

InvenSense Inc  
Form 10-Q  
August 04, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 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 3, 2016**

**or**

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from                      to**

**Commission File Number 001-35269**

**INVENSENSE, INC.**

**(Exact name of registrant as specified in its charter)**

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**Delaware**  
**(State or other jurisdiction of**  
**Incorporation or organization)**  
**1745 Technology Drive, Suite 200, San Jose, CA 95110**  
**(Address of principal executive offices and zip code)**  
**(408) 501-2200**  
**(Registrant's telephone number, including area code)**

**01-0789977**  
**(I.R.S. Employer**  
**Identification No.)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer  Accelerated filer   
 Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
 Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding at July 22, 2016
Common Stock, \$0.001 par value	93,689,000



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**INVENSENSE, INC.**

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

**INVENSENSE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except par value)**

	<b>July 3, 2016</b>	<b>April 3, 2016</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 23,054	\$ 41,105
Short-term investments	247,274	243,755
Accounts receivable	37,945	41,447
Inventories	51,626	62,297
Prepaid expenses and other current assets	8,012	9,250
Total current assets	367,911	397,854
Property and equipment, net	35,134	36,271
Intangible assets, net	40,795	43,169
Goodwill	139,175	139,175
Other assets	5,750	5,992
Total assets	\$ 588,765	\$ 622,461
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 13,282	\$ 35,200
Accrued liabilities	27,261	30,248
Total current liabilities	40,543	65,448
Long-term debt	153,151	151,038
Other long-term liabilities	26,755	27,230
Total liabilities	220,449	243,716
Commitments and contingencies (Note 4)		
Stockholders' equity:		
Preferred stock:		
Preferred stock, \$0.001 par value 20,000 shares authorized, no shares issued and outstanding at July 3, 2016 and April 3, 2016		

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Common stock:

Common stock, \$0.001 par value	750,000 shares authorized,		
93,641 shares issued and outstanding at July 3, 2016;			
93,010 shares issued and outstanding at April 3, 2016;		312,912	303,153
Accumulated other comprehensive (loss)		(29)	(26)
Retained earnings		55,433	75,618
Total stockholders' equity		368,316	378,745
Total liabilities and stockholders' equity		\$ 588,765	\$ 622,461

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

**Table of Contents****INVENSENSE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(In thousands, except per share amounts)**

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
Net revenue	\$ 60,636	\$ 106,296
Costs of revenue	35,891	61,465
Gross profit	24,745	44,831
Operating expenses:		
Research and development	26,541	20,255
Selling, general and administrative	13,862	15,824
Legal settlement		11,708
Total operating expenses	40,403	47,787
Loss from operations	(15,658)	(2,956)
Interest (expense)	(2,881)	(2,724)
Other income (expense), net	226	61
Loss before income taxes	(18,313)	(5,619)
Income tax provision	1,872	228
Net loss	\$ (20,185)	\$ (5,847)
Net loss per share of common stock:		
Basic	\$ (0.22)	\$ (0.06)
Diluted	\$ (0.22)	\$ (0.06)
Weighted average shares outstanding used in computing net loss per share:		
Basic	93,236	91,076
Diluted	93,236	91,076

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

Table of Contents**INVENSENSE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(Unaudited)****(In thousands)**

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
Net loss	\$ (20,185)	\$ (5,847)
Other comprehensive loss:		
Unrealized loss on available-for-sale securities, net of tax	(3)	(39)
Comprehensive loss	\$ (20,188)	\$ (5,886)

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



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## INVENSENSE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three Months Ended	
	July 3, 2016	June 28, 2015
Cash flows from operating activities:		
Net loss	\$ (20,185)	\$ (5,847)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	3,310	3,050
Amortization of intangible assets	2,375	2,142
Non cash interest expense	2,113	1,958
Loss on other investments	325	
Stock-based compensation expense	8,176	8,635
Contingent consideration adjustment		(5,307)
Deferred income tax assets	80	(1,824)
Tax effect of employee benefit plan		(301)
Changes in operating assets and liabilities:		
Accounts receivable	3,502	(5,865)
Inventories	10,670	10,614
Prepaid expenses and other assets	833	959
Other assets	207	(118)
Accounts payable	(22,282)	4,191
Accrued liabilities	(3,379)	12,975
Net cash provided by (used in) operating activities	\$ (14,255)	\$ 25,262
Cash flows from investing activities:		
Purchase of property and equipment	(1,892)	(2,342)
Sales and maturities of available-for-sale investments	56,448	15,365
Purchase of available-for-sale investments	(60,055)	(54,427)
Net cash used in investing activities	(5,499)	(41,404)
Cash flows from financing activities:		
Proceeds from the issuance of common stock	1,703	3,364
Net cash provided by financing activities	1,703	3,364
Net decrease in cash and cash equivalents	(18,051)	(12,778)

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<b>Cash and cash equivalents:</b>		
Beginning of period	41,105	85,637
End of period	\$ 23,054	\$ 72,859
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	\$ 1,531	\$ 1,531
Cash paid (received) for income taxes	\$ (17)	\$ 81
<b>Noncash investing and financing activities:</b>		
Unpaid purchases of property and equipment	\$ 771	\$ 653

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

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**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Organization and summary of significant accounting policies**

**Business**

InvenSense, Inc. (the Company) was incorporated in California in June 2003 and reincorporated in Delaware in January 2004. The Company designs, develops, markets and sells sensor systems on a chip, including accelerometers, gyroscopes and microphones for the mobile, wearable, smart home, gaming, industrial, and automotive market segments. The Company delivers leading solutions based on its advanced motion and sound technology and is dedicated to bringing the best-in-class size, performance and cost solutions to market. The Company targets solutions such as: smartphones, tablets, wearables, console and portable video gaming devices, digital television and set-top box remote controls, fitness accessories, sports equipment, digital still cameras, automobiles, ultra-books, laptops, hearing aids, stabilization systems, tools, navigation devices, remote controlled toys and other household consumer and industrial devices.

These condensed consolidated financial statements should be read in conjunction with the condensed consolidated financial statements and the notes thereto for the fiscal year ended April 3, 2016 included in the Company's Annual Report on Form 10-K filed on May 25, 2016 with the Securities and Exchange Commission (SEC). No material changes have been made to the Company's significant accounting policies since the Company's Annual Report on Form 10-K for the fiscal year ended April 3, 2016.

**Certain significant business risks and uncertainties**

The Company participates in the high-technology industry and believes that a number of factors including, but not limited to the following could have a material effect on the Company's future financial position, results of operations, or cash flows: reliance on a limited number of primary customers to support the Company's revenue generating activities; changes in end-user demand for the products manufactured and sold by the Company and its customers; the receipt, reduction, cancellation or delay of significant orders by customers; advances and trends in new technologies and industry standards; new product announcements and introductions by the Company's competitors; the general cyclicality and seasonality of the semiconductor and consumer electronics industries and the resulting effect on the Company's business; market acceptance of the Company's and its customers' products; the Company's development and introduction of new products on a timely basis; developing new sales channels and attracting new customers; significant warranty claims, including those not covered by the Company's suppliers; delays in the Company's customers' ability to manufacture and ship products that incorporate the Company's products caused by internal and external factors unrelated to the Company's business and that are out of its control; shortages of key third party components; the effects of competitive pricing pressures, including decreases in average selling prices of the Company's products; write-downs of inventory for excess quantity, changes in business priorities, technological obsolescence and erosion in net realizable value; strategic relationships, including key component suppliers; litigation or claims against the Company based on intellectual property, patent, product, regulatory, or other factors; and the Company's ability to attract and retain employees necessary to support its growth. Further information on potential risks that could affect the Company's business and financial results is included in the Company's Annual Report on Form 10-K for the year ended April 3, 2016 filed with SEC on May 25, 2016.

**Basis of consolidation**

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles, or GAAP, and include the Company's accounts and the accounts of its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The functional currency of each of the Company's subsidiaries is the U.S. dollar. Foreign currency gains or losses are recorded as other income (expense), net, in the condensed consolidated statements of operations.

**Fiscal year**

The Company's fiscal year is a 52 or 53 week period ending on the Sunday closest to March 31. Fiscal year 2016 was a 53-week fiscal year ended April 3, 2016 (Fiscal year 2016). The extra week was included in the Company's fourth fiscal quarter ended April 3, 2016. The Company's fiscal year ended March 29, 2015 (fiscal year 2015) was comprised of 52 weeks.

The first fiscal quarter in each of the two most recent fiscal years included 13 weeks.

**Basis of presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP and applicable rules and regulations of the SEC regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations.

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**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

The condensed consolidated balance sheet as of April 3, 2016, included herein was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP. The unaudited interim condensed consolidated financial statements, in the opinion of management, reflect adjustments, consisting of all normal recurring adjustments, necessary to present fairly the Company's financial position, results of operations, comprehensive loss and cash flows for the interim periods. The results of operations for the period ended July 3, 2016 is not necessarily indicative of the results to be expected for the fiscal year ending April 2, 2017 or for any future year or interim period.

**Use of estimates**

The preparation of the Company's condensed consolidated financial statements and related notes in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and related notes and the reported amounts of income and expenses during the reporting period. Significant estimates included in the condensed consolidated financial statements and related notes include income taxes, inventory valuation, stock-based compensation, loss contingencies, warranty reserves, goodwill, valuation of acquired assets, and valuation of convertible senior note, including the related convertible notes hedges and warrants. These estimates are based upon information available as of the date of the condensed consolidated financial statements, and actual results could differ from those estimates.

**Goodwill**

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. In accordance with Accounting Standard Codification (ASC) 350, the Company reviews goodwill for impairment at the reporting unit level on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. As the Company uses the market approach to assess impairment, its common stock price is an important component of the fair value calculation. The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. The Company monitors the recoverability of goodwill recorded in connection with acquisitions annually, or whenever events or changes in circumstances indicate the carrying value may not be recoverable. There were no changes in the carrying amount of goodwill since April 3, 2016. The Company performs the annual goodwill impairment analysis in the third quarter of each fiscal year. As of July 3, 2016, no events or changes in circumstances indicate the carrying value may not be recoverable.

**Concentration of credit risk**

The majority of the Company's products are shipped to distributors, original design manufacturers and contract manufacturers (collectively referred to as intermediaries), who are the legal counter-parties to the Company's sales. When the Company references customers, sales and revenue in this report, the Company is referring to the manufacturers of consumer electronics devices who are the end customers for our products. However, any disclosure

about the composition of the Company's accounts receivable refers to the intermediaries. Some of the Company's intermediaries may serve more than one of the Company's customers. As a result, attempting to compare or correlate disclosures about the Company's accounts receivable composition as of a particular date with the disclosures regarding revenues generated by the Company's customers for the period ending on the same date can be difficult or misleading.

One distributor accounted for 67% of accounts receivable at July 3, 2016. One distributor accounted for 48% of accounts receivable and another distributor accounted for 11% of accounts receivable at April 3, 2016.

For the three months ended July 3, 2016, Apple Inc. ( Apple ) accounted for 46% of net revenue. For the three months ended June 28, 2015, Apple accounted for 38% of net revenue, Samsung Electronics Co., Ltd. ( Samsung ) accounted for 23% of net revenue, and Xiaomi Inc. ( Xiaomi ) accounted for 10% of net revenue.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Warranty**

The Company offers one year standard warranty on its products. In selective cases, the warranty period can be extended to multiple years. The Company's accrual for anticipated warranty costs has increased primarily due to an increase in the product return rate under the warranty agreements. The accrual also includes management's judgment regarding anticipated rates of warranty claims and associated repair costs. The following table summarizes the activity related to product warranty liability during the three months ended July 3, 2016 and June 28, 2015:

	<b>Three Months Ended</b>	
	<b>July 3,</b>	<b>June 28,</b>
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
Beginning balance	\$ 625	\$ 341
Provision for warranty	624	297
Adjustments related to changes in estimate	(536)	(162)
Less: actual warranty costs	(12)	(53)
Ending balance	\$ 701	\$ 423

**Net loss per share**

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding during the period, which excludes dilutive unvested restricted stock. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding, including unvested restricted stock, certain warrants to purchase common stock and potential dilutive shares from the dilutive effect of outstanding stock options using the treasury stock method. In periods in which the Company has reported a net loss, the common stock equivalents are excluded from the calculation of diluted net loss per share of common stock as their effect is antidilutive under the treasury stock method.

The following table presents the calculation of basic and diluted net loss per share:

	<b>Three Months Ended</b>	
	<b>July 3,</b>	<b>June 28,</b>
	<b>2016</b>	<b>2015</b>
	<b>(in thousands, except per share data)</b>	
Numerator:		

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Basic and diluted		
Net loss	\$ (20,185)	\$ (5,847)
Denominator:		
Basic shares:		
Weighted-average shares used in computing basic net loss per share	93,236	91,076
Diluted shares:		
Weighted-average shares used in computing basic net loss per share	93,236	91,076
Effect of potentially dilutive securities:		
Stock options and unvested restricted stock		
Common stock warrants		
Weighted-average shares used in computing diluted net loss per share	93,236	91,076
Net loss per share		
Basic	\$ (0.22)	\$ (0.06)
Diluted	\$ (0.22)	\$ (0.06)



**Table of Contents****INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following summarizes the potentially dilutive securities outstanding at the end of each period that were excluded from the computation of diluted net loss per share for the periods presented as their effect would have been antidilutive:

	<b>Three Months Ended</b>	
	<b>July 3,</b>	<b>June 28,</b>
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
Employee stock options	11,186	8,865
Unvested restricted stock units	5,010	4,161
<b>Total antidilutive securities</b>	<b>16,196</b>	<b>13,026</b>

In November 2013, the Company issued \$175.0 million aggregate principal amount of 1.75% Convertible Senior Notes due on November 1, 2018 (the Notes). On or after August 1, 2018 until the maturity date, the Notes may be converted at the option of the holders under certain circumstances. The conversion rate is initially 45.683 shares per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$21.89 per share of common stock), subject to certain adjustments (see Note 5).

**Segment information**

The Company operates in one operating segment, the design, development, manufacture and marketing of sensor systems on a chip. The Chief Executive Officer has been identified as the Chief Operating Decision Maker as defined by Financial Accounting Standards Board (FASB) ASC 280 Segment Reporting. Enterprise-wide information is provided in accordance with ASC 280. Geographical revenue information is based on the location of the head offices of the Company's customers. Property and equipment information is based on the physical location of the assets at the end of each fiscal period.

Property and equipment by country were as follows:

<b>Country</b>	<b>July 3,</b>	<b>April 3,</b>
	<b>2016</b>	<b>2016</b>
	<b>(in thousands)</b>	
Taiwan	\$ 23,745	\$ 25,183
United States	9,421	9,207
Other	1,968	1,881

\$ 35,134    \$ 36,271

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Net revenue from unaffiliated customers by location of the Company's customers' headquarters offices was as follows:

Region	Three Months Ended	
	July 3, 2016	June 28, 2015
	(in thousands)	
United States	\$ 30,105	\$ 43,803
China	12,446	24,606
Korea	5,794	28,723
Japan	5,280	4,136
Taiwan	5,425	3,186
Rest of world	1,586	1,842
	\$ 60,636	\$ 106,296

A majority of sales to U.S. headquartered companies are sold to their distributors or contract manufacturers located overseas.

**Recent accounting pronouncements**

In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-13, Financial Instruments - Credit Losses. Under the new guidance, credit losses for certain types of financial instruments will be estimated based on expected losses. The new guidance also modifies the impairment models for available-for-sale debt securities and for purchased financial assets with credit deterioration since their origination. The new guidance will be effective for the Company starting in the first quarter of fiscal 2021. Early adoption is permitted starting in the first quarter of fiscal 2020. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

In March, 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends ASC Topic 718, Compensation - Stock Compensation. The new guidance simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance will be effective for the Company starting in the first quarter of fiscal 2018. Early adoption is permitted in any annual or interim period. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

In February 2016, the FASB issued new guidance related to leases that outlines a comprehensive lease accounting model and supersedes the current lease guidance. The new guidance requires lessees to recognize lease liabilities and corresponding right-of-use assets for all leases with lease terms of greater than 12 months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. The new guidance must be adopted using the modified retrospective approach and will be effective for the Company starting in the first quarter of fiscal 2020. Early adoption is permitted. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 provides guidance that companies will recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the payment to which a company expects to be entitled in exchange for those goods or services. The standard requires public entities to apply the amendments in ASU 2014-09 for annual reporting periods beginning after December 15, 2016, including interim reporting periods therein. On April 1, 2015, the FASB proposed for a one-year deferral of the effective date for this pronouncement. The Company then will be required to implement the new revenue recognition standard for the first quarter of fiscal year 2019. The Company is currently evaluating the impact on its consolidated financial statements.

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**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**2. Cash equivalents and available-for-sale investments**

At July 3, 2016, cash and cash equivalents totaled \$23.1 million, of which \$11.4 million was cash and \$11.7 million was cash equivalents invested in money market funds. At July 3, 2016, \$13.2 million of the cash and cash equivalents were held by the Company's foreign subsidiaries. Additionally, as of July 3, 2016, the Company had short-term available-for-sale investments of \$247.3 million.

At April 3, 2016, cash and cash equivalents totaled \$41.1 million, of which \$25.4 million was cash and \$15.7 million was cash equivalents invested in money market funds. At April 3, 2016, \$21.0 million of the cash and cash equivalents were held by the Company's foreign subsidiaries. Additionally, as of April 3, 2016, the Company had short-term available-for-sale investments of \$243.8 million.

The Company applies the provisions of ASC 820-10, *Fair Value Measurements*. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. ASC 820-10 requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The standard describes a fair value hierarchy based on three levels of inputs that may be used to measure fair value. The inputs for the first two levels are considered observable and the last is unobservable and include the following:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; or

Level 3 Unobservable inputs in which there is little or no market data, and as a result, prices or valuation techniques are employed that require inputs that are significant to the fair value measurement.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value. The fair values of the Company's money market funds were derived from quoted market prices as active markets for these instruments exist. The Company chose not to elect the fair value option as prescribed by ASC 825-10-05 *Fair Value Option* for its financial assets and liabilities that had not been previously carried at fair value. Therefore, financial assets and liabilities not carried at fair value, such as accounts payable, are reported at their carrying values.



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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

*Fair value measurements at each reporting date were as follows:*

**July 3, 2016:**

Assets and liabilities measured at fair value on a recurring basis were presented in the Company's condensed consolidated balance sheet as of July 3, 2016.

	July 3, 2016 balance	Quoted prices in active markets for identical assets or liabilities Level 1	Significant other observable inputs Level 2	Significant other unobservable inputs Level 3
	(in thousands)			
<b>Assets</b>				
Money market funds	\$ 11,676	\$ 11,676	\$	\$
Corporate notes and bonds	135,477		135,477	
Commercial paper	77,317		77,317	
U.S. agency securities	34,480		34,480	
Total investments	\$ 258,950	\$ 11,676	\$ 247,274	\$
<b>Liabilities</b>				
Contingent consideration	\$ 1,909	\$	\$	\$ 1,909
<b>Assets</b>				
Cash equivalents	\$ 11,676	\$ 11,676	\$	\$
Short-term investments	247,274		247,274	
Total investments	\$ 258,950	\$ 11,676	\$ 247,274	\$
<b>Liabilities</b>				
Accrued liabilities	\$ 1,909	\$	\$	\$ 1,909
Total contingent consideration	\$ 1,909	\$	\$	\$ 1,909

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	<b>July 3, 2016</b>		<b>gross unrealized gain</b>		<b>gross unrealized loss</b>		<b>July 3, 2016 estimated FMV</b>
	<b>amortized cost</b>						
			<b>(in thousands)</b>				
Corporate notes and bonds	\$ 135,503	\$	11	\$	(37)	\$	135,477
Commercial paper	77,343		6		(32)		77,317
U.S. agency securities	34,457		23				34,480
Total available-for-sale investments	\$ 247,303	\$	40	\$	(69)	\$	247,274
Money market funds							11,676
Total aggregate fair value						\$	258,950

The fair values of money market funds were derived from quoted market prices as active markets for these instruments exist. The fair values of corporate notes and bonds, commercial paper and U.S. agency securities were derived from non-binding market consensus prices that are corroborated by observable market data.

None of the gross unrealized losses as of July 3, 2016 were considered to be other-than-temporary impairments.

There were no transfers of assets measured at fair value between Level 1 and Level 2 during the three months ended July 3, 2016.



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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

April 3, 2016:

Assets and liabilities measured at fair value on a recurring basis were presented in the Company's condensed consolidated balance sheet as of April 3, 2016.

	April 3, 2016 balance	Quoted prices in active markets for identical assets or liabilities Level 1	Significant other observable inputs Level 2	Significant other unobservable inputs Level 3
(in thousands)				
<b>Assets</b>				
Money market funds	\$ 15,697	\$ 15,697	\$	\$
Corporate notes and bonds	163,675		163,675	
Commercial paper	45,473		45,473	
U.S. agency securities	34,607		34,607	
Total investments	\$ 259,452	\$ 15,697	\$ 243,755	\$
<b>Liabilities</b>				
Contingent consideration	\$ 1,909	\$	\$	\$ 1,909
<b>Assets</b>				
Cash equivalents	\$ 15,697	\$ 15,697	\$	\$
Short-term investments	243,755		243,755	
Total investments	\$ 259,452	\$ 15,697	\$ 243,755	\$
<b>Liabilities</b>				
Accrued liabilities	\$ 1,909	\$	\$	\$ 1,909
Total contingent consideration	\$ 1,909	\$	\$	\$ 1,909
	April 3, 2016	gross unrealized	gross unrealized	April 3, 2016

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	amortized cost	gain	loss	estimated FMV
	(in thousands)			
Corporate notes and bonds	\$ 163,712	\$ 19	\$ (56)	\$ 163,675
Commercial paper	45,480	3	(10)	45,473
U.S. agency securities	34,589	25	(7)	34,607
Total available-for-sale investments	\$ 243,781	\$ 47	\$ (73)	\$ 243,755
Money market funds				15,697
Total aggregate fair value				\$ 259,452

The fair values of money market funds were derived from quoted market prices as active markets for these instruments exist. The fair values of corporate notes and bonds, commercial paper and U.S. agency securities were derived from non-binding market consensus prices that are corroborated by observable market data.

There were no transfers of assets measured at fair value between Level 1 and Level 2 during fiscal year 2016.

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

*Level 3 financial liabilities:*

The following table provides a summary of changes in fair value of the Company's contingent consideration categorized as Level 3 for the three months ended July 3, 2016 and June 28, 2015:

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	
Beginning balance	\$ 1,909	\$ 9,124
Add: Contingent consideration in connection with acquisitions		
Payments made on contingent liabilities		
Change in fair value and other		(5,307)
Ending balance	\$ 1,909	\$ 3,817

Contingent consideration on acquired businesses (see Note 8) was measured at fair value using Level 3 inputs as defined in the fair value hierarchy. The following table presents certain information about the significant unobservable inputs used in the fair value measurement for the contingent consideration measured at fair value on a recurring basis using significant unobservable inputs:

<b>Description</b>	<b>Valuation Techniques</b>	<b>Significant Unobservable Inputs</b>
Liabilities: Contingent consideration	Present value of a Probability Weighted Earn-out model using an appropriate discount rate.	Estimate of achieving the milestones.

An increase in the estimate of probability of meeting the milestones could result in a significantly higher estimated fair value of the contingent consideration liability. Alternatively, a decrease in the estimate of probability of meeting the milestones could result in a significantly lower estimated fair value of contingent consideration liability. The fair value of contingent consideration was derived from a probability weighted earn-out model of future contingent payments. The cash payments are expected to be made upon meeting the milestones (see Note 8). The initial valuation of the contingent consideration was based on a collaborative effort of the Company's engineering and finance departments, and third party valuation experts. The estimate of meeting the milestones and discount rates is reviewed quarterly and updated as and when necessary. Potential valuation adjustments will be made to adjust the contingent consideration payments. These adjustments will be recorded in the statements of operations.

In fiscal year 2016, the fair value of contingent consideration declined by \$5.3 million. The decline in fair value was the result of a reduction in the probability of a design win milestone associated with the Movea, S.A. ( Movea ) acquisition from 50% to 0% and a reduction in the probability of a design win associated with the Trusted Positioning, Inc. ( TPI ) acquisition from 50% to 0%. The decline in fair value of the design win milestones for Movea and TPI was \$4.0 million and \$2.4 million, respectively, which were recorded as a credit to research and development expense. The earn-out payments for the Movea and TPI design win milestones were not made as these milestones were not met and expired during fiscal year 2016. Offsetting this amount is an increase in the fair value of two TPI cloud application milestones as a result of an increase in the estimated probability of achievement of those milestones. The increase in the fair value of the cloud application milestones was \$1.1 million, which was recorded as a debit to research and development expense in fiscal year 2016. A design milestone for TPI was achieved and the payment of \$1.9 million was made in fiscal year 2016. The last milestone of \$1.9 million for TPI is expected to be paid in fiscal year 2017.

### 3. Balance sheet details

#### Inventories

Inventories at July 3, 2016 and April 3, 2016 consist of the following:

	<b>July 3, 2016</b>	<b>April 3, 2016</b>
	<b>(in thousands)</b>	
Work in process	\$ 32,124	\$ 40,329
Finished goods	19,502	21,968
<b>Total inventories</b>	<b>\$ 51,626</b>	<b>\$ 62,297</b>

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Prepaid expenses and other current assets**

Prepaid expenses and other current assets at July 3, 2016 and April 3, 2016 consist of the following:

	July 3, 2016	April 3, 2016
	(in thousands)	
Prepaid expenses	\$ 5,646	\$ 5,256
Income tax receivable	77	156
Other receivables	994	1,676
Other current assets	1,295	2,162
<b>Total prepaid expenses and other current assets</b>	<b>\$ 8,012</b>	<b>\$ 9,250</b>

**Property and equipment**

Property and equipment at July 3, 2016 and April 3, 2016 consist of the following:

	July 3, 2016	April 3, 2016
	(in thousands)	
Production and lab equipment	\$ 54,215	\$ 52,821
Computer equipment and software	9,783	9,074
Equipment under construction	669	607
Leasehold improvements and furniture and fixtures	8,568	8,396
<b>Subtotal</b>	<b>73,235</b>	<b>70,898</b>
Accumulated depreciation and amortization	(38,101)	(34,627)
<b>Property and equipment net</b>	<b>\$ 35,134</b>	<b>\$ 36,271</b>

Depreciation expense for the three months ended July 3, 2016 and June 28, 2015 was \$3.3 million and \$3.1 million, respectively. Equipment under construction consists primarily of production and lab equipment. Equipment under construction is not subject to depreciation until it is available for its intended use. All of the equipment under construction is expected to be completed and placed in service by the end of fiscal 2017.

**Accrued liabilities**

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Accrued liabilities at July 3, 2016 and April 3, 2016 consist of the following:

	<b>July 3, 2016</b>	<b>April 3, 2016</b>
	<b>(in thousands)</b>	
Payroll-related expenses	\$ 7,297	\$ 8,030
Bonuses	3,002	5,040
Contingent consideration, current portion	1,908	1,908
Deferred revenue	1,727	1,949
Legal fees	293	197
Accrued contractual coupon interest payable on convertible senior notes	549	1,313
Income tax payable	1,834	553
Other tax payable	768	768
Customer deposit	2,750	4,008
Other accrued liabilities	7,133	6,482
<b>Total accrued liabilities</b>	<b>\$ 27,261</b>	<b>\$ 30,248</b>

**Table of Contents****INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Other long-term liabilities**

Other long-term liabilities at July 3, 2016 and April 3, 2016 consist of the following:

	<b>July 3, 2016</b>	<b>April 3, 2016</b>
	<b>(in thousands)</b>	
Long-term tax payable	\$ 14,421	\$ 13,928
Deferred rent	3,210	3,436
Deferred tax liabilities	2,790	3,026
Deferred revenue	3,900	4,100
Long-term debt	2,424	2,465
Other long-term liabilities	10	275
<b>Total other long-term liabilities</b>	<b>\$ 26,755</b>	<b>\$ 27,230</b>

**4. Commitments and contingencies****Operating lease obligations**

The Company has non-cancelable operating leases for its facilities through fiscal year 2022.

Future minimum lease payments, net of future minimum lease income, under operating leases as of July 3, 2016 are as follows:

<b>Fiscal Years Ending:</b>	<b>Amount</b>
	<b>(in thousands)</b>
2017 (remainder)	4,081
2018	6,503
2019	6,600
2020	5,277
2021	1,388
Beyond	513
<b>Total</b>	<b>\$ 24,362</b>

The Company's lease agreements provide for rental payments which have certain lease incentives and graduated rental payments. As a result, the rent expense is recognized on a straight-line basis over the term of the lease. The Company's rental expense under operating leases was approximately \$1.2 million and \$1.3 million for the three months ended July 3, 2016 and June 28, 2015, respectively. The Company's rental income from sublease was approximately \$0.4 million and \$0.3 million for the three months ended July 3, 2016 and June 28, 2015, respectively.

#### **Purchase Commitments**

The Company has non-cancelable purchase commitments with its foundry vendors. Future minimum payments of \$22.1 million under the purchase commitments as of July 3, 2016 are due in less than twelve months.



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**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Legal proceedings and contingencies**

From time to time the Company is involved in various disputes and litigation matters that arise in the ordinary course of our business, including disputes and lawsuits related to intellectual property and employment issues. In addition, the Company is a party to class action lawsuits.

In January and March of 2015, purported shareholders filed five substantially similar class action complaints in the U.S. District Court, Northern District of California against the Company and two of the Company's current and former executives ( Class Action Defendants ) (*Jim McMillan v. InvenSense, Inc., et al.* Case No. 3:15-cv-00084-JD, filed January 7, 2015; *William Lendales v. InvenSense, Inc. et al.*, Case No. 3:15-cv-00142-VC, filed on January 12, 2015; *Plumber & Steamfitters Local 21 Pension Fund v. InvenSense, Inc., et al.*, Case No. 5:15-cv-00249-BLF, filed on January 16, 2015; *William B. Davis vs. InvenSense, Inc., et al.*, Case No. 5:15-cv-00425-RMW, filed on January 29, 2015; and *Saratoga Advantage Trust Technology & Communications Portfolio v. InvenSense et al.*, Case No. 3:15-cv-01134, filed on March 11, 2015). On April 23, 2015, those cases were consolidated into a single proceeding which is currently pending in the U.S. District Court, Northern District of California and captioned *In re InvenSense, Inc. Securities Litigation*, Case No. 3:15-cv-00084-JD (the Securities Case ), and the Vossen Group was designated as lead plaintiff. On May 26, 2015, the lead plaintiffs filed a consolidated amended class action complaint, which alleges that the defendants violated the federal securities laws by making materially false and misleading statements regarding our business results between July 29, 2014 and October 28, 2014, and seeks unspecified damages along with plaintiff's costs and expenses, including attorneys' fees. On June 25, 2015, the Class Action Defendants filed a motion seeking dismissal of the case and a hearing on that motion was held on October 7, 2015. On March 28, 2016, the court granted the motion to dismiss, in part with prejudice and in part with leave to amend. On April 18, 2016, the lead plaintiff's counsel filed an amended complaint. On May 5, 2016, the Class Action Defendants filed a motion seeking dismissal of the case and a hearing on that motion was held on June 29, 2016. The Court has not yet issued an order. In light of the unresolved legal issues, the amount of any potential loss cannot be estimated. At this stage, the Company is unable to predict the outcome of this matter and, accordingly, cannot estimate the potential financial impact on the Company's business, operating results, cash flows or financial position.

In addition, in January and March of 2015, other purported shareholders filed three substantially similar shareholder derivative complaints against two of our current and former officers and several of our current directors, twice in the U.S. District Court, Northern District of California and once in Santa Clara Superior Court (*George E Rollins v. Behrooz Abdi et al.*, Case No. 5:15-cv-00184-PSG, filed on January 13, 2015; *Linda Karr v. Behrooz Abdi et al.*, Case No. 5:15-cv-00200-NC, filed on January 14, 2015; and *Robert Bilbrey v. Behrooz Abdi et al.*, Case No. 1-15-CV-278742 was filed on March 20, 2015) (collectively, the Derivative Cases ). In the Derivative Cases complaints, the plaintiffs make allegations similar to those presented in the Securities Case, but the plaintiffs asserts various state law causes of action, including claims of breach of fiduciary duty and unjust enrichment. The Company has undertaken an evaluation of these complaints. Plaintiffs in the Derivative Cases have agreed to an indefinite stay pending developments in the Securities Case.

The semiconductor and MEMS industries are characterized by companies that hold large numbers of patents and other intellectual property rights and that vigorously pursue, protect and enforce intellectual property rights.

Robert Bosch GmbH ( Bosch ), one of the Company's competitors, and the Company have each previously made generalized assertions of potential patent infringement by the other. On October 28, 2015, the Company and Bosch resolved all assertions of potential infringement between them and entered into a multi-year, worldwide patent cross license agreement for MEMS and sensor technologies, excluding patents covering InvenSense's CMOS-MEMS eutectic bonding production process and Bosch's two-layer porous silicon production process, and an upfront payment of \$11.5 million to Bosch. The other terms of the settlement and the patent cross license agreement remain confidential and are not expected to have a material impact on the Company's future results. Based on the status of the negotiations, the Company recognized a pre-tax charge of \$11.7 million during the quarter ended June 28, 2015. On October 28, 2015, Bosch and the Company resolved all assertions of potential infringement made by the other. There were no significant changes to the final terms which required any additional charge in the fiscal year 2016. In the future, other third parties may assert against the Company and its customers and distributors, their patent and other intellectual property rights to technologies that are important to the Company's business.

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**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

The Company is not aware of any other pending legal matters or claims, individually or in the aggregate, that are expected to have a material adverse impact on its condensed consolidated financial position, results of operations, or cash flows. However, the Company's analysis of whether a claim may proceed to litigation cannot be predicted with certainty, nor can the results of litigation be predicted with certainty. Nevertheless, defending any of these actions, regardless of the outcome, may be costly, time consuming, distract management personnel, and have a negative effect on the Company's business. An adverse outcome in any of these actions, including a judgment or settlement, may have a material adverse effect on the Company's future business, operating results, and/or financial condition.

The Company indemnifies certain customers, distributors, suppliers and subcontractors for attorney fees and damages and costs awarded against such parties in certain circumstances in which the Company's products are alleged to infringe third-party intellectual property rights, including patents, registered trademarks or copyrights. Indemnification costs are charged to operations as incurred.

The Company's Third Amended and Restated Bylaws require the Company to indemnify its directors and officers and employees to the fullest extent permitted by the Delaware General Corporation Law ( "DGCL" ). In addition, the Company's directors, the Company's chief executive officer and certain executive officers have entered into separate indemnification agreements with the Company. The Company's Second Amended and Restated Certificate of Incorporation, as amended, limits the liability of directors to the Company or its stockholders to the fullest extent permitted by the DGCL. The obligation to indemnify generally means that the Company is required to pay or reimburse the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters.

**5. Convertible senior notes**

In November 2013, the Company issued \$175.0 million aggregate principal amount of 1.75% Convertible Senior Notes due on November 1, 2018 (the "Notes" ), in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933 (the "Securities Act" ). The Notes have not been registered under the Securities Act, or applicable state securities laws or blue sky laws, and may not be offered or sold in the United States absent registration under the Securities Act and applicable state securities laws or available exemptions from the registration requirements.

The Notes are senior unsecured obligations of the Company and rank equally in right of payment with all of the Company's existing and future senior unsecured indebtedness and are junior to any of the Company's existing and future secured indebtedness. The Notes pay interest in cash semi-annually (May and November) at a rate of 1.75% per annum. Net proceeds received by the Company, after issuance costs, were approximately \$169.3 million.

On or after August 1, 2018 until the maturity date, the Notes may be converted at the option of the holders. Holders may convert the Notes at their option prior to August 1, 2018 only under the following circumstances:

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- 1) During any calendar quarter and only during such calendar quarter, if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price of \$21.89 on each applicable trading day;
- 2) During the five business day period after any five consecutive trading day 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 last reported sale price of our common stock and the conversion rate on each such trading day; or
- 3) Upon the occurrence of specified corporate events, including if there is a fundamental change.

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**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

Upon conversion, the Company will pay cash up to the aggregate principal amount of the Notes to be converted and pay or deliver cash, shares of its own common stock or a combination of cash and shares of its own common stock, at the Company's election, in respect of the remainder, if any, of its conversion obligation in excess of the aggregate principal amount of the Notes being converted.

The conversion rate is initially 45.683 shares per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$21.89 per share of common stock), subject to certain adjustments.

The Notes are not redeemable by the Company prior to the maturity date. At an event of default or fundamental change, the principal amount of the Notes plus accrued and unpaid interest may become due immediately at the Note holders' option.

The Company separately accounts for the liability and equity components of the Notes. The initial debt component of the Notes was valued at \$135.7 million based on the contractual cash flows discounted at an appropriate comparable market non-convertible debt borrowing rate at the date of issuance of 7.3%, with the equity component representing the residual amount of the proceeds of \$39.3 million which was recorded as a debt discount. The issuance costs were allocated pro-rata based on the relative initial carrying amounts of the debt and equity components, including the Note hedges and warrants transactions described below. As a result, \$2.5 million of the issuance costs were allocated to the equity component of the Notes, \$3.0 million of issuance costs paid to the initial purchaser were accounted for as a debt discount and \$0.25 million of the issuance costs were classified as other non-current assets. Debt issuance costs were reclassified and presented in the balance sheet as a direct deduction from the carrying value of the debt liability, consistent with the presentation of a debt discount in the first quarter of the Company's fiscal year 2016 pertaining to the requirement of ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. The debt discount and the issuance costs allocated to the debt component are amortized as additional interest expense over the term of the Notes using the effective interest method. As of July 3, 2016, the remaining amortization period of the debt discount and the issuance costs is 2.3 years. The effective interest rate of the Notes is 7.84% per annum (1.75% coupon rate plus 6.09% of non-cash accretion expense).

**Convertible notes hedges and warrants**

Concurrent with the issuance of the Notes on November 6 and 7, 2013, the Company purchased call options for its own common stock to hedge the Notes (the Note Hedge) and sold call options for its own common stock (the Warrants). The Note Hedges and Warrants transactions are structured to reduce the potential future economic dilution associated with the conversion of the Notes and are excluded from the computation of diluted earnings per share for each period presented, as the Company's average stock price during each period is less than the conversion price.

The Note Hedges On November 6 and 7, 2013, the Company purchased call options from a counterparty for an aggregate price of approximately \$39.1 million, which gives the Company the right to buy from the counterparty up to approximately 8.0 million shares of the Company's common stock at a price of \$21.89 per share, subject to adjustments. The Note Hedge is exercisable upon conversion of the Notes for a number of shares equal to the product

of 0.045683 and amount of the converted Note. Upon exercise of the Note Hedge, the Company will receive from the counterparty cash, shares of the Company's common stock, or a combination thereof, equal to the amount by which the market price per share of the Company's common stock exceeds \$21.89 during the applicable valuation period. By the Note Hedge terms, the Company will receive cash and shares in a combination that offsets share dilution caused by conversion of the Notes.

**Warrants** On November 6 and 7, 2013, the Company sold call options to the same counterparty for approximately \$25.6 million, which gives the counterparty the right to buy from the Company up to approximately 8.0 million shares of the Company's common stock at an exercise price of \$28.66 per share, subject to adjustments, on a series of days commencing on February 1, 2019 and ending May 13, 2019. Upon exercise of the Warrants, the Company has the option to deliver cash or shares of its common stock equal to the difference between the market price on the exercise date and the strike price of the Warrants. Upon exercise of the Warrants, the Company will pay to the initial purchaser cash, shares of the Company's common stock, or a combination thereof (at the Company's choice), equal to the amount by which the market price per share of the Company's common stock exceeds \$28.66 during the applicable valuation period.

The Note Hedges and Warrants are classified in stockholders' equity in the Company's condensed consolidated balance sheets.

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table summarizes the principal amounts and related unamortized discount on the Notes :

	July 3, 2016	April 3, 2016
	(in thousands)	
Principal amount of the Notes	\$ 175,000	\$ 175,000
Unamortized discount on the Notes	21,710	23,809
Unamortized debt issuance costs	139	153
Net carrying value	\$ 153,151	\$ 151,038

The following table presents the amount of interest expense recognized related to the Notes:

	Three Months Ended	
	July 3, 2016	June 28, 2015
	(in thousands)	
Contractual coupon interest expense	\$ 764	\$ 764
Accretion of debt discount	2,099	1,945
Amortization of debt issuance costs	14	13
Total interest expense related to the Notes	\$ 2,877	\$ 2,722

As of July 3, 2016, the Company's aggregate future principal debt maturities are as follows:

Fiscal Year	July 3, 2016 (in thousands)
2019	\$ 175,000
Total	\$ 175,000

The Notes are shown in the accompanying condensed consolidated balance sheets at their original issuance value, net of unamortized discount, and are not marked to market each period. The approximate fair value of the Notes as of July 3, 2016 was \$163.4 million. The fair value of the Notes was determined using quoted market prices for similar securities, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

## **6. Stockholders equity**

### **Stock plans**

In July 2011, the Company's Board of Directors and its stockholders approved the establishment of the 2011 Stock Incentive Plan (the 2011 Plan). The 2011 Plan provides for annual increases in the number of shares available for issuance thereunder on the first business day of each fiscal year, equal to four percent (4%) of the number of shares of the Company's common stock outstanding as of such date, which resulted in an annual increase of 3.7 million shares for fiscal year 2017.

Under the 2011 Plan, the Board of Directors may grant either incentive stock options, nonqualified stock options, or stock awards to eligible persons, including employees, nonemployees, members of the Board of Directors, consultants and other independent advisors who provide services to the Company.

The Company's 2004 Stock Incentive Plan (the 2004 Plan), was adopted by the Company's board of directors and approved by the Company's stockholders on April 13, 2004, and was last amended on August 31, 2011. The 2004 Plan provides for the grant of incentive stock options, within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, to employees and any parent and subsidiary corporation's employees, and for the grant of non-qualified stock options and restricted stock to employees, directors and consultants and any parent and subsidiary corporation's employees. The Company has not granted any additional awards under the 2004 Plan following the completion of the Company's initial public offering in November 2011. However, the 2004 Plan continues to govern the terms and conditions of outstanding awards granted thereunder.



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Incentive stock options may only be granted to employees and at an exercise price of no less than fair value on the date of grant. Nonqualified stock options may be granted at an exercise price of no less than 100% of fair value on the date of grant. For owners of more than 10% of the Company's common stock, options may only be granted for an exercise price of not less than 110% of fair value, and these options generally expire 10 years from the date of grant. Stock options may be exercisable immediately but subject to repurchase. Stock options vest over the period determined by the Board of Directors, generally four years.

Stock option activities of the Company under the 2011 Plan and 2004 Plan (the Plans) are as follows (in thousands, except per share amounts):

	<b>Options issued and outstanding</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual term (in years)</b>	<b>Aggregate intrinsic value</b>
Balance April 3, 2016	10,126	\$ 12.76	7.53	\$ 5,016
Options granted	2,595	5.77		
Exercised options	(23)	6.08		
Cancelled options	(567)	14.92		
Balance July 3, 2016	12,131	\$ 11.18	7.73	\$ 2,299
Vested and expected to vest July 3, 2016	10,683	\$ 11.44	7.51	\$ 1,986
Exercisable July 3, 2016	5,208	\$ 12.15	5.98	\$ 1,228

**Valuation of stock-based awards**

The Company applies the provisions of ASC 718-10 Compensation Stock Compensation which establishes the accounting for stock-based awards based on the fair value of the award measured at grant date. Accordingly, stock-based compensation cost is recognized in the condensed consolidated statements of operations as a component of both cost of revenues and operating expenses over the requisite service period. ASC 718-10 requires tax benefits in excess of compensation cost to be reported as a financing cash flow rather than as a reduction of taxes paid. The determination of the fair value of stock-based payment awards on the date of grant using the Black-Scholes option pricing model is affected by the volatilities of a peer group of companies based on industry, stage of life cycle, size and financial leverage, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The Company uses historical experience to estimate expected term. The expected volatility was based on the historical stock volatilities of the Company's historical data with that of a peer group of publicly listed companies over a period equal to the expected terms. The risk-free interest rate is based on U.S. Treasury zero-coupon

issues with remaining terms similar to the expected term. The Company does not anticipate paying any cash dividends in the foreseeable future and, therefore, uses an expected dividend yield of zero.

The aggregate intrinsic value of the stock options exercised during the three months ended July 3, 2016 and June 28, 2015 was \$22,000 and \$2.3 million, respectively. The aggregate intrinsic value was calculated as the difference between the exercise price of the stock options and the estimated fair market value of the underlying common stock at the date of exercise.

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The number of options expected to vest takes into account an estimate of expected forfeitures. As of July 3, 2016, the remaining unamortized stock-based compensation expense, reduced for estimated forfeitures related to non-vested options, was \$19.2 million to be amortized over a weighted-average remaining period of 3.4 years. Total unrecognized expense will be adjusted for future changes in estimated forfeitures.

The Company used the following weighted-average assumptions in determining stock-based compensation expense for options granted in the three months ended July 3, 2016 and June 28, 2015

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
Expected term (in years)	5.5	5.1
Volatility	49.0%	45.2%
Risk-free interest rate	1.4%	1.5%
Dividend rate	0%	0%

The weighted-average grant date fair value of the Company's stock options granted in the three month ended July 3, 2016 and June 28, 2015 was \$2.65 and \$6.14 per share, respectively.

**Market-based awards**

During the three months ended July 3, 2016, the Company's chief executive officer was granted options to purchase an aggregate of 700,000 shares of common stock with an exercise price of \$5.65 per share. Vesting is contingent upon meeting various price target thresholds that will trigger a four year ratable vesting period if the minimum twenty day closing stock prices cross thresholds of \$12.50, \$15.50 and \$17.50. The vesting threshold of one of the awards was subsequently changed from \$15.50 to \$15.00. As of July 3, 2016, zero shares were exercisable pursuant to the options. The exercise price of the options represents the closing price of the Company's common stock on the date of grant, and the options have a term of 10 years. The fair value of each option granted was estimated on the date of grant using a Monte Carlo Simulation analysis valuation model, assumes that price target thresholds will be achieved and results in an estimated term of 7.9 years. Even if the price target thresholds are not met, compensation cost is not reversed. The Company used the following assumptions in estimating the fair value of the award; expected volatility 44.0%, expected dividends 0%, and risk-free rate of 1.75%. The weighted-average grant-date fair value of options granted during the period was \$2.16. At July 3, 2016, there was \$1.5 million of total unrecognized compensation expense to be recognized over a period of approximately 8 years.

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Restricted stock units and restricted stock**

Restricted stock unit and restricted stock activity of the Company under the Plans are as follows:

Restricted stock units and restricted stock activities	Shares (in thousands, except per share amount)	Weighted Average Grant Date Fair Value Per Share
Unvested at April 3, 2016	4,972	\$ 13.47
Granted	896	6.10
Released	(365)	14.54
Forfeited	(313)	14.65
Unvested at July 3, 2016	5,190	\$ 12.05

Restricted stock units and restricted stock granted to employees are generally subject to the employee's continued service to the Company over the vesting period. The fair value of restricted stock units and restricted stock is determined using the fair value of the Company's common stock on the date of the grant. Compensation expense is generally recognized on a straight-line basis over the requisite service period of each grant adjusted for estimated forfeitures. As of July 3, 2016, the remaining unamortized stock-based compensation expense, reduced for estimated forfeitures related to non-vested restricted stock units and restricted stock, was \$41.4 million to be amortized over a weighted-average remaining period of 2.7 years.

The weighted-average grant-date fair value per share of restricted stock units and restricted stock awarded in the three months ended July 3, 2016 and June 28, 2015 was \$6.10 and \$15.07, respectively.

**2013 Employee stock purchase plan**

Under the 2013 Employee Stock Purchase Plan, as amended (the "ESPP"), eligible employees may apply accumulated payroll deductions, which may not exceed 10% of an employee's compensation, to the purchase of shares of the Company's common stock at periodic intervals. The purchase price of stock under the ESPP is equal to 85% of the lower of (i) the fair market value of the Company's common stock on the first day of each offering period, or (ii) the fair market value of the Company's common stock on the purchase date (as defined in the ESPP). Each offering period consists of one purchase period of approximately six months duration.

At the 2015 annual meeting of stockholders, stockholders of the Company approved an amendment to the ESPP to increase the number of shares of common stock reserved for future issuance by 1,000,000 shares which brought the

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total amount of common stock reserved for issuance pursuant to the ESPP to an aggregate of 1,400,000 shares. As of July 3, 2016, 722,000 shares had been purchased pursuant to the ESPP.

Compensation expense recognized in connection with the ESPP was \$0.2 million for each of the three months ended July 3, 2016 and June 28, 2015.

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Common stock**

As of July 3, 2016 and April 3, 2016, common stock reserved for future issuance was as follows:

Common stock reserved for issuance	July 3, 2016	April 3, 2016
	(in thousands)	
<b>Stock plans</b>		
Outstanding stock options	12,131	10,126
Outstanding restricted stock units and restricted stock	5,190	4,972
Reserved for future equity incentive grants	10,414	9,295
	27,735	24,393
Purchase plan	678	1,000
Shares issuable upon exercise of warrants to purchase common stock	7,995	7,995
Total common stock reserved for future issuances	36,408	33,388

**Stock-based compensation expense**

Total employee stock-based compensation cost for the Company's stock plans for the three months ended July 3, 2016 and June 28, 2015 is as follows:

	Three Months Ended	
	July 3, 2016	June 28, 2015
	(in thousands)	
Cost of revenue	\$ 616	\$ 600
Research and development	4,074	3,835
Selling, general and administrative	3,486	4,200
Total stock-based compensation expense	\$ 8,176	\$ 8,635

**7. Income taxes**

In the three months ended July 3, 2016 and June 28, 2015, the Company recorded an income tax provision of \$1.87 million and \$0.2 million, respectively. The primary difference between the 2016 effective tax rate and the federal statutory tax rate relates to the valuation allowances on certain of the Company's net operating losses and tax credits, foreign tax rate differences, integration of acquired technologies, and non-deductible stock-based compensation expense.

On July 27, 2015, the Tax Court issued an opinion (*Altera Corp. et al. v. Commissioner*) regarding the treatment of stock-based compensation expense in intercompany cost-sharing arrangements. However, U.S. Treasury has not withdrawn the requirement to include stock-based compensation from its regulations. Also, there is uncertainty related to the Internal Revenue Service (IRS) response to the Tax Court opinion, the final resolution of this issue, and the potential favorable benefits to the Company. As such, no impact will be recorded at this time. The Company will continue to monitor developments related to this opinion and the potential impact of those developments on the Company's current and prior fiscal years.

The Company does not provide for federal income taxes on undistributed earnings of its foreign subsidiaries because it is the Company's intent to reinvest earnings in definitely offshore.

The Company has recorded \$33.4 million of uncertain tax positions within Other long-term liabilities on the condensed consolidated balance sheet as at July 3, 2016. The Company does not expect any significant increases or decreases to its unrecognized tax benefits within the next twelve months. While management believes that the Company has adequately provided for all tax positions, amounts asserted by tax authorities could be greater or less than the recorded position. Accordingly, the Company's provisions on federal, state and foreign tax-related matters to be recorded in the future may change as revised estimates are made or the underlying matters are settled or otherwise resolved.

The Company is in the process of an IRS examination for tax years 2011, 2012, 2013 and 2014. The Company may be subject to examination by California for tax years 2010 and forward. Generally, the Company is subject to routine examination for tax years 2008 and forward in various foreign tax jurisdictions in which it operates.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****8. Acquisition**

The Company completed one acquisition in fiscal year 2016 and two acquisitions in fiscal year 2015. The acquisitions have been accounted for under ASC 805. Under ASC 805, the total purchase consideration of the acquisition is allocated to the tangible assets and identifiable intangible assets and liabilities assumed based on their relative fair values. The excess of the purchase consideration over the net tangible and identifiable intangible assets is recorded as goodwill, and was derived from expected benefits from future technology development, synergies and the knowledgeable and experienced workforce who joined the Company after the acquisition.

**Fiscal year 2016**

In December 2015, the Company acquired certain assets of Spirit Corp LLC and its affiliates used in the development of navigation solutions. The total cash consideration associated with the acquisition was approximately \$7 million for which the purchase price was attributable to the acquired in-process research and development. The fair value of in-process research and development was determined using a cost approach, which includes an estimate of time and expenses required to recreate the intangible asset. The Company also will record approximately \$1 million post-acquisition expense that may be payable in the future should certain specified milestones be met. This acquisition is not significant to the Company's results of operations.

**Fiscal year 2015*****Movea S.A***

On July 22, 2014, the Company acquired 100% equity interest of Movea, a leading provider of software for ultra-low power location, activity tracking and context sensing.

The Company paid \$60.9 million in cash as consideration for the acquisition, and an additional \$13.0 million in cash contingent upon the achievement of certain milestones within one year of the acquisition described below.

The table below is a summary of the purchase price allocation of the fair value of assets acquired and liabilities assumed in connection with the acquisition of Movea (in thousands):

Cash consideration	\$ 60,900
Contingent consideration	8,400
	<b>\$ 69,300</b>

**Allocation of purchase price:**



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Current assets	\$ 3,082
Fixed assets	209
Other non-current assets	592
Developed technology	7,200
Goodwill	68,330
Current liabilities	(5,016)
Long-term liabilities	(5,097)
Total purchase price	\$ 69,300

The purchase price included \$2.6 million of long-term debt which was included in the long-term liabilities. The debt was measured at fair value using the effective interest rate method which approximates carrying value as of July 3, 2016.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The purchase price includes contingent considerations of (i) \$8.0 million payable in cash to the former Movea shareholders upon a design win with a major smartphone manufacturer within one year of closing date, and (ii) \$5.0 million payable in cash to the former Movea shareholders upon a specific product development milestone before December 29, 2014. The fair value of the contingent consideration of \$8.4 million was derived from a probability weighted earn-out model of future contingent payments and recorded in accrued liabilities. The product development milestone of \$5.0 million was achieved and the payment was made in fiscal year 2015. The difference between the contractual amount of \$5.0 million and the fair value of this contingent consideration was recorded in research and development expense for fiscal year 2015. In fiscal year 2016, the fair value of contingent consideration for Movea declined by \$4.0 million. The decline in fair value was the result of a reduction in the probability of a design win milestone associated with the Movea acquisition from 50% to 0%. The decline in fair value of the design win milestones for Movea was recorded as a credit to research and development expense.

The purchase price exceeded the fair value of the net tangible and identifiable intangible assets acquired and, as a result, the Company recorded goodwill in connection with this transaction. The acquisition provides assembled workforce and synergy with other of the Company's offerings. These factors primarily contributed to a purchase price that resulted in goodwill.

The following table presents certain information on acquired identifiable intangible assets related to the Movea acquisition:

	<b>Estimated fair value</b> <b>(in thousands)</b>	<b>Estimated useful life</b> <b>(in years)</b>
Developed technology	\$ 7,200	5

The fair value of developed technology was determined using a cost approach, which includes an estimate of time and expenses required to recreate the intangible asset. The fair value of developed technology was capitalized as of the acquisition date and is being amortized using a straight-line method to cost of revenue over the estimated useful life of five years.

***Trusted Positioning, Inc.***

On August 29, 2014, the Company completed the acquisition of TPI, which is an indoor/outdoor positioning software company.

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company's acquisition of TPI was completed through a step acquisition. In fiscal year 2014, the Company made investments totaling \$0.3 million to own approximately 4.57% of TPI's outstanding common stock. On August 29, 2014, the Company purchased the remaining outstanding common stock of TPI for a total consideration of \$25.9 million. The total purchase price, as presented in the table below, consists of (i) cash of \$11.4 million, (ii) issuance of 236,000 shares of the Company's common stock with a fair value of \$5.7 million, (iii) contingent considerations with a combined fair value of \$7.6 million payable upon TPI's achievement of certain product development milestones, and (iv) initial investments with a fair value of \$1.2 million.

The table below is a summary of the purchase price allocation for the 100% equity interest of the fair value of assets acquired and liabilities assumed in connection with the acquisition of TPI (in thousands):

Cash consideration	\$ 11,379
Issuance of common stock	5,703
Contingent consideration	7,634
Fair value of previously held 4.57% equity interest	1,215
	\$ 25,931
<b>Allocation of purchase price:</b>	
Current assets	\$ 392
Fixed assets	50
Other non-current assets	546
Developed technology	8,600
Goodwill	19,893
Current liabilities	(1,247)
Long-term liabilities	(2,303)
Total purchase price	\$ 25,931

The purchase price includes contingent consideration comprised of (i) \$5 million payable upon a design win within one year of acquisition, (ii) \$3 million payable upon achieving a development milestone before December 29, 2014, (iii) \$2 million payable upon successful development of cloud application within two years of acquisition and (iv) \$2 million upon first deployment of cloud application which is expected within one year of successful development of cloud application. The contingent considerations, which was derived from a probability weighted earn-out model of future contingent payments, have a combined fair value of \$7.6 million, of which \$4.9 million was recorded in accrued liabilities and \$2.7 million was recorded in other long-term liabilities. The development milestone of \$3 million was achieved and the payment was made in fiscal year 2015. The difference between the contractual amount of \$3.0 million and the fair value of this contingent consideration was recorded in the research and

development expense for the year ended March 29, 2015.

In fiscal year 2016, the fair value of contingent consideration for TPI declined by \$1.3 million. The decline in fair value was the result of a reduction in the probability of a design win associated with the TPI acquisition from 50% to 0%. The decline in fair value of the design win milestones for TPI was \$2.4 million which was recorded as a credit to research and development expense. Offsetting this amount is an increase in the fair value of two TPI cloud application milestones as a result of an increase in the estimated probability of achievement of those milestones. The increase in the fair value of the cloud application milestones was \$1.1 million which was recorded as a debit to research and development expense. A design milestone for TPI was achieved and the payment of \$1.9 million was made in fiscal year 2016.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following table presents certain information on acquired identifiable intangible assets related to the TPI acquisition:

	<b>Estimated fair value (in thousands)</b>	<b>Estimated useful life (in years)</b>
Developed technology	\$ 8,600	5

The fair value of developed technology was determined using a cost approach, which includes an estimate of time and expenses required to recreate the intangible asset. The fair value of developed technology was capitalized as of the acquisition date and will be amortized using a straight-line method to cost of revenue over the estimated useful life of five years.

**9. Goodwill and intangible assets**

The Company monitors the recoverability of goodwill recorded in connection with acquisitions annually, or whenever events or changes in circumstances indicate the carrying value may not be recoverable. There were no changes in the carrying amount of goodwill since April 3, 2016. The Company performs the annual goodwill impairment analysis during the third quarter of each fiscal year. As of and for the three months ended July 3, 2016, the Company concluded that the \$139.2 million of goodwill was not impaired.

Purchased intangible assets subject to amortization consist primarily of developed technology, customer relationships and patents and are reported net of accumulated amortization. Developed technology, customer relationships and patents are amortized on a straight line basis over the estimated useful life of the assets. In-process research and development ( IPR&D ) is assessed for impairment until the development is completed and products are available for sale. In fiscal year 2015, the Company recorded \$0.8 million of impairment on IPR&D on the MEMS Microphone business. In fiscal year 2016, one product from one of the IPR&D projects was released to production. The IPR&D value allocated to this project of \$3.3 million was transferred to developed technology. The estimated useful life for this technology is five years. Another product from one of the IPR&D projects was also released to production in fiscal year 2016. The IPR&D value allocated to this project of \$1.7 million was transferred to developed technology. The amortization of the product started in the first quarter of fiscal year 2017. The estimated useful life for this technology is also five years. The costs that the Company incurred on the IPR&D projects after the acquisition were expensed. The Company expects to complete the remaining IPR&D project during fiscal year 2017 at which time amortization will commence.

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## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Amortization for acquired intangible assets for the three months ended July 3, 2016 and June 28, 2015 was approximately \$2.4 million and \$2.1 million, respectively. The following table represents intangible assets and accumulated amortization:

	Gross	July 3, 2016 Accumulated amortization (in thousands)	Net
Developed technology	\$ 49,310	\$ 19,387	\$ 29,923
Customer relationships	1,560	594	966
Patents	2,120	534	1,586
Total intangible assets subject to amortization	\$ 52,990	\$ 20,515	\$ 32,475

	Gross	April 3, 2016 Accumulated amortization (in thousands)	Net
Developed technology	\$ 49,310	\$ 17,159	\$ 32,151
Customer relationships	1,560	539	1,021
Patents	2,120	443	1,677
Total intangible assets subject to amortization	\$ 52,990	\$ 18,141	\$ 34,849

The estimated future amortization expense related to intangible assets at July 3, 2016, is as follows:

Fiscal Year	Estimated amortization (in thousands)
2017 (remainder)	7,126
2018	9,500
2019	9,500
2020	5,556
2021	793

Total	\$	32,475
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**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the notes to those statements included elsewhere in this Quarterly Report on Form 10-Q, the Consolidated Financial Statements and Notes thereto for the year ended April 3, 2016, and with management's discussion and analysis of our financial condition and results of operations included in our Annual Report on Form 10-K with the Securities and Exchange Commission (SEC) on May 25, 2016.*

*This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, includes a number of forward-looking statements that involve many risks and uncertainties. Forward-looking statements are identified by the use of the words "would", "could", "will", "may", "expect", "believe", "should", "anticipate", "outlook", "if", "future", "intend", "plan", "estimate", "predict", "potential", "targets", "seek or continue" and similar words and phrases, including the negatives of these terms, or other variations of these terms, that denote future events. These forward-looking statements include our expectations as to future sales of consumer electronics devices that could potentially integrate motion processors, our expectation that our products will remain a component of customers' products throughout any such product's life cycle, our belief that users of our products are likely to introduce these products into other devices as well as to adopt our more advanced devices, our belief that certain end-markets pose large growth opportunities for motion processing functionality, our ability to protect our intellectual property in the United States and abroad, our belief in the sufficiency of our cash flows to meet our needs and our future financial and operating results. These statements reflect our current views with respect to future events and our potential financial performance and are subject to risks and uncertainties that could cause our actual results and financial position to differ materially and adversely from what is projected or implied in any forward-looking statements included in this Form 10-Q. These factors include, but are not limited to, the risks referred to under Item 1A. of Part I "Risk Factors," included in the Company's Annual Report on Form 10-K filed on May 25, 2016 with the SEC and Item 2 of Part I "Management's Discussion and Analysis of Financial Condition and Results of Operations," and discussed elsewhere in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the SEC. We make these forward-looking statements based upon information available on the date of this Form 10-Q, and we have no obligation (and expressly disclaim any such obligation) to update or alter any forward-looking statements, whether as a result of new information or otherwise except as otherwise required by securities regulations.*

**Overview****Business overview**

We are a leader in sensor solutions, particularly sensors that combine microelectromechanical systems (MEMS) transducers, such as accelerometers, gyroscopes, barometers, compasses, and microphones, with proprietary algorithms, processors and firmware that synthesize and calibrate sensor output data. We utilize a fabless model, leveraging generally available complementary metal oxide semiconductor (CMOS) and MEMS foundries to whom we have granted licenses to use our proprietary enhancements and improvements for our benefit, as well as semiconductor packaging and services vendors. We perform critical test and calibration functions in our wholly owned subsidiary located in Hsinchu, Taiwan. We design our products and solutions in California, Massachusetts, China, Taiwan, Korea, Japan, France, Canada, Slovakia, and Italy.

**Net revenue**



We derive our net revenue from sales of our Motion and Audio sensor solutions. We primarily sell our products through our worldwide sales organization. We also sell our products through an indirect channel of distributors that fulfill orders from manufacturers of consumer electronics devices, original design manufacturers and contract manufacturers (collectively referred to as intermediaries). When we reference customers, we are referring to the manufacturers of consumer electronics devices to whom these intermediaries sell our products.

	<b>Three Months Ended</b>	
	<b>July 3,</b>	<b>June 28,</b>
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
Net revenue	\$ 60,636	\$ 106,296

Net revenue for the three months ended July 3, 2016 decreased by \$45.7 million, or 43%, compared to the corresponding period last year, primarily due to lower volume shipments to manufacturers of smartphones, tablet devices and camera modules incorporating optimal image stabilization, combined with lower per unit average selling prices. Total unit shipments decreased by approximately 40% and overall average unit selling price decreased slightly compared to the corresponding period last year.

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For the three months ended July 3, 2016, Apple accounted for 46% of net revenue. For the three months ended June 28, 2015, three customers each accounted for 38% (Apple), 23% (Samsung) and 10% (Xiaomi) of net revenue.

**Net revenue by target end market**

	<b>Three Months Ended</b>	
	<b>July 3,</b>	<b>June 28,</b>
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
Smartphone and tablet devices	\$ 38,236	\$ 77,020
% of net revenue	63%	72%
Optical image stabilization	\$ 7,343	\$ 16,750
% of net revenue	12%	16%
IoT and other	\$ 15,057	\$ 12,526
% of net revenue	25%	12%

The net revenue decrease for the smartphone and tablet end market in the three months ended July 3, 2016 compared to the corresponding period last year reflects the weak macro environment combined with increased competition for market share across this market segment. The net revenue decrease for the optimal image stabilization end market in the three months ended July 3, 2016 primarily reflects a loss of market share at a major customer in Korea. The net revenue growth and contribution to total net revenue for the Internet of Things and other end market in the three months ended July 3, 2016 primarily reflects increased adoption and expansion of a range of consumer electronic products in this market.

**Net revenue by geographic region**

	<b>Three Months Ended</b>	
	<b>July 3,</b>	<b>June 28,</b>
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
<b>Region</b>		
United States	\$ 30,105	\$ 43,803
China	12,446	24,606
Korea	5,794	28,723
Japan	5,280	4,136
Taiwan	5,425	3,186
Rest of world	1,586	1,842
	<b>\$ 60,636</b>	<b>\$ 106,296</b>

We report revenue by geographic region based upon the location of the headquarters of our customers. We primarily sell our products directly to customers and distributors in Asia and North America. Sales into companies headquartered in Asian countries constituted 48% of our net revenue in the three months ended July 3, 2016 compared with 57% of our net revenue in the three months ended June 28, 2015. The net revenue decreases in the United States and China reflect lower demand for our products primarily by mobile device manufacturers and consumer electronics manufacturers. The net revenue decrease in Korea in the three months ended July 3, 2016 compared to the

corresponding period last year resulted from a loss of market share at a major customer.

We believe that a substantial majority of our net revenue will continue to come from sales to customers in Asia and from sales to customers headquartered in the United States, but use contract manufacturers in Asia. As a result of this regional customer concentration, we may be subject to economic and political events and other developments that impact our customers in Asia. For more information, see the section titled "Risk Factors" Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business, referred to under Item 1A. of Part I in our Annual Report on Form 10-K filed on May 25, 2016 with the SEC.

**Table of Contents****Gross profit and gross margin**

Gross profit is the difference between net revenue and cost of revenue and gross margin is gross profit as a percentage of net revenue.

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	
Gross profit	24,745	44,831
% of net revenue	41%	42%

Gross profit decreased by \$20.1 million in the three months ended July 3, 2016, as compared to the corresponding period last year, primarily due to a decrease in unit sales of our products combined with decreases in average selling prices per unit. Gross profit as a percentage of net revenue, or gross margin, decreased slightly primarily due to decreased average selling prices per unit in the three months ended July 3, 2016 as compared to the corresponding period last year.

We expect gross margins to fluctuate during future periods due to changes in product mix, average unit selling prices, manufacturing costs, manufacturing yields, amortization of acquired intangible assets, levels of inventory valuation and excess reserves recorded, if any, and levels of product demand.

**Research and development**

Research and development expense primarily consists of personnel related expenses (including employee cash compensation and benefits, and stock-based compensation), contract engineering services, reference design development costs, development testing and evaluation costs, depreciation expense, amortization of certain acquisition intangibles and allocated occupancy costs. Research and development activities include the design of new products, refinement of existing products and processes and design of test methodologies, including hardware and software to ensure compliance with required specifications. All research and development costs are expensed as incurred. We expect our research and development expenses to increase slightly on an absolute basis in the near future as we continue to expand our product offerings and enhance existing products.

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	
Research and development	\$ 26,541	\$ 20,255
% of net revenue	44%	19%

Research and development expense for the three months ended July 3, 2016 increased by \$6.3 million, or 31%, primarily attributable to a contingent consideration credit adjustment in the three months ended June 28, 2015 (see Note 8 to the Condensed Consolidated Financial Statements) that resulted in lowering research and development expenses by \$5.3 million for the three months ended June 28, 2015. Excluding this credit, research and development expense for the three months ended July 3, 2016 increased by \$0.9 million compared to the corresponding period last year. The increase was primarily due to a \$1.5 million increase in employee compensation and benefits costs largely

from higher headcount, and a \$1.1 million increase in third-party project and contractor costs associated with new product development. These were partially offset by a \$1.9 million decrease in engineering supplies related to reduced manufacturing activities. Research and development headcount was 331 at the end of July 3, 2016 and 312 at the end of June 28, 2015.

### Selling, general and administrative

Selling, general and administrative expense primarily consists of personnel related expenses (including employee cash compensation and benefits, and stock-based compensation), sales commissions, field application engineering support, travel costs, professional and consulting fees, legal fees, depreciation expense and allocated occupancy costs. We expect selling, general and administrative expenses to remain flat or increase slightly on an absolute basis in the near future.

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	
Selling, general and administrative	\$ 13,862	\$ 15,824
% of net revenue	23%	15%

Selling, general and administrative expense decreased by \$2.0 million, or 12%, in the three months ended July 3, 2016 compared to the corresponding period last year. The decrease was primarily attributable to a \$1.3 million decrease in employee compensation and benefits costs mainly due to a decrease in headcount and a \$0.8 million decrease in outside services expenses primarily resulting from decreased legal costs. Selling, general and administrative headcount decreased to 152 at the end of July 3, 2016 from 155 at the end of June 28, 2015.

**Table of Contents****Legal settlement accrual**

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	
Legal settlement accrual	\$	11,708
% of net revenue	%	11%

During the three months ended June 28, 2015, we recorded a charge of \$11.7 million related to the settlement with Bosch for assertions of potential infringement made by Bosch.

**Interest expense**

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	
Interest (expense)	\$ (2,881)	\$ (2,724)
% of net revenue	5%	3%

Interest (expense) for the three months ended July 3, 2016 and June 28, 2015 was related to the Convertible Senior Notes issued in the third quarter of fiscal year 2014.

**Other income (expense), net**

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	
Other income (expense), net	\$ 226	\$ 61
% of net revenue	0%	0%

Other income (expense), net was \$0.2 million and \$0.1 million for the three months ended July 3, 2016 and June 28, 2015, respectively. Other income (expense), net increased by \$0.2 million due to higher interest income for the three months ended July 3, 2016 as compared to the corresponding period of last year.

**Income tax provision**

	<b>Three Months Ended</b>	
	<b>July 3, 2016</b>	<b>June 28, 2015</b>
	<b>(in thousands)</b>	

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Income tax provision	\$ 1,872	\$ 228
% (Loss) before income tax	(10)%	(4)%

In the three months ended July 3, 2016 and June 28, 2015, the Company recorded an income tax provision of \$1.87 million and \$0.2 million, respectively. The primary difference between the 2016 effective tax rate and the federal statutory tax rate relates to the valuation allowances on certain of the Company's net operating losses and tax credits, foreign tax rate differences, integration of acquired technologies, and non-deductible stock-based compensation expense.

On July 27, 2015, the Tax Court issued an opinion (*Altera Corp. et al. v. Commissioner*) regarding the treatment of stock-based compensation expense in intercompany cost-sharing arrangements. However, the U.S. Treasury has not withdrawn the requirement to include stock-based compensation from its regulations. Also, there is uncertainty related to the IRS response to the Tax Court opinion,

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the final resolution of this issue, and the potential favorable benefits to the Company. As such, no impact will be recorded at this time. The Company will continue to monitor developments related to this opinion and the potential impact of those developments on the Company's current and prior fiscal years.

The Company does not provide for federal income taxes on undistributed earnings of its foreign subsidiaries because it is the Company's intent to reinvest earnings indefinitely offshore.

The Company has recorded \$33.4 million of uncertain tax positions within Other long-term liabilities on the condensed consolidated balance sheet as at July 3, 2016. The Company does not expect any significant increases or decreases to its unrecognized tax benefits within the next twelve months. While management believes that the Company has adequately provided for all tax positions, amounts asserted by tax authorities could be greater or less than the recorded position. Accordingly, the Company's provisions on federal, state and foreign tax-related matters to be recorded in the future may change as revised estimates are made or the underlying matters are settled or otherwise resolved.

The Company is in the process of an Internal Revenue Service ( IRS ) examination for tax years 2011, 2012, 2013 and 2014. The Company may be subject to examination by California for tax years 2010 and forward. Generally, the Company is subject to routine examination for tax years 2008 and forward in various foreign tax jurisdictions in which it operates.

## **Critical accounting policies and estimates**

Our condensed consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, net revenue, costs, and expenses, and any related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Changes in accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. We evaluate our estimates and assumptions on an ongoing basis. To the extent that there are material differences between these estimates and our actual results, our future financial statement presentation, financial condition results of operations and cash flows will be affected.

We believe that the assumptions and estimates associated with income taxes, inventory valuation, stock-based compensation, loss contingencies, warranty reserves, goodwill, valuation of acquired assets, and valuation of convertible senior notes, including the related convertible notes hedges and warrants have the greatest potential impact on our condensed consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K filed with the SEC on May 25, 2016.

## **Liquidity and capital resources**

As of July 3, 2016, we had \$270.3 million of cash, cash equivalents and investments. We believe our current cash, cash equivalents and investments will be sufficient to satisfy our liquidity requirements for the next 12 months. Our liquidity may be negatively impacted as a result of a decline in sales of our products due to a decline in our end markets, decreases in sales of our customers' products in the market, or the adoption of competitors' products by our



customers or end users. Additionally, \$13.2 million of the \$23.1 million of our cash and cash equivalents were held by our foreign subsidiaries as of July 3, 2016. If these funds are needed for our operations in the United States, we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to indefinitely reinvest these funds outside of the United States, and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Our primary uses of cash are to fund operating expenses, purchases of inventory, the acquisition of property and equipment and to pursue strategic investments or acquisitions if opportunities arise. Cash used to fund operating expenses excludes the impact of non-cash items such as depreciation, amortization and stock-based compensation and is impacted by the timing of when we pay these expenses as reflected in the change in our outstanding accounts payable and accrued expenses.

Our primary sources of cash are cash receipts on accounts receivable from our shipment of products to customers and distributors. Aside from the growth in amounts billed to our customers, net cash collections of accounts receivable are impacted by the efficiency of our cash collections process, which can vary from period to period depending on the payment cycles of our major customers and distributors.

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The change in cash and cash equivalents for the three months ended July 3, 2016 and June 28, 2015 was as follows:

	<b>Three Months Ended</b>	
	<b>July 3,</b>	<b>June 28,</b>
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
Net cash provided by (used in) operating activities	\$ (14,255)	\$ 25,262
Net cash used in investing activities	(5,499)	(41,404)
Net cash provided by financing activities	1,703	3,364
Net decrease in cash and cash equivalents	\$ (18,051)	\$ (12,778)

**Net cash provided by (used in) operating activities**

Net cash used in operating activities for the three months ended July 3, 2016 of \$14.3 million was primarily due to a net loss of \$20.2 million and a change in operating assets and liabilities of \$10.4 million, offset partially by non-cash expenses of \$16.4 million. The changes in our net operating assets and liabilities of \$10.4 million were primarily comprised of a net decrease of \$25.7 million in accounts payable and accrued liabilities primarily due to timing of inventory purchases, partially offset by a decrease of \$10.7 million in inventories and a decrease of \$3.5 million in accounts receivable due to decrease in sales volume. The non-cash expense of \$16.4 million consisted primarily of stock-based compensation of \$8.2 million, depreciation and amortization of \$5.7 million and a non-cash interest expense of \$2.1 million.

Net cash provided by operating activities for the three months ended June 28, 2015 of \$25.3 million was primarily due to a change in operating assets and liabilities of \$22.7 million and non-cash expenses of \$8.4 million, partially offset by a net loss of \$5.8 million. The changes in our net operating assets and liabilities of \$22.7 million were comprised of a net increase of \$13.0 million in accrued liabilities primarily due to the accrual for a tentative legal settlement, a decrease of \$10.6 million in inventories, a net increase of \$4.2 million in accounts payable and a decrease of \$1.0 million in prepaid and other current assets, offset partially by an increase of \$5.9 million in accounts receivable. The non-cash expenses of \$8.4 million consisted primarily of stock-based compensation of \$8.6 million, depreciation and amortization of \$5.2 million, non-cash interest expense of \$2.0 million, partially offset by contingent consideration adjustment of \$5.3 million and deferred income tax assets of \$1.8 million.

**Net cash used in investing activities**

Net cash used in investing activities for the three months ended July 3, 2016 of \$5.5 million primarily reflected the purchase of available-for-sale investments of \$60.1 million and the purchase of property and equipment of \$1.9 million, partially offset by the sale and maturity of available-for-sale investments of \$56.4 million.

Net cash used in investing activities in the three months ended June 28, 2015 of \$41.4 million primarily reflected the purchase of available-for-sale investments of \$54.4 million and the purchase of property and equipment of \$2.3 million, partially offset by the sale and maturity of available-for-sale investments of \$15.4 million.

**Net Cash provided by financing activities**

Net cash provided by financing activities for the three months ended July 3, 2016 of \$1.7 million resulted primarily from proceeds from the issuance of common stock.

Net cash provided by financing activities in the three months ended June 28, 2015 of \$3.4 million resulted primarily from proceeds from the issuance of common stock.

### **Off Balance Sheet Arrangements**

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of July 3, 2016, we were not involved in any unconsolidated SPE transactions.

### **Warranties and Indemnification**

In connection with the sale of our products in the ordinary course of business, we often make representations affirming, among other things, that our products do not infringe on the intellectual property rights of others, and agree to indemnify customers against third-party claims for such infringement. Further, our certificate of incorporation and bylaws require us to indemnify our officers and directors against any action that may arise out of their services in that capacity. We have not been subject to any material liabilities under such provisions and therefore believe that our exposure for these indemnification obligations is minimal. Accordingly, we have no liabilities recorded for these indemnity agreements as of July 3, 2016.

**Table of Contents****Contractual Obligations**

The following table summarizes our outstanding contractual obligations as of July 3, 2016:

	Total	Payments Due by Period			
		Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
		(in thousands)			
Convertible senior notes obligations	\$ 175,000	\$	\$ 175,000	\$	\$
Interest on convertible senior notes obligations	7,122	3,054	4,068		
Operating lease obligations	24,362	5,691	13,121	5,313	237
Purchase obligations	22,095	22,095			
<b>Total contractual obligations</b>	<b>\$ 228,579</b>	<b>\$ 30,840</b>	<b>\$ 192,189</b>	<b>\$ 5,313</b>	<b>\$ 237</b>

Convertible senior notes and interest on convertible senior notes obligations relate to the convertible senior notes issued in November 2013. See Note 5 to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a description of the convertible senior notes.

Operating leases consist of contractual obligations from agreements for non-cancelable office space, net of future minimum lease income. Minimum sublease income from third parties was approximately \$0.4 million and \$0.3 million for the three months ended July 3, 2016 and June 28, 2015. In the event of the failure of a third party to comply with its obligations under the subleases, we remain contractually obligated, as primary lessee, under the lease.

Purchase obligations consist of the minimum purchase commitments made to contract manufacturers.

Included in our gross unrecognized tax benefits balance of \$33.4 million at July 3, 2016 are \$18.4 million of tax positions which would affect income tax expense if recognized. As of July 3, 2016, approximately \$15.0 million of unrecognized tax benefits including \$12.1 million in federal and \$2.9 million in state would be offset by a change in valuation allowance. Due to the high degree of uncertainty regarding the settlement of these liabilities, we are unable to estimate the year in which the future cash flows may occur. As a result, these amounts are not included in the tables above.

**Recent Accounting Pronouncements**

The information set forth under Note 1 Organization and Summary of Significant Accounting Policies of the Notes to Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Quarterly Report, is hereby incorporated by reference herein.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For quantitative and qualitative disclosures about market risk affecting InvenSense, see Quantitative and Qualitative Disclosures About Market Risk in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended April 3, 2016. Our exposure to market risk has not changed materially since April 3, 2016.



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**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were effective.

**Changes in Internal Control**

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Inherent Limitations of Internal Controls**

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information required by this Item 1 of Part II is set forth under Note 4 Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Quarterly Report, and is hereby incorporated by reference herein.

**ITEM 1A. RISK FACTORS**

Our operations and financial results are subject to various risks and uncertainties, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock. The risks facing our business have not changed materially from those discussed in our Annual Report on Form 10-K for the fiscal year ended April 3, 2016.

**ITEM 6. EXHIBITS**

The information required by this Item 6 of Part II is set forth in the Exhibit Index immediately following the signature page of this Quarterly Report, and is hereby incorporated by reference herein.

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**SIGNATURES**

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

Dated: August 3, 2016

INVENSENSE, INC.

By: /s/ Mark P. Dentinger  
Mark P. Dentinger  
Chief Financial Officer (Principal Financial Officer  
and Accounting Officer)



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**INDEX TO EXHIBITS**

**Exhibit**

**Number**

**Description**

31.1	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350.
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of July 3, 2016 and April 3, 2016, (ii) Condensed Consolidated Statements of Operations for the three months ended July 3, 2016 and June 28, 2015 (iii) Condensed Consolidated Statements of Comprehensive loss for three months ended July 3, 2016 and June 28, 2015 (iv) Condensed Consolidated Statements of Cash Flows for the three months ended July 3, 2016 and June 28, 2015, and (v) Notes to Condensed Consolidated Financial Statements.