

SILICON LABORATORIES INC  
Form 10-Q  
October 23, 2014  
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**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 September 27, 2014

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-29823

# SILICON LABORATORIES INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**74-2793174**

(I.R.S. Employer Identification No.)

**400 West Cesar Chavez, Austin, Texas**

(Address of principal executive offices)

**78701**

(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.  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 (§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).  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.

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

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

As of October 14, 2014, 42,381,139 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*

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*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.*

Table of Contents**Part I. Financial Information****Item 1. Financial Statements****Silicon Laboratories Inc.****Condensed Consolidated Balance Sheets****(In thousands, except per share data)****(Unaudited)**

|   | September 27,<br>2014 | December 28,<br>2013 |
|---|-----------------------|----------------------|
| <b>Assets</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$ 111,705            | \$ 95,800            |
| Short-term investments  | 216,973               | 179,593              |
| Accounts receivable, net of allowances for doubtful accounts of \$784 at September 27, 2014 and \$797 at December 28, 2013  | 71,355                | 72,124               |
| Inventories   | 47,015                | 45,271               |
| Deferred income taxes   | 18,064                | 18,878               |
| Prepaid expenses and other current assets   | 39,756                | 47,651               |
| Total current assets  | 504,868               | 459,317              |
| Long-term investments   | 11,505                | 10,632               |
| Property and equipment, net   | 128,433               | 132,445              |
| Goodwill  | 228,781               | 228,781              |
| Other intangible assets, net  | 119,854               | 131,593              |
| Other assets, net   | 21,476                | 28,382               |
| Total assets  | \$ 1,014,917          | \$ 991,150           |
| <b>Liabilities and Stockholders Equity</b>  |                       |                      |
| Current liabilities:  |                       |                      |
| Accounts payable  | \$ 28,361             | \$ 22,126            |
| Current portion of long-term debt   | 11,250                | 7,500                |
| Accrued expenses  | 74,732                | 45,975               |
| Deferred income on shipments to distributors  | 37,068                | 30,853               |
| Income taxes  | 1,319                 | 2,693                |
| Total current liabilities   | 152,730               | 109,147              |
| Long-term debt  | 80,000                | 87,500               |
| Other non-current liabilities   | 32,217                | 55,941               |
| Total liabilities   | 264,947               | 252,588              |
| Commitments and contingencies   |                       |                      |
| Stockholders equity:  |                       |                      |
| Preferred stock \$0.0001 par value; 10,000 shares authorized; no shares issued and outstanding  |                       |                      |
| Common stock \$0.0001 par value; 250,000 shares authorized; 42,490 and 42,779 shares issued and outstanding at September 27, 2014 and December 28, 2013, respectively | 4                     | 4                    |
| Additional paid-in capital  | 31,467                | 48,630               |
| Retained earnings   | 718,609               | 690,612              |
| Accumulated other comprehensive loss  | (110)                 | (684)                |

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|  |    |           |    |         |
|--|----|-----------|----|---------|
| Total stockholders' equity                 |    | 749,970   |    | 738,562 |
| Total liabilities and stockholders' equity | \$ | 1,014,917 | \$ | 991,150 |

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

Table of Contents**Silicon Laboratories Inc.****Condensed Consolidated Statements of Income****(In thousands, except per share data)****(Unaudited)**

|   | <b>Three Months Ended</b>     |                               | <b>Nine Months Ended</b>      |                               |
|---|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|   | <b>September 27,<br/>2014</b> | <b>September 28,<br/>2013</b> | <b>September 27,<br/>2014</b> | <b>September 28,<br/>2013</b> |
| Revenues                                    | \$ 158,144                    | \$ 146,933                    | \$ 458,753                    | \$ 433,851                    |
| Cost of revenues                            | 62,033                        | 58,772                        | 176,874                       | 169,545                       |
| Gross margin                                | 96,111                        | 88,161                        | 281,879                       | 264,306                       |
| Operating expenses:                         |                               |                               |                               |                               |
| Research and development                    | 42,517                        | 40,662                        | 126,846                       | 115,631                       |
| Selling, general and administrative         | 43,990                        | 37,009                        | 114,618                       | 98,519                        |
| Operating expenses                          | 86,507                        | 77,671                        | 241,464                       | 214,150                       |
| Operating income                            | 9,604                         | 10,490                        | 40,415                        | 50,156                        |
| Other income (expense):                     |                               |                               |                               |                               |
| Interest income                             | 231                           | 129                           | 733                           | 616                           |
| Interest expense                            | (768)                         | (813)                         | (2,346)                       | (2,486)                       |
| Other income (expense), net                 | 42                            | (23)                          | 103                           | 39                            |
| Income before income taxes                  | 9,109                         | 9,783                         | 38,905                        | 48,325                        |
| Provision for income taxes                  | 3,501                         | 3,252                         | 10,908                        | 9,148                         |
| Net income                                  | \$ 5,608                      | \$ 6,531                      | \$ 27,997                     | \$ 39,177                     |
| Earnings per share:                         |                               |                               |                               |                               |
| Basic                                       | \$ 0.13                       | \$ 0.15                       | \$ 0.65                       | \$ 0.92                       |
| Diluted                                     | \$ 0.13                       | \$ 0.15                       | \$ 0.64                       | \$ 0.90                       |
| Weighted-average common shares outstanding: |                               |                               |                               |                               |
| Basic                                       | 43,112                        | 42,684                        | 43,218                        | 42,477                        |
| Diluted                                     | 43,815                        | 43,922                        | 44,030                        | 43,437                        |

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

Table of Contents**Silicon Laboratories Inc.****Condensed Consolidated Statements of Comprehensive Income****(In thousands)****(Unaudited)**

|   | <b>Three Months Ended</b>     |                               | <b>Nine Months Ended</b>      |                               |
|---|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|   | <b>September 27,<br/>2014</b> | <b>September 28,<br/>2013</b> | <b>September 27,<br/>2014</b> | <b>September 28,<br/>2013</b> |
| Net income  | \$ 5,608                      | \$ 6,531                      | \$ 27,997                     | \$ 39,177                     |
| Other comprehensive income, before tax              |                               |                               |                               |                               |
| Net changes to available-for-sale securities        |                               |                               |                               |                               |
| Unrealized gains (losses) arising during the period | 417                           | 653                           | 889                           | (554)                         |
| Reclassification for gains included in net income   |                               |                               |                               | (232)                         |
| Net changes to cash flow hedges                     |                               |                               |                               |                               |
| Unrealized gains (losses) arising during the period | 193                           | (522)                         | (434)                         | 622                           |
| Reclassification for losses included in net income  | 142                           | 96                            | 428                           | 418                           |
| Other comprehensive income, before tax              | 752                           | 227                           | 883                           | 254                           |
| Provision for income taxes                          | 263                           | 79                            | 309                           | 89                            |
| Other comprehensive income                          | 489                           | 148                           | 574                           | 165                           |
| Comprehensive income                                | \$ 6,097                      | \$ 6,679                      | \$ 28,571                     | \$ 39,342                     |

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



Table of Contents**Silicon Laboratories Inc.****Condensed Consolidated Statements of Cash Flows****(In thousands)****(Unaudited)**

|   | <b>Nine Months Ended</b>      |                               |
|---|-------------------------------|-------------------------------|
|   | <b>September 27,<br/>2014</b> | <b>September 28,<br/>2013</b> |
| <b>Operating Activities</b>   |                               |                               |
| Net income  | \$ 27,997                     | \$ 39,177                     |
| Adjustments to reconcile net income to cash provided by operating activities: |                               |                               |
| Depreciation of property and equipment  | 9,512                         | 10,050                        |
| Amortization of other intangible assets and other assets                      | 13,090                        | 11,051                        |
| Stock-based compensation expense  | 28,173                        | 22,304                        |
| Income tax benefit (shortfall) from stock-based awards                        | 413                           | (621)                         |
| Excess income tax benefit from stock-based awards                             | (654)                         | (284)                         |
| Deferred income taxes   | 3,894                         | 6,790                         |
| Changes in operating assets and liabilities:                                  |                               |                               |
| Accounts receivable   | 769                           | 12,599                        |
| Inventories   | (1,591)                       | 6,213                         |
| Prepaid expenses and other assets   | 12,627                        | (1,606)                       |
| Accounts payable  | 5,074                         | (3,017)                       |
| Accrued expenses  | 6,966                         | (2,864)                       |
| Deferred income on shipments to distributors                                  | 6,215                         | (3,169)                       |
| Income taxes  | (4,898)                       | (1,429)                       |
| Net cash provided by operating activities                                     | 107,587                       | 95,194                        |
| <b>Investing Activities</b>   |                               |                               |
| Purchases of available-for-sale investments                                   | (137,373)                     | (164,317)                     |
| Proceeds from sales and maturities of available-for-sale investments          | 100,009                       | 186,936                       |
| Purchases of property and equipment   | (5,500)                       | (8,984)                       |
| Purchases of other assets   | (3,339)                       | (3,499)                       |
| Acquisition of businesses, net of cash acquired                               |                               | (86,441)                      |
| Net cash used in investing activities   | (46,203)                      | (76,305)                      |
| <b>Financing Activities</b>   |                               |                               |
| Proceeds from issuance of common stock, net of shares withheld for taxes      | 8,559                         | 11,900                        |
| Excess income tax benefit from stock-based awards                             | 654                           | 284                           |
| Repurchases of common stock   | (50,942)                      | (7,776)                       |
| Payments on debt  | (3,750)                       | (12,184)                      |
| Net cash used in financing activities   | (45,479)                      | (7,776)                       |
| Increase in cash and cash equivalents   | 15,905                        | 11,113                        |
| Cash and cash equivalents at beginning of period                              | 95,800                        | 105,426                       |
| Cash and cash equivalents at end of period                                    | \$ 111,705                    | \$ 116,539                    |

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 September 27, 2014 and December 28, 2013, the condensed consolidated results of its operations for the three and nine months ended September 27, 2014 and September 28, 2013, the Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 27, 2014 and September 28, 2013, and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 27, 2014 and September 28, 2013. All intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated results of operations for the three and nine months ended September 27, 2014 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 28, 2013, included in the Company's Form 10-K filed with the Securities and Exchange Commission (SEC) on January 31, 2014.

The Company prepares financial statements on a 52-53 week year that ends on the Saturday closest to December 31. Fiscal 2014 will have 53 weeks with the extra week occurring in the fourth quarter of the year. Fiscal 2013 had 52 weeks. In a 52-week year, each fiscal quarter consists of 13 weeks.

*Revenue Recognition*

Revenues are generated predominately by sales of the Company's integrated circuits (ICs). The Company recognizes revenue when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists, 2) delivery of goods has occurred, 3) the sales price is fixed or determinable, and 4) collectibility is reasonably assured. Generally, revenue from product sales to direct customers and contract manufacturers is recognized upon shipment.

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A portion of the Company's sales are made to distributors under agreements allowing certain rights of return and price protection related to the final selling price to the end customers. Accordingly, the Company defers revenue and cost of revenue on such sales until the distributors sell the product to the end customers. The net balance of deferred revenue less deferred cost of revenue associated with inventory shipped to a distributor but not yet sold to an end customer is recorded in the deferred income on shipments to distributors liability on the Consolidated Balance Sheet. Such net deferred income balance reflects the Company's estimate of the impact of rights of return and price protection.

A small portion of the Company's revenues is derived from the sale of patents. The above revenue recognition criteria for patent sales are generally met upon the execution of the patent sale agreement.

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**Silicon Laboratories Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(Unaudited)**

*Recent Accounting Pronouncements*

In June 2014, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Update (ASU) No. 2014-12, *Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. The amendments in this update require that a performance target that affects vesting and that could be achieved after the requisite service period should be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

In May 2014, the FASB issued FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition*. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, using one of two retrospective application methods. Early application is not permitted. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

In April 2014, the FASB issued FASB ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. The amendments in this update require a disposal of a component of an entity or a group of components of an entity to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. ASU 2014-08 expands disclosure requirements about discontinued operations and adds new disclosures for individually significant dispositions that do not qualify as discontinued operations. ASU 2014-08 is effective prospectively for annual periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015. Early adoption is permitted, but only for disposals that have not been reported in financial statements previously issued. The adoption of this ASU is not expected to have a material impact on the Company's financial statements.

Table of Contents**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    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2014 | September 28,<br>2013 | September 27,<br>2014 | September 28,<br>2013 |
| Net income  | \$ 5,608              | \$ 6,531              | \$ 27,997             | \$ 39,177             |
| Shares used in computing basic earnings per share   | 43,112                | 42,684                | 43,218                | 42,477                |
| Effect of dilutive securities:                      |                       |                       |                       |                       |
| Stock options and other stock-based awards          | 703                   | 1,238                 | 812                   | 960                   |
| Shares used in computing diluted earnings per share | 43,815                | 43,922                | 44,030                | 43,437                |
| Earnings per share:                                 |                       |                       |                       |                       |
| Basic   | \$ 0.13               | \$ 0.15               | \$ 0.65               | \$ 0.92               |
| Diluted   | \$ 0.13               | \$ 0.15               | \$ 0.64               | \$ 0.90               |

For the three months ended September 27, 2014 and September 28, 2013 and the nine months ended September 27, 2014 and September 28, 2013, approximately 0.1 million, 0.5 million, 0.1 million and 0.4 million shares, respectively, were not included in the diluted earnings per share calculation since the shares were anti-dilutive.

**3. Cash, Cash Equivalents and Investments**

The Company's cash equivalents and short-term investments as of September 27, 2014 consisted of municipal bonds, corporate bonds, money market funds, commercial paper, variable-rate demand notes, certificates of deposit, asset-backed securities, international government bonds, U.S. government bonds and U.S. government agency. The Company's long-term investments consisted of auction-rate securities. In fiscal 2008, auctions for many of the Company's auction-rate securities failed because sell orders exceeded buy orders. As of September 27, 2014, the Company held \$12.4 million par value auction-rate securities, all of which have experienced failed auctions. The underlying assets of the securities consisted of student loans and municipal bonds, of which \$10.4 million were guaranteed by the U.S. government and the remaining \$2.0 million were privately insured. As of September 27, 2014, \$6.0 million had credit ratings of AA, \$2.0 million had a credit rating of A and \$4.4 million of the auction-rate securities had credit ratings of BBB. These securities have contractual maturity dates ranging from 2033 to 2046 at September 27, 2014. The Company is receiving the underlying cash flows on all of its auction-rate securities. The principal amounts associated with failed auctions are 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. The Company is unable to predict if these funds will become available before their maturity dates.

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The Company does not expect to need access to the capital represented by any of its auction-rate securities prior to their maturities. The Company does not intend to sell, and believes it is not more likely than not that it will be required to sell, its auction-rate securities before their anticipated recovery in market value or final settlement at the underlying par value. 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 has determined that no other-than-temporary impairment losses existed as of September 27, 2014.

The Company's cash, cash equivalents and investments consist of the following (in thousands):

|                                       | Cost       | September 27, 2014            |                              | Fair Value |
|---------------------------------------|------------|-------------------------------|------------------------------|------------|
|                                       |            | Gross<br>Unrealized<br>Losses | Gross<br>Unrealized<br>Gains |            |
| <b>Cash and Cash Equivalents:</b>     |            |                               |                              |            |
| Cash on hand                          | \$ 63,284  | \$                            | \$                           | \$ 63,284  |
| <b>Available-for-sale securities:</b> |            |                               |                              |            |
| Money market funds                    | 28,036     |                               |                              | 28,036     |
| Commercial paper                      | 14,147     |                               |                              | 14,147     |
| Certificates of deposit               | 5,331      |                               |                              | 5,331      |
| Municipal bonds                       | 907        |                               |                              | 907        |
| Total available-for-sale securities   | 48,421     |                               |                              | 48,421     |
| Total cash and cash equivalents       | \$ 111,705 | \$                            | \$                           | \$ 111,705 |
| <b>Short-term Investments:</b>        |            |                               |                              |            |
| <b>Available-for-sale securities:</b> |            |                               |                              |            |
| Municipal bonds                       | \$ 143,212 | \$ (3)                        | \$ 240                       | \$ 143,449 |
| Corporate bonds                       | 36,000     | (33)                          | 47                           | 36,014     |
| Variable-rate demand notes            | 15,755     |                               |                              | 15,755     |
| Commercial paper                      | 11,439     |                               |                              | 11,439     |
| Asset-backed securities               | 5,689      | (3)                           | 1                            | 5,687      |
| International government bonds        | 2,533      | (5)                           |                              | 2,528      |
| Certificates of deposit               | 850        |                               |                              | 850        |
| U.S. government bonds                 | 650        |                               |                              | 650        |
| U.S. government agency                | 601        |                               |                              | 601        |
| Total short-term investments          | \$ 216,729 | \$ (44)                       | \$ 288                       | \$ 216,973 |
| <b>Long-term Investments:</b>         |            |                               |                              |            |
| <b>Available-for-sale securities:</b> |            |                               |                              |            |
| Auction rate securities               | \$ 12,425  | \$ (920)                      | \$                           | \$ 11,505  |
| Total long-term investments           | \$ 12,425  | \$ (920)                      | \$                           | \$ 11,505  |





Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

|                                     | December 28, 2013 |                               |                              |            |
|-------------------------------------|-------------------|-------------------------------|------------------------------|------------|
|                                     | Cost              | Gross<br>Unrealized<br>Losses | Gross<br>Unrealized<br>Gains | Fair Value |
| <b>Cash and Cash Equivalents:</b>   |                   |                               |                              |            |
| Cash on hand                        | \$ 45,544         | \$                            | \$                           | \$ 45,544  |
| Available-for-sale securities:      |                   |                               |                              |            |
| Money market funds                  | 39,538            |                               |                              | 39,538     |
| Certificates of deposit             | 7,768             |                               |                              | 7,768      |
| Commercial paper                    | 2,499             |                               |                              | 2,499      |
| Municipal bonds                     | 451               |                               |                              | 451        |
| Total available-for-sale securities | 50,256            |                               |                              | 50,256     |
| Total cash and cash equivalents     | \$ 95,800         | \$                            | \$                           | \$ 95,800  |
| <b>Short-term Investments:</b>      |                   |                               |                              |            |
| Available-for-sale securities:      |                   |                               |                              |            |
| Municipal bonds                     | \$ 119,289        | \$ (11)                       | \$ 182                       | \$ 119,460 |
| Variable-rate demand notes          | 38,025            |                               |                              | 38,025     |
| Corporate bonds                     | 17,788            | (4)                           | 60                           | 17,844     |
| Commercial paper                    | 3,748             |                               |                              | 3,748      |
| Asset-backed securities             | 515               |                               | 1                            | 516        |
| Total short-term investments        | \$ 179,365        | \$ (15)                       | \$ 243                       | \$ 179,593 |
| <b>Long-term Investments:</b>       |                   |                               |                              |            |
| Available-for-sale securities:      |                   |                               |                              |            |
| Auction rate securities             | \$ 12,425         | \$ (1,793)                    | \$                           | \$ 10,632  |
| Total long-term investments         | \$ 12,425         | \$ (1,793)                    | \$                           | \$ 10,632  |

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         |                               |
|---------------------------------|---------------------|-------------------------------|----------------------|-------------------------------|---------------|-------------------------------|
|                                 | Fair<br>Value       | Gross<br>Unrealized<br>Losses | Fair<br>Value        | Gross<br>Unrealized<br>Losses | Fair<br>Value | Gross<br>Unrealized<br>Losses |
| <b>As of September 27, 2014</b> |                     |                               |                      |                               |               |                               |
| Corporate bonds                 | \$ 16,564           | \$ (33)                       | \$                   | \$                            | \$ 16,564     | \$ (33)                       |
| Auction rate securities         |                     |                               | 11,505               | (920)                         | 11,505        | (920)                         |
| Municipal bonds                 | 7,893               | (3)                           |                      |                               | 7,893         | (3)                           |
| Asset-backed securities         | 5,102               | (3)                           |                      |                               | 5,102         | (3)                           |
| International government bond   | 2,527               | (5)                           |                      |                               | 2,527         | (5)                           |
|                                 | \$ 32,086           | \$ (44)                       | \$ 11,505            | \$ (920)                      | \$ 43,591     | \$ (964)                      |



Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

|                         | Less Than 12 Months |                         | 12 Months or Greater |                         | Total      |                         |
|-------------------------|---------------------|-------------------------|----------------------|-------------------------|------------|-------------------------|
| As of December 28, 2013 | Fair Value          | Gross Unrealized Losses | Fair Value           | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Municipal bonds         | \$ 11,079           | \$ (11)                 | \$ 10,632            | \$ (1,793)              | \$ 11,079  | \$ (11)                 |
| Auction rate securities |                     |                         | 10,632               | (1,793)                 | 10,632     | (1,793)                 |
| Corporate bonds         | 2,605               | (4)                     |                      |                         | 2,605      | (4)                     |
|                         | \$ 13,684           | \$ (15)                 | \$ 10,632            | \$ (1,793)              | \$ 24,316  | \$ (1,808)              |

The gross unrealized losses as of September 27, 2014 and December 28, 2013 were due primarily to the illiquidity of the Company's auction-rate securities and, to a lesser extent, to changes in market interest rates.

The following summarizes the contractual underlying maturities of the Company's available-for-sale investments at September 27, 2014 (in thousands):

|                                      | Cost       | Fair Value |
|--------------------------------------|------------|------------|
| Due in one year or less              | \$ 155,375 | \$ 155,485 |
| Due after one year through ten years | 97,195     | 97,329     |
| Due after ten years                  | 25,005     | 24,085     |
|                                      | \$ 277,575 | \$ 276,899 |

**4. Derivative Financial Instruments**

The Company is exposed to interest rate fluctuations in the normal course of its business, including through its Credit Facilities. The interest payments on the facility are calculated using a variable-rate of interest. The Company has entered into an interest rate swap agreement with an original notional value of \$100 million (equal to the full amount borrowed under the Term Loan Facility) and, effectively, converted the LIBOR portion of the variable-rate interest payments to fixed-rate interest payments through July 2017 (the maturity date of the Term Loan Facility). The Company's objective is to offset increases and decreases in expenses resulting from changes in interest rates with gains and losses on the derivative contract, thereby reducing volatility of earnings. The Company does not use derivative contracts for speculative purposes.

The Company's interest rate swap agreement is designated and qualifies as a cash flow hedge. The effective portion of the gain or loss on the interest rate swap is recorded in accumulated other comprehensive loss as a separate component of stockholders' equity and is subsequently recognized in earnings when the hedged exposure affects earnings. Cash flows from derivatives are classified according to the nature of the cash receipt or payment in the Consolidated Statement of Cash Flows.

The Company estimates the fair values of derivatives based on quoted prices and market observable data of similar instruments. If the Term Loan Facility or the interest rate swap agreement is terminated prior to maturity, the fair value of the interest rate swap recorded in accumulated other comprehensive loss may be recognized in the Consolidated Statement of Income based on an assessment of the agreements at the time of termination. The Company did not discontinue any cash flow hedges in any of the periods presented.

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The Company measures the effectiveness of its cash flow hedge by comparing the change in fair value of the hedged variable interest payments with the change in fair value of the interest rate swap. The Company recognizes ineffective portions of the hedge, as well as amounts not included in the assessment of effectiveness, in the Consolidated Statement of Income. As of September 27, 2014, no portion of the gains or losses from the Company's hedging instrument was excluded from the assessment of effectiveness. Hedge ineffectiveness was not material for any of the periods presented.

The Company's derivative financial instrument consisted of the following (in thousands):

|                    | Balance Sheet Location | Fair Value            |                      |
|--------------------|------------------------|-----------------------|----------------------|
|                    |                        | September 27,<br>2014 | December 28,<br>2013 |
| Interest rate swap | Other assets, net      | \$ 507                | \$ 513               |

The before-tax effect of derivative instruments in cash flow hedging relationships was as follows (in thousands):

|                     | Gain (Loss) Recognized in<br>OCI on Derivatives<br>(Effective Portion)<br>during the: |                       | Location of Loss<br>Reclassified into<br>Income | Loss Reclassified<br>from Accumulated<br>OCI into Income<br>(Effective Portion)<br>during the: |                       |
|---------------------|---|-----------------------|---|--|-----------------------|
|                     | Three Months Ended  |                       |   | Three Months Ended   |                       |
|                     | September 27,<br>2014   | September 28,<br>2013 |   | September 27,<br>2014  | September 28,<br>2013 |
| Interest rate swaps | \$ 193  | \$ (522)              | Interest expense                                | \$ (142)   | \$ (96)               |
|                     | Nine Months Ended   |                       |   | Nine Months Ended  |                       |
|                     | September 27,<br>2014   | September 28,<br>2013 |   | September 27,<br>2014  | September 28,<br>2013 |
| Interest rate swaps | \$ (434)  | \$ 622                | Interest expense                                | \$ (428)   | \$ (418)              |

The Company expects to reclassify \$0.5 million of its interest rate swap losses included in accumulated other comprehensive loss as of September 27, 2014 into earnings in the next 12 months, which would be offset by lower interest payments.

**5. Fair Value of Financial Instruments**

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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.

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## 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.

| Description                           | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Fair Value Measurements<br>at September 27, 2014 Using<br>Significant Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total      |
|---------------------------------------|---|--|--|------------|
| <b>Assets:</b>                        |   |  |  |            |
| <b>Cash Equivalents:</b>              |   |  |  |            |
| Money market funds                    | \$ 28,036   | \$   | \$   | \$ 28,036  |
| Commercial paper                      |   | 14,147   |  | 14,147     |
| Certificates of deposit               |   | 5,331  |  | 5,331      |
| Municipal bonds                       |   | 907  |  | 907        |
| Total cash equivalents                | \$ 28,036   | \$ 20,385  | \$   | \$ 48,421  |
| <b>Short-term Investments:</b>        |   |  |  |            |
| Municipal bonds                       | \$  | \$ 143,449   | \$   | \$ 143,449 |
| Corporate bonds                       |   | 36,014   |  | 36,014     |
| Variable-rate demand notes            |   | 15,755   |  | 15,755     |
| Commercial paper                      |   | 11,439   |  | 11,439     |
| Asset-backed securities               |   | 5,687  |  | 5,687      |
| International government bonds        |   | 2,528  |  | 2,528      |
| Certificates of deposit               |   | 850  |  | 850        |
| U.S. government bond                  | 650   |  |  | 650        |
| U.S. government agency                |   | 601  |  | 601        |
| Total short-term investments          | \$ 650  | \$ 216,323   | \$   | \$ 216,973 |
| <b>Long-term Investments:</b>         |   |  |  |            |
| Auction rate securities               | \$  | \$   | \$ 11,505  | \$ 11,505  |
| Total long-term investments           | \$  | \$   | \$ 11,505  | \$ 11,505  |
| <b>Other assets, net:</b>             |   |  |  |            |
| Derivative instruments                | \$  | \$ 507   | \$   | \$ 507     |
| Total                                 | \$  | \$ 507   | \$   | \$ 507     |
| <b>Total</b>                          | \$ 28,686   | \$ 237,215   | \$ 11,505  | \$ 277,406 |
| <b>Liabilities:</b>                   |   |  |  |            |
| <b>Accrued expenses:</b>              |   |  |  |            |
| Contingent consideration              | \$  | \$   | \$ 6,279   | \$ 6,279   |
| <b>Other non-current liabilities:</b> |   |  |  |            |
| Contingent consideration              | \$  | \$   | \$ 11,680  | \$ 11,680  |
| <b>Total</b>                          | \$  | \$   | \$ 17,959  | \$ 17,959  |





Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

| Description                           | Fair Value Measurements<br>at December 28, 2013 Using                   |  |  | Total             |
|---------------------------------------|---|--|--|-------------------|
|                                       | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                   |
| <b>Assets:</b>                        |   |  |  |                   |
| <b>Cash Equivalents:</b>              |   |  |  |                   |
| Money market funds                    | \$ 39,538   | \$   | \$   | \$ 39,538         |
| Certificates of deposit               |   | 7,768  |  | 7,768             |
| Commercial paper                      |   | 2,499  |  | 2,499             |
| Municipal bonds                       |   | 451  |  | 451               |
| <b>Total cash equivalents</b>         | <b>\$ 39,538</b>  | <b>\$ 10,718</b>                                 | <b>\$</b>  | <b>\$ 50,256</b>  |
| <b>Short-term Investments:</b>        |   |  |  |                   |
| Municipal bonds                       | \$  | \$ 119,460                                       | \$   | \$ 119,460        |
| Variable-rate demand notes            |   | 38,025   |  | 38,025            |
| Corporate bonds                       |   | 17,844   |  | 17,844            |
| Commercial paper                      |   | 3,748  |  | 3,748             |
| Asset-backed securities               |   | 516  |  | 516               |
| <b>Total short-term investments</b>   | <b>\$</b>   | <b>\$ 179,593</b>                                | <b>\$</b>  | <b>\$ 179,593</b> |
| <b>Long-term Investments:</b>         |   |  |  |                   |
| Auction rate securities               | \$  | \$   | \$ 10,632  | \$ 10,632         |
| <b>Total long-term investments</b>    | <b>\$</b>   | <b>\$</b>  | <b>\$ 10,632</b>                                   | <b>\$ 10,632</b>  |
| <b>Other assets, net:</b>             |   |  |  |                   |
| Derivative instruments                | \$  | \$ 513   | \$   | \$ 513            |
| <b>Total</b>                          | <b>\$</b>   | <b>\$ 513</b>                                    | <b>\$</b>  | <b>\$ 513</b>     |
| <b>Total</b>                          | <b>\$ 39,538</b>  | <b>\$ 190,824</b>                                | <b>\$ 10,632</b>                                   | <b>\$ 240,994</b> |
| <b>Liabilities:</b>                   |   |  |  |                   |
| <b>Other non-current liabilities:</b> |   |  |  |                   |
| Contingent consideration              | \$  | \$   | \$ 12,919  | \$ 12,919         |
| <b>Total</b>                          | <b>\$</b>   | <b>\$</b>  | <b>\$ 12,919</b>                                   | <b>\$ 12,919</b>  |

The Company's cash equivalents and short-term investments that are classified as Level 1 are valued using quoted prices and other relevant information generated by market transactions involving identical assets. Cash equivalents and short-term investments 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 a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include quoted interest swap rates and market observable data of similar instruments.



Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The Company's contingent consideration is valued using a Monte Carlo simulation model or a probability weighted discounted cash flow model. The assumptions used in preparing the Monte Carlo simulation model include estimates for revenue growth rates, revenue volatility, contractual terms and discount rates. The assumptions used in preparing the discounted cash flow model include estimates for outcomes if milestone goals are achieved, the probability of achieving each outcome and discount rates.

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

**Auction rate securities**

| Fair Value at<br>September 27, 2014<br>(000s) | Valuation Technique  | Unobservable Input      | Weighted Average |
|---|----------------------|-------------------------|------------------|
| \$ 11,505                                     | Discounted cash flow | Estimated yield         | 1.15%            |
|   |                      | Expected holding period | 10 years         |
|   |                      | Estimated discount rate | 3.50%            |

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.

**Contingent consideration**

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| Fair Value at<br>September 27, 2014<br>(000s) | Valuation Technique    | Unobservable Input           | Range               |
|---|------------------------|------------------------------|---------------------|
| \$ 17,959                                     | Monte Carlo simulation | Expected revenue growth rate | 35.6% 69.1%         |
|   |                        | Expected revenue volatility  | 20.0%               |
|   |                        | Expected term                | 0.3 years 4.3 years |
|   |                        | Estimated discount rate      | 0.1% 1.8%           |

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The Company has followed an established internal control procedure used in valuing contingent consideration. The valuation of contingent consideration for the Energy Micro acquisition is based on a Monte Carlo simulation model. The fair value of this valuation is estimated on a quarterly basis through a collaborative effort by the Company's sales, marketing and finance departments.

Significant changes in any of the unobservable inputs used in the fair value measurement of contingent consideration in isolation could result in a significantly lower or higher fair value. A change in projected revenue growth rates would be accompanied by a directionally similar change in fair value. A change in discount rate would be accompanied by a directionally opposite change in fair value.

The following summarizes the activity in Level 3 financial instruments for the three and nine months ended September 27, 2014 (in thousands):

**Assets**

| <b>Auction Rate Securities</b>              | <b>Three Months<br/>Ended</b> | <b>Nine Months<br/>Ended</b> |
|---|-------------------------------|------------------------------|
| Beginning balance                           | \$ 10,993                     | \$ 10,632                    |
| Gain included in other comprehensive income | 512                           | 873                          |
| Balance at September 27, 2014               | \$ 11,505                     | \$ 11,505                    |

**Liabilities**

| <b>Contingent Consideration (1)</b>  | <b>Three Months<br/>Ended</b> | <b>Nine Months<br/>Ended</b> |
|--|-------------------------------|------------------------------|
| Beginning balance  | \$ 11,955                     | \$ 12,919                    |
| Loss recognized in earnings (2)  | 6,004                         | 5,040                        |
| Balance at September 27, 2014  | \$ 17,959                     | \$ 17,959                    |
| Net loss for the period included in earnings attributable to contingent consideration held at the end of the period: | \$ (6,004)                    | \$ (5,040)                   |

(1) In connection with the acquisition of Energy Micro, the Company recorded contingent consideration based upon the expected achievement of certain milestone goals. Changes to the fair value of contingent consideration due to changes in assumptions used in preparing the valuation model are recorded in selling, general and administrative expenses in the Consolidated Statement of Income.

(2) The Company increased the estimated fair value of contingent consideration because the Company now expects a higher level of earn-out achievement.

Fair values of other financial instruments

The Company's Term Loan Facility bears interest at LIBOR plus an applicable margin. The Term Loan Facility is recorded at cost, but is measured at fair value for disclosure purposes. Fair value is estimated based on Level 2 inputs, using a discounted cash flow analysis of future principal payments and projected interest based on current market rates. As of September 27, 2014 and December 28, 2013, the fair value of the Company's debt was approximately \$91.2 million and \$94.8 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.

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****6. Balance Sheet Details**

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

*Inventories*

|                  | <b>September 27,<br/>2014</b> | <b>December 28,<br/>2013</b> |
|------------------|-------------------------------|------------------------------|
| Work in progress | \$ 35,505                     | \$ 34,503                    |
| Finished goods   | 11,510                        | 10,768                       |
|                  | \$ 47,015                     | \$ 45,271                    |

**7. Debt**

On July 31, 2012, the Company and certain of its domestic subsidiaries (the Guarantors) entered into a \$230 million five-year Credit Agreement (the Agreement). The Agreement consists of a \$100 million Term Loan Facility and a \$130 million Revolving Credit Facility (collectively, the Credit Facilities).

The Term Loan Facility provides for quarterly principal amortization (equal to 5% of the principal in each of the first two years and 10% of the principal in each of the next three years) with the remaining balance payable upon the maturity date. The Revolving Credit Facility includes a \$25 million letter of credit sublimit and a \$10 million swingline loan sublimit. The Company has an option to increase the size of the Revolving Credit Facility by up to an aggregate of \$50 million in additional commitments, subject to certain conditions. On September 27, 2012, the Company borrowed \$100 million under the Term Loan Facility. To date, the Company has not borrowed under the Revolving Credit Facility.

The Term Loan Facility and Revolving Credit Facility, other than swingline loans, will bear interest at LIBOR plus an applicable margin or, at the option of the Company, a base rate (defined as the highest of the Bank of America prime rate, the Federal Funds rate plus 0.50% and a daily rate equal to one-month LIBOR 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 LIBOR rate loans range from 1.50% to 2.50% and for base rate loans range from 0.50% to 1.50%, depending in each case, on the leverage ratio as defined in the Agreement. The Company also pays a commitment fee on the unused amount of the Revolving Credit Facility.



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In connection with the closing of the Credit Agreement, the Company entered into a security and pledge agreement. Under the security and pledge agreement, the Company pledged equity securities of certain of its subsidiaries, subject to exceptions and limitations. The Credit Facilities contain 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 2.5 to 1 and a minimum fixed charge coverage ratio (EBITDA/debt payments, income taxes and capital expenditures) of no less than 1.50 to 1. As of September 27, 2014, the Company was in compliance with all covenants of the Credit Facilities.

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**Silicon Laboratories Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(Unaudited)**

As of September 27, 2014, the remaining contractual maturities of the Term Loan Facility were as follows (in thousands):

| <b>Fiscal Year</b> |    |        |
|--------------------|----|--------|
| 2014               | \$ | 3,750  |
| 2015               |    | 10,000 |
| 2016               |    | 10,000 |
| 2017               |    | 67,500 |
| Total              | \$ | 91,250 |

*Interest Rate Swap Agreement*

In connection with the \$100 million borrowed under the Term Loan Facility, the Company entered into an interest rate swap agreement as a hedge against the LIBOR portion of such variable interest payments. Under the terms of the swap agreement, the Company effectively converted the LIBOR portion of the interest on the Term Loan Facility to a fixed interest rate of 0.764% through the maturity date. As of September 27, 2014, the combined interest rate on the Term Loan Facility (which includes an applicable margin) was 2.514%. See Note 4, *Derivative Financial Instruments*, for additional information.

**8. Stockholders' Equity**

*Common Stock*

The Company issued 1.0 million shares of common stock during the nine months ended September 27, 2014.

*Share Repurchase Programs*

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

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| <b>Program Authorization Date</b> | <b>Program Termination Date</b> | <b>Program Amount</b> |
|-----------------------------------|---------------------------------|-----------------------|
| October 2014                      | December 2015                   | \$ 100,000            |
| January 2014                      | October 2014                    | \$ 100,000            |
| January 2013                      | January 2014                    | \$ 50,000             |
| April 2012                        | January 2013                    | \$ 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 repurchased 1.3 million shares of its common stock for \$53.9 million during the nine months ended September 27, 2014. The Company repurchased 0.2 million shares of its common stock for \$7.8 million during the nine months ended September 28, 2013. These shares were retired upon repurchase. In October 2014, the Board of Directors authorized a program to repurchase up to \$100 million of the Company's common stock through December 2015 (and terminated the \$35.6 million remaining authorization under the previously announced share repurchase program).

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)***Accumulated Other Comprehensive Loss*

The components of accumulated other comprehensive loss, net of taxes, were as follows (in thousands):

|   | <b>Unrealized Gain<br/>on Cash Flow<br/>Hedge</b> |  | <b>Net Unrealized Losses<br/>on Available-For-Sale<br/>Securities</b> |  | <b>Total</b> |
|---|---|--|---|--|--------------|
| Balance at December 28, 2013                                  | \$ 333  |  | \$ (1,017)  |  | \$ (684)     |
| Other comprehensive income (loss) before reclassifications    | (282)   |  | 578   |  | 296          |
| Amount reclassified from accumulated other comprehensive loss | 278   |  |   |  | 278          |
| Net change for the period                                     | (4)   |  | 578   |  | 574          |
| Balance at September 27, 2014                                 | \$ 329  |  | \$ (439)  |  | \$ (110)     |

*Reclassifications From Accumulated Other Comprehensive Loss*

| <b>Reclassification (in thousands)</b>      | <b>Three Months Ended</b>     |                               | <b>Nine Months Ended</b>      |                               |
|---|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|   | <b>September 27,<br/>2014</b> | <b>September 28,<br/>2013</b> | <b>September 27,<br/>2014</b> | <b>September 28,<br/>2013</b> |
| Losses on cash flow hedges to:              |                               |                               |                               |                               |
| Interest expense                            | \$ (142)                      | \$ (96)                       | \$ (428)                      | \$ (418)                      |
| Gains on available-for-sales securities to: |                               |                               |                               |                               |
| Interest income                             | (142)                         | (96)                          | (428)                         | (186)                         |
| Income tax benefit                          | 50                            | 33                            | 150                           | 65                            |
| Total reclassifications                     | \$ (92)                       | \$ (63)                       | \$ (278)                      | \$ (121)                      |

**9. 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 ). On April 15, 2014, the stockholders of the Company approved amendments to both the 2009 Plan and the 2009

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Purchase Plan. The 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. The amended plans are currently effective.

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

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

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

|                                     | Three Months Ended    |                       | Nine Months Ended     |                       |
|-------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                     | September 27,<br>2014 | September 28,<br>2013 | September 27,<br>2014 | September 28,<br>2013 |
| Cost of revenues                    | \$ 201                | \$ 269                | \$ 574                | \$ 785                |
| Research and development            | 4,713                 | 3,729                 | 13,282                | 10,551                |
| Selling, general and administrative | 4,700                 | 4,622                 | 14,317                | 10,968                |
|                                     | 9,614                 | 8,620                 | 28,173                | 22,304                |
| Income tax benefit                  | 1,158                 | 904                   | 3,056                 | 1,822                 |
|                                     | \$ 8,456              | \$ 7,716              | \$ 25,117             | \$ 20,482             |

The increase in stock-based compensation costs in the recent three and nine month periods was principally due to increased headcount. The Company had approximately \$60.3 million of total unrecognized compensation costs related to granted stock awards as of September 27, 2014 that are expected to be recognized over a weighted-average period of approximately 2.1 years. There were no significant stock-based compensation costs capitalized into assets in any of the periods presented.

**10. Commitments and Contingencies***Patent Litigation*

On January 21, 2014, Cresta Technology Corporation ( Cresta Technology ), a Delaware corporation, filed a lawsuit against the Company, Samsung Electronics Co., Ltd., Samsung Electronics America, Inc., LG Electronics Inc. and LG Electronics U.S.A., Inc. in the United States District Court in the District of Delaware, alleging infringement of United States Patent Nos. 7,075,585, 7,265,792 and 7,251,466. The lawsuit relates to the Company's family of television tuner products. Cresta Technology seeks unspecified compensatory and enhanced damages, attorney fees and a permanent injunction. On January 28, 2014, Cresta Technology also filed a complaint with the United States International Trade Commission ( ITC ) alleging infringement of the same patents against the Company, Samsung and LG Electronics and seeking to prevent the importation and sale of allegedly infringing products in the United States. The ITC instituted an investigation based on Cresta Technology's complaint on February 27, 2014. The Delaware District Court action has been stayed pending completion of the proceedings in the ITC. The Company intends to vigorously defend against these allegations.

On April 11, 2014, the Company filed a lawsuit against Cresta Technology in the United States District Court in the Western District of Texas, Austin Division, alleging infringement of United States Patent Nos. 6,308,055, 6,965,761 and 7,353,011. On July 14, 2014, the Court dismissed

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the lawsuit without prejudice due to the lack of commercial activity by Cresta Technology in the Western District of Texas. On July 16, 2014, the Company refiled its claims for the 055, 761 and 011 patents in a lawsuit in the United States District Court in the Northern District of California. In addition, the Company added additional claims alleging infringement of United States Patent Nos. 6,304,146, 6,137,372 and 6,233,441. The Company is seeking a permanent injunction stopping the sale of all allegedly infringing Cresta Technology products and an award of damages and attorney fees.

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**Silicon Laboratories Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(Unaudited)**

On May 6, 2014, the Company filed a complaint with the ITC alleging infringement of United States Patent Nos. 6,137,372 and 6,233,441 against Cresta Technology, Hauppauge Digital, Inc., Hauppauge Computer Works, Inc., PCTV Systems, S.a.r.l., Luxembourg and PCTV Systems S.a.r.l., seeking to prevent the importation and sale of allegedly infringing products in the United States. On June 6, 2014, the ITC instituted an investigation based on the Company's complaint. On June 13, 2014, Cresta Technology proposed a consent order whereby Cresta Technology will not sell for importation, import or sell in the United States television tuners that infringe the patent claims asserted by the Company. On July 1, 2014, the Administrative Law Judge accepted the proposed consent order. Accordingly, this ITC investigation has been terminated in its entirety. Under the consent order, Cresta Technology is prohibited from selling for importation, importing or selling in the United States television tuners that infringe the Company's United States Patent Nos. 6,137,372 and 6,233,441.

As is customary in the semiconductor industry, the Company provides indemnification protection to its customers for intellectual property claims related to the Company's products. The Company has not accrued any material liability on its consolidated balance sheet related to such indemnification obligations in connection with the Cresta Technology litigation.

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.

**11. Income Taxes**

Provision for income taxes includes both domestic and foreign income taxes at the applicable statutory rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences. Income tax expense was \$3.5 million and \$3.3 million for the three months ended September 27, 2014 and September 28, 2013, resulting in effective tax rates of 38.4% and 33.2%, respectively. Income tax expense was \$10.9 million and \$9.1 million for the nine months ended September 27, 2014 and September 28, 2013, respectively, resulting in effective tax rates of 28.0% and 18.9%, respectively. The effective tax rate for the three months ended September 27, 2014 increased from the prior period, primarily due to the non-renewal of the 2014 federal research and development tax credit in the current period, as well as an increase in nondeductible costs related to the Energy Micro acquisition. This increase was partially offset by an increase in the foreign rate benefit in the current period. The effective tax rate for the nine months ended September 27, 2014 increased from the prior period, primarily due to the prior period recognition of the 2012 federal research and development tax credit due to the enactment of the American Taxpayer Relief Act of 2012 on January 2, 2013, as well as the non-renewal of the 2014 federal research and development tax credit in the current period. This



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increase was partially offset by the release in the current period of prior year unrecognized tax benefits due to the lapse of the statute of limitations applicable to a tax deduction claimed on a prior year foreign tax return.

At September 27, 2014, the Company had gross unrecognized tax benefits of \$3.6 million, \$3.5 million of which would affect the effective tax rate if recognized. The Company recognizes interest and penalties related to unrecognized tax benefits in the provision for income taxes. The Company had a gross decrease of \$1.5 million to its prior year unrecognized tax benefits related to the lapse of the statute of limitations applicable to an uncertain tax position during the nine months ended September 27, 2014, a portion of which represented a foreign currency remeasurement adjustment and was recognized in other income (expense), net.

The tax years 2009 through 2014 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.

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**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 year ending on the Saturday closest to December 31st. Fiscal 2014 will have 53 weeks with the extra week occurring in the fourth quarter of the year. Fiscal 2013 had 52 weeks. Our third quarter of fiscal 2014 ended September 27, 2014. Our third quarter of fiscal 2013 ended September 28, 2013.

**Overview**

We design and develop proprietary, analog-intensive, mixed-signal integrated circuits (ICs) for a broad range of applications. Mixed-signal ICs are electronic components that convert real-world analog signals, such as sound and radio waves, into digital signals that electronic products can process. Therefore, mixed-signal ICs are critical components in products addressing a variety of markets, including communications, consumer, industrial and automotive. Our major customers include Cisco, Harman Becker, Huawei, LG Electronics, Pace, Panasonic, Samsung, Technicolor, Varian Medical Systems and ZTE.

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 enables us to develop highly differentiated solutions that address multiple markets. We group our products into the following categories:

- Broad-based products, which include our microcontroller (MCU), wireless and sensor products, timing products (clocks and oscillators), and power and isolation devices;
- Broadcast products, which include our broadcast audio and video products; and
- Access products, which include our Voice over IP (VoIP) products, embedded modems and our Power over Ethernet (PoE) devices.

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Through acquisitions and internal development efforts, we have continued to diversify our product portfolio and introduce next-generation ICs with added functionality and further integration. On February 28, 2014, we purchased the full product portfolio and intellectual property of Touchstone Semiconductor, including op-amps, current sense amplifiers, low-power analog-to-digital converters (ADCs), comparators, power management ICs, timers, and voltage detectors and references.

In the first nine months of fiscal 2014, we introduced sensor development kits to accelerate Internet of Things (IoT) system design; high-performance automotive tuner ICs designed to enhance AM/FM digital radio performance for car radio systems supporting broadcast standards worldwide; ultra-low-jitter, frequency-flexible clock solutions for high-speed data centers and Internet infrastructure; digital isolators offering high channel count, reliability and data rates for cost-sensitive consumer electronics applications; energy-efficient capacitive sensing MCUs for human-machine interfaces (HMI); a comprehensive software solution designed to simplify the development of wirelessly connected smart meters; a 32-bit hardware and firmware development kit designed to accelerate the design of Made for iPod®/iPhone®/iPad® (MFi) accessories; a new version of the Simplicity Studio development ecosystem that provides unified support for our energy-friendly 32-bit EFM32 Gecko MCUs and 8-bit MCUs; the expansion of our ARM®-based Ember® ZigBee® system-on-chip (SoC) family for advanced smart energy and home automation applications; and single-chip digital ultraviolet (UV) index sensors designed to track UV exposure, ambient light and biometrics for smartphones and wearables. 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.

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During the nine months ended September 27, 2014, we had one customer, Samsung, whose purchases across a variety of product areas 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. Two of our distributors, Edom Technology and Avnet, represented more than 10% of our revenues during the nine months ended September 27, 2014. There were no other distributors or contract manufacturers that accounted for more than 10% of our revenues during the nine months ended September 27, 2014.

The percentage of our revenues derived from outside of the United States was 85% during the nine months ended September 27, 2014. 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.

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 and radios, 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.

**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 ICs. We recognize revenue on sales when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists, 2) delivery of goods has occurred, 3) the sales price is fixed or determinable, and 4) collectibility is reasonably assured. Generally, we recognize revenue from product sales to direct customers and contract manufacturers upon shipment. Certain of our sales are made to distributors under agreements allowing certain rights of return and price protection on products unsold by distributors. Accordingly, we defer the revenue and cost of revenue on such sales until the distributors sell the product to the end customer. A small portion of our revenues is derived from the sale of patents. The above revenue recognition criteria for patent sales are generally met upon the execution of the patent sale agreement. Our products typically carry a one-year replacement warranty. Replacements have been insignificant to date.

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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. The vast majority of our revenues were negotiated at prices that reflect a discount from the list prices for our products. These discounts are made for a variety of reasons, including: 1) to establish a relationship with a new customer, 2) as an incentive for customers to purchase products in larger volumes, 3) to provide profit margin to our distributors who resell our products or 4) in response to competition. In addition, as a product matures, we expect that the average selling price for such product will decline due to the greater availability of competing products. Our ability to increase revenues in the future is dependent on increased demand for our established products and our ability to ship larger volumes of those products in response to such demand, as well as our ability to develop or acquire new products and subsequently achieve customer acceptance of newly introduced products.

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**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.

**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.** Interest income reflects interest earned on our cash, cash equivalents and investment balances.

**Interest Expense.** Interest expense consists of interest on our short and long-term obligations, including our Credit Facilities.

**Other Income (Expense), Net.** Other income (expense), net consists primarily of foreign currency remeasurement adjustments as well as other non-operating income and expenses.

**Provision for Income Taxes.** Provision for income taxes includes both domestic and foreign income taxes at the applicable statutory 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    |                       | Nine Months Ended     |                       |
|-------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                     | September 27,<br>2014 | September 28,<br>2013 | September 27,<br>2014 | September 28,<br>2013 |
| Revenues                            | 100.0%                | 100.0%                | 100.0%                | 100.0%                |
| Cost of revenues                    | 39.2                  | 40.0                  | 38.6                  | 39.1                  |
| Gross margin                        | 60.8                  | 60.0                  | 61.4                  | 60.9                  |
| Operating expenses:                 |                       |                       |                       |                       |
| Research and development            | 26.9                  | 27.7                  | 27.7                  | 26.7                  |
| Selling, general and administrative | 27.8                  | 25.2                  | 24.9                  | 22.6                  |

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|                             |       |       |       |       |
|-----------------------------|-------|-------|-------|-------|
| Operating expenses          | 54.7  | 52.9  | 52.6  | 49.3  |
| Operating income            | 6.1   | 7.1   | 8.8   | 11.6  |
| Other income (expense):     |       |       |       |       |
| Interest income             | 0.1   | 0.1   | 0.2   | 0.1   |
| Interest expense            | (0.5) | (0.6) | (0.5) | (0.6) |
| Other income (expense), net | 0.0   | 0.0   | 0.0   | 0.0   |
| Income before income taxes  | 5.7   | 6.6   | 8.5   | 11.1  |
| Provision for income taxes  | 2.2   | 2.2   | 2.4   | 2.1   |
| Net income                  | 3.5%  | 4.4%  | 6.1%  | 9.0%  |

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| (in millions) | Three Months Ended    |                       |         |             | Nine Months Ended     |                       |         |             |
|---------------|-----------------------|-----------------------|---------|-------------|-----------------------|-----------------------|---------|-------------|
|               | September 27,<br>2014 | September 28,<br>2013 | Change  | %<br>Change | September 27,<br>2014 | September 28,<br>2013 | Change  | %<br>Change |
| Broad-based   | \$ 80.3               | \$ 73.3               | \$ 7.0  | 9.5%        | \$ 232.2              | \$ 209.4              | \$ 22.8 | 10.9%       |
| Broadcast     | 53.0                  | 50.7                  | 2.3     | 4.6%        | 154.3                 | 150.3                 | 4.0     | 2.6%        |
| Access        | 24.8                  | 22.9                  | 1.9     | 8.4%        | 72.3                  | 74.2                  | (1.9)   | (2.6)%      |
| Revenues      | \$ 158.1              | \$ 146.9              | \$ 11.2 | 7.6%        | \$ 458.8              | \$ 433.9              | \$ 24.9 | 5.7%        |

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

- Increased revenues of \$7.0 million for our Broad-based ICs, due primarily to market share gains for our MCU, wireless and sensor products.
- Increased revenues of \$2.3 million for Broadcast, due primarily to the sale of patents of \$2.1 million.
- Increased revenues of \$1.9 million for our Access ICs, due primarily to increased demand for our VoIP products.

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

- Increased revenues of \$22.8 million for our Broad-based ICs, due primarily to market share gains for our MCU, wireless and sensor products, including products acquired from Energy Micro in July 2013. Broad-based revenue growth was offset in part by a decline in revenue for our touch controller ICs due to our exit from this market.
- Increased revenues of \$4.0 million for Broadcast, due primarily to market share gains for our video ICs and the sale of patents of \$7.1 million. The increase in Broadcast revenues was offset by decreased revenues for our audio ICs due to declines in market share.
- Decreased revenues of \$1.9 million for our Access ICs, due primarily to declines in the market for embedded modem ICs.

Unit volumes of our products increased by 10.9% and average selling prices decreased by 4.2% compared to the three months ended September 28, 2013. Unit volumes of our products increased by 3.2% and average selling prices increased by 1.0% compared to the nine months ended September 28, 2013. The average selling prices of our products may fluctuate significantly from period to period. 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**



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| (in millions)      | Three Months Ended    |                       |        | Nine Months Ended     |                       |         |
|--------------------|-----------------------|-----------------------|--------|-----------------------|-----------------------|---------|
|                    | September 27,<br>2014 | September 28,<br>2013 | Change | September 27,<br>2014 | September 28,<br>2013 | Change  |
| Gross margin       | \$ 96.1               | \$ 88.2               | \$ 7.9 | \$ 281.9              | \$ 264.3              | \$ 17.6 |
| Percent of revenue | 60.8%                 | 60.0%                 | 0.8%   | 61.4%                 | 60.9%                 | 0.5%    |

The increased dollar amount of gross margin in the recent three month period was due to increases in gross margin of \$4.6 million for our Broad-based products, \$2.0 million for our Broadcast products and \$1.3 million for our Access products. The increased dollar amount of gross margin in the recent nine month period was due to increases in gross margin of \$15.2 million for our Broad-based products and \$3.3 million for our Broadcast products, offset by a decrease in gross margin of \$0.9 million for our Access products. The recent three and nine month periods include gross margin from the sale of patents of \$2.1 million and \$7.1 million, respectively, which had no associated cost of revenues.

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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 ICs; 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**

| (in millions)            | Three Months Ended    |                       |        |             | Nine Months Ended     |                       |         |             |
|--------------------------|-----------------------|-----------------------|--------|-------------|-----------------------|-----------------------|---------|-------------|
|                          | September 27,<br>2014 | September 28,<br>2013 | Change | %<br>Change | September 27,<br>2014 | September 28,<br>2013 | Change  | %<br>Change |
| Research and development | \$ 42.5               | \$ 40.7               | \$ 1.8 | 4.6%        | \$ 126.8              | \$ 115.6              | \$ 11.2 | 9.7%        |
| Percent of revenue       | 26.9%                 | 27.7%                 |        |             | 27.7%                 | 26.7%                 |         |             |

The increase in research and development expense in the recent three month period was principally due to an increase of \$2.2 million for personnel-related expenses, including personnel costs associated with increased headcount. The increase in research and development expense in the recent nine month period was principally due to increases of (a) \$7.0 million for personnel-related expenses, including personnel costs associated with (i) increased headcount, and (ii) the acquisition of Energy Micro, (b) \$2.5 million for the amortization of intangible assets primarily related to our acquisition of Energy Micro, and (c) \$1.4 million for new product introduction costs. We expect that research and development expense will increase in absolute dollars in the fourth quarter of 2014.

Recent development projects include sensor development kits to accelerate IoT system design; high-performance automotive tuner ICs designed to enhance AM/FM digital radio performance for car radio systems supporting broadcast standards worldwide; ultra-low-jitter, frequency-flexible clock solutions for high-speed data centers and Internet infrastructure; digital isolators offering high channel count, reliability and data rates for cost-sensitive consumer electronics applications; energy-efficient capacitive sensing MCUs for HMI; a comprehensive software solution designed to simplify the development of wirelessly connected smart meters; a 32-bit hardware and firmware development kit designed to accelerate the design of MFi accessories; a new version of the Simplicity Studio development ecosystem that provides unified support for our energy-friendly 32-bit EFM32 Gecko MCUs and 8-bit MCUs; the expansion of our ARM-based Ember ZigBee SoC family for advanced smart energy and home automation applications; single-chip digital UV index sensors designed to track UV exposure, ambient light and biometrics for smartphones and wearables; a new family of sub-GHz wireless MCUs optimized for power-sensitive, battery-powered systems with RF connectivity; a high-performance bridge controller for USB connectivity applications; relative humidity (RH) and temperature sensors that simplify RH sensing designs while providing power efficiency and ease of use; and the EFM32 Zero Gecko MCU family designed to achieve low system energy consumption for a wide range of battery-powered applications.

**Selling, General and Administrative**

| (in millions)                       | Three Months Ended    |                       |        |             | Nine Months Ended     |                       |         |             |
|-------------------------------------|-----------------------|-----------------------|--------|-------------|-----------------------|-----------------------|---------|-------------|
|                                     | September 27,<br>2014 | September 28,<br>2013 | Change | %<br>Change | September 27,<br>2014 | September 28,<br>2013 | Change  | %<br>Change |
| Selling, general and administrative | \$ 44.0               | \$ 37.0               | \$ 7.0 | 18.9%       | \$ 114.6              | \$ 98.5               | \$ 16.1 | 16.3%       |
| Percent of revenue                  | 27.8%                 | 25.2%                 |        |             | 24.9%                 | 22.6%                 |         |             |

The increase in selling, general and administrative expense in the recent three month period was principally due to increases of (a) \$6.8 million for adjustments to the fair value of acquisition-related contingent consideration, and (b) \$1.9 million for legal fees, primarily related to litigation. The increase in selling, general and administrative expense in the recent nine month period was principally due to increases of (a) \$9.6 million for adjustments to the fair value of acquisition-related contingent consideration, (b) \$5.5 million for personnel-related expenses, primarily associated with (i) increased headcount, and (ii) the acquisition of Energy Micro, and (c) \$3.2 million for legal fees. The increases in selling, general and administrative expense in the recent three and nine month periods were offset in part by acquisition-related costs of \$1.3 million and \$1.5 million, respectively, in the prior periods. We expect that selling, general and administrative expense will decrease in absolute dollars in the fourth quarter of 2014, primarily due to a reduction in acquisition-related costs.

Table of Contents**Interest Income**

Interest income for the three and nine months ended September 27, 2014 was \$0.2 million and \$0.7 million, respectively, compared to \$0.1 million and \$0.6 million for the three and nine months ended September 28, 2013, respectively.

**Interest Expense**

Interest expense for the three and nine months ended September 27, 2014 was \$0.8 million and \$2.3 million, respectively, compared to \$0.8 million and \$2.5 million for the three and nine months ended September 28, 2013, respectively.

**Other Income (Expense), Net**

Other income (expense), net for the three and nine months ended September 27, 2014 was \$42 thousand and \$103 thousand, respectively, compared to \$(23) thousand and \$39 thousand for the three and nine months ended September 28, 2013, respectively.

**Provision for Income Taxes**

| (in millions)              | Three Months Ended    |                       |        | Nine Months Ended     |                       |        |
|----------------------------|-----------------------|-----------------------|--------|-----------------------|-----------------------|--------|
|                            | September 27,<br>2014 | September 28,<br>2013 | Change | September 27,<br>2014 | September 28,<br>2013 | Change |
| Provision for income taxes | \$ 3.5                | \$ 3.3                | \$ 0.2 | \$ 10.9               | \$ 9.1                | \$ 1.8 |
| Effective tax rate         | 38.4%                 | 33.2%                 |        | 28.0%                 | 18.9%                 |        |

The effective tax rate for the three months ended September 27, 2014 increased from the prior period, primarily due to the non-renewal of the 2014 federal research and development tax credit in the current period, as well as an increase in nondeductible costs related to the Energy Micro acquisition. This increase was partially offset by an increase in the foreign rate benefit in the current period. The effective tax rate for the nine months ended September 27, 2014 increased from the prior period, primarily due to the prior period recognition of the 2012 federal research and development tax credit due to the enactment of the American Taxpayer Relief Act of 2012 on January 2, 2013, as well as the non-renewal of the 2014 federal research and development tax credit in the current period. This increase was partially offset by the release in the current period of prior year unrecognized tax benefits due to the lapse of the statute of limitations applicable to a tax deduction claimed on a prior year foreign tax return.

The effective tax rates for each of the periods presented differ from the federal statutory rate of 35% due to the amount of income earned in foreign jurisdictions where the tax rate may be lower than the federal statutory rate, research and development tax credits and other permanent items including changes to the liability for unrecognized tax benefits.

## **Business Outlook**

We expect revenues in the fourth quarter of fiscal 2014 to be in the range of \$155 to \$161 million. Furthermore, we expect our diluted earnings per share to be in the range of \$0.12 to \$0.18.

## **Liquidity and Capital Resources**

Our principal sources of liquidity as of September 27, 2014 consisted of \$328.7 million in cash, cash equivalents and short-term investments, of which approximately \$228.5 million was held by our U.S. entities. The remaining balance was held by our foreign subsidiaries. Our cash equivalents and short-term investments consisted of municipal bonds, corporate bonds, money market funds, commercial paper, variable-rate demand notes, certificates of deposit, asset-backed securities, international government bonds, U.S. government bonds and U.S. government agency.

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Our long-term investments consisted of auction-rate securities. In fiscal 2008, auctions for many of our auction-rate securities failed because sell orders exceeded buy orders. As of September 27, 2014, we held \$12.4 million par value auction-rate securities, all of which have experienced failed auctions. These securities have contractual maturity dates ranging from 2033 to 2046. We are receiving the underlying cash flows on all of our auction-rate securities. The principal amounts associated with failed auctions are not expected to be accessible until a successful auction occurs, the issuer redeems the security, a buyer is found outside of the auction process or the underlying securities mature. We are unable to predict if these funds will become available before their maturity dates. We do not expect to need access to the capital represented by any of our auction-rate securities prior to their maturities.

Net cash provided by operating activities was \$107.6 million during the nine months ended September 27, 2014, compared to net cash provided of \$95.2 million during the nine months ended September 28, 2013. Operating cash flows during the nine months ended September 27, 2014 reflect our net income of \$28.0 million, adjustments of \$54.4 million for depreciation, amortization, stock-based compensation and deferred income taxes, and a net cash inflow of \$25.2 million due to changes in our operating assets and liabilities.

Accounts receivable decreased to \$71.4 million at September 27, 2014 from \$72.1 million at December 28, 2013. The decrease in accounts receivable resulted primarily from normal variations in the timing of collections and billings. Our average days sales outstanding (DSO) was 41 days at September 27, 2014 and 44 days at December 28, 2013.

Inventory increased to \$47.0 million at September 27, 2014 from \$45.3 million at December 28, 2013. Our inventory level is primarily impacted by our need to make purchase commitments to support forecasted demand and variations between forecasted and actual demand. Our average days of inventory (DOI) was 68 days at September 27, 2014 and 71 days at December 28, 2013.

Net cash used in investing activities was \$46.2 million during the nine months ended September 27, 2014, compared to net cash used of \$76.3 million during the nine months ended September 28, 2013. The decrease in cash outflows was principally due to a net payment of \$86.4 million for the acquisition of Energy Micro during the nine months ended September 28, 2013, offset by a decrease of \$60.0 million of net proceeds from sales and maturities of marketable securities.

We anticipate capital expenditures of approximately \$10 to \$14 million for fiscal 2014. Additionally, as part of our growth strategy, we expect to evaluate opportunities to invest in or acquire other businesses, intellectual property or technologies that would complement or expand our current offerings, expand the breadth of our markets or enhance our technical capabilities.

Net cash used in financing activities was \$45.5 million during the nine months ended September 27, 2014, compared to net cash used of \$7.8 million during the nine months ended September 28, 2013. The increase in cash outflows was principally due to an increase of \$43.2 million for repurchases of our common stock. In January 2014, our Board of Directors authorized a program to repurchase up to \$100 million of our common stock through January 2015. In October 2014, the Board of Directors authorized a program to repurchase up to \$100 million of our common stock through December 2015 (and terminated the \$35.6 million remaining authorization under the previously announced share repurchase program).

*Debt*

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On July 31, 2012, we entered into a \$230 million five-year Credit Agreement (the Agreement ). The Agreement consists of a \$100 million Term Loan Facility and a \$130 million Revolving Credit Facility.

The Term Loan Facility provides for quarterly principal amortization (equal to 5% of the principal in each of the first two years and 10% of the principal in each of the next three years) with the remaining balance payable upon the maturity date. The Revolving Credit Facility includes a \$25 million letter of credit sublimit and a \$10 million swingline loan sublimit. We have an option to increase the size of the Revolving Credit Facility by up to an aggregate of \$50 million in additional commitments, subject to certain conditions. On September 27, 2012, we borrowed \$100 million under the Term Loan Facility. To date, we have not borrowed under the Revolving Credit Facility.

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The Term Loan Facility and Revolving Credit Facility, other than swingline loans, will bear interest at LIBOR plus an applicable margin or, at our option, a base rate (defined as the highest of the Bank of America prime rate, the Federal Funds rate plus 0.50% and a daily rate equal to one-month LIBOR 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 LIBOR rate loans range from 1.50% to 2.50% and for base rate loans range from 0.50% to 1.50%, depending in each case, on the leverage ratio as defined in the Agreement. We also pay a commitment fee on the unused amount of the Revolving Credit Facility.

In connection with the closing of the Credit Agreement, we entered into a security and pledge agreement. Under the security and pledge agreement, we pledged equity securities of certain of our subsidiaries, subject to exceptions and limitations. The Credit Facilities contain various conditions, covenants and representations with which we must be in compliance in order to borrow funds and to avoid an event of default, including financial covenants that we must maintain a leverage ratio (funded debt/EBITDA) of no more than 2.5 to 1 and a minimum fixed charge coverage ratio (EBITDA/debt payments, income taxes and capital expenditures) of no less than 1.50 to 1. As of September 27, 2014, the Company was in compliance with all covenants of the Credit Facilities. See Note 7, *Debt*, to the Condensed Consolidated Financial Statements for additional information.

We have entered into an interest rate swap agreement as a hedge against the LIBOR portion of the variable interest payments under the Term Loan Facility and effectively converted the LIBOR portion of the interest on the Term Loan Facility to a fixed interest rate through the maturity date. See Note 4, *Derivative Financial Instruments*, to the Condensed Consolidated Financial Statements for additional information.

Our future capital requirements will depend on many factors, including the rate of sales growth, market acceptance of our products, the timing and extent of research and development projects, potential acquisitions of companies or technologies and the expansion of our sales and marketing activities. We believe our existing cash, cash equivalents, investments and credit under our Credit Facilities are sufficient to meet our capital requirements through at least the next 12 months, although we could be required, or could elect, to seek additional funding prior to that time. We may enter into acquisitions or strategic arrangements in the future which also could require us to seek additional equity or debt financing.

**Critical Accounting Policies and Estimates**

The preparation of financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles requires that we make estimates and assumptions that affect the amounts reported. Changes in facts and circumstances could have a significant impact on the resulting estimated amounts included in the financial statements. We believe the following critical accounting policies affect our more complex judgments and estimates. We also have other policies that we consider to be key accounting policies, such as our policies for revenue recognition, including the deferral of revenues and cost of revenues on sales to distributors; however, these policies do not meet the definition of critical accounting estimates because they do not generally require us to make estimates or judgments that are difficult or subjective.

*Inventory valuation* We assess the recoverability of inventories through the application of a set of methods, assumptions and estimates. In determining net realizable value, we write down inventory that may be slow moving or have some form of obsolescence, including inventory that has aged more than 12 months. We also adjust the valuation of inventory when its manufacturing cost exceeds the estimated market value less selling costs. We assess the potential for any unusual customer returns based on known quality or business issues and write-off inventory losses for scrap or non-saleable material. Inventory not otherwise identified to be written down is compared to an assessment of our 12-month forecasted demand. The result of this methodology is compared against the product life cycle and competitive situations in the marketplace to determine the appropriateness of the resulting inventory levels. Demand for our products may fluctuate significantly over time, and actual



demand and market conditions may be more or less favorable than those that we project. In the event that actual demand is lower or market conditions are worse than originally projected, additional inventory write-downs may be required.

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*Stock-based compensation* We recognize the fair-value of stock-based compensation transactions in the Consolidated Statements of Income. The fair value of our full-value stock awards (with the exception of market-based performance awards) equals the fair market value of our stock on the date of grant. The fair value of our market-based performance award grants is estimated at the date of grant using a Monte-Carlo simulation. The fair value of our stock option and employee stock purchase plan grants is estimated at the date of grant using the Black-Scholes option pricing model. In addition, we are required to estimate the expected forfeiture rate of our stock grants and only recognize the expense for those shares expected to vest. If our actual experience differs significantly from the assumptions used to compute our stock-based compensation cost, or if different assumptions had been used, we may have recorded too much or too little stock-based compensation cost. See Note 9, *Stock-Based Compensation*, to the Condensed Consolidated Financial Statements for additional information.

*Investments in auction-rate securities* We determine the fair value of our investments in auction-rate securities 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 our inability to liquidate the securities. For available-for-sale auction-rate securities, if the calculated value is below the carrying amount of the securities, we then determine if the decline in value is other-than-temporary. We consider various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, changes in underlying credit ratings, forecasted recovery, our intent to sell or the likelihood that we 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. When we conclude that an other-than-temporary impairment has occurred, we assess whether we intend to sell the security or if it is more likely than not that we will be required to sell the security before recovery. If either of these two conditions is met, we recognize a charge in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If we do not intend to sell a security and it is not more likely than not that we will be required to sell the security before recovery, the unrealized loss is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recorded in accumulated other comprehensive loss.

*Acquired intangible assets* When we acquire a business, a portion of the purchase price is typically allocated to identifiable intangible assets, such as acquired technology and customer relationships. Fair value of these assets is determined primarily using the income approach, which requires us to project future cash flows and apply an appropriate discount rate. We amortize intangible assets with finite lives over their expected useful lives. Our estimates are based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and unanticipated events and circumstances may occur. Incorrect estimates could result in future impairment charges, and those charges could be material to our results of operations.

*Impairment of goodwill and other long-lived assets* We review long-lived assets which are held and used, including fixed assets and purchased intangible assets, for impairment whenever changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Such evaluations compare the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset over its expected useful life and are significantly impacted by estimates of future prices and volumes for our products, capital needs, economic trends and other factors which are inherently difficult to forecast. If the asset is considered to be impaired, we record an impairment charge equal to the amount by which the carrying value of the asset exceeds its fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique.

We test our goodwill for impairment annually as of the first day of our fourth fiscal quarter and in interim periods if certain events occur indicating that the carrying value of goodwill may be impaired. The goodwill impairment test is a two-step process. The first step of the impairment analysis compares our fair value to our net book value. In determining fair value, the accounting guidance allows for the use of several valuation methodologies, although it states quoted market prices are the best evidence of fair value. If the fair value is less than the net book value, the second step of the analysis compares the implied fair value of our goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, we recognize an impairment loss equal to that excess amount.



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*Income taxes* We are required to calculate income taxes in each of the jurisdictions in which we operate. This process involves calculating the actual current tax liability together with assessing temporary differences in recognition of income (loss) for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our Consolidated Balance Sheet. We record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. In assessing the need for a valuation allowance, we are required to estimate the amount of expected future taxable income. Judgment is inherent in this process and differences between the estimated and actual taxable income could result in a material impact on our Consolidated Financial Statements.

We recognize liabilities for uncertain tax positions based on a two-step process. The first step requires us to determine if the weight of available evidence indicates that the tax position has met the threshold for recognition; therefore, we must evaluate whether it is more likely than not that the position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step requires us to measure the tax benefit of the tax position taken, or expected to be taken, in an income tax return as the largest amount that is more than 50% likely of being realized upon ultimate settlement. This measurement step is inherently complex and requires subjective estimations of such amounts to determine the probability of various possible outcomes. We re-evaluate the uncertain tax positions each quarter based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, expirations of statutes of limitation, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period.

Although we believe the measurement of our liabilities for uncertain tax positions is reasonable, no assurance can be given that the final outcome of these matters will not be different than what is reflected in the historical income tax provisions and accruals. If additional taxes are assessed as a result of an audit or litigation, it could have a material effect on our income tax provision and net income in the period or periods for which that determination is made. We operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions. These audits can involve complex issues which may require an extended period of time to resolve and could result in additional assessments of income tax. We believe adequate provisions for income taxes have been made for all periods.

**Recent Accounting Pronouncements**

In June 2014, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Update (ASU) No. 2014-12, *Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. The amendments in this update require that a performance target that affects vesting and that could be achieved after the requisite service period should be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. We are currently evaluating the effect that the adoption of this ASU will have on our financial statements.

In May 2014, the FASB issued FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition*. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, using one of two retrospective application methods. Early application is not permitted. We are currently evaluating the effect that the adoption of this ASU will have on our

financial statements.

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In April 2014, the FASB issued FASB ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. The amendments in this update require a disposal of a component of an entity or a group of components of an entity to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. ASU 2014-08 expands disclosure requirements about discontinued operations and adds new disclosures for individually significant dispositions that do not qualify as discontinued operations. ASU 2014-08 is effective prospectively for annual periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015. Early adoption is permitted, but only for disposals that have not been reported in financial statements previously issued. The adoption of this ASU is not expected to have a material impact on our financial statements.

**Quantitative and Qualitative Disclosures about Market Risk**

*Interest Income*

Our investment portfolio includes cash, cash equivalents, short-term investments and long-term investments. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Our interest income is sensitive to changes in the general level of U.S. interest rates. Our investment portfolio holdings as of September 27, 2014 yielded less than 100 basis points. A decline in yield to zero basis points on our investment portfolio holdings as of September 27, 2014 would decrease our annual interest income by approximately \$1.2 million. We believe that our investment policy, which defines the duration, concentration, and minimum credit quality of the allowable investments, meets our investment objectives.

*Interest Expense*

We are exposed to interest rate fluctuations in the normal course of our business, including through our Credit Facilities. The interest payments on the facility are calculated using a variable-rate of interest. We have entered into an interest rate swap agreement with an original notional value of \$100 million (equal to the full amount borrowed under the Term Loan Facility) and, effectively, converted the variable-rate interest payments on the Term Loan Facility to fixed-rate interest payments through July 2017.

*Investments in Auction-rate Securities*

In fiscal 2008, auctions for many of our auction-rate securities failed because sell orders exceeded buy orders. As of September 27, 2014, we held \$12.4 million par value auction-rate securities, all of which have experienced failed auctions. The principal amounts associated with failed auctions are 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. We are unable to predict if these funds will become available before their maturity dates. Additionally, if we determine that an other-than-temporary decline in the fair value of any of our available-for-sale auction-rate securities has occurred, we may be required to adjust the carrying value of the investments through an impairment charge.

**Available Information**

Our website address is [www.silabs.com](http://www.silabs.com). Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the investor relations page of our website free of charge as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). Our website and the information contained therein or connected thereto are not intended to be incorporated into this Quarterly Report on Form 10-Q.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Information related to quantitative and qualitative disclosures regarding market risk is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations under Item 2 above. Such information is incorporated by reference herein.

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**Item 4. Controls and Procedures**

We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of September 27, 2014 to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Such disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosures. There was no change in our internal controls during the fiscal quarter ended September 27, 2014 that materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

**Part II. Other Information**

**Item 1. Legal Proceedings**

*Patent Litigation*

On January 21, 2014, Cresta Technology Corporation (Cresta Technology), a Delaware corporation, filed a lawsuit against us, Samsung Electronics Co., Ltd., Samsung Electronics America, Inc., LG Electronics Inc. and LG Electronics U.S.A., Inc. in the United States District Court in the District of Delaware, alleging infringement of United States Patent Nos. 7,075,585, 7,265,792 and 7,251,466. The lawsuit relates to our family of television tuner products. Cresta Technology seeks unspecified compensatory and enhanced damages, attorney fees and a permanent injunction. On January 28, 2014, Cresta Technology also filed a complaint with the United States International Trade Commission (ITC) alleging infringement of the same patents against us, Samsung and LG Electronics and seeking to prevent the importation and sale of allegedly infringing products in the United States. The ITC instituted an investigation based on Cresta Technology's complaint on February 27, 2014. The Delaware District Court action has been stayed pending completion of the proceedings in the ITC. We intend to vigorously defend against these allegations.

On April 11, 2014, we filed a lawsuit against Cresta Technology in the United States District Court in the Western District of Texas, Austin Division, alleging infringement of United States Patent Nos. 6,308,055, 6,965,761 and 7,353,011. On July 14, 2014, the Court dismissed the lawsuit without prejudice due to the lack of commercial activity by Cresta Technology in the Western District of Texas. On July 16, 2014, we refiled our claims for the 055, 761 and 011 patents in a lawsuit in the United States District Court in the Northern District of California. In addition, we added additional claims alleging infringement of United States Patent Nos. 6,304,146, 6,137,372 and 6,233,441. We are seeking a permanent injunction stopping the sale of all allegedly infringing Cresta Technology products and an award of damages and attorney fees.

On May 6, 2014, we filed a complaint with the ITC alleging infringement of United States Patent Nos. 6,137,372 and 6,233,441 against Cresta Technology, Hauppauge Digital, Inc., Hauppauge Computer Works, Inc., PCTV Systems, S.a.r.l., Luxembourg and PCTV Systems S.a.r.l., seeking to prevent the importation and sale of allegedly infringing products in the United States. On June 6, 2014, the ITC instituted an investigation based on our complaint. On June 13, 2014, Cresta Technology proposed a consent order whereby Cresta Technology will not sell



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for importation, import or sell in the United States television tuners that infringe the patent claims asserted by us. On July 1, 2014, the Administrative Law Judge accepted the proposed consent order. Accordingly, this ITC investigation has been terminated in its entirety. Under the consent order, Cresta Technology is prohibited from selling for importation, importing or selling in the United States television tuners that infringe our United States Patent Nos. 6,137,372 and 6,233,441.

As is customary in the semiconductor industry, we provide indemnification protection to our customers for intellectual property claims related to our products. We have not accrued any material liability on our consolidated balance sheet related to such indemnification obligations in connection with the Cresta Technology litigation.

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

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*Other*

We are 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, we do not expect them to have a material adverse effect on our consolidated financial statements.

**Item 1A. Risk Factors**

**Risks Related to our Business**

**We may not be able to maintain our historical growth and may experience significant period-to-period fluctuations in our revenues and operating results, which may result in volatility in our stock price**

Although we have generally experienced revenue growth in our history, we may not be able to sustain this growth. We may also experience significant period-to-period fluctuations in our revenues and operating results in the future due to a number of factors, and any such variations may cause our stock price to fluctuate. In some future period our revenues or operating results may be below the expectations of public market analysts or investors. If this occurs, our stock price may drop, perhaps significantly.

A number of factors, in addition to those cited in other risk factors applicable to our business, may contribute to fluctuations in our revenues and operating results, including:

- The timing and volume of orders received from our customers;
  
- The timeliness of our new product introductions and the rate at which our new products may cannibalize our older products;
  
- The rate of acceptance of our products by our customers, including the acceptance of new products we may develop for integration in the products manufactured by such customers, which we refer to as *design wins* ;
  
- The time lag and realization rate between *design wins* and production orders;

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- The demand for, and life cycles of, the products incorporating our ICs;
- The rate of adoption of mixed-signal ICs in the markets we target;
- Deferrals or reductions of customer orders in anticipation of new products or product enhancements from us or our competitors or other providers of ICs;
- Changes in product mix;
- The average selling prices for our products could drop suddenly due to competitive offerings or competitive predatory pricing;
- The average selling prices for our products generally decline over time;
- Changes in market standards;
- Impairment charges related to inventory, equipment or other long-lived assets;
- The software used in our products, including software provided by third parties, may not meet the needs of our customers;
- Significant legal costs to defend our intellectual property rights or respond to claims against us; and

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- The rate at which new markets emerge for products we are currently developing or for which our design expertise can be utilized to develop products for these new markets.

The markets for consumer electronics, for example, are characterized by rapid fluctuations in demand and seasonality that result in corresponding fluctuations in the demand for our products that are incorporated in such devices. Additionally, the rate of technology acceptance by our customers results in fluctuating demand for our products as customers are reluctant to incorporate a new IC into their products until the new IC has achieved market acceptance. Once a new IC achieves market acceptance, demand for the new IC can quickly accelerate to a point and then level off such that rapid historical growth in sales of a product should not be viewed as indicative of continued future growth. In addition, demand can quickly decline for a product when a new IC product is introduced and receives market acceptance. Due to the various factors mentioned above, the results of any prior quarterly or annual periods should not be relied upon as an indication of our future operating performance.

**If we are unable to develop or acquire new and enhanced products that achieve market acceptance in a timely manner, our operating results and competitive position could be harmed**

Our future success will depend on our ability to develop or acquire new ICs and product enhancements that achieve market acceptance in a timely and cost-effective manner. The development of mixed-signal ICs is highly complex, and we have at times experienced delays in completing the development and introduction of new products and product enhancements. Successful product development and market acceptance of our products depend on a number of factors, including:

- Requirements of customers;
- Accurate prediction of market and technical requirements;
- Timely completion and introduction of new designs;
- Timely qualification and certification of our ICs for use in our customers' products;
- Commercial acceptance and volume production of the products into which our ICs will be incorporated;
- Availability of foundry, assembly and test capacity;

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- Achievement of high manufacturing yields;
- Quality, price, performance, power use and size of our products;
- Availability, quality, price and performance of competing products and technologies;
- Our customer service, application support capabilities and responsiveness;
- Successful development of our relationships with existing and potential customers;
- Technology, industry standards or end-user preferences; and
- Cooperation of third-party software providers and our semiconductor vendors to support our chips within a system.

We cannot provide any assurance that products which we recently have developed or may develop in the future will achieve market acceptance. We have introduced to market or are in development of many ICs. If our ICs fail to achieve market acceptance, or if we fail to develop new products on a timely basis that achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected.

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**Our research and development efforts are focused on a limited number of new technologies and products, and any delay in the development, or abandonment, of these technologies or products by industry participants, or their failure to achieve market acceptance, could compromise our competitive position**

Our ICs are used as components in electronic devices in various markets. As a result, we have devoted and expect to continue to devote a large amount of resources to develop products based on new and emerging technologies and standards that will be commercially introduced in the future. Research and development expense during the nine months ended September 27, 2014 was \$126.8 million, or 27.7% of revenues. A number of large companies are actively involved in the development of these new technologies and standards. Should any of these companies delay or abandon their efforts to develop commercially available products based on new technologies and standards, our research and development efforts with respect to these technologies and standards likely would have no appreciable value. In addition, if we do not correctly anticipate new technologies and standards, or if the products that we develop based on these new technologies and standards fail to achieve market acceptance, our competitors may be better able to address market demand than we would. Furthermore, if markets for these new technologies and standards develop later than we anticipate, or do not develop at all, demand for our products that are currently in development would suffer, resulting in lower sales of these products than we currently anticipate.

**We depend on a limited number of customers for a substantial portion of our revenues, and the loss of, or a significant reduction in orders from, any key customer could significantly reduce our revenues**

The loss of any of our key customers, or a significant reduction in sales to any one of them, would significantly reduce our revenues and adversely affect our business. During the nine months ended September 27, 2014, our ten largest customers accounted for 36% of our revenues. Some of the markets for our products are dominated by a small number of potential customers. Therefore, our operating results in the foreseeable future will continue to depend on our ability to sell to these dominant customers, as well as the ability of these customers to sell products that incorporate our IC products. In the future, these customers may decide not to purchase our ICs at all, purchase fewer ICs than they did in the past or alter their purchasing patterns, particularly because:

- We do not have material long-term purchase contracts with our customers;
  
- Substantially all of our sales to date have been made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty;
  
- Some of our customers may have efforts underway to actively diversify their vendor base which could reduce purchases of our ICs; and
  
- Some of our customers have developed or acquired products that compete directly with products these customers purchase from us, which could affect our customers' purchasing decisions in the future.

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While we have been a significant supplier of ICs used in many of our customers' products, our customers regularly evaluate alternative sources of supply in order to diversify their supplier base, which increases their negotiating leverage with us and protects their ability to secure these components. We believe that any expansion of our customers' supplier bases could have an adverse effect on the prices we are able to charge and volume of product that we are able to sell to our customers, which would negatively affect our revenues and operating results.

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**Significant litigation over intellectual property in our industry may cause us to become involved in costly and lengthy litigation which could seriously harm our business**

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. From time to time, we receive letters from various industry participants alleging infringement of patents, trademarks or misappropriation of trade secrets or from customers or suppliers requesting indemnification for claims brought against them by third parties. The exploratory nature of these inquiries has become relatively common in the semiconductor industry. We respond when we deem appropriate and as advised by legal counsel. We have been involved in litigation to protect our intellectual property rights in the past and may become involved in such litigation again in the future. We are currently involved in litigation with Cresta Technology in which we and certain of our customers have been accused of patent infringement related to our television tuner products. In the future, we may become involved in additional litigation to defend allegations of infringement asserted by others, both directly and indirectly as a result of certain industry-standard indemnities we may offer to our customers or suppliers. Legal proceedings could subject us to significant liability for damages or invalidate our proprietary rights. Legal proceedings initiated by us to protect our intellectual property rights could also result in counterclaims or countersuits against us. Any litigation, regardless of its outcome, would likely be time-consuming and expensive to resolve and would divert our management's time and attention. Intellectual property litigation also could force us to take specific actions, including:

- Cease selling or manufacturing products that use the challenged intellectual property;
- Obtain from the owner of the infringed intellectual property a right to a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all;
- Redesign those products that use infringing intellectual property; or
- Pursue legal remedies with third parties to enforce our indemnification rights, which may not adequately protect our interests.

**Any acquisitions we make could disrupt our business and harm our financial condition**

As part of our growth and product diversification strategy, we continue to evaluate opportunities to acquire other businesses, intellectual property or technologies that would complement our current offerings, expand the breadth of our markets or enhance our technical capabilities. The acquisitions that we have made and may make in the future entail a number of risks that could materially and adversely affect our business and operating results, including:

- Problems integrating the acquired operations, technologies or products with our existing business and products;



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- Diversion of management's time and attention from our core business;
- Need for financial resources above our planned investment levels;
- Difficulties in retaining business relationships with suppliers and customers of the acquired company;
- Risks associated with entering markets in which we lack prior experience;
- Risks associated with the transfer of licenses of intellectual property;
- Increased operating costs due to acquired overhead;
- Tax issues associated with acquisitions;
- Acquisition-related disputes, including disputes over earn-outs and escrows;
- Potential loss of key employees of the acquired company; and

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- Potential impairment of related goodwill and intangible assets.

Future acquisitions also could cause us to incur debt or contingent liabilities or cause us to issue equity securities that could negatively impact the ownership percentages of existing shareholders.

**We may be unable to protect our intellectual property, which would negatively affect our ability to compete**

Our products rely on our proprietary technology, and we expect that future technological advances made by us will be critical to sustain market acceptance of our products. Therefore, we believe that the protection of our intellectual property rights is and will continue to be important to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into confidentiality or license agreements with our employees, consultants, intellectual property providers and business partners, and control access to and distribution of our documentation and other proprietary information. Despite these efforts, unauthorized parties may attempt to copy or otherwise obtain and use our proprietary technology. Monitoring unauthorized use of our technology is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. We cannot be certain that patents will be issued as a result of our pending applications nor can we be certain that any issued patents would protect or benefit us or give us adequate protection from competing products. For example, issued patents may be circumvented or challenged and declared invalid or unenforceable. We also cannot be certain that others will not develop effective competing technologies on their own.

**Failure to manage our distribution channel relationships could impede our future growth**

The future growth of our business will depend in large part on our ability to manage our relationships with current and future distributors and sales representatives, develop additional channels for the distribution and sale of our products and manage these relationships. During the nine months ended September 27, 2014, 62% of our revenue was derived from distributors. As we execute our indirect sales strategy, we must manage the potential conflicts that may arise with our direct sales efforts. For example, conflicts with a distributor may arise when a customer begins purchasing directly from us rather than through the distributor. The inability to successfully execute or manage a multi-channel sales strategy could impede our future growth. In addition, relationships with our distributors often involve the use of price protection and inventory return rights. This often requires a significant amount of sales management's time and system resources to manage properly.

**We are subject to increased inventory risks and costs because we build our products based on forecasts provided by customers before receiving purchase orders for the products**

In order to ensure availability of our products for some of our largest customers, we start the manufacturing of our products in advance of receiving purchase orders based on forecasts provided by these customers. However, these forecasts do not represent binding purchase commitments and we do not recognize sales for these products until they are shipped to the customer. As a result, we incur inventory and manufacturing costs in advance of anticipated sales. Because demand for our products may not materialize, manufacturing based on forecasts subjects us to increased risks of high inventory carrying costs, increased obsolescence and increased operating costs. These inventory risks are exacerbated when our customers purchase indirectly through contract manufacturers or hold component inventory levels greater than their consumption rate because this causes us to have less visibility regarding the accumulated levels of inventory for such customers. A resulting

write-off of unusable or excess inventories would adversely affect our operating results.

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**Our products are complex and may contain errors which could lead to product liability, an increase in our costs and/or a reduction in our revenues**

Our products are complex and may contain errors, particularly when first introduced or as new versions are released. Our new products are increasingly being designed in more complex processes which further increases the risk of errors. We rely primarily on our in-house testing personnel to design test operations and procedures to detect any errors prior to delivery of our products to our customers. Because our products are manufactured by third parties, should problems occur in the operation or performance of our ICs, we may experience delays in meeting key introduction dates or scheduled delivery dates to our customers. These errors also could cause us to incur significant re-engineering costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations and business reputation problems. Any defects could require product replacement or recall or we could be obligated to accept product returns. Any of the foregoing could impose substantial costs and harm our business.

Product liability claims may be asserted with respect to our products. Our products are typically sold at prices that are significantly lower than the cost of the end-products into which they are incorporated. A defect or failure in our product could cause failure in our customer's end-product, so we could face claims for damages that are disproportionately higher than the revenues and profits we receive from the products involved. Furthermore, product liability risks are particularly significant with respect to medical and automotive applications because of the risk of serious harm to users of these products. There can be no assurance that any insurance we maintain will sufficiently protect us from any such claims.

**We rely on third parties to manufacture, assemble and test our products and the failure to successfully manage our relationships with our manufacturers and subcontractors would negatively impact our ability to sell our products**

We do not have our own wafer fab manufacturing facilities. Therefore, we rely on third-party vendors to manufacture the ICs we design. We also currently rely on Asian third-party assembly subcontractors to assemble and package the silicon chips provided by the wafers for use in final products. Additionally, we rely on these offshore subcontractors for a substantial portion of the testing requirements of our products prior to shipping. We expect utilization of third-party subcontractors to continue in the future.

The cyclical nature of the semiconductor industry drives wide fluctuations in available capacity at third-party vendors. On occasion, we have been unable to adequately respond to unexpected increases in customer demand due to capacity constraints and, therefore, were unable to benefit from this incremental demand. We may be unable to obtain adequate foundry, assembly or test capacity from our third-party subcontractors to meet our customers' delivery requirements even if we adequately forecast customer demand.

There are significant risks associated with relying on these third-party foundries and subcontractors, including:

- Failure by us, our customers or their end customers to qualify a selected supplier;

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- Potential insolvency of the third-party subcontractors;
- Reduced control over delivery schedules and quality;
- Limited warranties on wafers or products supplied to us;
- Potential increases in prices or payments in advance for capacity;
- Increased need for international-based supply, logistics and financial management;
- Their inability to supply or support new or changing packaging technologies; and
- Low test yields.

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We typically do not have long-term supply contracts with our third-party vendors which obligate the vendor to perform services and supply products to us for a specific period, in specific quantities, and at specific prices. Our third-party foundry, assembly and test subcontractors typically do not guarantee that adequate capacity will be available to us within the time required to meet demand for our products. In the event that these vendors fail to meet our demand for whatever reason, we expect that it would take up to 12 months to transition performance of these services to new providers. Such a transition may also require qualification of the new providers by our customers or their end customers.

Most of the silicon wafers for the products that we sold during fiscal 2013 were manufactured either by Taiwan Semiconductor Manufacturing Co. (TSMC) or TSMC's affiliates or by Semiconductor Manufacturing International Corporation (SMIC). Our customers typically complete their own qualification process. If we fail to properly balance customer demand across the existing semiconductor fabrication facilities that we utilize or are required by our foundry partners to increase, or otherwise change the number of fab lines that we utilize for our production, we might not be able to fulfill demand for our products and may need to divert our engineering resources away from new product development initiatives to support the fab line transition, which would adversely affect our operating results.

We monitor the financial condition of our third-party foundries and subcontractor partners. In August 2014, we received notice that Telefunken Semiconductors GmbH & Co (TSG), a wafer supplier for our high-voltage products, had filed an insolvency proceeding in Germany. Currently, the operations of TSG are being managed by a trustee appointed by the local court of Heilbronn, Germany.

It is unclear whether TSG will emerge from its insolvency as an ongoing business. We have negotiated with the trustee to purchase a limited number of wafers from TSG through the end of 2014 in an attempt to mitigate the impact of TSG's insolvency on our customers. In addition, we have expedited our previously-planned transition of the manufacturing of certain high-voltage products to another of our foundry partners, Vanguard International Semiconductor Corporation. If there is a disruption in the supply of wafers or if our customers or their end-customers take longer than expected to qualify our replacement products, we may experience a short term decline in revenue or a longer term decline in revenue if our customers shift their demand to alternative suppliers. Either of these conditions which would adversely affect our operating results.

**Our customers require our products to undergo a lengthy and expensive qualification process without any assurance of product sales**

Prior to purchasing our products, our customers require that our products undergo an extensive qualification process, which involves testing of the products in the customer's system as well as rigorous reliability testing. This qualification process may continue for six months or longer. However, qualification of a product by a customer does not ensure any sales of the product to that customer. Even after successful qualification and sales of a product to a customer, a subsequent revision to the IC or software, changes in the IC's manufacturing process or the selection of a new supplier by us may require a new qualification process, which may result in delays and in us holding excess or obsolete inventory. After our products are qualified, it can take an additional six months or more before the customer commences volume production of components or devices that incorporate our products. Despite these uncertainties, we devote substantial resources, including design, engineering, sales, marketing and management efforts, toward qualifying our products with customers in anticipation of sales. If we are unsuccessful or delayed in qualifying any of our products with a customer, such failure or delay would preclude or delay sales of such product to the customer, which may impede our growth and cause our business to suffer.

**We have substantial international activities, which subjects us to additional business risks including logistical and financial complexity, political instability and currency fluctuations**

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We have established international subsidiaries and have opened offices in international markets to support our activities in Europe and Asia. This has included the establishment of a headquarters in Singapore for non-U.S. operations. The percentage of our revenues derived from outside of the United States was 85% during the nine months ended September 27, 2014. We may not be able to maintain or increase international market demand for our products. Our international operations are subject to a number of risks, including:

- Complexity and costs of managing international operations and related tax obligations, including our headquarters for non-U.S. operations in Singapore;

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- Protectionist laws and business practices that favor local competition in some countries;
- Difficulties related to the protection of our intellectual property rights in some countries;
- Multiple, conflicting and changing tax and other laws and regulations that may impact both our international and domestic tax and other liabilities and result in increased complexity and costs;
- Longer sales cycles;
- Greater difficulty in accounts receivable collection and longer collection periods;
- High levels of distributor inventory subject to price protection and rights of return to us;
- Political and economic instability;
- Greater difficulty in hiring and retaining qualified technical sales and applications engineers and administrative personnel; and
- The need to have business and operations systems that can meet the needs of our international business and operating structure.

To date, all of our sales to international customers and purchases of components from international suppliers have been denominated in U.S. dollars. As a result, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive for our international customers to purchase, thus rendering our products less competitive. Similarly, a decrease in the value of the U.S. dollar could reduce our buying power with respect to international suppliers.

**Our products incorporate technology licensed from third parties**



We incorporate technology (including software) licensed from third parties in our products. We could be subjected to claims of infringement regardless of our lack of involvement in the development of the licensed technology. Although a third-party licensor is typically obligated to indemnify us if the licensed technology infringes on another party's intellectual property rights, such indemnification is typically limited in amount and may be worthless if the licensor becomes insolvent. See *Significant litigation over intellectual property in our industry may cause us to become involved in costly and lengthy litigation which could seriously harm our business*. Furthermore, any failure of third-party technology to perform properly would adversely affect sales of our products incorporating such technology.

**Our inability to manage growth could materially and adversely affect our business**

Our past growth has placed, and any future growth of our operations will continue to place, a significant strain on our management personnel, systems and resources. We anticipate that we will need to implement a variety of new and upgraded sales, operational and financial enterprise-wide systems, information technology infrastructure, procedures and controls, including the improvement of our accounting and other internal management systems to manage this growth and maintain compliance with regulatory guidelines, including Sarbanes-Oxley Act requirements. To the extent our business grows, our internal management systems and processes will need to improve to ensure that we remain in compliance. We also expect that we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort, and we anticipate that we will require additional management personnel and internal processes to manage these efforts and to plan for the succession from time to time of certain persons who have been key management and technical personnel. If we are unable to effectively manage our expanding global operations, including our international headquarters in Singapore, our business could be materially and adversely affected.

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**We are subject to risks relating to product concentration**

We derive a substantial portion of our revenues from a limited number of products, and we expect these products to continue to account for a large percentage of our revenues in the near term. Continued market acceptance of these products, is therefore, critical to our future success. In addition, substantially all of our products that we have sold include technology related to one or more of our issued U.S. patents. If these patents are found to be invalid or unenforceable, our competitors could introduce competitive products that could reduce both the volume and price per unit of our products. Our business, operating results, financial condition and cash flows could therefore be adversely affected by:

- A decline in demand for any of our more significant products;
- Failure of our products to achieve continued market acceptance;
- Competitive products;
- New technological standards or changes to existing standards that we are unable to address with our products;
- A failure to release new products or enhanced versions of our existing products on a timely basis; and
- The failure of our new products to achieve market acceptance.

**We are subject to credit risks related to our accounts receivable**

We do not generally obtain letters of credit or other security for payment from customers, distributors or contract manufacturers. Accordingly, we are not protected against accounts receivable default or bankruptcy by these entities. The current economic situation could increase the likelihood of such defaults and bankruptcies. Our ten largest customers or distributors represent a substantial majority of our accounts receivable. If any such customer or distributor, or a material portion of our smaller customers or distributors, were to become insolvent or otherwise not satisfy their obligations to us, we could be materially harmed.

**We depend on our key personnel to manage our business effectively in a rapidly changing market, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed**

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing personnel. We believe that our future success will be dependent on retaining the services of our key personnel, developing their successors and certain internal processes to reduce our reliance on specific individuals, and on properly managing the transition of key roles when they occur. There is currently a shortage of qualified personnel with significant experience in the design, development, manufacturing, marketing and sales of analog and mixed-signal ICs. In particular, there is a shortage of engineers who are familiar with the intricacies of the design and manufacturability of analog elements, and competition for such personnel is intense. Our key technical personnel represent a significant asset and serve as the primary source for our technological and product innovations. We may not be successful in attracting and retaining sufficient numbers of technical personnel to support our anticipated growth. The loss of any of our key employees or the inability to attract or retain qualified personnel both in the United States and internationally, including engineers, sales, applications and marketing personnel, could delay the development and introduction of, and negatively impact our ability to sell, our products.

**Any dispositions could harm our financial condition**

Any disposition of a product line would entail a number of risks that could materially and adversely affect our business and operating results, including:

- Diversion of management's time and attention from our core business;
- Difficulties separating the divested business;

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- Risks to relations with customers who previously purchased products from our disposed product line;
- Reduced leverage with suppliers due to reduced aggregate volume;
- Risks related to employee relations;
- Risks associated with the transfer and licensing of intellectual property;
- Security risks and other liabilities related to the transition services provided in connection with the disposition;
- Tax issues associated with dispositions; and
- Disposition-related disputes, including disputes over earn-outs and escrows.

**Our stock price may be volatile**

The market price of our common stock has been volatile in the past and may be volatile in the future. The market price of our common stock may be significantly affected by the following factors:

- Actual or anticipated fluctuations in our operating results;
- Changes in financial estimates by securities analysts or our failure to perform in line with such estimates;
- Changes in market valuations of other technology companies, particularly semiconductor companies;

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- Announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Introduction of technologies or product enhancements that reduce the need for our products;
- The loss of, or decrease in sales to, one or more key customers;
- A large sale of stock by a significant shareholder;
- Dilution from the issuance of our stock in connection with acquisitions;
- The addition or removal of our stock to or from a stock index fund;
- Departures of key personnel; and
- The required expensing of stock awards.

The stock market has experienced extreme volatility that often has been unrelated to the performance of particular companies. These market fluctuations may cause our stock price to fall regardless of our performance.

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**Most of our current manufacturers, assemblers, test service providers, distributors and customers are concentrated in the same geographic region, which increases the risk that a natural disaster, epidemic, labor strike, war or political unrest could disrupt our operations or sales**

Most of our foundries and several of our assembly and test subcontractors' sites are located in Taiwan and most of our other foundry, assembly and test subcontractors are located in the Pacific Rim region. In addition, many of our customers are located in the Pacific Rim region. The risk of earthquakes in Taiwan and the Pacific Rim region is significant due to the proximity of major earthquake fault lines in the area. Earthquakes, tsunamis, fire, flooding, lack of water or other natural disasters, an epidemic, political unrest, war, labor strikes or work stoppages in countries where our semiconductor manufacturers, assemblers and test subcontractors are located, likely would result in the disruption of our foundry, assembly or test capacity. There can be no assurance that alternate capacity could be obtained on favorable terms, if at all.

A natural disaster, epidemic, labor strike, war or political unrest where our customers' facilities are located would likely reduce our sales to such customers. North Korea's geopolitical maneuverings have created unrest. Such unrest could create economic uncertainty or instability, could escalate to war or otherwise adversely affect South Korea and our South Korean customers and reduce our sales to such customers, which would materially and adversely affect our operating results. In addition, a significant portion of the assembly and testing of our products occurs in South Korea. Any disruption resulting from these events could also cause significant delays in shipments of our products until we are able to shift our manufacturing, assembling or testing from the affected subcontractor to another third-party vendor.

**The semiconductor manufacturing process is highly complex and, from time to time, manufacturing yields may fall below our expectations, which could result in our inability to satisfy demand for our products in a timely manner and may decrease our gross margins due to higher unit costs**

The manufacturing of our products is a highly complex and technologically demanding process. Although we work closely with our foundries and assemblers to minimize the likelihood of reduced manufacturing yields, we have from time to time experienced lower than anticipated manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials could result in lower than anticipated manufacturing yields or unacceptable performance deficiencies, which could lower our gross margins. If our foundries fail to deliver fabricated silicon wafers of satisfactory quality in a timely manner, we will be unable to meet our customers' demand for our products in a timely manner, which would adversely affect our operating results and damage our customer relationships. Additionally, we are beginning to utilize microelectromechanical systems (MEMS) in certain of our timing products rather than the pure CMOS manufacturing process that we have traditionally utilized. We have less operating history with MEMS IC design and MEMS IC manufacturing processes. If we are unable to successfully execute the design and product qualification of MEMS-based products we may encounter lower yields and reduced manufacturing capacity.

**We depend on our customers to support our products, and some of our customers offer competing products**

We rely on our customers to provide hardware, software, intellectual property indemnification and other technical support for the products supplied by our customers. If our customers do not provide the required functionality or if our customers do not provide satisfactory support for their products, the demand for these devices that incorporate our products may diminish or we may otherwise be materially adversely affected. Any reduction in the demand for these devices would significantly reduce our revenues.

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In certain products, some of our customers offer their own competitive products. These customers may find it advantageous to support their own offerings in the marketplace in lieu of promoting our products.

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**Our debt could adversely affect our operations and financial condition**

We believe we have the ability to service our debt under our credit facilities, but our ability to make the required payments thereunder when due depends upon our future performance, which will be subject to general economic conditions, industry cycles and other factors affecting our operations, including risk factors described under this Item 1A, many of which are beyond our control. Our credit facilities also contain covenants, including financial covenants. If we breach any of the covenants under our credit facilities and do not obtain appropriate waivers, then, subject to any applicable cure periods, our outstanding indebtedness thereunder could be declared immediately due and payable.

**We could seek to raise additional debt or equity capital in the future, but additional capital may not be available on terms acceptable to us, or at all**

We believe that our existing cash, cash equivalents, investments and credit under our credit facilities will be sufficient to meet our working capital needs, capital expenditures, investment requirements and commitments for at least the next 12 months. However, our ability to borrow further under the credit facilities is dependent upon our ability to satisfy various conditions, covenants and representations. It is possible that we may need to raise additional funds to finance our activities or to facilitate acquisitions of other businesses, products, intellectual property or technologies. We believe we could raise these funds, if needed, by selling equity or debt securities to the public or to selected investors. In addition, even though we may not need additional funds, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. However, we may not be able to obtain additional funds on favorable terms, or at all. If we decide to raise additional funds by issuing equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced.

**We are a relatively small company with limited resources compared to some of our current and potential competitors and we may not be able to compete effectively and increase market share**

Some of our current and potential competitors have longer operating histories, significantly greater resources and name recognition and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. They also may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than we can to ours. In addition, some of our current and potential competitors have already established supplier or joint development relationships with the decision makers at our current or potential customers. These competitors may be able to leverage their existing relationships to discourage their customers from purchasing products from us or persuade them to replace our products with their products. Our competitors may also offer bundled solutions offering a more complete product despite the technical merits or advantages of our products. These competitors may elect not to support our products which could complicate our sales efforts. These and other competitive pressures may prevent us from competing successfully against current or future competitors, and may materially harm our business. Competition could decrease our prices, reduce our sales, lower our gross margins and/or decrease our market share.

**Provisions in our charter documents and Delaware law could prevent, delay or impede a change in control of us and may reduce the market price of our common stock**

Provisions of our certificate of incorporation and bylaws could have the effect of discouraging, delaying or preventing a merger or acquisition that a stockholder may consider favorable. For example, our certificate of incorporation and bylaws provide for:



- The division of our Board of Directors into three classes to be elected on a staggered basis, one class each year;
- The ability of our Board of Directors to issue shares of our preferred stock in one or more series without further authorization of our stockholders;
- A prohibition on stockholder action by written consent;
- Elimination of the right of stockholders to call a special meeting of stockholders;

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- A requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders; and
- A requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation.

We also are subject to the anti-takeover laws of Delaware which may discourage, delay or prevent someone from acquiring or merging with us, which may adversely affect the market price of our common stock.

**Risks related to our industry**

**We are subject to the cyclical nature of the semiconductor industry, which has been subject to significant fluctuations**

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry has experienced significant fluctuations, often connected with, or in anticipation of, maturing product cycles and new product introductions of both semiconductor companies and their customers products and fluctuations in general economic conditions. Deteriorating general worldwide economic conditions, including reduced economic activity, concerns about credit and inflation, increased energy costs, decreased consumer confidence, reduced corporate profits, decreased spending and similar adverse business conditions, would make it very difficult for our customers, our vendors, and us to accurately forecast and plan future business activities and could cause U.S. and foreign businesses to slow spending on our products. We cannot predict the timing, strength, or duration of any economic slowdown or economic recovery. If the economy or markets in which we operate deteriorate, our business, financial condition, and results of operations would likely be materially and adversely affected.

Downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. In the recent past, we believe the semiconductor industry suffered a downturn due in large part to adverse conditions in the global credit and financial markets, including diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increased unemployment rates and general uncertainty regarding the economy. Such downturns may have a material adverse effect on our business and operating results.

Upturns have been characterized by increased product demand and production capacity constraints created by increased competition for access to third-party foundry, assembly and test capacity. We are dependent on the availability of such capacity to manufacture, assemble and test our ICs. None of our third-party foundry, assembly or test subcontractors have provided assurances that adequate capacity will be available to us.

**The average selling prices of our products could decrease rapidly which may negatively impact our revenues and gross margins**

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We may experience substantial period-to-period fluctuations in future operating results due to the erosion of our average selling prices. We have reduced the average unit price of our products in anticipation of or in response to competitive pricing pressures, new product introductions by us or our competitors and other factors. If we are unable to offset any such reductions in our average selling prices by increasing our sales volumes, increasing our sales content per application or reducing production costs, our gross margins and revenues will suffer. To maintain our gross margin percentage, we will need to develop and introduce new products and product enhancements on a timely basis and continually reduce our costs. Our failure to do so could cause our revenues and gross margin percentage to decline.

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**Competition within the numerous markets we target may reduce sales of our products and reduce our market share**

The markets for semiconductors in general, and for mixed-signal ICs in particular, are intensely competitive. We expect that the market for our products will continually evolve and will be subject to rapid technological change. In addition, as we target and supply products to numerous markets and applications, we face competition from a relatively large number of competitors. We compete with Analog Devices, Atmel, Conexant, Cypress, Epson, Freescale, IDT, Lantiq, Maxim Integrated Products, MaxLinear, Microchip, Microsemi, NXP Semiconductors, Renesas, Sony Semiconductor, STMicroelectronics, Texas Instruments, Vectron International and others. We expect to face competition in the future from our current competitors, other manufacturers and designers of semiconductors, and start-up semiconductor design companies. As the markets for communications products grow, we also may face competition from traditional communications device companies. These companies may enter the mixed-signal semiconductor market by introducing their own ICs or by entering into strategic relationships with or acquiring other existing providers of semiconductor products. In addition, large companies may restructure their operations to create separate companies or may acquire new businesses that are focused on providing the types of products we produce or acquire our customers.

**Our products must conform to industry standards and technology in order to be accepted by end users in our markets**

Generally, our products comprise only a part of a device. All components of such devices must uniformly comply with industry standards in order to operate efficiently together. We depend on companies that provide other components of the devices to support prevailing industry standards. Many of these companies are significantly larger and more influential in affecting industry standards than we are. Some industry standards may not be widely adopted or implemented uniformly, and competing standards may emerge that may be preferred by our customers or end users. If larger companies do not support the same industry standards that we do, or if competing standards emerge, market acceptance of our products could be adversely affected which would harm our business.

Products for certain applications are based on industry standards that are continually evolving. Our ability to compete in the future will depend on our ability to identify and ensure compliance with these evolving industry standards. The emergence of new industry standards could render our products incompatible with products developed by other suppliers. As a result, we could be required to invest significant time and effort and to incur significant expense to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we could miss opportunities to achieve crucial design wins.

Our pursuit of necessary technological advances may require substantial time and expense. We may not be successful in developing or using new technologies or in developing new products or product enhancements that achieve market acceptance. If our ICs fail to achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected.

**We may be subject to information technology failures that could damage our reputation, business operations and financial condition**

We rely on information technology for the effective operation of our business. Our systems are subject to damage or interruption from a number of potential sources, including natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, computer viruses, physical or electronic break-ins, cyber attacks, sabotage, vandalism, or similar events or disruptions. Our security measures may not detect or prevent such security breaches. Any such compromise of our information security could result in the theft or unauthorized publication or use of our confidential business or proprietary information, result in the unauthorized release of customer, supplier or employee data, result in

a violation of privacy or other laws, expose us to a risk of litigation or damage our reputation. In addition, our inability to use or access these information systems at critical points in time could unfavorably impact the timely and efficient operation of our business, which could negatively affect our business and operating results.

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Third parties with which we conduct business, such as foundries, assembly and test contractors, and distributors, have access to certain portions of our sensitive data. In the event that these third parties do not properly safeguard our data that they hold, security breaches could result and negatively impact our business, operations and financial results.

**Customer demands and new regulations related to conflict-free minerals may adversely affect us**

The Dodd-Frank Wall Street Reform and Consumer Protection Act imposes new disclosure requirements regarding the use of conflict minerals mined from the Democratic Republic of Congo and adjoining countries in products, whether or not these products are manufactured by third parties. These new requirements could affect the pricing, sourcing and availability of minerals used in the manufacture of semiconductor devices (including our products). There will be additional costs associated with complying with the disclosure requirements, such as costs related to determining the source of any conflict minerals used in our products. Our supply chain is complex and we may be unable to verify the origins for all metals used in our products. We may also encounter challenges with our customers and stockholders if we are unable to certify that our products are conflict free.

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

Our registration statement (Registration No. 333-94853) under the Securities Act of 1933, as amended, relating to our initial public offering of our common stock became effective on March 23, 2000.

The following table summarizes repurchases of our common stock during the three months ended September 27, 2014 (in thousands, except per share amounts):

| Period          |                    | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|-----------------|--------------------|----------------------------------|------------------------------|--|--|
| June 29, 2014   | July 26, 2014      | 25                               | \$ 40.55                     | 25   | \$ 88,052  |
| July 27, 2014   | August 23, 2014    | 436                              | \$ 42.28                     | 436  | \$ 69,616  |
| August 24, 2014 | September 27, 2014 | 547                              | \$ 43.04                     | 547  | \$ 46,082  |
| Total           |                    | 1,008                            | \$ 42.65                     | 1,008  |  |

In January 2014, our Board of Directors authorized a program to repurchase up to \$100 million of our common stock through January 2015. In October 2014, the Board of Directors authorized a program to repurchase up to \$100 million of our common stock through December 2015 (and terminated the \$35.6 million remaining authorization under the previously announced share repurchase program). The 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.

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Mine Safety Disclosures**

Not applicable

**Item 5. Other Information**

Not applicable

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**Item 6. Exhibits**

The following exhibits are filed as part of this report:

| <b>Exhibit<br/>Number</b> |   |
|---------------------------|---|
| 2.1*                      | Share Purchase Agreement, dated June 6, 2013, by and between Silicon Laboratories International Pte. Ltd. and Energy AS and Silicon Laboratories Inc. (filed as Exhibit 2.1 to the Form 8-K filed on June 7, 2013).   |
| 3.1*                      | Form of Fourth Amended and Restated Certificate of Incorporation of Silicon Laboratories Inc. (filed as Exhibit 3.1 to the Registrant's Registration Statement on Form S-1 (Securities and Exchange Commission File No. 333-94853) (the IPO Registration Statement)). |
| 3.2*                      | Second Amended and Restated Bylaws of Silicon Laboratories Inc. (filed as Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended January 3, 2004).  |
| 4.1*                      | Specimen certificate for shares of common stock (filed as Exhibit 4.1 to the IPO Registration Statement).   |
| 31.1                      | Certification of the Principal Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2                      | Certification of the Principal Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1                      | Certification as required by Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 101.INS                   | XBRL Instance Document  |
| 101.SCH                   | XBRL Taxonomy Extension Schema Document   |
| 101.CAL                   | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.LAB                   | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE                   | XBRL Taxonomy Extension Presentation Linkbase Document  |
| 101.DEF                   | XBRL Taxonomy Extension Definition Linkbase Document  |

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\* Incorporated herein by reference to the indicated filing.



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**SIGNATURES**

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.

SILICON LABORATORIES INC.

October 23, 2014

Date

/s/ G. Tyson Tuttle

G. Tyson Tuttle

*Chief Executive Officer*

*(Principal Executive Officer)*

October 23, 2014

Date

/s/ John C. Hollister

John C. Hollister

*Senior Vice President and*

*Chief Financial Officer*

*(Principal Financial and Accounting Officer)*