

SILICON LABORATORIES INC
Form 10-Q
July 26, 2017
[Table of Contents](#)

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 July 1, 2017

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, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

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

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 July 18, 2017, 42,546,889 shares of common stock of Silicon Laboratories Inc. were outstanding.

Table of ContentsTable of Contents

| | Page Number |
|---|------------------------|
| <u>Part I. Financial Information</u> | |
| <u>Item 1.</u> | |
| <u>Financial Statements (Unaudited); Condensed Consolidated Balance Sheets at July 1, 2017 and December 31, 2016</u> | 3 |
| <u>Condensed Consolidated Statements of Income for the three and six months ended July 1, 2017 and July 2, 2016</u> | 4 |
| <u>Condensed Consolidated Statements of Comprehensive Income for the three and six months ended July 1, 2017 and July 2, 2016</u> | 5 |
| <u>Condensed Consolidated Statements of Cash Flows for the six months ended July 1, 2017 and July 2, 2016</u> | 6 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 7 |
| <u>Item 2.</u> | |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 23 |
| <u>Item 3.</u> | |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 34 |
| <u>Item 4.</u> | |
| <u>Controls and Procedures</u> | 34 |
| <u>Part II. Other Information</u> | |
| <u>Item 1.</u> | |
| <u>Legal Proceedings</u> | 34 |
| <u>Item 1A.</u> | |
| <u>Risk Factors</u> | 35 |
| <u>Item 2.</u> | |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 49 |
| <u>Item 3.</u> | |
| <u>Defaults Upon Senior Securities</u> | 49 |
| <u>Item 4.</u> | |
| <u>Mine Safety Disclosures</u> | 49 |
| <u>Item 5.</u> | |
| <u>Other Information</u> | 49 |
| <u>Item 6.</u> | |
| <u>Exhibits</u> | 50 |

Cautionary Statement

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

materially from those indicated by such forward-looking statements. Factors that could cause or contribute to such differences include those discussed under Risk Factors and elsewhere in this report. Silicon Laboratories disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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)**

| | July 1, 2017 | December 31, 2016 |
|---|-------------------------|------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 210,615 | \$ 141,106 |
| Short-term investments | 451,114 | 153,961 |
| Accounts receivable, net | 75,488 | 74,401 |
| Inventories | 67,427 | 59,578 |
| Prepaid expenses and other current assets | 46,862 | 61,805 |
| Total current assets | 851,506 | 490,851 |
| Long-term investments | 5,379 | 5,196 |
| Property and equipment, net | 130,909 | 129,559 |
| Goodwill | 288,629 | 276,130 |
| Other intangible assets, net | 96,819 | 103,565 |
| Other assets, net | 61,085 | 76,543 |
| Total assets | \$ 1,434,327 | \$ 1,081,844 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 39,989 | \$ 39,577 |
| Accrued expenses | 50,797 | 50,100 |
| Deferred income on shipments to distributors | 48,914 | 45,568 |
| Income taxes | 3,543 | 4,450 |
| Total current liabilities | 143,243 | 139,695 |
| Long-term debt | | 72,500 |
| Convertible debt | 335,639 | |
| Other non-current liabilities | 43,240 | 42,691 |
| Total liabilities | 522,122 | 254,886 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock \$0.0001 par value; 10,000 shares authorized; no shares issued | | |
| Common stock \$0.0001 par value; 250,000 shares authorized; 42,539 and 41,889 shares issued and outstanding at July 1, 2017 and December 31, 2016, respectively | 4 | 4 |
| Additional paid-in capital | 76,409 | 24,463 |
| Retained earnings | 836,210 | 801,999 |
| Accumulated other comprehensive income (loss) | (418) | 492 |
| Total stockholders equity | 912,205 | 826,958 |
| Total liabilities and stockholders equity | \$ 1,434,327 | \$ 1,081,844 |

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)**

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | July 1, 2017 | July 2, 2016 | July 1, 2017 | July 2, 2016 |
| Revenues | \$ 190,098 | \$ 174,908 | \$ 369,126 | \$ 336,933 |
| Cost of revenues | 76,906 | 66,614 | 150,773 | 133,108 |
| Gross margin | 113,192 | 108,294 | 218,353 | 203,825 |
| Operating expenses: | | | | |
| Research and development | 52,432 | 51,635 | 104,756 | 100,681 |
| Selling, general and administrative | 39,826 | 39,045 | 79,981 | 78,682 |
| Operating expenses | 92,258 | 90,680 | 184,737 | 179,363 |
| Operating income | 20,934 | 17,614 | 33,616 | 24,462 |
| Other income (expense): | | | | |
| Interest income and other, net | 1,595 | 296 | 2,171 | 176 |
| Interest expense | (4,699) | (641) | (4,501) | (1,296) |
| Income before income taxes | 17,830 | 17,269 | 31,286 | 23,342 |
| Provision (benefit) for income taxes | 1,261 | 1,710 | (709) | 1,975 |
| Net income | \$ 16,569 | \$ 15,559 | \$ 31,995 | \$ 21,367 |
| Earnings per share: | | | | |
| Basic | \$ 0.39 | \$ 0.37 | \$ 0.76 | \$ 0.51 |
| Diluted | \$ 0.38 | \$ 0.37 | \$ 0.74 | \$ 0.51 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 42,478 | 41,775 | 42,287 | 41,702 |
| Diluted | 43,178 | 42,284 | 43,104 | 42,242 |

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)**

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|-------------------------|-------------------------|-------------------------|
| | July 1, 2017 | July 2, 2016 | July 1, 2017 | July 2, 2016 |
| Net income | \$ 16,569 | \$ 15,559 | \$ 31,995 | \$ 21,367 |
| Other comprehensive income (loss), before tax | | | | |
| Net changes to available-for-sale securities | | | | |
| Unrealized gains (losses) arising during the period | 163 | 198 | 408 | (53) |
| Net changes to cash flow hedges | | | | |
| Unrealized losses arising during the period | | (126) | | (412) |
| Reclassification for (gains) losses included in net income | | 61 | (1,808) | 127 |
| Other comprehensive income (loss), before tax | 163 | 133 | (1,400) | (338) |
| Provision (benefit) for income taxes | 57 | 47 | (490) | (118) |
| Other comprehensive income (loss) | 106 | 86 | (910) | (220) |
| Comprehensive income | \$ 16,675 | \$ 15,645 | \$ 31,085 | \$ 21,147 |

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)**

| | Six Months Ended | |
|---|-------------------------|-------------------------|
| | July 1, 2017 | July 2, 2016 |
| Operating Activities | | |
| Net income | \$ 31,995 | \$ 21,367 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation of property and equipment | 7,308 | 6,675 |
| Amortization of other intangible assets and other assets | 13,571 | 15,534 |
| Amortization of debt discount and debt issuance costs | 3,907 | |
| Stock-based compensation expense | 21,652 | 20,861 |
| Income tax shortfall from stock-based awards | | (1,218) |
| Deferred income taxes | (6,242) | 817 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (887) | 1,611 |
| Inventories | (7,737) | (2,888) |
| Prepaid expenses and other assets | 12,539 | 3,282 |
| Accounts payable | 2,363 | (1,680) |
| Accrued expenses | 141 | 4,372 |
| Deferred income on shipments to distributors | 3,251 | 3,773 |
| Income taxes | (127) | (1,338) |
| Other non-current liabilities | (1,169) | (10,737) |
| Net cash provided by operating activities | 80,565 | 60,431 |
| Investing Activities | | |
| Purchases of available-for-sale investments | (389,234) | (92,222) |
| Sales and maturities of available-for-sale investments | 92,307 | 78,950 |
| Purchases of property and equipment | (8,390) | (5,146) |
| Purchases of other assets | (1,784) | (2,215) |
| Acquisition of business, net of cash acquired | (13,658) | |
| Net cash used in investing activities | (320,759) | (20,633) |
| Financing Activities | | |
| Proceeds from issuance of long-term debt, net | 389,468 | |
| Payments on debt | (72,500) | (5,000) |
| Repurchases of common stock | | (36,103) |
| Payment of taxes withheld for vested stock awards | (14,101) | (9,308) |
| Proceeds from the issuance of common stock | 6,836 | 7,362 |
| Payment of acquisition-related contingent consideration | | (9,500) |
| Net cash provided by (used in) financing activities | 309,703 | (52,549) |
| Increase (decrease) in cash and cash equivalents | 69,509 | (12,751) |
| Cash and cash equivalents at beginning of period | 141,106 | 114,085 |
| Cash and cash equivalents at end of period | \$ 210,615 | \$ 101,334 |

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

Table of Contents

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 July 1, 2017 and December 31, 2016, the condensed consolidated results of its operations for the three and six months ended July 1, 2017 and July 2, 2016, the Condensed Consolidated Statements of Comprehensive Income for the three and six months ended July 1, 2017 and July 2, 2016, and the Condensed Consolidated Statements of Cash Flows for the six months ended July 1, 2017 and July 2, 2016. All intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated results of operations for the three and six months ended July 1, 2017 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 31, 2016, included in the Company's Form 10-K filed with the Securities and Exchange Commission (SEC) on February 1, 2017.

The Company prepares financial statements on a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2017 will have 52 weeks and fiscal 2016 had 52 weeks. In a 52-week year, each fiscal quarter consists of 13 weeks.

Use of Estimates

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

Reclassifications

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

Revenue Recognition

Revenues are generated predominately by sales of the Company's products. 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.

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.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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.

Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments - Equity Method and Joint Ventures (Topic 323)*. This ASU amends the disclosure requirements for ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, ASU No. 2016-02, *Leases (Topic 842)* and ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU states that if a registrant does not know or cannot reasonably estimate the impact that the adoption of the above ASUs is expected to have on the financial statements, then in addition to making a statement to that effect, the registrant should consider additional qualitative financial statement disclosures to assist the reader in assessing the significance of the impact that the standard will have on the financial statements of the registrant when adopted. This ASU was effective upon issuance. The Company adopted this ASU and added qualitative financial statement disclosures as necessary.

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

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. This ASU clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

In August 2016, the FASB issued ASU No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. This ASU requires the recognition of the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this ASU should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company early adopted this ASU on January 1, 2017. The adoption did not have a material impact on its financial statements.

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This ASU provides guidance on statement of cash flows presentation for eight specific cash flow issues where diversity in practice exists. This ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is currently evaluating the effect of the adoption of this ASU, but anticipates that the adoption will not have a material impact on its financial statements.

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

In March 2016, the FASB issued ASU No. 2016-09, *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. This ASU simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The Company adopted this ASU on January 1, 2017. Amendments related to the classification of excess tax benefits on the statement of cash flows were applied prospectively. Prior periods have not been adjusted. In connection with its adoption of ASU 2016-09, the Company has recorded excess tax benefits of \$3.9 million through the six months ended July 1, 2017. The adoption had no other material impact on the Company's financial statements.

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

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the effect of the adoption of this ASU, but anticipates that the adoption will not have a material impact on its financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in Accounting Standards Codification (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. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which deferred the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In 2016, the FASB issued the following amendments to ASC 606: ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, which clarifies the implementation guidance on principal versus agent considerations; ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, which clarifies guidance on identification of performance obligations and licensing implementation; ASU No. 2016-12, *Compensation - Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, which provides clarifying guidance on assessing collectibility, presentation of sales taxes, noncash consideration, contract modifications and completed contracts; and ASU No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, which clarifies narrow aspects of ASC 606 or corrects unintended application of the guidance. The standard may be applied retrospectively to each prior period presented (full retrospective method) or retrospectively with the cumulative effect recognized as of the date of initial application (modified retrospective method). Under the new standard, the Company expects the timing of revenue recognition from sales to distributors to be accelerated. The Company will recognize revenue at the time of sale to the distributor, net of the impact of estimated price adjustments and rights of return. The Company currently anticipates adopting this standard using the modified retrospective method. Under

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

this method, incremental disclosures will be provided to present each financial statement line item for fiscal 2018 under the prior standard. The Company has completed an initial assessment of the new standard and is continuing to evaluate the effect that the adoption will have on its 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 | | Six Months Ended | |
|---|---------------------------|-------------------------|-------------------------|-------------------------|
| | July 1, 2017 | July 2, 2016 | July 1, 2017 | July 2, 2016 |
| Net income | \$ 16,569 | \$ 15,559 | \$ 31,995 | \$ 21,367 |
| Shares used in computing basic earnings per share | 42,478 | 41,775 | 42,287 | 41,702 |
| Effect of dilutive securities: | | | | |
| Stock options and other stock-based awards | 700 | 509 | 817 | 540 |
| Shares used in computing diluted earnings per share | 43,178 | 42,284 | 43,104 | 42,242 |
| Earnings per share: | | | | |
| Basic | \$ 0.39 | \$ 0.37 | \$ 0.76 | \$ 0.51 |
| Diluted | \$ 0.38 | \$ 0.37 | \$ 0.74 | \$ 0.51 |

For the three months ended July 1, 2017 and July 2, 2016 and the six months ended July 1, 2017 and July 2, 2016, approximately 0.0 million, 0.2 million, 0.0 million and 0.3 million shares, respectively, consisting of restricted stock units (RSUs), market stock units (MSUs) and stock options, were not included in the diluted earnings per share calculation since the shares were anti-dilutive.

The Company intends to settle the principal amount of its convertible senior notes in cash and any excess value in shares in the event of a conversion. Accordingly, shares issuable upon conversion of the principal amount have been excluded from the calculation of diluted earnings per share. If the market value of the notes under certain prescribed conditions exceeds the conversion amount, the excess will be included in the denominator for the computation of diluted earnings per share using the treasury stock method. As of July 1, 2017, no such shares were included in the denominator for the calculation of diluted earnings per share.

3. Fair Value of Financial Instruments

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

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.

Table of Contents

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 Active Markets for Identical Assets (Level 1) | Fair Value Measurements at July 1, 2017 Using Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---------------------------------------|---|--|--|------------|
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$ 78,006 | \$ | \$ | \$ 78,006 |
| Corporate debt securities | | 31,827 | | 31,827 |
| Government debt securities | | 1,496 | | 1,496 |
| Total cash equivalents | \$ 78,006 | \$ 33,323 | \$ | \$ 111,329 |
| Short-term investments: | | | | |
| Government debt securities | \$ 60,769 | \$ 215,086 | \$ | \$ 275,855 |
| Corporate debt securities | | 175,259 | | 175,259 |
| Total short-term investments | \$ 60,769 | \$ 390,345 | \$ | \$ 451,114 |
| Long-term investments: | | | | |
| Auction rate securities | \$ | \$ | \$ 5,379 | \$ 5,379 |
| Total long-term investments | \$ | \$ | \$ 5,379 | \$ 5,379 |
| Total | \$ 138,775 | \$ 423,668 | \$ 5,379 | \$ 567,822 |
| Liabilities: | | | | |
| Other non-current liabilities: | | | | |
| Contingent consideration | \$ | \$ | \$ 3,993 | \$ 3,993 |
| Total | \$ | \$ | \$ 3,993 | \$ 3,993 |

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

| Description | Fair Value Measurements at December 31, 2016 Using | | | Total |
|--------------------------------|---|--|--|-------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$ 69,432 | \$ | \$ | \$ 69,432 |
| Corporate debt securities | | 7,153 | | 7,153 |
| Government debt securities | | 3,904 | | 3,904 |
| Total cash equivalents | \$ 69,432 | \$ 11,057 | \$ | \$ 80,489 |
| Short-term investments: | | | | |
| Government debt securities | \$ 12,416 | \$ 97,103 | \$ | \$ 109,519 |
| Corporate debt securities | | 44,442 | | 44,442 |
| Total short-term investments | \$ 12,416 | \$ 141,545 | \$ | \$ 153,961 |
| Long-term investments: | | | | |
| Auction rate securities | \$ | \$ | \$ 5,196 | \$ 5,196 |
| Total long-term investments | \$ | \$ | \$ 5,196 | \$ 5,196 |
| Other assets, net: | | | | |
| Derivative instruments | \$ | \$ 1,808 | \$ | \$ 1,808 |
| Total | \$ | \$ 1,808 | \$ | \$ 1,808 |
| Total | \$ 81,848 | \$ 154,410 | \$ 5,196 | \$ 241,454 |

Valuation methodology

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

The Company's contingent consideration is valued using a probability weighted discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for the outcome if the milestone goal is achieved, the probability of achieving each outcome

and discount rates.

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**Available-for-sale investments

The Company's investments typically have original maturities greater than ninety days as of the date of purchase. Investments are reported at fair value, with unrealized gains and losses, net of tax, recorded as a component of accumulated other comprehensive income (loss) in the Consolidated Balance Sheet. The following summarizes the contractual underlying maturities of the Company's available-for-sale investments at July 1, 2017 (in thousands):

| | Cost | Fair Value |
|--------------------------------------|------------|------------|
| Due in one year or less | \$ 293,156 | \$ 293,132 |
| Due after one year through ten years | 179,050 | 179,051 |
| Due after ten years | 96,260 | 95,639 |
| | \$ 568,466 | \$ 567,822 |

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 Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| As of July 1, 2017 | | | | | | |
| Government debt securities | \$ 110,741 | \$ (97) | \$ | \$ | \$ 110,741 | \$ (97) |
| Corporate debt securities | 84,486 | (124) | | | 84,486 | (124) |
| Auction rate securities | | | 5,379 | (621) | 5,379 | (621) |
| | \$ 195,227 | \$ (221) | \$ 5,379 | \$ (621) | \$ 200,606 | \$ (842) |

| | Less Than 12 Months | | 12 Months or Greater | | Total | |
|--------------------------------|---------------------|-------------------------|----------------------|-------------------------|------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| As of December 31, 2016 | | | | | | |
| Government debt securities | \$ 79,743 | \$ (156) | \$ | \$ | \$ 79,743 | \$ (156) |
| Corporate debt securities | 21,737 | (132) | | | 21,737 | (132) |
| Auction rate securities | | | 5,196 | (804) | 5,196 | (804) |
| | \$ 101,480 | \$ (288) | \$ 5,196 | \$ (804) | \$ 106,676 | \$ (1,092) |

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

The gross unrealized losses as of July 1, 2017 and December 31, 2016 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 Company's auction-rate securities have been illiquid since 2008 when auctions for the securities failed because sell orders exceeded buy orders. These securities have a contractual maturity date of 2046 at July 1, 2017. The Company is unable to predict if these funds will become available before their maturity date.

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 July 1, 2017.

At July 1, 2017 and December 31, 2016, there were no material unrealized gains associated with the Company's available-for-sale investments.

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**Level 3 fair value measurements

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

Auction rate securities

| Fair Value at July 1, 2017 (000s) | Valuation Technique | Unobservable Input | Weighted Average |
|---|----------------------|-------------------------|------------------|
| \$ 5,379 | Discounted cash flow | Estimated yield | 0.88% |
| | | Expected holding period | 10 years |
| | | Estimated discount rate | 3.29% |

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

| Fair Value at July 1, 2017 | Valuation Technique | Unobservable Input | Weighted Average |
|-------------------------------|---------------------|--------------------|------------------|
|-------------------------------|---------------------|--------------------|------------------|

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

| | | | | | |
|----|--------|----------------------|-------------------------|----------|--|
| | (000s) | | | | |
| \$ | 3,993 | Discounted cash flow | Expected term | 6 months | |
| | | | Estimated discount rate | 12.0% | |

The Company has followed an established internal control procedure used in valuing contingent consideration. The valuation of contingent consideration for the Zentri acquisition is based on a discounted cash flow 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 would be accompanied by a directionally similar change in fair value.

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

The following summarizes the activity in Level 3 financial instruments for the three and six months ended July 1, 2017 (in thousands):

Assets

| | Three Months Ended | Six Months Ended |
|--|-------------------------------|-----------------------------|
| Auction Rate Securities | | |
| Beginning balance | \$ 5,257 | \$ 5,196 |
| Gain included in other comprehensive income (loss) | 122 | 183 |
| Balance at July 1, 2017 | \$ 5,379 | \$ 5,379 |

Liabilities

| | Three Months Ended | Six Months Ended |
|--|-------------------------------|-----------------------------|
| Contingent Consideration (1) | | |
| Beginning balance | \$ 3,829 | \$ 3,829 |
| Issues | | 3,829 |
| Loss recognized in earnings | 164 | 164 |
| Balance at July 1, 2017 | \$ 3,993 | \$ 3,993 |
| Net loss for the period included in earnings attributable to contingent consideration held at the end of the period: | \$ (164) | \$ (164) |

(1) In connection with the acquisition of Zentri, the Company recorded contingent consideration based upon the expected achievement of a milestone goal. 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.

Fair values of other financial instruments

The Company's debt is recorded at cost, but is measured at fair value for disclosure purposes. The fair value of the Company's convertible senior notes is determined using observable market prices. The notes are traded in less active markets and are therefore classified as a Level 2 fair value measurement. The fair value of the convertible senior notes at July 1, 2017 was \$414.8 million. The Company's prior debt under the Credit

Facility bore interest at the Eurodollar rate plus an applicable margin. Fair value was 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 July 1, 2017 and December 31, 2016, the fair value of the Company's debt under the Credit Facility was approximately \$0.0 and \$72.5 million, respectively.

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

4. Derivative Financial Instruments

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

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

The Company is exposed to interest rate fluctuations in the normal course of its business, including through its Credit Facility. The interest payments on the facility are calculated using a variable-rate of interest. The Company entered into an interest rate swap agreement with an original notional value of \$72.5 million and, effectively, converted the Eurodollar portion of the variable-rate interest payments to fixed-rate interest payments through July 2020. The Company terminated the swap agreement on March 6, 2017 in connection with the payoff of its Credit Facility.

The Company's interest rate swap agreement was designated and qualified as a cash flow hedge. The effective portion of the gain or loss on the interest rate swap was recorded in accumulated other comprehensive income (loss) as a separate component of stockholders' equity and was subsequently recognized as interest expense in the Consolidated Statement of Income when the hedged exposure affected earnings. The termination of the swap agreement resulted in the reclassification of \$1.8 million of unrealized gains that were previously recorded in accumulated other comprehensive income (loss) into earnings during the three months ended April 1, 2017. The Company did not discontinue any other cash flow hedges in any of the periods presented.

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

| | | Fair Value | |
|--------------------|------------------------|-----------------|----------------------|
| | Balance Sheet Location | July 1, 2017 | December 31, 2016 |
| Interest rate swap | Other assets, net | \$ | \$ 1,808 |

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

| | Gain (Loss) Recognized in OCI on Derivatives (Effective Portion) during the: Three Months Ended | | | Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) during the: Three Months Ended | |
|---------------------|---|-----------------|---|---|-----------------|
| | July 1, 2017 | July 2, 2016 | Location of Loss Reclassified into Income | July 1, 2017 | July 2, 2016 |
| Interest rate swaps | \$ | \$ (126) | Interest expense | \$ | \$ (61) |

| | July 1, 2017 | July 2, 2016 | | July 1, 2017 | July 2, 2016 |
|---------------------|-----------------|-----------------|------------------|-----------------|-----------------|
| Interest rate swaps | \$ | (412) | Interest expense | \$ 1,808 | \$ (127) |

Foreign Currency Forward Contracts

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

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

As of July 1, 2017 and July 2, 2016, the Company held one foreign currency forward contract denominated in Norwegian Krone with a notional value of \$3.6 million and \$4.7 million, respectively. The fair value of the contracts was not material as of July 1, 2017 or July 2, 2016. The contract held as of July 1, 2017 has a maturity date of September 28, 2017 and it was not designated as a hedging instrument.

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

| Gain (Loss) Recognized in Income | Three Months Ended | | Six Months Ended | | Location |
|------------------------------------|--------------------|-----------------|------------------|-----------------|-----------------------------------|
| | July 1, 2017 | July 2, 2016 | July 1, 2017 | July 2, 2016 | |
| Foreign currency forward contracts | \$ (35) | \$ 48 | \$ (129) | \$ (252) | Interest income and other, net |

5. Balance Sheet Details

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

Inventories

| | July 1, 2017 | December 31, 2016 |
|------------------|-----------------|----------------------|
| Work in progress | \$ 47,053 | \$ 40,755 |
| Finished goods | 20,374 | 18,823 |
| | \$ 67,427 | \$ 59,578 |

6. Acquisitions*Zentri*

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

On January 20, 2017, the Company acquired Zentri, Inc., a private company. Zentri is an innovator in low-power, cloud-connected Wi-Fi® technologies for the Internet of Things (IoT). The Company acquired Zentri for approximately \$18.1 million, including initial cash consideration of approximately \$14.3 million, and potential additional consideration with an estimated fair value of approximately \$3.8 million at the date of acquisition. The amount of potential additional consideration is up to approximately \$10.0 million based on fiscal 2017 revenue from certain Zentri products.

The purchase price was allocated as follows: intangible assets \$6.7 million; goodwill \$12.5 million; and other net liabilities \$1.1 million. The goodwill is not deductible for tax purposes. The allocation of the purchase price is preliminary and subject to change, primarily for the finalization of income tax matters. Accordingly, adjustments may be made to the values of the assets acquired and liabilities assumed as additional information is obtained about the facts and circumstances that existed at the valuation date.

Pro forma information related to this acquisition has not been presented because it would not be materially different from amounts reported.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

7. Debt

1.375% Convertible Senior Notes

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

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

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

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

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

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

| | July 1, 2017 | |
|---------------------------------|-----------------|----------|
| Liability component | | |
| Principal | \$ | 400,000 |
| Unamortized debt discount | | (55,921) |
| Unamortized debt issuance costs | | (8,440) |
| Net carrying amount | \$ | 335,639 |
| Equity component | | |
| Net carrying amount | \$ | 57,735 |

The liability component of the Notes is recorded in long-term debt on the Consolidated Balance Sheet. The equity component of the Notes is recorded in additional paid-in capital. The effective interest rate for the liability component was 4.75%. As of July 1, 2017, the remaining period over which the debt discount and debt issuance costs will be amortized was 4.7 years.

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

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

| | Three Months Ended July 1, 2017 | Six Months Ended July 1, 2017 |
|-------------------------------------|--|--|
| Contractual interest expense | \$ 1,375 | \$ 1,757 |
| Amortization of debt discount | 2,640 | 3,395 |
| Amortization of debt issuance costs | 398 | 512 |
| | \$ 4,413 | \$ 5,664 |

Amended Credit Agreement

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

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

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

The Second Amended Credit Agreement contains various conditions, covenants and representations with which the Company must be in compliance in order to borrow funds and to avoid an event of default, including financial covenants that the Company must maintain a leverage ratio (funded debt/EBITDA) of no more than 3.00 to 1 and a minimum fixed charge coverage ratio (EBITDA/interest payments, income taxes and capital expenditures) of no less than 1.25 to 1. As of July 1, 2017, the Company was in compliance with all covenants of the Second

Amended Credit Agreement. The Company's obligations under the Second Amended Credit Agreement are guaranteed by the Guarantors and are secured by a security interest in substantially all assets of the Company and the Guarantors.

8. Stockholders' Equity

Common Stock

The Company issued 0.6 million shares of common stock during the six months ended July 1, 2017.

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

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

| Program Authorization Date | Program Termination Date | Program Amount |
|---------------------------------------|-------------------------------------|---------------------------|
| January 2017 | December 2017 | \$ 100,000 |
| August 2015 | December 2016 | \$ 100,000 |

These programs allow for repurchases to be made in the open market or in private transactions, including structured or accelerated transactions, subject to applicable legal requirements and market conditions. The Company did not repurchase any shares of its common stock during the six months ended July 1, 2017. The Company repurchased 0.8 million shares of its common stock for \$38.1 million during the six months ended July 2, 2016. These shares were retired upon repurchase.

Reclassifications From Accumulated Other Comprehensive Income (Loss)

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

| Reclassification | Three Months Ended | | Six Months Ended | |
|--|---------------------------|-------------------------|-------------------------|-------------------------|
| | July 1, 2017 | July 2, 2016 | July 1, 2017 | July 2, 2016 |
| Gains (losses) on cash flow hedges to: | | | | |
| Interest expense | \$ | \$ (61) | \$ 1,808 | \$ (127) |
| Income tax benefit (provision) | | 22 | (633) | 45 |
| Total reclassifications | \$ | \$ (39) | \$ 1,175 | \$ (82) |

9. Stock-Based Compensation

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

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

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

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 | | Six Months Ended | |
|-------------------------------------|--------------------|-----------------|------------------|-----------------|
| | July 1, 2017 | July 2, 2016 | July 1, 2017 | July 2, 2016 |
| Cost of revenues | \$ 264 | \$ 269 | \$ 522 | \$ 535 |
| Research and development | 5,503 | 5,205 | 10,750 | 10,114 |
| Selling, general and administrative | 5,399 | 5,044 | 10,380 | 10,212 |
| | 11,166 | 10,518 | 21,652 | 20,861 |
| Income tax benefit | 3,175 | 2,270 | 8,457 | 4,506 |
| | \$ 7,991 | \$ 8,248 | \$ 13,195 | \$ 16,355 |

The increases in income tax benefit in the three and six months ended July 1, 2017 were primarily due to the recognition of excess tax benefits in connection with the Company's adoption of ASU 2016-09. The Company had approximately \$81.0 million of total unrecognized compensation costs related to granted stock options and awards as of July 1, 2017 that are expected to be recognized over a weighted-average period of approximately 2.3 years. There were no significant stock-based compensation costs capitalized into assets in any of the periods presented.

10. Commitments and Contingencies*Patent Litigation*

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

The Delaware proceedings are currently stayed. In 2014 and 2015, the Company challenged the validity of two sets of claims in the Cresta Patents at the Patent Trial and Appeal Board (PTAB) of the United States Patent and Trademark Office (USPTO). The PTAB found the first set of reviewed claims to be invalid, a determination that was affirmed by

the Federal Circuit Court of Appeals and is now final. The PTAB similarly found the second set of claims to be invalid. An appeal to that second determination is currently pending at the Federal Circuit.

On July 16, 2014, the Company filed a lawsuit against Cresta Technology in the United States District Court in the Northern District of California alleging infringement of six United States Patents. These California proceedings are currently stayed pending resolution of an order by the Bankruptcy Court to substitute the Cresta Successors as defendants.

The Company intends to continue to vigorously defend the Delaware proceeding and to continue to pursue its claims against the Cresta Successors and their patents. 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.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

11. Income Taxes

Provision (benefit) for income taxes includes both domestic and foreign income taxes at the applicable tax rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences. Income tax expense was \$1.3 million and \$1.7 million for the three months ended July 1, 2017 and July 2, 2016, resulting in effective tax rates of 7.1% and 9.9%, respectively. Income tax expense was \$(0.7) million and \$2.0 million for the six months ended July 1, 2017 and July 2, 2016, resulting in effective tax rates of (2.3)% and 8.5%, respectively. The effective tax rates for both the three and six months ended July 1, 2017 decreased from the prior periods primarily due to excess tax benefits from stock-based compensation from the adoption of ASU 2016-09 and an increase in the realization of the U.S. federal research and development tax credit in the current year. These increases were partially offset by a decrease in the foreign tax rate benefit.

On July 27, 2015, the U.S. Tax Court (the Court) issued an opinion in *Altera Corp. v. Commissioner* related to the treatment of stock-based compensation expense in an intercompany cost-sharing arrangement. A final decision was entered by the Court on December 1, 2015. In its opinion, the Court accepted Altera's position of excluding stock-based compensation from its cost-sharing arrangement and concluded that the related U.S. Treasury Regulations were invalid. In February 2016, the U.S. Internal Revenue Service (the IRS) appealed the decision to the U.S. Court of Appeals for the Ninth Circuit. Although the IRS has appealed the decision, and the U.S. Treasury has not withdrawn the requirement to include stock-based compensation from its regulations, based on the facts and circumstances of the Tax Court Case, the Company believes that it is more likely than not that the Tax Court decision will be upheld. Therefore, the Company continues to reflect the effects of the decision in its Condensed Consolidated Financial Statements. This change to cost-sharing is expected to increase the Company's cumulative foreign earnings at the time of final resolution of the case. As such, the Company continues to accrue a deferred tax liability for the U.S. tax cost of potential repatriation of the associated contingent foreign earnings because at this time, the Company cannot reasonably conclude that it will have the ability and intent to indefinitely reinvest these contingent earnings. The overall net impact on the Company's Condensed Consolidated Financial Statements is not material. The Company will continue to monitor ongoing developments and potential impacts to its Consolidated Financial Statements.

The Company's Norwegian subsidiary is currently under examination by the Norwegian Tax Administration (NTA) for income tax matters relating to fiscal years 2013, 2014 and 2015. While it has not yet received a final assessment from the NTA, in June 2017, the Norwegian subsidiary received a proposed notice of reassessment from the NTA concerning an adjustment to its 2013 taxable income related to the pricing of an intercompany transaction. The adjustment to 2013 taxable income would result in additional Norwegian tax of approximately \$33 million, excluding interest and penalties. The Company disagrees with the NTA's assessment and intends to defend itself vigorously in this matter. The Company plans to exhaust all available administrative remedies, and if unable to resolve this matter through administrative remedies with the NTA, the Company plans to pursue judicial remedies.

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

impact on its financial statements.

As of July 1, 2017, the Company had gross unrecognized tax benefits of \$3.7 million, of which \$2.3 million would affect the effective tax rate if recognized.

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

Tax years 2012 through 2017 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company is not currently under audit in any major taxing jurisdiction, except Norway.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Company believes it is reasonably possible that the gross unrecognized tax benefits will decrease by approximately \$1.9 million in the next 12 months due to the lapse of the statute of limitations applicable to tax deductions and tax credits claimed on prior year tax returns.

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related notes thereto included elsewhere in this report. This discussion contains forward-looking statements. Please see the Cautionary Statement above and Risk Factors below for discussions of the uncertainties, risks and assumptions associated with these statements. Our fiscal year-end financial reporting periods are a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2017 will have 52 weeks and fiscal 2016 had 52 weeks. Our second quarter of fiscal 2017 ended July 1, 2017. Our second quarter of fiscal 2016 ended July 2, 2016.

Overview

We are a provider of silicon, software and solutions for the Internet of Things (IoT), Internet infrastructure, industrial, consumer and automotive markets. We solve some of the electronics industry's toughest problems, providing customers with significant advantages in performance, energy savings, connectivity and design simplicity. Mixed-signal integrated circuits (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 industrial, communications, consumer and automotive.

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

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

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

Current Period Highlights

Revenues increased \$15.2 million in the recent quarter compared to the second quarter of fiscal 2016, primarily due to increased revenues from our IoT products offset by decreases in revenues from our Infrastructure, Access and Broadcast products.

Infrastructure revenues in the second quarter of fiscal 2016 included \$5.0 million from the sale of patents. Gross margin increased \$4.9 million during the recent period due primarily to increased product sales. Gross margin as a percent of revenues decreased to 59.5% in the recent quarter compared to 61.9% in the second quarter of fiscal 2016 primarily due to variations in product mix and the sale of patents in the prior period, which had no associated cost of revenues. Operating expenses increased by \$1.6 million in the recent quarter compared to the second quarter of fiscal 2016 due primarily to increased personnel-related expenses, offset by decreased expenses for new product introduction costs and amortization of intangible assets.

Table of Contents

We ended the second quarter with \$661.7 million in cash, cash equivalents and short-term investments. Net cash provided by operating activities was \$80.6 million during the recent six-month period. Accounts receivable was \$75.5 million at July 1, 2017, representing 36 days sales outstanding (DSO). Inventory was \$67.4 million at July 1, 2017, representing 79 days of inventory (DOI).

Through acquisitions and internal development efforts, we have continued to diversify our product portfolio and introduce new products and solutions with added functionality and further integration. On January 20, 2017, we acquired Zentri, Inc., an innovator in low-power, cloud-connected Wi-Fi technologies for the IoT. See Note 6, *Acquisitions*, to the Condensed Consolidated Financial Statements for additional information.

In the first six months of fiscal 2017, we introduced the Ultra Series family of crystal oscillators (XOs) delivering ultra-low jitter performance; EFR32xG13 Wireless Gecko SoCs supporting full Bluetooth® 5 connectivity and more memory options; a USB-to-I2S bridge chip that provides a simple, turnkey solution for transferring digital audio data; new EFR32 Wireless Gecko SoCs supporting a broad range of multiprotocol, multiband use cases; EFM32® Gecko MCUs offering new security features, large memory options, higher peripheral integration and ultra-low power consumption; and an enhanced Micrium® real-time operating system (RTOS) and new Platform Builder software to accelerate embedded design. We plan to continue to introduce products that increase the content we provide for existing applications, thereby enabling us to serve markets we do not currently address and expand our total available market opportunity.

During the six months ended July 1, 2017, we had no customer that represented more than 10% of our revenues. In addition to direct sales to customers, some of our end customers purchase products indirectly from us through distributors and contract manufacturers. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer. Three of our distributors, Edom Technology, Avnet and Arrow Electronics, each represented more than 10% of our revenues during the six months ended July 1, 2017. There were no other distributors or contract manufacturers that accounted for more than 10% of our revenues during the six months ended July 1, 2017.

The percentage of our revenues derived from outside of the United States was 85% during the six months ended July 1, 2017. 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.

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

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

Table of Contents

Results of Operations

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

Revenues. Revenues are generated predominately by sales of our products. A small portion of our revenues is derived from the sale of patents. 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.

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

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

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

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

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

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

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

Table of Contents

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

| | Three Months Ended | | Six Months Ended | |
|--------------------------------------|--------------------|-----------------|------------------|-----------------|
| | July 1, 2017 | July 2, 2016 | July 1, 2017 | July 2, 2016 |
| Revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of revenues | 40.5 | 38.1 | 40.8 | 39.5 |
| Gross margin | 59.5 | 61.9 | 59.2 | 60.5 |
| Operating expenses: | | | | |
| Research and development | 27.6 | 29.5 | 28.4 | 29.9 |
| Selling, general and administrative | 20.9 | 22.3 | 21.7 | 23.3 |
| Operating expenses | 48.5 | 51.8 | 50.1 | 53.2 |
| Operating income | 11.0 | 10.1 | 9.1 | 7.3 |
| Other income (expense): | | | | |
| Interest income and other, net | 0.8 | 0.2 | 0.6 | 0.0 |
| Interest expense | (2.4) | (0.4) | (1.2) | (0.4) |
| Income before income taxes | 9.4 | 9.9 | 8.5 | 6.9 |
| Provision (benefit) for income taxes | 0.7 | 1.0 | (0.2) | 0.6 |
| Net income | 8.7% | 8.9% | 8.7% | 6.3% |

Revenues

| (in millions) | July 1, 2017 | Three Months Ended | | | July 1, 2017 | Six Months Ended | | |
|--------------------|-----------------|--------------------|---------|-------------|-----------------|------------------|---------|-------------|
| | | July 2, 2016 | Change | % Change | | July 2, 2016 | Change | % Change |
| Internet of Things | \$ 97.7 | \$ 76.7 | \$ 21.0 | 27.3% | \$ 185.6 | \$ 147.6 | \$ 38.0 | 25.7% |
| Broadcast | 36.7 | 38.0 | (1.3) | (3.6)% | 74.0 | 76.5 | (2.5) | (3.3)% |
| Infrastructure | 38.2 | 40.7 | (2.5) | (6.0)% | 74.2 | 72.2 | 2.0 | 2.7% |
| Access | 17.5 | 19.5 | (2.0) | (10.1)% | 35.3 | 40.6 | (5.3) | (12.8)% |
| | \$ 190.1 | \$ 174.9 | \$ 15.2 | 8.7% | \$ 369.1 | \$ 336.9 | \$ 32.2 | 9.6% |

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

- Increased revenues of \$21.0 million for our IoT products, due primarily to increased demand for our products.
- Decreased revenues of \$1.3 million for Broadcast products, due primarily to decreases in the market for our consumer products.

- Decreased revenues of \$2.5 million for our Infrastructure products, due primarily to the sale of patents for \$5.0 million in the prior year three month period with no patents sales in the current period. The decrease in Infrastructure revenues was offset by increased product revenues due primarily to increased demand.
- Decreased revenues of \$2.0 million for our Access products, due primarily to decreased demand for our products and decreases in the market for such products.

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

- Increased revenues of \$38.0 million for our IoT products, due primarily to increased demand for our products.
- Decreased revenues of \$2.5 million for Broadcast products, due primarily to decreases in the market for our consumer products.
- Increased revenues of \$2.0 million for our Infrastructure products, due primarily to increased demand for our products offset by decreased patent sale revenue of \$5.0 million.
- Decreased revenues of \$5.3 million for our Access products, due primarily to decreased demand for our products and decreases in the market for such products.

Table of Contents

Unit volumes of our products increased by 21.0% and average selling prices decreased by 7.8% compared to the three months ended July 2, 2016. Unit volumes of our products increased by 19.9% and average selling prices decreased by 7.5% compared to the six months ended July 2, 2016. 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

| (in millions) | Three Months Ended | | | Six Months Ended | | |
|--------------------|--------------------|-----------------|--------|------------------|-----------------|---------|
| | July 1, 2017 | July 2, 2016 | Change | July 1, 2017 | July 2, 2016 | Change |
| Gross margin | \$ 113.2 | \$ 108.3 | \$ 4.9 | \$ 218.4 | \$ 203.8 | \$ 14.6 |
| Percent of revenue | 59.5% | 61.9% | (2.4)% | 59.2% | 60.5% | (1.3)% |

The increased dollar amount of gross margin in the recent three month period was due to increases in gross margin of \$12.0 million for our Internet of Things products, offset by decreases in gross margin of \$3.2 million for our Infrastructure products, \$2.0 million for our Access products and \$1.9 million for our Broadcast products. The increased dollar amount of gross margin in the recent six month period was due to increases in gross margin of \$21.9 million for our Internet of Things products, offset by decreases in gross margin of \$4.3 million for our Access products and \$3.1 million for our Broadcast products. Gross margin increased during the recent three and six month periods due primarily to increased product sales. Gross margin as a percent of revenues decreased during the recent three and six month periods primarily due to variations in product mix and the sale of patents in the second quarter of fiscal 2016, which had no associated cost of revenues.

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

Research and Development

| (in millions) | Three Months Ended | | | | Six Months Ended | | | |
|--------------------------|--------------------|-----------------|--------|-------------|------------------|-----------------|--------|-------------|
| | July 1, 2017 | July 2, 2016 | Change | % Change | July 1, 2017 | July 2, 2016 | Change | % Change |
| Research and development | \$ 52.4 | \$ 51.6 | \$ 0.8 | 1.5% | \$ 104.8 | \$ 100.7 | \$ 4.1 | 4.0% |
| Percent of revenue | 27.6% | 29.5% | | | 28.4% | 29.9% | | |

The increase in research and development expense in the recent three and six month periods was primarily due to increases of \$3.2 million and \$6.9 million, respectively, for personnel-related expenses, including costs associated with increased headcount and acquisitions. The increase in research and development expense in the recent three and six month periods was offset in part by decreases of \$1.6 million and \$1.3 million, respectively, for new product introduction costs, and \$0.6 million and \$1.3 million, respectively, for the amortization of intangible assets. The decrease in research and development expense as a percent of revenues in the recent three and six month periods was due to our increased revenues. We expect that research and development expense will increase in absolute dollars in the third quarter of fiscal 2017.

Table of Contents**Selling, General and Administrative**

| (in millions) | Three Months Ended | | | | Six Months Ended | | | |
|-------------------------------------|--------------------|-----------------|--------|-------------|------------------|-----------------|--------|-------------|
| | July 1, 2017 | July 2, 2016 | Change | % Change | July 1, 2017 | July 2, 2016 | Change | % Change |
| Selling, general and administrative | \$ 39.8 | \$ 39.0 | \$ 0.8 | 2.0% | \$ 80.0 | \$ 78.7 | \$ 1.3 | 1.7% |
| Percent of revenue | 20.9% | 22.3% | | | 21.7% | 23.3% | | |

The increase in selling, general and administrative expense in the recent three and six month periods was primarily due to increases of \$0.8 million and \$1.2 million, respectively, for personnel-related expenses, including costs associated with increased headcount and acquisitions. The decrease in selling, general and administrative expense as a percent of revenues in the recent three and six month periods was due to our increased revenues. We expect that selling, general and administrative expense will decrease in absolute dollars in the third quarter of fiscal 2017.

Interest Income and Other, Net

Interest income and other, net for the three and six months ended July 1, 2017 was \$1.6 million and \$2.2 million, respectively, compared to \$0.3 million and \$0.2 million for the three and six months ended July 2, 2016, respectively. The increase in interest income and other, net in the recent three and six month periods was primarily due to increased interest income earned as a result of higher market interest rates and higher cash, cash equivalents and short-term investments balances.

Interest Expense

Interest expense for the three and six months ended July 1, 2017 was \$4.7 million and \$4.5 million, respectively, compared to \$0.6 million and \$1.3 million for the three and six months ended July 2, 2016, respectively. The increase in interest expense in the recent three and six month periods was primarily due to increased interest expense of \$4.4 million and \$5.7 million, respectively, on our convertible debt, including amortization of the debt discount and debt issuance costs. The increase in interest expense in the recent six month period was offset in part by a \$2.0 million gain recorded in connection with the termination of our interest rate swap agreement.

Provision (Benefit) for Income Taxes

| (in millions) | Three Months Ended | | | Six Months Ended | | |
|--------------------------------------|--------------------|-----------------|----------|------------------|-----------------|----------|
| | July 1, 2017 | July 2, 2016 | Change | July 1, 2017 | July 2, 2016 | Change |
| Provision (benefit) for income taxes | \$ 1.3 | \$ 1.7 | \$ (0.4) | \$ (0.7) | \$ 2.0 | \$ (2.7) |
| Effective tax rate | 7.1% | 9.9% | | (2.3)% | 8.5% | |

The effective tax rates for both the three and six months ended July 1, 2017 decreased from the prior periods primarily due to excess tax benefits from stock-based compensation from the adoption of ASU 2016-09 and an increase in the realization of the U. S. federal research and development tax credit in the current year. These increases were partially offset by a decrease in the foreign tax rate benefit. The adoption of ASU 2016-09 resulted in a reduction to income tax expense of \$0.6 million and \$3.9 million for the three and six months ended July 1, 2017, respectively. See Note 11, *Income Taxes*, to the Condensed Consolidated Financial Statements for additional information.

The effective tax rates for each of the periods presented differ from the federal statutory tax 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, excess tax benefits from stock-based compensation from the adoption of ASU 2016-09 and other permanent items including research and development tax credits and nondeductible compensation expenses.

Table of Contents**Business Outlook**

The following represents our business outlook for the third quarter of fiscal 2017.

| Income Statement Item | Estimate |
|------------------------------|--------------------------------|
| Revenues | \$193 million to \$199 million |
| Gross margin | 58.5% |
| Operating expenses | \$92.5 million to \$93 million |
| Effective tax rate | 11.0% |
| Diluted earnings per share | \$0.35 to \$0.41 |

Liquidity and Capital Resources

Our principal sources of liquidity as of July 1, 2017 consisted of \$661.7 million in cash, cash equivalents and short-term investments, of which approximately \$512.5 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 government debt securities, which include agency bonds, municipal bonds, U.S. government bonds, international government bonds, international agency commercial paper and variable-rate demand notes; corporate debt securities, which include asset-backed securities, corporate bonds, commercial paper and certificates of deposit; and money market funds. Our long-term investments consisted of auction-rate securities. As of July 1, 2017, we held \$6.0 million par value auction-rate securities, all of which have experienced failed auctions because sell orders exceeded buy orders. See Note 3, *Fair Value of Financial Instruments*, to the Condensed Consolidated Financial Statements for additional information.

Operating Activities

Net cash provided by operating activities was \$80.6 million during the six months ended July 1, 2017, compared to net cash provided of \$60.4 million during the six months ended July 2, 2016. Operating cash flows during the six months ended July 1, 2017 reflect our net income of \$32.0 million, adjustments of \$40.2 million for depreciation, amortization, stock-based compensation and deferred income taxes, and a net cash inflow of \$8.4 million due to changes in our operating assets and liabilities.

Accounts receivable increased to \$75.5 million at July 1, 2017 from \$74.4 million at December 31, 2016. The increase in accounts receivable resulted primarily from normal variations in the timing of collections and billings. Our average DSO was 36 days at July 1, 2017 and 37 days at December 31, 2016.

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

Inventory increased to \$67.4 million at July 1, 2017 from \$59.6 million at December 31, 2016. 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 DOI was 79 days at July 1, 2017 and 73 days at December 31, 2016.

Investing Activities

Net cash used in investing activities was \$320.8 million during the six months ended July 1, 2017, compared to net cash used of \$20.6 million during the six months ended July 2, 2016. The increase in cash outflows was principally due to an increase of \$283.7 million in net purchases of marketable securities and a net payment of \$13.7 million for the acquisition of Zentri. See Note 6, *Acquisitions*, to the Condensed Consolidated Financial Statements for additional information.

We anticipate capital expenditures of approximately \$18 to \$22 million for fiscal 2017. 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.

Table of Contents

Financing Activities

Net cash provided by financing activities was \$309.7 million during the six months ended July 1, 2017, compared to net cash used of \$52.5 million during the six months ended July 2, 2016. The increase in cash inflows was principally due to \$389.5 million in net proceeds from the issuance of long-term debt and a decrease of \$36.1 million for repurchases of our common stock, offset by an increase of \$67.5 million in payments on debt. See Note 7, *Debt*, to the Condensed Consolidated Financial Statements for additional information. In January 2017, the Board of Directors authorized a program to repurchase up to \$100 million of our common stock through December 2017.

Our debt facilities include \$400 million principal amount convertible senior notes (the *Notes*) and a \$300 million revolving credit facility. On March 6, 2017, we completed a private offering of the Notes. The Notes bear interest semi-annually at a rate of 1.375% per year and will mature on March 1, 2022, unless repurchased, redeemed or converted at an earlier date. In connection with our offering of the Notes, we entered into a second amendment to our prior credit agreement and paid off the remaining balance of \$72.5 million. We have an option to increase the size of the borrowing capacity of the revolving credit facility by up to an aggregate of \$200 million in additional commitments, subject to certain conditions. See Note 7, *Debt*, 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 Facility 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 selling price less costs of completion, disposal and

transportation. 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.

Table of Contents

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 awards 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 income (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.

Table of Contents

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 whether 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, they 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

Recent accounting pronouncements which we believe may materially impact the judgments and uncertainties in the application of our accounting policies are described below. See Note 1, *Significant Accounting Policies*, to the Condensed Consolidated Financial Statements for additional information.

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

Table of Contents

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in Accounting Standards Codification (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. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which deferred the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In 2016, the FASB issued the following amendments to ASC 606: ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, which clarifies the implementation guidance on principal versus agent considerations; ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, which clarifies guidance on identification of performance obligations and licensing implementation; ASU No. 2016-12, *Compensation Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, which provides clarifying guidance on assessing collectibility, presentation of sales taxes, noncash consideration, contract modifications and completed contracts; and ASU No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, which clarifies narrow aspects of ASC 606 or corrects unintended application of the guidance. The standard may be applied retrospectively to each prior period presented (full retrospective method) or retrospectively with the cumulative effect recognized as of the date of initial application (modified retrospective method). Under the new standard, we expect the timing of revenue recognition from sales to distributors to be accelerated. We will recognize revenue at the time of sale to the distributor, net of the impact of estimated price adjustments and rights of return. We currently anticipate adopting this standard using the modified retrospective method. Under this method, incremental disclosures will be provided to present each financial statement line item for fiscal 2018 under the prior standard. We have completed an initial assessment of the new standard and are continuing to evaluate the effect that the adoption will have 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. A 100 basis point decline in yield on our investment portfolio holdings as of July 1, 2017 would decrease our future annual interest income by approximately \$6.1 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 Facility. The interest rate on the Credit Facility consists of a variable-rate of interest and an applicable margin. While we have drawn from the Credit Facility in the past, we have no borrowings as of July 1, 2017. If we borrow from the Credit Facility in the future, we will again be exposed to interest rate fluctuations.

Foreign currency exchange rate risk

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

We are exposed to foreign currency exchange rate risk primarily through assets and liabilities of our subsidiaries denominated in currencies other than the U.S. dollar. Our foreign subsidiaries are considered to be extensions of the U.S. parent. The functional currency of the foreign subsidiaries is the U.S. dollar. Accordingly, gains and losses resulting from remeasuring transactions denominated in currencies other than U.S. dollars are recorded in interest income and other, net in the Consolidated Statements of Income. We use foreign currency forward contracts to manage exposure to foreign exchange risk. Gains and losses on foreign currency forward contracts are recognized in earnings in the same period as the remeasurement loss and gain of the related foreign currency denominated asset or liability.

Table of Contents

Investments in Auction-rate Securities

As of July 1, 2017, we held \$6.0 million par value auction-rate securities, all of which have experienced failed auctions because sell orders exceeded buy orders. 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. 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.

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 July 1, 2017 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 July 1, 2017 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 28, 2014, Cresta Technology Corporation (Cresta Technology), a Delaware corporation, filed a lawsuit against us (among others) in the United States District Court in the District of Delaware, alleging infringement of three United States Patents (the Cresta Patents). Cresta Technology declared bankruptcy in 2016. One of its creditors, DBD Credit Funding LLC (DBD) and/or CF Crespe LLC (the Cresta Successors) claims to have assumed ownership of the Cresta Patents and has substituted in for Cresta Technology in related proceedings.

The Delaware proceedings are currently stayed. In 2014 and 2015, we challenged the validity of two sets of claims in the Cresta Patents at the Patent Trial and Appeal Board (PTAB) of the United States Patent and Trademark Office (USPTO). The PTAB found the first set of reviewed claims to be invalid, a determination that was affirmed by the Federal Circuit Court of Appeals and is now final. The PTAB similarly found the second set of claims to be invalid. An appeal to that second determination is currently pending at the Federal Circuit.

Table of Contents

On July 16, 2014, we filed a lawsuit against Cresta Technology in the United States District Court in the Northern District of California alleging infringement of six United States Patents. These California proceedings are currently stayed pending resolution of an order by the Bankruptcy Court to substitute the Cresta Successors as defendants.

We intend to continue to vigorously defend the Delaware proceeding and to continue to pursue its claims against the Cresta Successors and their patents. At this time, we cannot predict the outcome of these matters or the resulting financial impact to it, if any.

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;
- The demand for, and life cycles of, the products incorporating our mixed-signal solutions;
- The rate of adoption of mixed-signal products 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 mixed-signal 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;

Table of Contents

- 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
- 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 products 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 products 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;
- 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.

Table of Contents

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 products. If our products 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. The growth of the IoT market is dependent on the adoption of industry standards to permit devices to connect and communicate with each other. If the industry cannot agree on a common set of standards, then the growth of the IoT market may be slower than expected.

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 products serve as components and solutions 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 six months ended July 1, 2017 was \$104.8 million, or 28.4% of revenues. A number of 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.

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 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.

Table of Contents

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;
- 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

- 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.

Table of Contents

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 six months ended July 1, 2017, 71% 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 depend on a limited number of customers for a significant 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 six months ended July 1, 2017, our ten largest customers accounted for 21% 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 products at all, purchase fewer products 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 products; 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.

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.

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.

Table of Contents

Our products are complex and may contain errors which could lead to 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 products are increasingly being designed in more complex processes, include higher levels of software and hardware integration in modules and system-level solutions and/or include elements provided by third parties which further increase the risk of errors. We rely primarily on our in-house testing personnel to design test operations and procedures to detect any errors or vulnerabilities prior to delivery of our products to our customers.

Should problems occur in the operation or performance of our products, 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 result in refunds or other liability or require product replacement or recall. Any of the foregoing could impose substantial costs and harm our business.

Product liability, data breach or cyber 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 products 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;

- 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.

Table of Contents

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 have sold 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.

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 product 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 are a global company, which subjects us to additional business risks including logistical and financial complexity, political instability and currency fluctuations

We have established international subsidiaries and have opened offices in international markets to support our activities in Asia, the Americas and Europe. 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 six months ended July 1, 2017. We may not be able to maintain or increase global 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;
- Protectionist laws and business practices;

- 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;

Table of Contents

- Greater difficulty in hiring and retaining qualified personnel; and
- The need to have business and operations systems that can meet the needs of our international business and operating structure.

To date, substantially 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 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.

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.

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

Edgar Filing: SILICON LABORATORIES INC - Form 10-Q

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

Table of Contents

- 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. 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 products. 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;
- 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.

Table of Contents

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;
- 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;

- The required expensing of stock awards; and
- The required changes in our reported revenue and revenue recognition accounting policy expected under Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*.

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.

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 recent geopolitical maneuverings, including nuclear weapons and long-range missile testing, 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.

Table of Contents

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.

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.

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.

Our convertible senior notes could adversely affect our operating results and financial condition

Upon conversion, our convertible senior notes may be settled in cash, shares of our common stock or a combination of cash and shares, at our election. We intend to settle the principal amount of the notes in cash. If we do not have adequate cash available, we may not be able to settle the principal amount in cash. In such case, we will be required to settle the principal amount in stock, which would result in immediate, and possibly material, dilution to the ownership interests of our existing stockholders. Any sales in the public market of our common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock.

Following any conclusion that we no longer have the ability to settle the convertible senior notes in cash, we will be required on a going forward basis to change our accounting policy for earnings per share from the treasury stock method to the if-converted method. Earnings per share may be lower under the if-converted method as compared to the treasury stock method.

The principal balance of the convertible senior notes was separated into liability and equity components, which were recorded initially at fair value. The excess of the principal amount of the liability component over its carrying amount represents the debt discount, which is accreted to interest expense over the term of the notes using the effective interest method. Accordingly, we will report higher interest expense because of the recognition of both the debt discount amortization and the notes' coupon interest.

Our debt could adversely affect our operations and financial condition

We believe we have the ability to service our debt, 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 herein, many of which are beyond our control. Our credit facility also contains covenants, including financial covenants. If we breach any of the covenants under our credit facility and do not obtain appropriate waivers, then, subject to any applicable cure periods, our outstanding indebtedness thereunder could be declared immediately due and payable.

Table of Contents

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 facility 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 facility 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 have 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;
- 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.

Table of Contents

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 products. 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

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.

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 products 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, Broadcom, Conexant, Cypress, IDT, Marvell Technology Group, Maxim Integrated Products, MaxLinear, Microchip, Microsemi, Nordic Semiconductor, NXP Semiconductors, Qualcomm, Renesas, 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 products 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.

Table of Contents

We may be the victim of cyber-attacks against our products and our networks, which could lead to liability and damage our reputation and financial results

Many of our products focus on wireless connectivity and the IoT market and such connectivity may make these products particularly susceptible to cyber-attacks. We routinely face attacks attempting to breach our security protocols, gain access to or disrupt our computerized systems, or steal proprietary company, customer, partner or employee information. These attacks are sometimes successful. We may be subject to security breaches, employee error, theft, malfeasance, phishing schemes, ransomware, faulty password or data security management, or other irregularities. The theft, loss or misuse of personal or business data collected, used, stored or transferred by us to run our business could result in increased security costs or costs related to defending legal claims. Industrial espionage, theft or loss of our intellectual property data could lead to counterfeit products or harm the competitive position of our products and services. Costs to comply with and implement privacy-related and data protection measures could be significant. Federal, state or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others. Attempted or successful attacks against our products and services could damage our reputation with customers or users and reduce demand for our products and services.

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, theft, 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 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.

Third parties with which we conduct business, such as foundries, assembly and test contractors, distributors and customers, 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 reputation, business operations and financial results.

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.

Table of Contents

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 products fail to achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected.

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 July 1, 2017 (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 |
| April 2, 2017 - April 29, 2017 | | \$ | | \$ 100,000 |
| April 30, 2017 - May 27, 2017 | | \$ | | \$ 100,000 |
| May 28, 2017 - July 1, 2017 | | \$ | | \$ 100,000 |
| Total | | \$ | | |

In January 2017, the Board of Directors authorized a program to repurchase up to \$100 million of our common stock through December 2017. The program allows 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

Table of Contents

Item 6. Exhibits

The following exhibits are filed as part of this report:

| Exhibit Number | |
|---------------------------|---|
| 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* | Fourth Amended and Restated Bylaws of Silicon Laboratories Inc. (filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on January 27, 2017). |
| 4.1* | Specimen certificate for shares of common stock (filed as Exhibit 4.1 to the IPO Registration Statement). |
| 4.2* | Indenture between Silicon Laboratories Inc. and Wilmington Trust, National Association, as trustee, dated March 6, 2017 (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on March 6, 2017). |
| 4.3* | Form of 1.375% Convertible Senior Note due 2022 (filed as Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed on March 6, 2017). |
| 10.1+ | Silicon Laboratories Inc. 2009 Stock Incentive Plan, as amended and restated on April 20, 2017. |
| 10.2+ | Silicon Laboratories Inc. 2009 Employee Stock Purchase Plan, as amended and restated on April 20, 2017. |
| 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 |

* Incorporated herein by reference to the indicated filing.

+ Management contract or compensatory plan or arrangement

Table of Contents

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.

July 26, 2017

Date

/s/ G. Tyson Tuttle

G. Tyson Tuttle

President and

Chief Executive Officer

(Principal Executive Officer)

July 26, 2017

Date

/s/ John C. Hollister

John C. Hollister

Senior Vice President and

Chief Financial Officer

(Principal Financial and Accounting Officer)