 10-Q
April 25, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

or

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

For the transition period from to

Commission file number: 000-29823

SILICON LABORATORIES INC.

(Exact name of registrant as specified in its charter)

Delaware	**74-2793174**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
400 West Cesar Chavez, Austin, Texas	**78701**
(Address of principal executive offices)	(Zip Code)

(512) 416-8500

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

As of April 17, 2018, 43,231,069 shares of common stock of Silicon Laboratories Inc. were outstanding.

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Cautionary Statement

Except for the historical financial information contained herein, the matters discussed in this report on Form 10-Q (as well as documents incorporated herein by reference) may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include declarations regarding the intent, belief or current expectations of Silicon Laboratories Inc. and its management and may be signified by the words believe, estimate, expect, intend, anticipate, plan, project, will or similar language. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Factors that could cause or contribute to such differences include those *discussed under Risk Factors and elsewhere in this report. Silicon Laboratories disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

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Part I. Financial Information

Item 1. Financial Statements

Silicon Laboratories Inc.

Condensed Consolidated Balance Sheets

(In thousands, except per share data)

(Unaudited)

		March 31, 2018		December 30, 2017
Assets				
Current assets:				
Cash and cash equivalents	$	342,272	$	269,366
Short-term investments		417,867		494,657
Accounts receivable, net		75,122		71,367
Inventories		76,505		73,132
Prepaid expenses and other current assets		64,555		39,120
Total current assets		976,321		947,642
Property and equipment, net		129,894		127,682
Goodwill		288,227		288,227
Other intangible assets, net		76,716		83,144
Other assets, net		94,837		88,387
Total assets	$	1,565,995	$	1,535,082
Liabilities and Stockholders Equity				
Current liabilities:				
Accounts payable	$	50,068	$	38,851
Deferred revenue and returns liability		25,426		
Deferred income on shipments to distributors				50,115
Other current liabilities		69,310		73,359
Total current liabilities		144,804		162,325
Convertible debt		345,049		341,879
Other non-current liabilities		75,567		77,862
Total liabilities		565,420		582,066
Commitments and contingencies				
Stockholders equity:				
Preferred stock $0.0001 par value; 10,000 shares authorized; no shares issued				
Common stock $0.0001 par value; 250,000 shares authorized; 43,227 and 42,707 shares issued and outstanding at March 31, 2018 and December 30, 2017, respectively		4		4
Additional paid-in capital		98,396		102,862
Retained earnings		904,160		851,307
Accumulated other comprehensive loss		(1,985)		(1,157)
Total stockholders equity		1,000,575		953,016
Total liabilities and stockholders equity	$	1,565,995	$	1,535,082

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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Silicon Laboratories Inc.

Condensed Consolidated Statements of Income

(In thousands, except per share data)

(Unaudited)

	Three Months Ended	
	March 31, 2018	April 1, 2017
Revenues	$ 205,384	$ 179,028
Cost of revenues	81,147	73,867
Gross margin	124,237	105,161
Operating expenses:		
Research and development	54,828	52,324
Selling, general and administrative	45,694	40,155
Operating expenses	100,522	92,479
Operating income	23,715	12,682
Other income (expense):		
Interest income and other, net	3,202	576
Interest expense	(4,883)	198
Income before income taxes	22,034	13,456
Provision (benefit) for income taxes	(4,371)	(1,970)
Net income	$ 26,405	$ 15,426
Earnings per share:		
Basic	$ 0.61	$ 0.37
Diluted	$ 0.60	$ 0.36
Weighted-average common shares outstanding:		
Basic	42,963	42,096
Diluted	43,918	43,030

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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Silicon Laboratories Inc.

Condensed Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three Months Ended	
	March 31, 2018	April 1, 2017
Net income	$ 26,405	$ 15,426
Other comprehensive loss, before tax:		
Net changes to available-for-sale securities:		
Unrealized gain (losses) arising during the period	(757)	245
Reclassification for losses included in net income	49	
Net changes to cash flow hedges:		
Unrealized losses arising during the period	(24)	
Reclassification for gains included in net income		(1,808)
Other comprehensive loss, before tax	(732)	(1,563)
Benefit from income taxes	(154)	(546)
Other comprehensive loss	(578)	(1,017)
Comprehensive income	$ 25,827	$ 14,409

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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Silicon Laboratories Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2018	Three Months Ended April 1, 2017
Operating Activities		
Net income	$ 26,405	$ 15,426
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation of property and equipment	3,704	3,596
Amortization of other intangible assets and other assets	6,427	6,752
Amortization of debt discount and debt issuance costs	3,169	869
Stock-based compensation expense	12,192	10,486
Deferred income taxes	(4,780)	(4,059)
Changes in operating assets and liabilities:		
Accounts receivable	(3,307)	(1,252)
Inventories	(3,368)	(1,636)
Prepaid expenses and other assets	(17,169)	6,708
Accounts payable	13,030	5,565
Other current liabilities and income taxes	(9,643)	(2,944)
Deferred income, deferred revenue and returns liability	(2,599)	4,038
Other non-current liabilities	(1,849)	(1,536)
Net cash provided by operating activities	22,212	42,013
Investing Activities		
Purchases of available-for-sale investments	(52,821)	(267,777)
Sales and maturities of available-for-sale investments	128,975	25,595
Purchases of property and equipment	(4,102)	(4,543)
Purchases of other assets	(4,698)	(1,446)
Acquisition of business, net of cash acquired		(13,658)
Net cash provided by (used in) investing activities	67,354	(261,829)
Financing Activities		
Proceeds from issuance of long-term debt, net		390,000
Payments on debt		(72,500)
Payment of taxes withheld for vested stock awards	(17,871)	(13,553)
Proceeds from the issuance of common stock	1,211	162
Net cash provided by (used in) financing activities	(16,660)	304,109
Increase in cash and cash equivalents	72,906	84,293
Cash and cash equivalents at beginning of period	269,366	141,106
Cash and cash equivalents at end of period	$ 342,272	$ 225,399

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The Condensed Consolidated Financial Statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the condensed consolidated financial position of Silicon Laboratories Inc. and its subsidiaries (collectively, the Company) at March 31, 2018 and December 30, 2017, the condensed consolidated results of its operations for the three months ended March 31, 2018 and April 1, 2017, the Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2018 and April 1, 2017, and the Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2018 and April 1, 2017. All intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the full year.

The accompanying unaudited Condensed Consolidated Financial Statements do not include certain footnotes and financial presentations normally required under U.S. generally accepted accounting principles (GAAP). Therefore, these Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto for the year ended December 30, 2017, included in the Company s Form 10-K filed with the Securities and Exchange Commission (SEC) on January 31, 2018.

The Company prepares financial statements on a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2018 will have 52 weeks and fiscal 2017 had 52 weeks. In a 52-week year, each fiscal quarter consists of 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Among the significant estimates affecting the financial statements are those related to inventories, goodwill, acquired intangible assets, investments in auction-rate securities, other long-lived assets, revenue recognition, stock-based compensation and income taxes. Actual results could differ from those estimates, and such differences could be material to the financial statements.

Reclassifications

Certain reclassifications have been made to prior year financial statements to conform to current year presentation.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Adoption of New Revenue Accounting Standard

The Company adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*, on December 31, 2017, the first day of its fiscal year ending December 29, 2018. The Company elected the modified retrospective method of adoption which only applies to those contracts which were not completed as of December 31, 2017. Prior periods have not been adjusted. In connection with its adoption of ASC 606, the Company recorded a cumulative-effect adjustment to retained earnings of $26.2 million on December 31, 2017. The following reflects the material changes recorded in connection with the cumulative-effect adjustment (in thousands):

Financial Statement Line Item		**Increase (Decrease)**
Accounts receivable, net	$	230
Prepaid expenses and other current assets	$	7,579
Other assets, net	$	(2,282)
Deferred revenue and returns liability	$	27,806
Deferred income on shipments to distributors	$	(50,115)
Other current liabilities	$	1,641
Retained earnings	$	26,195

The following presents the amounts by which financial statement line items were affected in the current period due to the adoption of ASC 606 (in thousands):

Financial Statement Line Item*		**Increase (Decrease)**
Condensed Consolidated Statements of Income		**Three Months Ended March 31, 2018**
Revenues	$	698
Cost of revenues	$	(250)
Net income	$	390
Earnings per share:		
Basic	$	0.01
Diluted	$	0.01
Condensed Consolidated Balance Sheet**		**March 31, 2018**
Prepaid expenses and other current assets	$	5,425
Other assets, net	$	(2,952)
Deferred revenue and returns liability	$	25,426
Deferred income on shipments to distributors	$	(52,051)
Other current liabilities	$	2,636

Retained earnings	$	26,585

* Excludes line items that were not materially affected by the Company s adoption of ASC 606. The adoption had no impact to cash provided by or used in net operating, investing or financing activities in the Condensed Consolidated Statements of Cash Flows.

** Balance sheet line item amounts include the cumulative-effect adjustment recorded on December 31, 2017.

The primary impact of the Company s adoption of ASC 606 resulted from the acceleration of the timing of revenue recognition on sales to distributors. The Company previously deferred revenue and cost of revenue on such sales until the distributors sold the product to the end customers. The Company now recognizes revenue at the time of sale to the distributor provided all other revenue recognition criteria have been met. The Company records a right of return asset and a returns liability in place of the deferred income on shipments to distributors previously recorded under ASC 605.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Revenue Recognition

Revenue is recognized when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services.

Performance Obligations

Substantially all of the Company s contracts with customers contain a single performance obligation, the sale of mixed-signal integrated circuit (IC) products. Such sales represent a single performance obligation because the sale is one type of good (e.g. an IC) or includes multiple goods that are neither capable of being distinct nor separable from the other promises in the contract (e.g. an IC embedded with software). This performance obligation is satisfied when control of the product is transferred to the customer, which typically occurs upon delivery. Unsatisfied performance obligations primarily represent contracts for products with future delivery dates and with an original expected duration of one year or less. As allowed under ASC 606, the Company has opted to not disclose the amount of unsatisfied performance obligations as these contracts have original expected durations of less than one year.

The Company s products carry a one-year replacement warranty. The replacement warranty promises customers that delivered products are as specified in the contract (an assurance-type warranty). Therefore, the Company accounts for such warranties under ASC 460, *Guarantees*, and not as a separate performance obligation.

Transaction Price

The transaction price reflects the Company s expectations about the consideration it will be entitled to receive from the customer and may include fixed or variable amounts. Fixed consideration primarily includes sales to direct customers and sales to distributors in which both the sale to the distributor and the sale to the end customer occur within the same reporting period. Variable consideration includes sales in which the amount of consideration that the Company will receive is unknown as of the end of a reporting period. Such consideration primarily includes sales made to distributors under agreements allowing certain rights of return, referred to as stock rotation, and credits issued to the distributor due to price protection. Stock rotation allows distributors limited levels of returns and is based on the distributor s prior purchases. Price protection represents price discounts granted to certain distributors and is based on negotiations on sales to end customers.

The Company estimates variable consideration at the most likely amount to which it expects to be entitled. Included in the transaction price estimate are amounts in which it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. The estimate is based on information available to the Company, including recent sales activity and pricing data. The Company applies a constraint to its variable consideration estimate which considers both the likelihood of a return and the amount of a potential price concession.

Variable consideration that does not meet revenue recognition criteria is deferred. The Company records a right of return asset for the costs of distributor inventory not meeting revenue recognition criteria. A corresponding deferred revenue and returns liability is recorded for unrecognized revenue associated with such costs.

Contract Balances

Accounts receivable represents the Company s unconditional right to receive consideration from its customer. Payments are typically due within 30 days of invoicing and do not include a significant financing component. To date, there have been no material impairment losses on accounts receivable. There were no material contract assets or contract liabilities recorded on the Condensed Consolidated Balance Sheet in any of the periods presented.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Recent Accounting Pronouncements

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2018-02, *Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* This ASU allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The Company early adopted this ASU on December 31, 2017. The adoption did not have a material impact on its financial statements.

In August 2017, the FASB issued ASU No. 2017-12*, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.* The objectives of this ASU are to improve the financial reporting of hedging relationships to better portray the economic results of an entity s risk management activities in its financial statements and to make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. This ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. The Company early adopted this ASU on December 31, 2017. The adoption did not have a material impact on its financial statements.

In January 2017, the FASB issued ASU No. 2017-04*, Intangibles Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* This ASU eliminates Step 2 from the goodwill impairment test. Instead, an entity should recognize an impairment charge for the amount by which the carrying value exceeds the reporting unit s fair value, not to exceed the total amount of goodwill allocated to that reporting unit. This ASU is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company is currently evaluating the effect of the adoption of this ASU, but anticipates that the adoption will not have a material impact on its financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* This ASU requires instruments measured at amortized cost to be presented at the net amount expected to be collected. Entities are also required to record allowances for available-for-sale debt securities rather than reduce the carrying amount. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company expects that the adoption will not have a material impact on its financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. For operating leases, a lessee is required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the effect that the adoption of this ASU will have on its financial statements. The Company currently expects that most of its operating lease commitments will be subject to the new standard and recognized as right-of-use assets and operating lease liabilities upon the adoption of ASU 2016-02, which will increase the total assets and total liabilities that it reports relative to such amounts prior to adoption.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

2. Earnings Per Share

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

	Three Months Ended	
	March 31, 2018	April 1, 2017
Net income	$ 26,405	$ 15,426
Shares used in computing basic earnings per share	42,963	42,096
Effect of dilutive securities:		
Stock options and other stock-based awards	955	934
Shares used in computing diluted earnings per share	43,918	43,030
Earnings per share:		
Basic	$ 0.61	$ 0.37
Diluted	$ 0.60	$ 0.36

For the three months ended March 31, 2018 and April 1, 2017, approximately 0.0 million and 0.3 million shares, respectively, consisting of restricted stock awards (RSUs), market stock awards (MSUs) and stock options, were not included in the diluted earnings per share calculation since the shares were anti-dilutive.

The Company intends to settle the principal amount of its convertible senior notes in cash and any excess value in shares in the event of a conversion. Accordingly, shares issuable upon conversion of the principal amount have been excluded from the calculation of diluted earnings per share. If the market value of the notes under certain prescribed conditions exceeds the conversion amount, the excess is included in the denominator for the computation of diluted earnings per share using the treasury stock method. As of March 31, 2018, approximately 0.1 million shares were included in the denominator for the calculation of diluted earnings per share. See Note 7, *Debt*, to the Condensed Consolidated Financial Statements for additional information.

3. Fair Value of Financial Instruments

The fair values of the Company s financial instruments are recorded using a hierarchical disclosure framework based upon the level of subjectivity of the inputs used in measuring assets and liabilities. The three levels are described below:

Level 1 - Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 - Inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - Inputs are unobservable for the asset or liability and are developed based on the best information available in the circumstances, which might include the Company s own data.

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The following summarizes the valuation of the Company s financial instruments (in thousands). The tables do not include either cash on hand or assets and liabilities that are measured at historical cost or any basis other than fair value.

	Fair Value Measurements at March 31, 2018 Using			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets:				
Cash equivalents:				
Money market funds	$ 111,866	$	$	$ 111,866
Corporate debt securities		9,419		9,419
Government debt securities	24,997			24,997
Total cash equivalents	$ 136,863	$ 9,419	$	$ 146,282
Short-term investments:				
Government debt securities	$ 65,239	$ 219,493	$	$ 284,732
Corporate debt securities		133,135		133,135
Total short-term investments	$ 65,239	$ 352,628	$	$ 417,867
Other assets, net:				
Auction rate securities	$	$	$ 5,609	$ 5,609
Total	$	$	$ 5,609	$ 5,609
Total	$ 202,102	$ 362,047	$ 5,609	$ 569,758

	Fair Value Measurements at December 30, 2017 Using			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets:				
Cash equivalents:				
Money market funds	$ 106,047	$	$	$ 106,047
Corporate debt securities		11,231		11,231
Government debt securities	53,615	1,453		55,068
Total cash equivalents	$ 159,662	$ 12,684	$	$ 172,346
Short-term investments:				
Government debt securities	$ 94,575	$ 228,247	$	$ 322,822
Corporate debt securities		171,835		171,835
Total short-term investments	$ 94,575	$ 400,082	$	$ 494,657

Other assets, net:								
Auction rate securities	$		$		$	5,681	$	5,681
Total	$		$		$	5,681	$	5,681
Total	$	254,237	$	412,766	$	5,681	$	672,684

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Valuation methodology

The Company s cash equivalents and short-term investments that are classified as Level 2 are valued using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments in active markets; or pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data. Investments classified as Level 3 are valued using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, amount of cash flows, expected holding periods of the securities and a discount to reflect the Company s inability to liquidate the securities. The Company s derivative instruments are valued using discounted cash flow models. The assumptions used in preparing the valuation models include foreign exchange rates, forward and spot prices for currencies, and market observable data of similar instruments.

Available-for-sale investments

The Company s investments are reported at fair value, with unrealized gains and losses, net of tax, recorded as a component of accumulated other comprehensive loss in the Consolidated Balance Sheet. The following summarizes the contractual underlying maturities of the Company s available-for-sale investments at March 31, 2018 (in thousands):

	Cost	Fair Value
Due in one year or less	$ 338,056	$ 337,433
Due after one year through ten years	135,923	134,453
Due after ten years	98,269	97,872
	$ 572,248	$ 569,758

The available-for-sale investments that were in a continuous unrealized loss position, aggregated by length of time that individual securities have been in a continuous loss position, were as follows (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
As of March 31, 2018	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Government debt securities	$ 182,320	$ (1,059)	$ 4,432	$ (10)	$ 186,752	$ (1,069)
Corporate debt securities	120,303	(929)	11,327	(100)	131,630	(1,029)
Auction rate securities			5,609	(391)	5,609	(391)
	$ 302,623	$ (1,988)	$ 21,368	$ (501)	$ 323,991	$ (2,489)

	Less Than 12 Months		12 Months or Greater		Total	
As of December 30, 2017	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**
Government debt securities	$ 244,880	$ (931)	$ 3,027	$ (15)	$ 247,907	$ (946)
Corporate debt securities	151,149	(447)	11,578	(73)	162,727	(520)
Auction rate securities			5,681	(319)	5,681	(319)
	$ 396,029	$ (1,378)	$ 20,286	$ (407)	$ 416,315	$ (1,785)

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The gross unrealized losses as of March 31, 2018 and December 30, 2017 were due primarily to changes in market interest rates and the illiquidity of the Company s auction-rate securities. The Company s auction-rate securities have been illiquid since 2008 when auctions for the securities failed because sell orders exceeded buy orders. These securities have a contractual maturity date of 2046 at March 31, 2018. The Company is unable to predict if these funds will become available before their maturity date.

The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the severity and duration of the impairment, changes in underlying credit ratings, forecasted recovery, the Company s intent to sell or the likelihood that it would be required to sell the investment before its anticipated recovery in market value and the probability that the scheduled cash payments will continue to be made. As of March 31, 2018, the Company has determined that no other-than-temporary impairment losses existed.

At March 31, 2018 and December 30, 2017, there were no material unrealized gains associated with the Company s available-for-sale investments.

Level 3 fair value measurements

The following summarizes quantitative information about Level 3 fair value measurements.

Auction rate securities

Fair Value at March 31, 2018 (000s)		Valuation Technique	Unobservable Input	Weighted Average
$	5,609	Discounted cash flow	Estimated yield	2.22%
			Expected holding period	10 years
			Estimated discount rate	3.63%

The Company has followed an established internal control procedure used in valuing auction rate securities. The procedure involves the analysis of valuation techniques and evaluation of unobservable inputs commonly used by market participants to price similar instruments, and which have been demonstrated to provide reasonable estimates of prices obtained in actual market transactions. Outputs from the valuation process are assessed against various market sources when they are available, including marketplace quotes, recent trades of similar illiquid securities, benchmark indices and independent pricing services. The technique and unobservable input parameters may be recalibrated periodically to achieve an appropriate estimation of the fair value of the securities.

Significant changes in any of the unobservable inputs used in the fair value measurement of auction rate securities in isolation could result in a significantly lower or higher fair value measurement. An increase in expected yield would result in a higher fair value measurement, whereas an increase in expected holding period or estimated discount rate would result in a lower fair value measurement. Generally, a change in the assumptions used for expected holding period is accompanied by a directionally similar change in the assumptions used for estimated yield and discount rate.

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The following summarizes the activity in Level 3 financial instruments for the three months ended March 31, 2018 (in thousands):

Assets

Auction Rate Securities		**Three Months Ended**
Beginning balance	$	5,681
Loss included in other comprehensive loss		(72)
Balance at March 31, 2018	$	5,609

Fair values of other financial instruments

The Company s debt is recorded at cost, but is measured at fair value for disclosure purposes. The fair value of the Company s convertible senior notes is determined using observable market prices. The notes are traded in less active markets and are therefore classified as a Level 2 fair value measurement. As of March 31, 2018 and December 30, 2017, the fair value of the convertible senior notes was $457.4 million and $466.2 million, respectively.

The Company s other financial instruments, including cash, accounts receivable and accounts payable, are recorded at amounts that approximate their fair values due to their short maturities.

4. Derivative Financial Instruments

The Company uses derivative financial instruments to manage certain exposures to the variability of interest rates and foreign currency exchange rates. The Company s objective is to offset increases and decreases in expenses resulting from these exposures with gains and losses on the derivative contracts, thereby reducing volatility of earnings. The Company does not use derivative contracts for speculative or trading purposes. The Company recognizes derivatives, on a gross basis, in the Consolidated Balance Sheet at fair value. Cash flows from derivatives are classified according to the nature of the cash receipt or payment in the Consolidated Statement of Cash Flows.

Cash Flow Hedges

Foreign Currency Forward Contracts

The Company uses foreign currency forward contracts to reduce the earnings impact that exchange rate fluctuations have on operating expenses denominated in currencies other than the U.S. dollar. Changes in the fair value of the contracts are recorded in accumulated other comprehensive loss in the Consolidated Balance Sheet and subsequently reclassified into earnings in the period during which the hedged transaction is recognized. The reclassified amount is reported in the same financial statement line item as the hedged item. If the foreign currency forward contracts are terminated or can no longer qualify as hedging instruments prior to maturity, the fair value of the contracts recorded in accumulated other comprehensive loss may be recognized in the Consolidated Statement of Income based on an assessment of the contracts at the time of termination.

The Company entered into foreign currency forward contracts in March 2018 for a portion of its forecasted operating expenses denominated in the Norwegian Krone. As of March 31, 2018, the contracts had maturities of one to twelve months and an aggregate notional value of $8.3 million. The fair value of the contracts was not material as of March 31, 2018. Contract losses recognized in other comprehensive income during the three months ended March 31, 2018 as well as losses expected to be reclassified into earnings in the next 12 months were not material. There were no amounts reclassified from accumulated other comprehensive loss into earnings during the three months ended March 31, 2018.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Interest Rate Swaps

The Company entered into an interest rate swap agreement with an original notional value of $72.5 million in connection with its Credit Facility in July 2016. The Company terminated the swap agreement on March 6, 2017, which resulted in the reclassification of $1.8 million of unrealized gains that were previously recorded in accumulated other comprehensive loss into earnings during the three months ended April 1, 2017.

Non-designated Hedges

Foreign Currency Forward Contracts

The Company uses foreign currency forward contracts to reduce the earnings impact that exchange rate fluctuations have on non-U.S. dollar balance sheet exposures. The Company recognizes gains and losses on the foreign currency forward contracts in interest income and other, net in the Consolidated Statement of Income in the same period as the remeasurement loss and gain of the related foreign currency denominated asset or liability. The Company does not apply hedge accounting to these foreign currency forward contracts.

As of March 31, 2018 and April 1, 2017, the Company held one foreign currency forward contract denominated in the Norwegian Krone with a notional value of $2.6 million and $4.0 million, respectively. The fair value of the contracts was not material as of March 31, 2018 or April 1, 2017. The contract held as of March 31, 2018 has a maturity date of June 28, 2018 and it was not designated as a hedging instrument.

The before-tax effect of derivative instruments not designated as hedging instruments was as follows (in thousands):

	Three Months Ended		
Loss Recognized in Income	**March 31, 2018**	**April 1, 2017**	**Location**
Foreign currency forward contracts	$ (123)	$ (94)	Interest income and other, net

5. Balance Sheet Details

The following shows the details of selected Condensed Consolidated Balance Sheet items (in thousands):

Inventories

	March 31, 2018	December 30, 2017
Work in progress	$ 52,566	$ 46,698
Finished goods	23,939	26,434
	$ 76,505	$ 73,132

6. Acquisitions

Z-Wave

On April 18, 2018, the Company completed the acquisition of the Z-Wave business from Sigma Designs, Inc. for $240 million in cash. Z-Wave is an Internet of Things (IoT) technology for smart home solutions. The Company will record the purchase using the acquisition method of accounting and will recognize the assets acquired and liabilities assumed at their fair values as of the date of the acquisition. The results of the Z-Wave operations will be included in the Company s consolidated results of operations beginning on the date of the acquisition. The Company is currently evaluating the fair values of the consideration transferred, assets acquired and liabilities assumed. The Company expects to complete its preliminary purchase price allocation in the second quarter of fiscal 2018.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

7. Debt

1.375% Convertible Senior Notes

On March 6, 2017, the Company completed a private offering of $400 million principal amount convertible senior notes (the Notes). The Notes bear interest semi-annually at a rate of 1.375% per year and will mature on March 1, 2022, unless repurchased, redeemed or converted at an earlier date. The Company used $72.5 million of the proceeds to pay off the remaining balance of its Amended Credit Agreement.

The Notes are convertible at an initial conversion rate of 10.7744 shares of common stock per $1,000 principal amount of the Notes, or approximately 4.3 million shares of common stock, which is equivalent to a conversion price of approximately $92.81 per share. The conversion rate is subject to adjustment under certain circumstances. Holders may convert the Notes under the following circumstances: during any calendar quarter after the calendar quarter ended on June 30, 2017 if the closing price of the Company s common stock for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than or equal to 130% of the conversion price of the Notes; during the five business day period after any ten consecutive trading day period (the measurement period) in which the trading price per $1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the closing sale price of our common stock and the conversion rate on each such trading day; if specified distributions or corporate events occur; if the Notes are called for redemption; or at any time after December 1, 2021. The Company may redeem all or any portion of the Notes, at its option, on or after March 6, 2020, if the last reported sale price of the Company s common stock has been at least 130% of the conversion price then in effect for at least 20 trading days during any 30 consecutive trading day period. Upon conversion, the Notes may be settled in cash, shares of the Company s common stock or a combination of cash and shares, at the Company s election.

The principal balance of the Notes was separated into liability and equity components, and was recorded initially at fair value. The excess of the principal amount of the liability component over its carrying amount represents the debt discount, which is amortized to interest expense over the term of the Notes using the effective interest method. The carrying amount of the liability component was estimated by discounting the contractual cash flows of similar non-convertible debt at an appropriate market rate at the date of issuance.

The Company incurred debt issuance costs of approximately $10.6 million, which was allocated to the liability and equity components in proportion to the allocation of the proceeds. The costs allocated to the liability component are being amortized as interest expense over the term of the Notes using the effective interest method.

The carrying amount of the Notes consisted of the following (in thousands):

	March 31, 2018	December 30, 2017
Liability component		
Principal	$ 400,000	$ 400,000
Unamortized debt discount	(47,745)	(50,499)
Unamortized debt issuance costs	(7,206)	(7,622)
Net carrying amount	$ 345,049	$ 341,879
Equity component		
Net carrying amount	$ 57,735	$ 57,735

The liability component of the Notes is recorded in convertible debt on the Consolidated Balance Sheet. The equity component of the Notes is recorded in additional paid-in capital. The effective interest rate for the liability component was 4.75%. As of March 31, 2018, the remaining period over which the debt discount and debt issuance costs will be amortized was 3.9 years.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Interest expense related to the Notes was comprised of the following (in thousands):

	Three Months Ended	
	March 31, 2018	April 1, 2017
Contractual interest expense	$ 1,390	$ 382
Amortization of debt discount	2,753	754
Amortization of debt issuance costs	416	115
	$ 4,559	$ 1,251

Amended Credit Agreement

On July 31, 2012, the Company and certain of its domestic subsidiaries (the Guarantors) entered into a $230 million five-year Credit Agreement (the Credit Agreement), which consisted of a $100 million Term Loan Facility and a $130 million Revolving Credit Facility. On July 24, 2015, the Company and the Guarantors amended the Credit Agreement (the Amended Credit Agreement) in order to, among other things, increase the borrowing capacity under the Revolving Credit Facility to $300 million (the Credit Facility), eliminate the Term Loan Facility and extend the maturity date to five years from the closing date. On July 24, 2015, the Company borrowed $82.5 million under the Amended Credit Agreement and paid off the remaining balance of its Term Loan Facility. In connection with the Company s offering of the Notes, it entered into a second amendment to the Credit Agreement (the Second Amended Credit Agreement) on February 27, 2017 and paid off the remaining balance of $72.5 million.

The Second Amended Credit Agreement retained the key terms and provisions of the first Amended Credit Agreement, including a $25 million letter of credit sublimit and a $10 million swingline loan sublimit. The Company also has an option to increase the size of the borrowing capacity by up to an aggregate of $200 million in additional commitments, subject to certain conditions.

The Revolving Credit Facility, other than swingline loans, will bear interest at the Eurodollar rate plus an applicable margin or, at the option of the Company, a base rate (defined as the highest of the Wells Fargo prime rate, the Federal Funds rate plus 0.50% and the Eurodollar Base Rate plus 1.00%) plus an applicable margin. Swingline loans accrue interest at the base rate plus the applicable margin for base rate loans. The applicable margins for the Eurodollar rate loans range from 1.25% to 2.00% and for base rate loans range from 0.25% to 1.00%, depending in each case, on the leverage ratio as defined in the Agreement.

The Second Amended Credit Agreement contains various conditions, covenants and representations with which the Company must be in compliance in order to borrow funds and to avoid an event of default, including financial covenants that the Company must maintain a leverage ratio (funded debt/EBITDA) of no more than 3.00 to 1 and a minimum fixed charge coverage ratio (EBITDA/interest payments, income taxes and capital expenditures) of no less than 1.25 to 1. As of March 31, 2018, the Company was in compliance with all covenants of the Second Amended Credit Agreement. The Company s obligations under the Second Amended Credit Agreement are guaranteed by the Guarantors and are secured by a security interest in substantially all assets of the Company and the Guarantors.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

8. Commitments and Contingencies

Securities Litigation

On March 15, 2018, a purported class action lawsuit was filed by Ann Noyes on behalf of the stockholders of Sigma Designs, Inc. in the United States District Court in the Northern District of California against Sigma Designs, certain current and former Sigma Designs board members and the Company (collectively, the Defendants). The lawsuit alleges violations of Section 14(a) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 14a-9 arising out Sigma Designs attempt to sell its Z-Wave business to the Company. The lawsuit claims that the Defendants filed a materially incomplete and misleading preliminary proxy statement in connection with the proposed sale of the Z-Wave business. The lawsuit seeks to certify the class, enjoin the sale of the Z-Wave business, award rescissory damages if the sale is consummated, and award unspecified damages and other relief. At this time, the Company cannot predict the outcome of this matter or the resulting financial impact to it, if any.

Patent Litigation

On January 28, 2014, Cresta Technology Corporation (Cresta Technology), a Delaware corporation, filed a lawsuit against the Company (among others) in the United States District Court in the District of Delaware, alleging infringement of three United States Patents (the Cresta Patents). Cresta Technology declared bankruptcy in 2016. One of its creditors, DBD Credit Funding LLC (DBD) and/or CF Crespe LLC (the Cresta Successors) assumed ownership of the Cresta Patents and has substituted in for Cresta Technology in related proceedings.

In 2014 and 2015, the Company challenged the validity of two sets of claims in the Cresta Patents at the Patent Trial and Appeal Board (PTAB) of the United States Patent and Trademark Office (USPTO). In each respective proceeding, the PTAB found the reviewed claims to be invalid. The Federal Circuit Court of Appeals affirmed both determinations. The U.S. District Court dismissed the Delaware proceedings without prejudice on April 3, 2018.

On July 16, 2014, the Company filed a lawsuit against Cresta Technology in the United States District Court in the Northern District of California alleging infringement of six United States Patents. A motion to substitute the Cresta Successors as defendants in lieu of Cresta

Technology is pending.

At this time, the Company cannot predict the outcome of these matters or the resulting financial impact to it, if any.

Other

The Company is involved in various other legal proceedings that have arisen in the normal course of business. While the ultimate results of these matters cannot be predicted with certainty, the Company does not expect them to have a material adverse effect on its Consolidated Financial Statements.

9. Stockholders Equity

Common Stock

The Company issued 0.5 million shares of common stock during the three months ended March 31, 2018.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Share Repurchase Programs

The Board of Directors authorized the following share repurchase programs (in thousands):

Program Authorization Date	**Program Termination Date**		**Program Amount**
October 2017	December 2018	$	100,000
January 2017	December 2017	$	100,000

These programs allow for repurchases to be made in the open market or in private transactions, including structured or accelerated transactions, subject to applicable legal requirements and market conditions. The Company did not repurchase any shares of its common stock during the three months ended March 31, 2018 or April 1, 2017.

Reclassifications From Accumulated Other Comprehensive Loss

The following table summarizes the effect on net income from reclassifications out of accumulated other comprehensive loss (in thousands):

	Three Months Ended			
Reclassification		**March 31, 2018**		**April 1, 2017**
Losses on available-for-sales securities to:				
Interest income and other, net	$	(49)	$	
Gains on cash flow hedges to:				
Interest expense				1,808
		(49)		1,808
Income tax expense (benefit)		10		(633)
Total reclassifications	$	(39)	$	1,175

10. Revenues

The Company groups its revenues into four categories, based on the markets and applications in which its products may be used. The following disaggregates the Company s revenue by product category (in thousands):

	Three Months Ended			
		March 31, 2018		April 1, 2017 (1)
Internet of Things	$	103,091	$	87,848
Infrastructure		49,420		35,981
Broadcast		36,065		37,328
Access		16,808		17,871
Revenues	$	205,384	$	179,028

(1) Under the modified retrospective method, prior period amounts have not been adjusted.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

A portion of the Company s sales are made to distributors under agreements allowing certain rights of return and/or price protection related to the final selling price to the end customers. These factors impact the timing and uncertainty of revenues and cash flows. The Company recognized revenue of $12.7 million during the three months ended March 31, 2018 from performance obligations that were satisfied in previous reporting periods. The following disaggregates the Company s revenue by sales channel (in thousands):

	Three Months Ended			
	March 31, 2018		April 1, 2017 (1)	
Distributors	$	150,271	$	125,743
Direct customers		55,113		53,285
Revenues	$	205,384	$	179,028

(1) Under the modified retrospective method, prior period amounts have not been adjusted.

11. Stock-Based Compensation

In fiscal 2009, the stockholders of the Company approved the 2009 Stock Incentive Plan (the 2009 Plan) and the 2009 Employee Stock Purchase Plan (the 2009 Purchase Plan). In fiscal 2017, the stockholders of the Company approved amendments to both the 2009 Plan and the 2009 Purchase Plan. These amendments authorized additional shares of common stock for issuance, to comply with changes in applicable law, improve the Company s corporate governance and to implement other best practices.

Stock-based compensation costs are based on the fair values on the date of grant for stock awards and stock options and on the date of enrollment for the employee stock purchase plans. The fair values of stock awards (such as RSUs, performance stock units (PSUs) and restricted stock awards (RSAs)) are estimated based on their intrinsic values. The fair values of MSUs are estimated using a Monte Carlo simulation. The fair values of stock options and employee stock purchase plans are estimated using the Black-Scholes option-pricing model.

The following table presents details of stock-based compensation costs recognized in the Condensed Consolidated Statements of Income (in thousands):

	Three Months Ended	
	March 31, 2018	April 1, 2017

Cost of revenues	$	296	$	258
Research and development		5,769		5,246
Selling, general and administrative		6,127		4,982
		12,192		10,486
Income tax benefit		5,219		5,282
	$	6,973	$	5,204

The Company had approximately $93.8 million of total unrecognized compensation costs related to granted stock options and awards as of March 31, 2018 that are expected to be recognized over a weighted-average period of approximately 2.3 years. There were no significant stock-based compensation costs capitalized into assets in any of the periods presented.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

12. Income Taxes

Provision (benefit) for income taxes includes both domestic and foreign income taxes at the applicable tax rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences. Income tax expense (benefit) was $(4.4) million and $(2.0) million for the three months ended March 31, 2018 and April 1, 2017, resulting in effective tax rates of (19.8)% and (14.6)%, respectively. The effective tax rate for the three months ended March 31, 2018 decreased from the prior period primarily due to a decrease in the U.S. statutory tax rate from 35% to 21% as well as a release of prior year unrecognized tax benefits in the current period. These decreases were partially offset by a decrease in the foreign tax rate benefit as well as a decrease in the impact of excess tax benefits from stock-based compensation.

U.S. Tax Reform

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate income tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries previously deferred from tax and creates a new provision designed to tax global intangible low-taxed income (GILTI). Also on December 22, 2017, the U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 (SAB 118) which provides for a measurement period of up to one year from the enactment for companies to complete their accounting for the Act. The Company is applying the guidance in SAB 118 when accounting for the enactment-date effects of the Act.

At March 31, 2018, the Company has not completed its accounting for the tax effects of the Act but has made reasonable estimates of the effects on the re-measurement of its deferred tax assets and liabilities as well as its transition tax liability. During the three month period ended March 31, 2018, the Company recognized immaterial adjustments to the provisional amounts recorded at December 30, 2017 and included these adjustments as a component of tax expense from continuing operations. The Company has not yet fully collected all necessary data to complete its analysis of the effect of the Act on its deferred tax assets and liabilities and is awaiting additional guidance to complete its analysis. Therefore, the Company has not yet completed its accounting of the re-measurement of its deferred tax assets and liabilities. Additionally, the Company has not yet collected and analyzed all necessary tax and earnings data of its foreign operations and therefore, the Company has also not yet completed its accounting for the income tax effects of the transition tax. The Company will continue to make and refine its calculations as additional analysis is completed.

In other cases, the Company has not been able to make a reasonable estimate and therefore continues to account for those items based in its existing accounting under ASC 740, *Income Taxes*, and the provisions of the tax laws that were in effect immediately prior to enactment of the Act.

The Act subjects a U.S. shareholder to tax on GILTI earned by certain foreign subsidiaries. Under U.S. GAAP, the Company is permitted to make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred as a period expense only. Given the complexity of the GILTI provisions, the Company is still evaluating the effects of the GILTI provisions and has not yet made its accounting policy election. At March 31, 2018, because the Company is still evaluating the GILTI provisions, the Company has included tax expense related to GILTI for the current year in its estimated annual effective tax rate and has not provided additional GILTI on deferred items.

Additionally, while the Act has applied a tax on accumulated foreign earnings as of the end of fiscal 2017, the Company is still evaluating whether to continue to apply the exception under ASC 740-30-25-18 to the presumption of repatriation of foreign earnings. As a result, the Company has not provided an estimate of the taxes associated with the reversal of this exception. The Company is analyzing the impact of a change in this presumption but until completing its analysis, the Company continues to apply the exception under ASC 740-30-25-18.

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Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Uncertain Tax Positions

As of March 31, 2018, the Company had gross unrecognized tax benefits of $2.6 million, of which $2.0 million would affect the effective tax rate if recognized. During the three months ended March 31, 2018, the Company released $1.5 million of unrecognized tax benefits as a result of a lapse in the statute of limitations.

The Company recognizes interest and penalties related to unrecognized tax benefits in the provision (benefit) for income taxes. These amounts were not material for any of the periods presented.

The Norwegian Tax Administration (NTA) has completed its examination of the Company s Norwegian subsidiary for income tax matters relating to fiscal years 2013, 2014, 2015 and 2016. The Company received a final assessment from the NTA in December 2017 concerning an adjustment to its 2013 taxable income related to the pricing of an intercompany transaction. The adjustment to 2013 taxable income would result in additional Norwegian tax of approximately $30 million, excluding interest and penalties. The Company disagrees with the NTA s assessment and believes the Company s position on this matter is more likely than not to be sustained. The Company plans to exhaust all available administrative remedies, and if unable to resolve this matter through administrative remedies with the NTA, the Company plans to pursue judicial remedies. The Company believes that it is likely that the NTA will request a payment of approximately $15 million in 2018 during the appeal process.

The Company believes that it has accrued adequate reserves related to all matters contained in tax periods open to examination. Should the Company experience an unfavorable outcome in the NTA matter, however, such an outcome could have a material impact on its financial statements.

Tax years 2013 through 2017 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company is not currently under audit in any major taxing jurisdiction, except Norway.

The Company believes it is reasonably possible that the gross unrecognized tax benefits will decrease by approximately $0.4 million in the next 12 months due to the lapse of the statute of limitations applicable to tax deductions and tax credits claimed on prior year tax returns.

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related notes thereto included elsewhere in this report. This discussion contains forward-looking statements. Please see the Cautionary Statement above and Risk Factors below for discussions of the uncertainties, risks and assumptions associated with these statements. Our fiscal year-end financial reporting periods are a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2018 will have 52 weeks and fiscal 2017 had 52 weeks. Our first quarter of fiscal 2018 ended March 31, 2018. Our first quarter of fiscal 2017 ended April 1, 2017.

Overview

We are a leading provider of silicon, software and solutions for a smarter, more connected world. Our award-winning technologies are shaping the future of the Internet of Things (IoT), Internet infrastructure, industrial automation, consumer and automotive markets. Our world-class engineering team creates products focused on performance, energy savings, connectivity and simplicity. Our primary semiconductor products are mixed-signal integrated circuits (ICs), which are electronic components that convert real-world analog signals, such as sound and radio waves, into digital signals that electronic products can process.

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As a fabless semiconductor company, we rely on third-party semiconductor fabricators in Asia, and to a lesser extent the United States and Europe, to manufacture the silicon wafers that reflect our IC designs. Each wafer contains numerous die, which are cut from the wafer to create a chip for an IC. We rely on third parties in Asia to assemble, package, and, in most cases, test these devices and ship these units to our customers. Testing performed by such third parties facilitates faster delivery of products to our customers (particularly those located in Asia), shorter production cycle times, lower inventory requirements, lower costs and increased flexibility of test capacity.

Our expertise in analog-intensive, high-performance, mixed-signal ICs and software enables us to develop highly differentiated solutions that address multiple markets. We group our products into the following categories:

- Internet of Things products, which include our microcontroller (MCU), wireless and sensor products;
- Broadcast products, which include our broadcast consumer and automotive products;
- Infrastructure products, which include our timing products (clocks and oscillators), and isolation devices; and
- Access products, which include our Voice over IP (VoIP) products, embedded modems and Power over Ethernet (PoE) devices.

The sales cycle for our ICs can be as long as 12 months or more. An additional three to six months or more are usually required before a customer ships a significant volume of devices that incorporate our ICs. Due to this lengthy sales cycle, we typically experience a significant delay between incurring research and development and selling, general and administrative expenses, and the corresponding sales. Consequently, if sales in any quarter do not occur when expected, expenses and inventory levels could be disproportionately high, and our operating results for that quarter and, potentially, future quarters would be adversely affected. Moreover, the amount of time between initial research and development and commercialization of a product, if ever, can be substantially longer than the sales cycle for the product. Accordingly, if we incur substantial research and development costs without developing a commercially successful product, our operating results, as well as our growth prospects, could be adversely affected.

Because many of our ICs are designed for use in consumer products such as televisions, set-top boxes, radios and wearables, we expect that the demand for our products will be typically subject to some degree of seasonal demand. However, rapid changes in our markets and across our product areas make it difficult for us to accurately estimate the impact of seasonal factors on our business.

Current Period Highlights

Revenues increased $26.4 million in the recent quarter compared to the first quarter of fiscal 2017, primarily due to increased revenues from our IoT and Infrastructure products offset by decreased revenues from our Broadcast and Access products. Gross margin increased $19.1 million during the same period due primarily to increased product sales. Gross margin as a percent of revenues increased to 60.5% in the recent quarter compared to 58.7% in the first quarter of fiscal 2017 primarily due to variations in product mix. Operating expenses increased by $8.0 million in the recent quarter compared to the first quarter of fiscal 2017 due primarily to increased personnel-related expenses.

We ended the first quarter with $760.1 million in cash, cash equivalents and short-term investments. Net cash provided by operating activities was $22.2 million during the recent three-month period. Accounts receivable was $75.1 million at March 31, 2018, representing 33 days sales outstanding (DSO). Inventory was $76.5 million at March 31, 2018, representing 85 days of inventory (DOI).

Through acquisitions and internal development efforts, we have continued to diversify our product portfolio and introduce new products and solutions with added functionality and further integration. On April 18, 2018, we acquired the Z-Wave business of Sigma Designs, Inc.. Z-Wave is an IoT technology for smart home solutions. See Note 6, *Acquisitions*, to the Condensed Consolidated Financial Statements for additional information.

In the first three months of fiscal 2018, we introduced low-power PCI Express® (PCIe®) Gen 4 clock buffers for 1.5 V and 1.8 V applications; two new Power over Ethernet (PoE) Powered Device (PD) families for a wide range of IoT applications; new Tiny Gecko MCUs that extend battery life for IoT connected devices; and a new Wi-Fi® portfolio to simplify the design of power-sensitive, battery-operated Wi-Fi products. We plan to continue to introduce products that increase the content we provide for existing applications, thereby enabling us to serve markets we do not currently address and expand our total available market opportunity.

During the three months ended March 31, 2018, we had no customer that represented more than 10% of our revenues. In addition to direct sales to customers, some of our end customers purchase products indirectly from us through distributors and contract manufacturers. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer. Three of our distributors who sell to our customers, Arrow Electronics, Edom Technology and Avnet, each represented more than 10% of our revenues during the three months ended March 31, 2018. There were no contract manufacturers that accounted for more than 10% of our revenues during the three months ended March 31, 2018.

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During the first quarter of 2018, we consolidated our distribution relationships to a single global distributor, Arrow Electronics. We are maintaining our extensive network of regional distributor partners and etailers to complement our single global distributor partner. We anticipate this change to our distributor network will create greater efficiencies and contribute to both near and long-term revenue growth. We have also undertaken an initiative to increase our direct sales force in anticipation that this change will also drive future revenue growth.

The percentage of our revenues derived from outside of the United States was 81% during the three months ended March 31, 2018. All of our revenues to date have been denominated in U.S. dollars. We believe that a majority of our revenues will continue to be derived from customers outside of the United States.

Results of Operations

The following describes the line items set forth in our Condensed Consolidated Statements of Income:

Revenues. Revenues are generated predominately by sales of our products. Our revenues are subject to variation from period to period due to the volume of shipments made within a period, the mix of products we sell and the prices we charge for our products.

Cost of Revenues. Cost of revenues includes the cost of purchasing finished silicon wafers processed by independent foundries; costs associated with assembly, test and shipping of those products; costs of personnel and equipment associated with manufacturing support, logistics and quality assurance; costs of software royalties, other intellectual property license costs and certain acquired intangible assets; and an allocated portion of our occupancy costs. Our gross margin as a percentage of revenue fluctuates depending on product mix, manufacturing yields, inventory valuation adjustments, average selling prices and other factors.

Research and Development. Research and development expense consists primarily of personnel-related expenses, including stock-based compensation, as well as new product masks, external consulting and services costs, equipment tooling, equipment depreciation, amortization of intangible assets, and an allocated portion of our occupancy costs. Research and development activities include the design of new products, refinement of existing products and design of test methodologies to ensure compliance with required specifications.

Selling, General and Administrative. Selling, general and administrative expense consists primarily of personnel-related expenses, including stock-based compensation, as well as an allocated portion of our occupancy costs, sales commissions to independent sales representatives, applications engineering support, professional fees, legal fees and promotional and marketing expenses.

Interest Income and Other, Net. Interest income and other, net reflects interest earned on our cash, cash equivalents and investment balances, foreign currency remeasurement adjustments and other non-operating income and expenses.

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Interest Expense. Interest expense consists of interest on our short and long-term obligations, including our convertible senior notes and credit facility. Interest expense on our convertible senior notes includes contractual interest, amortization of the debt discount and amortization of debt issuance costs.

Provision (Benefit) for Income Taxes. Provision (benefit) for income taxes includes both domestic and foreign income taxes at the applicable tax rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences.

The following table sets forth our Condensed Consolidated Statements of Income data as a percentage of revenues for the periods indicated:

	Three Months Ended	
	March 31, 2018	**April 1, 2017**
Revenues	100.0%	100.0%
Cost of revenues	39.5	41.3
Gross margin	60.5	58.7
Operating expenses:		
Research and development	26.7	29.2
Selling, general and administrative	22.3	22.4
Operating expenses	49.0	51.6
Operating income	11.5	7.1
Other income (expense):		
Interest income and other, net	1.6	0.3
Interest expense	(2.4)	0.1
Income before income taxes	10.7	7.5
Provision (benefit) for income taxes	(2.1)	(1.1)
Net income	12.8%	8.6%

Revenues

	Three Months Ended			
(in millions)	**March 31, 2018**	**April 1, 2017**	**Change**	**% Change**
Internet of Things	$ 103.1	$ 87.8	$ 15.3	17.4%
Infrastructure	49.4	36.0	13.4	37.4%
Broadcast	36.1	37.3	(1.2)	(3.4)%
Access	16.8	17.9	(1.1)	(6.0)%
Revenues	$ 205.4	$ 179.0	$ 26.4	14.7%

The change in revenues in the recent three month period was due primarily to:

- Increased revenues of $15.3 million for our IoT products, due primarily to increased demand for our wireless products.

- Increased revenues of $13.4 million for our Infrastructure products, due primarily to increased demand for our isolation products and timing products.

- Decreased revenues of $1.2 million for Broadcast products, due primarily to decreases in the market for our consumer products offset by increased demand for our automotive products.

- Decreased revenues of $1.1 million for our Access products, due primarily to decreased demand for our VoIP products and decreases in the market for such products.

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Unit volumes of our products increased by 16.9% and average selling prices decreased by 1.9% compared to the three months ended April 1, 2017. The average selling prices of our products may fluctuate significantly from period to period due to changes in product mix and other factors. In general, as our products become more mature, we expect to experience decreases in average selling prices. We anticipate that newly announced, higher priced, next generation products and product derivatives will offset some of these decreases.

Gross Margin

	Three Months Ended		
(in millions)	**March 31, 2018**	**April 1, 2017**	**Change**
Gross margin	$ 124.2	$ 105.2	$ 19.0
Percent of revenue	60.5%	58.7%	1.8%

The increased dollar amount of gross margin in the recent three month period was due to increases in gross margin of $10.3 million for our Infrastructure products and $10.3 million for our Internet of Things products, offset by decreases in gross margin of $1.4 million for our Broadcast products and $0.2 million for our Access products. Gross margin increased during the recent period due primarily to increased product sales. Gross margin as a percent of revenues increased primarily due to a higher mix of Infrastructure products sold in the recent period.

We may experience declines in the average selling prices of certain of our products. This creates downward pressure on gross margin as a percentage of revenues and may be offset to the extent we are able to: 1) introduce higher margin new products and gain market share with our products; 2) reduce costs of existing products through improved design; 3) achieve lower production costs from our wafer suppliers and third-party assembly and test subcontractors; 4) achieve lower production costs per unit as a result of improved yields throughout the manufacturing process; or 5) reduce logistics costs.

Research and Development

	Three Months Ended			
(in millions)	**March 31, 2018**	**April 1, 2017**	**Change**	**% Change**
Research and development	$ 54.8	$ 52.3	$ 2.5	4.8%
Percent of revenue	26.7%	29.2%		

The increase in research and development expense in the recent three month period was primarily due to increases of $2.6 million for personnel-related expenses. The decrease in research and development expense as a percent of revenues in the recent three month period was due to our increased revenues. We expect that research and development expense will increase in absolute dollars in the second quarter of fiscal 2018 due to costs associated with increased headcount and costs incurred in connection with the acquisition of the Z-Wave business.

Selling, General and Administrative

(in millions)	Three Months Ended March 31, 2018	Three Months Ended April 1, 2017	Change	% Change
Selling, general and administrative	$ 45.7	$ 40.2	$ 5.5	13.8%
Percent of revenue	22.3%	22.4%		

The increase in selling, general and administrative expense in the recent three month period was primarily due to an increase of $5.3 million for personnel-related expenses. The decrease in selling, general and administrative expense as a percent of revenues in the recent three month period was due to our increased revenues. We expect that selling, general and administrative expense will increase in absolute dollars in the second quarter of fiscal 2018 due to costs associated with increased headcount and costs incurred in connection with the acquisition of the Z-Wave business.

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Interest Income and Other, Net

Interest income and other, net for the three months ended March 31, 2018 was $3.2 million compared to $0.6 million for the three months ended April 1, 2017. The increase in interest income and other, net in the recent three month period was primarily due to increased interest income earned as a result of higher market interest rates and higher cash, cash equivalents and short-term investments balances and a gain of $1.0 million recorded in connection with a fair value adjustment to an equity investment.

Interest Expense

Interest expense for the three months ended March 31, 2018 was $4.9 million compared to $(0.2) million for the three months ended April 1, 2017. The increase in interest expense in the recent three month period was primarily due to increased interest expense of $3.3 million on our convertible debt, including amortization of the debt discount and debt issuance costs, and a $2.0 million gain recorded in the prior three month period in connection with the termination of our interest rate swap agreement.

Provision (Benefit) for Income Taxes

	Three Months Ended		
(in millions)	**March 31, 2018**	**April 1, 2017**	**Change**
Provision (benefit) for income taxes			