

MICROCHIP TECHNOLOGY INC

Form 10-Q

November 07, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018.

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: 0-21184

MICROCHIP TECHNOLOGY INCORPORATED

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

86-0629024

(IRS Employer Identification No.)

2355 W. Chandler Blvd., Chandler, AZ 85224-6199

(480) 792-7200

(Address, Including Zip Code, and Telephone Number,

Including Area Code, of Registrant's

Principal Executive Offices)

Indicate by checkmark 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 the filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). (Check One)

Yes ☐ No ☒

Shares Outstanding of Registrant's Common Stock

Class	Outstanding at November 5, 2018
Common Stock, \$0.001 par value	236,509,664 shares

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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## MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except share and per share amounts)

(unaudited)

## Item 1. Financial Statements

	September 30, March 31,	
	2018	2018
<b>ASSETS</b>		
Cash and cash equivalents	\$ 459.7	\$ 901.3
Short-term investments	4.5	1,295.3
Accounts receivable, net	668.8	563.7
Inventories	836.7	476.2
Other current assets	206.5	119.8
Total current assets	2,176.2	3,356.3
Property, plant and equipment, net	1,051.9	767.9
Goodwill	6,787.5	2,299.0
Intangible assets, net	6,825.9	1,662.0
Long-term deferred tax assets	1,715.5	100.2
Other assets	110.1	71.8
Total assets	\$ 18,667.1	\$ 8,257.2
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable	\$ 271.2	\$ 144.1
Accrued liabilities	481.9	229.6
Deferred income on shipments to distributors	—	333.8
Current portion of long-term debt	1,335.0	1,309.9
Total current liabilities	2,088.1	2,017.4
Long-term debt	9,551.1	1,758.4
Long-term income tax payable	777.1	754.9
Long-term deferred tax liability	815.4	205.8
Other long-term liabilities	265.2	240.9
Stockholders' equity:		
Preferred stock, \$0.001 par value; authorized 5,000,000 shares; no shares issued or outstanding	—	—
Common stock, \$0.001 par value; authorized 450,000,000 shares; 253,232,909 shares issued and 236,208,392 shares outstanding at September 30, 2018; 253,232,909 shares issued and 235,027,767 shares outstanding at March 31, 2018	0.2	0.2
Additional paid-in capital	2,652.5	2,562.5
Common stock held in treasury: 17,024,517 shares at September 30, 2018; 18,205,142 shares at March 31, 2018	(625.4	) (662.6 )
Accumulated other comprehensive loss	(16.7	) (17.6 )
Retained earnings	3,159.6	1,397.3
Total stockholders' equity	5,170.2	3,279.8
Total liabilities and stockholders' equity	\$ 18,667.1	\$ 8,257.2
See accompanying notes to condensed consolidated financial statements		

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in millions, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net sales	\$1,432.5	\$1,012.1	\$2,644.9	\$1,984.3
Cost of sales (1)	743.2	398.0	1,313.6	785.8
Gross profit	689.3	614.1	1,331.3	1,198.5
Research and development (1)	221.9	133.6	393.8	264.0
Selling, general and administrative (1)	176.6	114.3	340.7	228.6
Amortization of acquired intangible assets	169.9	120.9	303.6	241.8
Special charges and other, net (1)	18.2	19.9	58.3	17.1
Operating expenses	586.6	388.7	1,096.4	751.5
Operating income	102.7	225.4	234.9	447.0
Losses on equity method investment	(0.1)	) (0.1)	) (0.1)	) (0.1)
Other income (expense):				
Interest income	0.9	4.6	6.6	8.1
Interest expense	(138.6)	) (49.5)	) (229.0)	) (98.9)
Loss on settlement of debt	(4.1)	) —	(4.1)	) (13.8)
Other (loss) income, net	(0.2)	) 5.8	(10.0)	) 10.1
(Loss) income before income taxes	(39.4)	) 186.2	(1.7)	) 352.4
Income tax benefit	(135.7)	) (3.0)	) (133.7)	) (7.3)
Net income	\$96.3	\$189.2	\$132.0	\$359.7
Basic net income per common share	\$0.41	\$0.81	\$0.56	\$1.55
Diluted net income per common share	\$0.38	\$0.77	\$0.52	\$1.48
Dividends declared per common share	\$0.3640	\$0.3620	\$0.7275	\$0.7235
Basic common shares outstanding	235.8	233.3	235.5	231.4
Diluted common shares outstanding	251.8	244.8	252.0	243.8
(1) Includes share-based compensation expense as follows:				
Cost of sales	\$3.9	\$3.7	\$7.5	\$7.1
Research and development	\$19.7	\$10.6	\$33.8	\$20.9
Selling, general and administrative	\$17.8	\$9.3	\$29.5	\$18.0
Special charges and other, net	\$1.2	\$—	\$17.1	\$—

See accompanying notes to condensed consolidated financial statements

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(unaudited)

	Three Months Ended September 30, 2018		Six Months Ended September 30, 2017	
Net income	\$96.3	\$189.2	\$132.0	\$359.7
Components of other comprehensive (loss) income:				
Available-for-sale securities:				
Unrealized holding losses, net of tax effect	—	0.5	(5.6 )	(0.4 )
Reclassification of realized transactions, net of tax effect	—	—	5.6	—
Defined benefit plans:				
Actuarial (losses) gains related to defined benefit pension plans, net of tax benefit (provision)	(0.9 )	0.6	3.5	(3.5 )
Reclassification of realized transactions, net of tax effect	0.2	0.2	0.5	0.4
Change in net foreign currency translation adjustment	(1.1 )	—	(1.4 )	—
Other comprehensive (loss) income, net of tax effect	(1.8 )	1.3	2.6	(3.5 )
Comprehensive income	\$94.5	\$190.5	\$134.6	\$356.2

See accompanying notes to condensed consolidated financial statements

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## MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(unaudited)

	Six Months Ended September 30, 2018      2017	
Cash flows from operating activities:		
Net income	\$ 132.0	\$ 359.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	393.8	304.4
Deferred income taxes	(71.6 )	(46.9 )
Share-based compensation expense related to equity incentive plans	87.9	46.0
Loss on settlement of debt	4.1	13.8
Amortization of debt discount on convertible debt	55.4	52.3
Amortization of debt issuance costs	8.4	3.3
Losses on equity method investments	0.1	0.1
Gains on sale of assets	—	(5.4 )
Impairment of intangible assets	3.1	0.2
Losses on available-for-sale investments, net	6.2	—
Amortization of premium on available-for-sale investments	(0.2 )	0.6
Changes in operating assets and liabilities, excluding impact of acquisitions:		
Decrease (increase) in accounts receivable	65.4	(67.0 )
Decrease (increase) in inventories	261.5	(40.1 )
Increase in deferred income on shipments to distributors	—	31.5
(Decrease) increase in accounts payable and accrued liabilities	(37.8 )	25.9
Change in other assets and liabilities	(25.1 )	(0.7 )
Change in income tax payable	(93.3 )	17.4
Net cash provided by operating activities	789.9	695.1
Cash flows from investing activities:		
Purchases of available-for-sale investments	(167.7 )	(879.4 )
Maturities of available-for-sale investments	75.9	363.0
Sales of available-for-sale investments	1,376.6	—
Acquisition of Microsemi, net of cash acquired	(7,850.6 )	—
Investments in other assets	(8.9 )	(3.8 )
Proceeds from sale of assets	0.1	10.2
Capital expenditures	(161.4 )	(82.0 )
Net cash used in investing activities	(6,736.0 )	(592.0 )
Cash flows from financing activities: <sup>(1)</sup>		
Payments on settlement of convertible debt	—	(15.2 )
Proceeds from Issuance of 2023 and 2021 Senior Notes	1,989.5	—
Proceeds from borrowings on Term Loan Facility	3,000.0	—
Repayments of term loan facility	(267.0 )	—
Proceeds from borrowings on revolving loan under credit facility	3,632.5	113.0
Repayments of revolving loan under credit facility	(532.5 )	(113.0 )
Repayment of debt assumed in Microsemi acquisition	(2,056.9 )	—
Deferred financing costs	(72.7 )	(0.8 )
Payment of cash dividends	(171.4 )	(167.4 )



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Proceeds from sale of common stock	20.3	19.6
Tax payments related to shares withheld for vested restricted stock units	(36.9 )	(21.2 )
Capital lease payments	(0.4 )	(0.4 )
Net cash provided by (used in) financing activities	5,504.5	(185.4 )
Net decrease in cash, cash equivalents, and restricted cash	(441.6 )	(82.3 )
Cash and cash equivalents, and restricted cash at beginning of period <sup>(2)</sup>	901.3	908.7
Cash and cash equivalents, and restricted cash at end of period <sup>(2)</sup>	\$459.7	\$826.4

Schedule of significant non-cash financing activity:

<sup>(1)</sup>During the six months ended September 30, 2017, the Company issued \$111.3 million principal amount of 2017 Junior Convertible Debt and 3.2 million shares of common stock in exchange for \$111.3 million principal amount of 2007 Junior Convertible Debt. Refer to Note 13 Debt and Credit Facility for further discussion.

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(unaudited)

Schedule of restricted cash:

<sup>(2)</sup> In the three months ended June 30, 2018, the Company adopted ASU 2016-18 - Statement of Cash Flows:

Restricted Cash. The following table presents the balance of restricted cash which consists of cash denominated in a foreign currency and restricted in use due to a foreign taxing authority requirement (in millions):

	As of		
	March	March	
	31, September	31, September	
	30, 2017	2018	30, 2018
Restricted cash	\$— \$ 40.2	\$ 42.1	\$ 40.0

See accompanying notes to condensed consolidated financial statements

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## Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Microchip Technology Incorporated and its majority-owned and controlled subsidiaries (the Company). All intercompany balances and transactions have been eliminated in consolidation. All dollar amounts in the financial statements and tables in these notes, except per share amounts, are stated in millions of U.S. dollars unless otherwise noted.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP), pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The information furnished herein reflects all adjustments which are, in the opinion of management, of a normal recurring nature and necessary for a fair statement of the results for the interim periods reported. Certain information and footnote disclosures normally included in audited consolidated financial statements have been condensed or omitted pursuant to such SEC rules and regulations. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2018. As further discussed in Note 3, on May 29, 2018, the Company completed its acquisition of Microsemi Corporation (Microsemi) and the Company's results for the three and six months ended September 30, 2018 include Microsemi's results beginning as of such acquisition date. The results of operations for the six months ended September 30, 2018 are not indicative of the results that may be expected for the fiscal year ending March 31, 2019 or for any other period.

## Note 2. Recently Issued Accounting Pronouncements

## Recently Adopted Accounting Pronouncements

On April 1, 2018, the Company adopted ASU 2014-09-Revenue from Contracts with Customers (Topic 606) and all related amendments ("New Revenue Standard") using the modified retrospective method. The Company has applied the new revenue standard to all contracts that were entered into after adoption and to all contracts that were open as of the initial date of adoption. The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company expects the adoption of the new standard to impact its net sales on an ongoing basis depending on the relative amount of revenue sold through its distributors, the change in inventory held by its distributors, and the changes in price concessions granted to its distributors. Previously, the Company deferred revenue and cost of sales on shipments to distributors until the distributor sold the product to their end customer. As required by the new revenue standard, the Company no longer defers revenue and cost of sales, but rather, estimates the effects of returns and allowances provided to distributors and records revenue at the time of sale to the distributor. Sales to non-distributor customers, under both the previous and new revenue standards, are generally recognized upon the Company's shipment of the product. The cumulative effect of the changes made to our condensed consolidated April 1, 2018 balance sheet for the adoption of the new revenue standard is summarized in the table of opening balance sheet adjustments below. In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on our condensed consolidated income statement and balance sheet for the period ended September 30, 2018 was as follows (in millions):

Income Statement	For the three months ended		
	September 30, 2018		
	As reported	Balances without	Effect of Change

		adoption of New Revenue Standard	Higher / (Lower)
Net Sales	\$1,432.5	\$1,437.6	\$ (5.1 )
Cost of Sales	\$743.2	\$747.6	\$ (4.4 )
Gross Profit	\$689.3	\$690.0	\$ (0.7 )
Income tax provision (benefit)	\$(135.7 )	\$(133.0 )	\$ (2.7 )
Net Income	\$96.3	\$94.3	\$ 2.0

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For the six months ended September 30, 2018			
Income Statement	As reported	Balances without adoption of New Revenue Standard	Effect of Change Higher / (Lower)
Net Sales	\$2,644.9	\$2,647.5	\$ (2.6 )
Cost of Sales	\$1,313.6	\$1,319.2	\$ (5.6 )
Gross Profit	\$1,331.3	\$1,328.3	\$ 3.0
Income tax provision (benefit)	\$(133.7 )	\$(133.3 )	\$ (0.4 )
Net Income	\$132.0	\$128.6	\$ 3.4

  

As of September 30, 2018				
Balance Sheet	As reported	Balances without adoption of New Revenue Standard	Effect of Change Higher / (Lower)	
ASSETS				
Accounts receivable, net		\$668.8	\$706.3	\$(37.5 )
Inventories		\$836.7	\$841.8	\$(5.1 )
Other current assets		\$206.5	\$188.1	\$18.4
Long-term deferred tax assets		\$1,715.5	\$1,739.3	\$(23.8 )
LIABILITIES				
Accrued liabilities		\$481.9	\$458.6	\$23.3
Deferred income on shipments to distributors		\$—	\$332.4	\$(332.4)
Long-term deferred tax liability		\$815.4	\$798.6	\$16.8
STOCKHOLDERS' EQUITY				
Retained Earnings		\$3,159.6	\$2,915.3	\$244.3

The significant changes in our financial statements noted in the table above are primarily due to the transition from sell-through revenue recognition to sell-in revenue recognition as required by the New Revenue Standard, which eliminated the balance of deferred income on shipments to distributors, significantly reduced accounts receivable, and significantly increased retained earnings.

During the three months ended June 30, 2018, the Company adopted ASU 2016-01-Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This standard requires available-for-sale equity investments to be measured at fair value with changes in fair value recognized in net income. The adoption of this standard did not have a material impact on the Company's financial statements.

During the three months ended June 30, 2018, the Company adopted ASU 2016-16-Intra-Entity Transfers of Assets Other Than Inventory. This standard addresses the recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset other than inventory. This standard has been applied on a modified retrospective basis

through a cumulative-effect adjustment directly to retained earnings. The adoption of this standard resulted in a cumulative-effect increase in the Company's deferred tax assets of approximately \$1.58 billion, a decrease to the Company's deferred tax liabilities of \$1.1 million, a decrease to other assets of \$24.1 million, and a decrease of \$1.7 million to other long-term liabilities.

During the three months ended June 30, 2018, the Company adopted ASU 2016-18-Statement of Cash Flows: Restricted Cash. This standard requires that the statement of cash flows explain the change during the period in total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The standard has been applied using a retrospective transition method to each period presented. The adoption of this standard did not have a material impact on the Company's financial statements.

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The following table summarizes the opening balance sheet adjustments related to the adoption of the New Revenue Standard, ASU 2016-01-Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, and ASU 2016-16-Intra-Entity Transfers of Assets Other Than Inventory (in millions):

	Balance as of March 31, 2018	Adjustments from ASC Topic 606	ASU 2016-01	ASU 2016-16	Balance as of April 1, 2018
<b>ASSETS</b>					
Accounts receivable, net	\$563.7	\$(45.6 )	\$ —	\$ —	\$518.1
Inventories	\$476.2	\$(5.1 )	\$ —	\$ —	\$471.1
Other current assets	\$119.8	\$17.2	\$ —	\$ —	\$137.0
Long-term deferred tax assets	\$100.2	\$(23.1 )	\$ —	\$1,579.4	\$1,656.5
Other assets	\$71.8	\$ —	\$ —	\$(24.1 )	\$47.7
<b>LIABILITIES</b>					
Accrued liabilities	\$229.6	\$18.5	\$ —	\$ —	\$248.1
Deferred income on shipments to distributors	\$333.8	\$(333.8)	\$ —	\$ —	\$ —
Long-term deferred tax liability	\$205.8	\$16.8	\$ —	\$(1.1 )	\$221.5
Other long-term liabilities	\$240.9	\$ —	\$ —	\$(1.7 )	\$239.2
<b>STOCKHOLDERS' EQUITY</b>					
Accumulated other comprehensive loss	\$(17.6 )	\$ —	\$(1.7 )	\$ —	\$(19.3 )
Retained earnings	\$1,397.3	\$241.9	\$ 1.7	\$1,558.1	\$3,199.0

**Recently Issued Accounting Pronouncements Not Yet Adopted**

In August 2017, the FASB issued ASU 2017-12-Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The update expands an entity's ability to apply hedge accounting for non-financial and financial risk components and allows for a simplified approach for fair value hedging of interest rate risk. The update eliminates the need to separately measure and report hedge ineffectiveness and generally requires the entire change in fair value of a hedging instrument to be presented in the same income statement line as the hedged item. Additionally, the update simplifies the hedge documentation and effectiveness assessment requirements under the previous guidance. The effective date of this standard is for fiscal years beginning after December 15, 2018 and early adoption is permitted. Adoption will be applied through a cumulative-effect adjustment for cash flow and net investment hedges existing at the date of adoption and prospectively for presentation and disclosure. The Company is currently evaluating the impact the adoption of this standard will have on its condensed consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04-Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The amendment is effective for annual periods and interim periods within those annual periods beginning after December 15, 2019, and early adoption is permitted. The Company does not expect this standard to have an impact on its condensed consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13-Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments. This standard requires entities to use a current lifetime expected credit loss methodology to measure impairments of certain financial assets. Using this methodology will result in earlier recognition of losses than under the current incurred loss approach, which requires waiting to recognize a loss until it is probable of having been incurred. The amendments in ASU 2016-13 broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually and can include forecasted information. There are other provisions within the standard affecting how impairments of other financial assets may be recorded and presented, as well as expanded disclosures. ASU 2016-13 is effective for interim and annual periods beginning after December 15, 2019, and



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permits early adoption, but not before December 15, 2018. The standard is to be applied using a modified retrospective approach. The Company is currently evaluating the impact the adoption of this standard will have on its condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02-Leases. This standard requires lessees to recognize a lease liability and a right-of-use asset on the balance sheet and aligns many of the underlying principles of the new lessor model with those in Accounting Standards Codification Topic 606, Revenue from Contracts with Customers. ASU 2016-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, with early adoption permitted. The standard is to be applied using the modified retrospective approach to all periods presented. The Company is currently evaluating the impact the adoption of this standard will have on its condensed consolidated financial statements.

### Note 3. Business Acquisitions

#### Acquisition of Microsemi

On May 29, 2018, the Company completed its acquisition of Microsemi Corporation, a publicly traded company headquartered in Aliso Viejo, California. The Company paid an aggregate of approximately \$8.19 billion in cash to the stockholders of Microsemi. The total consideration transferred in the acquisition, including approximately \$53.9 million of non-cash consideration for the exchange of certain share-based payment awards of Microsemi for stock awards of the Company, was approximately \$8.24 billion. In addition to the consideration transferred, the Company recognized in its consolidated financial statements \$3.15 billion in liabilities of Microsemi consisting of debt, taxes payable and deferred, restructuring, and contingent and other liabilities of which \$2.06 billion of existing debt was paid off. The Company financed the purchase price using approximately \$8.10 billion of borrowings consisting of \$3.10 billion under its amended and restated revolving line of credit (the "Credit Facility"), \$3.0 billion under the term loan feature of the Credit Facility ("Term Loan Facility"), and \$2.0 billion in newly issued senior secured notes. The Company incurred \$22.0 million in acquisition costs related to the acquisition. As a result of the acquisition, Microsemi became a wholly owned subsidiary of the Company. Microsemi offers a comprehensive portfolio of semiconductor and system solutions for aerospace and defense, communications, data center and industrial markets. The Company's primary reason for this acquisition was to expand the Company's range of solutions, products and capabilities by extending its served available market.

The acquisition was accounted for under the acquisition method of accounting, with the Company identified as the acquirer, and the operating results of Microsemi have been included in the Company's consolidated financial statements as of the closing date of the acquisition. Under the acquisition method of accounting, the aggregate amount of consideration paid by the Company was allocated to Microsemi's net tangible assets and intangible assets based on their estimated fair values as of May 29, 2018. The excess of the purchase price over the value of the net tangible assets and intangible assets was recorded to goodwill. The factors contributing to the recognition of goodwill were based upon the Company's conclusion that there are strategic and synergistic benefits that are expected to be realized from the acquisition. The goodwill has been allocated to the Company's semiconductor products reporting segment. None of the goodwill related to the Microsemi acquisition is deductible for tax purposes. The Company has retained independent third-party appraisers to assist management in its ongoing valuation of the acquired assets and liabilities. The purchase price allocation has not been finalized and is based on estimates and assumptions that are subject to change related to the valuation of inventory, intangible assets, taxes and other assets and liabilities. This could result in adjustments to the fair values of the assets acquired and liabilities assumed, the useful lives of intangible assets, the residual amount allocated to goodwill and deferred income taxes recognized. The preliminary allocation of the purchase price is based on the best estimates of management and is subject to revision based on the final valuation and estimates of useful lives. The purchase price allocation is preliminary and could change materially during the measurement period.



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The table below represents the preliminary allocation of the purchase price to the net assets acquired based on their estimated fair values, as well as the associated estimated useful lives of the acquired intangible assets (in millions).

	Previously reported June 30, 2018	Adjustments	September 30, 2018
Assets acquired			
Cash and cash equivalents	\$ 340.0	\$ —	\$ 340.0
Accounts receivable	216.1	—	216.1
Inventories	716.8	(91.8 )	625.0
Prepaid expenses and other current assets	66.6	—	66.6
Property, plant and equipment	241.2	(39.3 )	201.9
Goodwill	4,974.2	(485.7 )	4,488.5
Purchased intangible assets	4,722.0	744.9	5,466.9
Long-term deferred tax assets	19.2	(13.2 )	6.0
Other assets	101.2	(44.0 )	57.2
Total assets acquired	11,397.3	70.9	11,468.2
Liabilities assumed			
Accounts payable	(226.9 )	—	(226.9 )
Other current liabilities	(174.8 )	—	(174.8 )
Long-term debt	(2,056.9 )	—	(2,056.9 )
Deferred tax liabilities	(545.7 )	(71.5 )	(617.2 )
Long-term income tax payable	(101.6 )	—	(101.6 )
Other long-term liabilities	(46.3 )	—	(46.3 )
Total liabilities assumed	(3,152.2 )	(71.5 )	(3,223.7 )
Purchase price allocated	\$ 8,245.1	\$ (0.6 )	\$ 8,244.5

Purchased Intangible Assets	Weighted Average Useful Life (in years)	May 29, 2018 (in millions)
Core and developed technology	15	\$ 4,312.1
In-process research and development	—	794.2
Customer-related	12	326.9
Backlog	1	27.9
Other	4	5.8
Total purchased intangible assets		\$ 5,466.9

Purchased intangible assets include core and developed technology, in-process research and development, customer-related intangibles and acquisition-date backlog.

The estimated fair values of the core and developed technology and in-process research and development are being determined based on the present value of the expected cash flows to be generated by the respective existing technology or future technology. The core and developed technology intangible assets are being amortized in a manner based on the expected cash flows used in the initial determination of fair value.

In-process research and development is capitalized until such time as the related projects are completed or abandoned at which time the capitalized amounts will begin to be amortized or written off.



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Customer-related intangible assets consist of Microsemi's contractual relationships and customer loyalty related to its distributor and end-customer relationships. The fair values of the customer-related intangibles are being determined based on expected attrition and revenue growth for Microsemi's existing customers as of the acquisition date.

Customer relationships are being amortized in a manner based on the estimated cash flows associated with the existing customers and anticipated retention rates.

Backlog relates to the value of orders not yet shipped by Microsemi at the acquisition date, and the fair values are being determined based on the estimated profit associated with those orders. Backlog related assets had a one year useful life and are being amortized on a straight-line basis over that period.

The total weighted average amortization period of intangible assets acquired as a result of the Microsemi transaction is 9 years. Amortization expense associated with acquired intangible assets is not deductible for tax purposes. Thus, approximately \$851.4 million was established as a net deferred tax liability for the future amortization of the intangible assets.

The amount of Microsemi net sales included in the Company's condensed consolidated statements of income for the three and six months ended September 30, 2018 was approximately \$431.7 million and \$620.2 million, respectively. The amount of Microsemi net loss included in the Company's condensed consolidated statements of income for the three and six months ended September 30, 2018, was approximately \$216.4 million and \$250.4 million, respectively.

The following unaudited pro-forma consolidated results of operations for the three and six months ended September 30, 2018 and 2017 assume the closing of the Microsemi acquisition occurred as of April 1, 2017. The pro-forma adjustments are mainly comprised of acquired inventory fair value costs and amortization of purchased intangible assets. The pro-forma results of operations are presented for informational purposes only and are not indicative of the results of operations that would have been achieved if the acquisition had taken place on April 1, 2017 or of results that may occur in the future (in millions except per share data):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
Net sales	\$1,432.5	\$1,487.4	\$2,859.3	\$2,917.6
Net income (loss)	\$210.0	\$(30.1)	\$318.1	\$(303.7)
Basic net income (loss) per common share	\$0.89	\$(0.13)	\$1.35	\$(1.31)
Diluted net income (loss) per common share	\$0.83	\$(0.13)	\$1.26	\$(1.31)

## Note 4. Segment Information

The Company's reportable segments are semiconductor products and technology licensing. The Company does not allocate operating expenses, interest income, interest expense, other income or expense, or provision for or benefit from income taxes to these segments for internal reporting purposes, as the Company does not believe that allocating these expenses is beneficial in evaluating segment performance. Additionally, the Company does not allocate assets to segments for internal reporting purposes as it does not manage its segments by such metrics.

The following table represents net sales and gross profit for each segment for the three and six months ended September 30, 2018 (in millions):

Three Months Ended September 30, 2018	Six Months Ended September 30, 2018
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	Net Sales	Gross Profit	Net Sales	Gross Profit
Semiconductor products	\$1,394.3	\$651.1	\$2,580.0	\$1,266.4
Technology licensing	38.2	38.2	64.9	64.9
Total	\$1,432.5	\$689.3	\$2,644.9	\$1,331.3

The following table represents net sales and gross profit for each segment for the three and six months ended September 30, 2017 (in millions):

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	Three Months Ended September 30, 2017		Six Months Ended September 30, 2017	
	Net Sales	Gross Profit	Net Sales	Gross Profit
Semiconductor products	\$986.3	\$588.3	\$1,933.5	\$1,147.7
Technology licensing	25.8	25.8	50.8	50.8
Total	\$1,012.1	\$614.1	\$1,984.3	\$1,198.5

## Note 5. Net Sales

The following table represents the Company's net sales by product line (in millions):

	Three Months Ended September 30, 2018	Six Months Ended September 30, 2018
Microcontrollers	\$778.6	\$1,500.9
Analog, interface, mixed signal and timing products	419.2	751.1
Memory products	48.1	98.1
Field-programmable gate array products	70.8	108.7
Technology licensing	38.2	64.9
Multi-market and other	77.6	121.2
Total net sales	\$1,432.5	\$2,644.9

All of the product lines listed above are included in the Company's Semiconductor Product segment with the exception of Technology Licensing, which belongs to the Technology Licensing segment.

The following table represents the Company's net sales by contract type (in millions).

	Three Months Ended September 30, 2018	Six Months Ended September 30, 2018
Distributors	\$712.4	\$1,358.0
Direct customers	681.9	1,222.0
Licensees	38.2	64.9
Total net sales	\$1,432.5	\$2,644.9

Distributors are customers that buy products with the intention of reselling them. Distributors generally have a distributor agreement with the Company to govern the terms of the relationship. Direct customers are non-distributor customers, which generally do not have a master sales agreement with the Company. The Company's direct customers primarily consist of original equipment manufacturers (OEMs) and, to a lesser extent, contract manufacturers. Licensees are customers of our Technology Licensing segment, which include purchasers of our intellectual property and customers that have licensing agreements to use the Company's SuperFlash® embedded flash and Smartbits® one time programmable NVM technologies. All of the contract types listed in the table above are included in the

Company's Semiconductor Product segment with the exception of Licensees, which belong to the Technology Licensing segment.

Substantially all of the Company's net sales is recognized from contracts with customers, and therefore, subject to the new revenue recognition standard.

#### Semiconductor Product Segment

For contracts related to the purchase of semiconductor products, the Company satisfies its performance obligation when control of the ordered product transfers to the customer. The timing of the transfer of control depends on the agreed upon shipping terms with the customer, but generally occurs upon shipment, which is when physical possession of the product has been transferred and legal title of the product transfers to the customer. Payment is generally due within 30 days of the ship date. Payment is generally collected after the Company satisfies its performance obligation, therefore contract liabilities are



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uncommon. Also, the Company usually does not record contract assets because the Company has an unconditional right to payment upon satisfaction of the performance obligation, and therefore, a receivable is more commonly recorded than a contract asset. Refer to Note 10 for the opening and closing balances of the Company's receivables. As contracts with customers generally have an expected duration of one year or less, the balance of open performance obligations as of period end that will be recognized as revenue subsequent to September 30, 2019 is immaterial.

Generally, there is only a single performance obligation in the Company's contracts with customers for semiconductor products; as such, the entire transaction price is allocated to the single performance obligation and allocation of the transaction price to individual performance obligations is not necessary. The consideration received from customers is fixed, with the exception of consideration from certain distributors. Certain of the Company's distributors are granted price concessions and return rights, which result in variable consideration. The amount of revenue recognized for sales to these certain distributors is adjusted for estimates of the price concessions and return rights that are expected to be claimed. These estimates are based on the recent history of price concessions and stock rotations.

## Technology Licensing Segment

The technology licensing segment includes sales and licensing of the Company's intellectual property. For contracts related to the sale of the Company's intellectual property, the Company satisfies its performance obligation and recognizes revenue when control of the intellectual property transfers to the customer. For contracts related to the licensing of the Company's technology, the Company satisfies its performance obligation and recognizes revenue as usage of the license occurs. The transaction price is fixed by the license agreement. Payment is collected after the Company satisfies its performance obligation, and therefore no contract liabilities are recorded. The Company does not record contract assets due to the fact that the Company has an unconditional right to payment upon satisfaction of the performance obligation, and therefore, the Company recognizes a receivable instead of a contract asset. Refer to Note 10 for the opening and closing balances of the Company's receivables.

## Note 6. Special Charges and Other, Net

The following table summarizes activity included in the "special charges and other, net" caption on the Company's condensed consolidated statements of income (in millions):

	Three Months Ended September 30, 2018		Six Months Ended September 30, 2017	
Restructuring				
Employee separation costs	\$12.1	\$0.3	\$57.2	\$1.4
Gain on sale of assets	—	—	—	(4.4 )
Impairment charges	1.5	—	3.5	0.1
Contract exit costs	4.0	19.6	(3.0 )	20.2
Other	0.6	—	0.6	(0.2 )
Total	\$18.2	\$19.9	\$58.3	\$17.1

The Company continuously evaluates its existing operations in an attempt to identify and realize cost savings opportunities and operational efficiencies. This same approach is applied to businesses that are acquired by the Company and often the operating models of acquired companies are not as efficient as the Company's operating model

which enables the Company to realize significant savings and efficiencies. As a result, following an acquisition, the Company will from time to time incur restructuring expenses; however, the Company is often not able to estimate the timing or amount of such costs in advance of the period in which they occur. The primary reason for this is that the Company regularly reviews and evaluates each position, contract and expense against the Company's strategic objectives, long-term operating targets and other operational priorities. Decisions related to restructuring activities are made on a "rolling basis" during the course of the integration of an acquisition whereby department managers, executives and other leaders work together to evaluate each of these expenses and make recommendations. As a result of this approach, at the time of an acquisition, the Company is not able to estimate the total amount of expected employee separation or exit costs that it will incur in connection with its restructuring activities.

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The Company's restructuring expenses during the three and six months ended September 30, 2018 were related to the Company's most recent business acquisitions, and resulted from workforce, property and other operating expense rationalizations as well as combining product roadmaps and manufacturing operations. These expenses were for employee separation costs and intangible asset impairment charges. The impairment charges in the three and six months ended September 30, 2018 were recognized as a result of writing off intangible assets purchased from Microsemi prior to the close of the acquisition and other intangible assets that were impaired as a result of changes in the combined product roadmaps after the acquisition that affected the use and life of the assets. Additional costs will be incurred in the future as additional synergies or operational efficiencies are identified in connection with the Microsemi transaction and other previous acquisitions.

All of the Company's restructuring activities occurred in its semiconductor products segment. The Company has incurred \$107.1 million in costs since the start of fiscal 2016 in connection with employee separation activities, of which \$12.1 million and \$57.2 million was incurred during the three and six months ended September 30, 2018, respectively, and \$0.3 million and 1.4 million was incurred during the three and six months ended September 30, 2017, respectively. The Company could incur future expenses as additional synergies or operational efficiencies are identified. The Company is not able to estimate future expenses, if any, to be incurred in employee separation costs. The Company has incurred \$42.5 million in costs in connection with contract exit activities since the start of fiscal 2016 which includes expense of \$4.0 million and income of \$3.0 million for the three and six months ended September 30, 2018, respectively, and costs of \$19.6 million and \$20.2 million for the three and six months ended September 30, 2017, respectively. The amounts recognized during the six months ended September 30, 2018 were related to vacated lease liabilities. While the Company expects to incur further acquisition-related contract exit expenses, it is not able to estimate the amount at this time.

In the three months ended September 30, 2017, the Company recognized a \$19.5 million charge for fees associated with transitioning from the public utility provider in Oregon to a lower cost direct access provider. The fee is being paid monthly starting in calendar year 2018 and depends on the amount of actual energy consumed by the Company's wafer fabrication facility in Oregon over the next five years. In connection with the transition to a direct access provider, the Company signed a ten-year supply agreement to purchase monthly amounts of energy that are less than the current average usage and priced on a per mega watt hour published index rate in effect at those future dates.

In the three months ended June 30, 2017, the Company completed the sale of an asset it acquired as part of its acquisition of Micrel for proceeds of \$10.0 million and the gain of \$4.4 million is included in the gain on sale of assets in the above table.

The following is a roll forward of accrued restructuring and other exit charges from April 1, 2018 to September 30, 2018 (in millions):

	Restructuring		Non-Restructuring	
	Employee Separation Costs	Exit Costs	Exit Costs	Total
Balance at April 1, 2018	\$0.8	\$27.3	\$ 19.1	\$47.2
Additions due to Microsemi acquisition	11.4	6.6	—	18.0
Charges/income	40.1	(3.0 )	—	37.1
Payments	(15.5 )	(6.5 )	(1.9 )	(23.9 )
Non-cash - Other	—	0.6	0.4	1.0
Balance at September 30, 2018	\$36.8	\$25.0	\$ 17.6	\$79.4
Current				\$49.2
Non-current				30.2

Total	\$79.4
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The liability for restructuring and other exit costs of \$79.4 million is included in accrued liabilities and other long-term liabilities on the Company's condensed consolidated balance sheet as of September 30, 2018.

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## Note 7. Investments

The Company's investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations, and delivers an appropriate yield in relationship to the Company's investment guidelines and market conditions. The following is a summary of available-for-sale debt securities at September 30, 2018 (in millions):

Available-for-sale Debt Securities			
Adjusted	Gross	Gross	Estimated
Cost	Unrealized	Unrealized	Fair
	Gains	Losses	Value
Time deposits	\$ 2.2	—	\$ 2.2

At September 30, 2018, short-term investments of \$4.5 million included available-for-sale debt securities of \$2.2 million and marketable equity securities of \$2.3 million.

The following is a summary of available-for-sale debt securities at March 31, 2018 (in millions):

Available-for-sale Debt Securities			
Adjusted	Gross	Gross	Estimated
Cost	Unrealized	Unrealized	Fair
	Gains	Losses	Value
Available-for-sale debt securities:			
Government agency bonds	\$723.2	\$ —	\$723.2
Municipal bonds - taxable	14.9	—	14.9
Time deposits	11.5	—	11.5
Corporate bonds and debt	542.9	—	542.9
Total	\$1,292.5	\$ —	\$1,292.5

At March 31, 2018, short-term investments of \$1.30 billion included available-for-sale debt securities of \$1.29 billion and marketable equity securities of \$2.8 million.

The Company sold available-for-sale debt securities for proceeds of \$1.38 billion during the six months ended September 30, 2018 to help finance the acquisition of Microsemi. The Company had no sales of available-for-sale debt securities during the six months ended September 30, 2017. During the six months ended September 30, 2018, the Company recognized a loss of \$5.6 million on available-for-sale debt securities. During fiscal 2018, the Company recognized an impairment of \$15.5 million on available-for-sale debt securities based on its evaluation of available evidence and the Company's intent to sell these investments which were subsequently sold in the first quarter of fiscal 2019. The Company determines the cost of available-for-sale debt securities sold on a first-in first-out (FIFO) basis at the individual security level for sales from multiple lots. For sales of marketable equity securities, the Company uses an average cost basis at the individual security level. Gains and losses recognized in earnings are credited or charged to other income (expense) on the consolidated statements of income.

As of September 30, 2018 and March 31, 2018, the Company had no available-for-sale debt securities in an unrealized loss position.

The amortized cost and estimated fair value of the available-for-sale debt securities at September 30, 2018, by contractual maturity are shown below (in millions). Expected maturities can differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale debt securities as available for current operations.

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	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale debt securities				
Due in one year or less	\$ 2.2	\$	—\$	—\$ 2.2

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## Note 8. Fair Value Measurements

Accounting rules for fair value clarify that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. 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. As a basis for considering such assumptions, the Company utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1- Observable inputs such as quoted prices in active markets;

Level 2- Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3- Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

## Marketable Debt Instruments

Marketable debt instruments include instruments such as corporate bonds and debt, government agency bonds, bank deposits, municipal bonds, and money market mutual funds. When the Company uses observable market prices for identical securities that are traded in less active markets, the Company classifies its marketable debt instruments as Level 2. When observable market prices for identical securities are not available, the Company prices its marketable debt instruments using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments; or pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data. Non-binding market consensus prices are based on the proprietary valuation models of pricing providers or brokers. These valuation models incorporate a number of inputs, including non-binding and binding broker quotes; observable market prices for identical or similar securities; and the internal assumptions of pricing providers or brokers that use observable market inputs and, to a lesser degree, unobservable market inputs. The Company corroborates non-binding market consensus prices with observable market data using statistical models when observable market data exists. The discounted cash flow model uses observable market inputs, such as LIBOR-based yield curves, currency spot and forward rates, and credit ratings.

## Assets Measured at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis at September 30, 2018 are as follows (in millions):

	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total Balance
Assets			
Cash and cash equivalents:			
Money market mutual funds	\$ 12.8	\$ —	\$ 12.8
Deposit accounts	—	446.9	446.9
Short-term investments:			
Marketable equity securities	2.3	—	2.3
Time deposits	—	2.2	2.2
Total assets measured at fair value	\$ 15.1	\$ 449.1	\$ 464.2





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Assets measured at fair value on a recurring basis at March 31, 2018 are as follows (in millions):

	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total Balance
Assets			
Cash and cash equivalents:			
Money market mutual funds	\$ 121.0	\$ —	\$121.0
Deposit accounts	—	641.6	641.6
Commercial Paper	—	118.7	118.7
Government agency bonds	—	20.0	20.0
Short-term investments:			
Marketable equity securities	2.8	—	2.8
Corporate bonds and debt	—	542.9	542.9
Time deposits	—	11.5	11.5
Government agency bonds	—	723.2	723.2
Municipal bonds - taxable	—	14.9	14.9
Total assets measured at fair value	\$ 123.8	\$ 2,072.8	\$2,196.6

There were no transfers between Level 1 and Level 2 during the three and six months ended September 30, 2018 or the fiscal year ended March 31, 2018. There were no assets measured on a recurring basis using significant unobservable inputs (Level 3).

#### Assets and Liabilities Measured and Recorded at Fair Value on a Non-Recurring Basis

The Company's non-marketable equity, cost method investments, certain acquired liabilities and non-financial assets, such as intangible assets, assets held for sale and property, plant and equipment, are recorded at fair value on a non-recurring basis. These assets are subject to fair value adjustments in certain circumstances, for example, when there is evidence of impairment.

The Company's non-marketable and cost method investments are monitored on a quarterly basis for impairment charges. The fair values of these investments have been determined as Level 3 fair value measurements because the valuations use unobservable inputs that require management's judgment due to the absence of quoted market prices. There were no impairment charges recognized on these investments during each of the three and six-month periods ended September 30, 2018 and September 30, 2017. These investments are included in other assets on the condensed consolidated balance sheets.

The fair value measurements related to the Company's non-financial assets, such as intangible assets, assets held for sale and property, plant and equipment are based on available market prices at the measurement date based on transactions of similar assets and third-party independent appraisals, less costs to sell where appropriate. The Company classifies these measurements as Level 2.

#### Note 9. Fair Value of Financial Instruments

The carrying amount of cash equivalents approximates fair value because their maturity is less than three months. Management believes the carrying amount of the equity and cost-method investments materially approximated fair value at September 30, 2018 based upon unobservable inputs. The fair values of these investments have been determined as Level 3 fair value measurements. The fair values of the Company's line of credit borrowings are estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements and approximate carrying value excluding debt issuance costs. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of the Company's line of credit borrowings at September 30, 2018 approximated the carrying value and are considered Level 2 in the fair value hierarchy described in Note

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8. The carrying amount of accounts receivable, accounts payable and accrued liabilities approximates fair value due to the short-term maturity of the amounts and are considered Level 2 in the fair value hierarchy.

#### Fair Value of Subordinated Convertible Debt, Senior Secured Notes, and Term Loan Facility

The Company measures the fair value of its senior and junior subordinated convertible debt and senior secured notes for disclosure purposes. These fair values are based on observable market prices for this debt, which is traded in less active markets and are therefore classified as a Level 2 fair value measurement.

The following table shows the carrying amounts and fair values of the Company's senior and junior subordinated convertible debt, senior secured notes, and term loan facility as of September 30, 2018 and March 31, 2018 (in millions).

	September 30, 2018		March 31, 2018	
	Carrying Amount (1)	Fair Value	Carrying Amount (1)	Fair Value
2023 Senior Secured Notes	\$983.7	\$987.5	\$—	\$—
2021 Senior Secured Notes	\$984.5	\$994.0	\$—	\$—
Term Loan Facility	\$2,703.0	\$2,733.0	\$—	\$—
2017 Senior Convertible Debt	\$1,465.2	\$2,201.3	\$1,437.6	\$2,459.2
2015 Senior Convertible Debt	\$1,335.0	\$2,615.5	\$1,309.9	\$3,079.1
2017 Junior Convertible Debt	\$331.2	\$724.8	\$326.7	\$876.9

(1) The carrying amounts presented are net of debt discounts and debt issuance costs (see Note 13. Debt and Credit Facility for further information).

#### Note 10. Other Financial Statement Details

##### Accounts Receivable

Accounts receivable consists of the following (in millions):

	September 30, March 31, 2018 2018	
Trade accounts receivable	\$ 664.6	\$ 557.8
Other	6.3	8.1
Total accounts receivable, gross	670.9	565.9
Less allowance for doubtful accounts	2.1	2.2
Total accounts receivable, net	\$ 668.8	\$ 563.7

##### Inventories

The components of inventories consist of the following (in millions):

	September 30, March 31, 2018 2018	
Raw materials	\$ 80.6	\$ 26.0

Work in process	455.6	311.8
Finished goods	300.5	138.4
Total inventories \$	836.7	\$ 476.2

Inventories are valued at the lower of cost and net realizable value using the first-in, first-out method. Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable. The inventory balance at September 30, 2018 includes \$120.1 million acquired inventory fair value mark-up resulting from the acquisition of Microsemi.

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## Property, Plant and Equipment

Property, plant and equipment consists of the following (in millions):

	September 30, March 31,	
	2018	2018
Land	\$ 82.3	\$ 73.4
Building and building improvements	623.1	508.5
Machinery and equipment	2,176.9	1,943.9
Projects in process	127.6	118.3
Total property, plant and equipment, gross	3,009.9	2,644.1
Less accumulated depreciation and amortization	1,958.0	1,876.2
Total property, plant and equipment, net	\$ 1,051.9	\$ 767.9

Depreciation expense attributed to property, plant and equipment was \$47.2 million and \$85.2 million for the three and six months ended September 30, 2018, respectively, compared to \$29.9 million and \$58.9 million for the three and six months ended September 30, 2017, respectively.

## Note 11. Intangible Assets and Goodwill

Intangible assets consist of the following (in millions):

	September 30, 2018		
	Gross Amount	Accumulated Amortization	Net Amount
Core and developed technology	\$6,266.4	\$ (844.9)	) \$5,421.5
Customer-related	1,043.9	(464.0)	) 579.9
Backlog	27.9	(11.2)	) 16.7
In-process research and development	801.9	—	801.9
Distribution rights	0.4	(0.2)	) 0.2
Other	7.2	(1.5)	) 5.7
Total	\$8,147.7	\$ (1,321.8)	) \$6,825.9

	March 31, 2018		
	Gross Amount	Accumulated Amortization	Net Amount
Core and developed technology	\$1,952.3	\$ (644.4)	) \$1,307.9
Customer-related	716.9	(375.9)	) 341.0
In-process research and development	12.1	—	12.1
Distribution rights	0.3	(0.1)	) 0.2
Other	1.5	(0.7)	) 0.8
Total	\$2,683.1	\$ (1,021.1)	) \$1,662.0

The Company amortizes intangible assets over their expected useful lives, which range between 1 and 15 years. During the six months ended September 30, 2018, due to the acquisition of Microsemi, the Company acquired \$4.31 billion of core and developed technology which has a weighted average amortization period of 15 years, \$326.9 million of customer-related intangible assets which have a weighted average amortization period of 12 years, \$27.9 million of intangible assets related to backlog with an amortization period of 1 year, and \$794.2 million of in-process

technology which will begin amortization once the technology reaches technological feasibility. In the six months ended September 30, 2018, \$4.4 million of in-process research and development intangible assets reached technological feasibility and was reclassified as core and developed technology and began being amortized over the respective estimated useful lives. The following is an expected amortizati

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on schedule for the intangible assets for the remainder of fiscal 2019 through fiscal 2023, absent any future acquisitions or impairment charges (in millions):

## Fiscal Year Ending Projected Amortization

March 31,	Expense
2019	\$393.9
2020	\$991.9
2021	\$926.6
2022	\$852.0
2023	\$660.4

Amortization expense attributed to intangible assets was \$173.8 million and \$308.6 million for the three and six months ended September 30, 2018, respectively. Amortization expense attributed to intangible assets was \$122.7 million and \$245.5 million for the three and six months ended September 30, 2017, respectively. In the three and six months ended September 30, 2018, approximately \$2.1 million and \$3.1 million of amortization expense, respectively, was charged to cost of sales, and approximately \$171.7 million and \$305.5 million, respectively, was charged to operating expenses. In the three and six months ended September 30, 2017, approximately \$1.9 million and \$3.9 million of amortization expense, respectively, was charged to cost of sales, and approximately \$120.8 million and \$241.6 million, respectively, was charged to operating expenses. The Company recognized \$1.2 million and \$3.1 million of intangible asset impairment charges in the three and six months ended September 30, 2018, respectively. The impairment charges in the three and six months ended September 30, 2018 were recognized as a result of writing off intangible assets purchased from Microsemi prior to the close of the acquisition and as a result of changes in the combined product roadmaps after the acquisition that affected the use and life of these assets. The Company recognized an immaterial amount of intangible asset impairment charges in the three and six months ended September 30, 2017.

Goodwill activity for the three and six months ended September 30, 2018 was as follows (in millions):

	Semiconductor Products Reporting Unit	Technology Licensing Reporting Unit
Balance at March 31, 2018	\$ 2,279.8	\$ 19.2
Additions due to the acquisition of Microsemi	4,488.5	—
Balance at September 30, 2018	\$ 6,768.3	\$ 19.2

At March 31, 2018, the Company applied a qualitative goodwill impairment test to its two reporting units, concluding it was not more likely than not that goodwill was impaired. Through September 30, 2018, the Company has never recorded an impairment charge against its goodwill balance.

## Note 12. Income Taxes

The provision for income taxes reflects tax on foreign earnings and federal and state tax on U.S. earnings. The Company's effective tax rate for the six months ended September 30, 2018 was not meaningful due to the amount of pre-tax income and the tax benefits recorded during the period. The Company had a negative effective tax rate of 2.1% for the six months ended September 30, 2017.

The Company's effective tax rate for the six months ended September 30, 2018 is higher compared to the prior year primarily due to a worldwide pre-tax loss combined with discrete benefits related to releases of uncertain tax positions

due to lapses of statutes of limitations, successful closure of tax examinations, discrete adjustments to deferred tax assets related to intellectual property, offset by the impact of the new Global Intangible Low-Taxed Income (“GILTI”) tax in the United States. The Company's effective tax rate is different than statutory rates in the U.S. due to one-time discrete tax benefits related to changes in U.S. and foreign tax laws, changes in uncertain tax benefit positions, and favorable adjustments from revaluing deferred tax assets related to intellectual property. In addition, the Company has numerous tax holidays it receives related to its Thailand manufacturing operations based on its investment in property, plant and equipment in Thailand, as well as Microsemi's tax holiday in Malaysia that effectively reduces its Malaysia net income tax rate to zero in that jurisdiction. The Company's tax holiday periods in Thailand expire at various times in the future, however, the Company actively seeks to obtain new tax holidays. The Company does not expect the future expiration of any of its tax holiday periods in Thailand to have a material impact on its effective tax rate. Microsemi's tax holiday in Malaysia was granted in 2009 and is effective through



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December 2019, subject to continued compliance with the tax holiday's requirements. The material components of foreign income taxed at a rate lower than the U.S. are earnings accrued in Thailand, Malta and Ireland.

The Company files U.S. federal, U.S. state, and foreign income tax returns. For U.S. federal, and in general for U.S. state tax returns, the fiscal 2005 and later tax years remain effectively open for examination by tax authorities. For foreign tax returns, the Company is generally no longer subject to income tax examinations for years prior to fiscal 2007.

The Company recognizes liabilities for anticipated tax audit issues in the U.S. and other domestic and international tax jurisdictions based on its estimate of whether, and the extent to which, additional tax payments are more likely than not. The Company believes that it has appropriate support for the income tax positions taken and to be taken on its tax returns and that its accruals for tax liabilities are adequate for all open years based on an assessment of many factors including past experience and interpretations of tax laws applied to the facts of each matter.

The Company believes it maintains appropriate reserves to offset any potential income tax liabilities that may arise upon final resolution of matters for open tax years. If such reserve amounts ultimately prove to be unnecessary, the resulting reversal of such reserves could result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

The following tables summarize the activity related to the Company's gross unrecognized tax benefits for the six months ended September 30, 2018 and the year ended March 31, 2018 (in millions):

	Six Months Ended September 30, 2018
Balance at March 31, 2018	\$ 436.0
Increases related to acquisitions	284.0
Decreases related to settlements with tax authorities	—
Decreases related to statute of limitation expirations	(11.3 )
Increases related to current year tax positions	23.2
Decreases related to prior year tax positions	(50.1 )
Balance at September 30, 2018	\$ 681.8
	Year Ended March 31, 2018
Balance at March 31, 2017	\$398.5
Increases related to acquisitions	—
Decreases related to settlements with tax authorities	(0.1 )
Decreases related to statute of limitation expirations	(10.9 )
Increases related to current year tax positions	30.3
Increases related to prior year tax positions	18.2
Balance at March 31, 2018	\$436.0

As of September 30, 2018, the Company had accrued approximately \$38.9 million related to the potential payment of interest on the Company's uncertain tax positions. The current year increase to the potential payment of interest is primarily composed of a \$23.2 million increase related to acquisitions. As of March 31, 2018, the Company had accrued approximately \$12.9 million related to the potential payment of interest on the Company's uncertain tax positions. As of September 30, 2018, the Company had accrued for \$56.5 million of penalties related to its uncertain tax positions. The current year increase to the potential payment of penalties is primarily composed of a \$15.8 million increase related to acquisitions. As of March 31, 2018, the Company had accrued for approximately \$67.9 million of penalties related to its uncertain tax positions.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Act") was enacted into law. The Act provides for numerous significant tax law changes and modifications including the reduction of the U.S. federal corporate income tax rate from 35.0% to 21.0%, the requirement for companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and the creation of new taxes on certain foreign-sourced earnings.

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Accounting Standards Codification ("ASC") 740, Income Taxes, requires companies to recognize the effect of the tax law changes in the period of enactment. However, the SEC staff issued Staff Accounting Bulletin ("SAB") 118 which allows companies to record provisional amounts during a measurement period that is similar to the measurement period used when accounting for business combinations. The Company recorded a reasonable estimate when measurable and with the understanding that the provisional amount is subject to further adjustments under SAB 118. In addition, for significant items for which the Company could not make a reasonable estimate, no provisional amounts were recorded. Amounts will be recorded during the measurement period allowed under SAB 118 when a reasonable estimate can be made, or when the effect of the Act is known. As of March 31, 2018, the Company made a reasonable estimate of the effects on the one-time transition tax, its existing deferred tax balances and the release of its valuation allowances on foreign tax credits due to the Act, and the Company recognized a provisional amount of income tax expense of \$471.6 million, which decreased diluted net income per common share by \$1.89 for the fiscal year ended March 31, 2018 and which was included as a component of income tax provision from continuing operations. As of September 30, 2018, the Company made adjustments to the provisional estimates of its uncertain tax positions recorded on the financial statements for the fiscal year ended March 31, 2018. The Company will continue to refine the provisional balances and adjustments that may be made under SAB 118 during the measurement period as a result of future changes in interpretation, information available, assumptions made by the Company and/or issuance of additional guidance and these adjustments could be material.

The Company has not yet completed its calculation of the total post-1986 E&P for its foreign subsidiaries. The one-time transition tax is based in part on the amount of those earnings held in cash and other specified assets either as of the end of fiscal 2018 or the average of the year-end balances for fiscal 2016 and fiscal 2017. The Company's calculation of this amount will change with further analysis and guidance from the U.S. federal and state tax authorities about the application of these new rules. The Company will continue to evaluate the impact of the tax law change as it relates to the accounting for the outside basis difference of its foreign entities.

On July 24, 2018, the Ninth Circuit Court of Appeals issued an opinion in *Altera Corp. v. Commissioner* requiring related parties in an intercompany cost-sharing arrangement to share expenses related to share-based compensation.

This opinion reversed the prior decision of the United States Tax Court. On August 7, 2018, the decision on July 24, 2018 was withdrawn. We will continue to monitor the case and will quantify the potential impact as more information is available.

Note 13. Debt and Credit Facility

Debt obligations included in the condensed consolidated balance sheets consisted of the following (in millions):

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	Coupon Interest Rate	Effective Interest Rate	Fair Value of Liability Component at Issuance <sup>(1)</sup>	September 30, 2018	March 31, 2018
Senior Secured Indebtedness					
Revolving Credit Facility				\$3,100.0	\$—
Term Loan Facility				2,733.0	—
2023 Notes, maturing June 1, 2023 ("2023 Notes")	4.333%			1,000.0	—
2021 Notes, maturing June 1, 2021 ("2021 Notes")	3.922%			1,000.0	—
Total Senior Secured Indebtedness				7,833.0	—
Senior Subordinated Convertible Debt - Principal Outstanding					
2017 Senior Debt, maturing February 15, 2027 (2017 Senior Convertible Debt)	1.625%	6.0%	\$1,396.3	\$2,070.0	\$2,070.0
2015 Senior Debt, maturing February 15, 2025 (2015 Senior Convertible Debt)	1.625%	5.9%	\$1,160.1	1,725.0	1,725.0
Junior Subordinated Convertible Debt - Principal Outstanding					
2017 Junior Debt, maturing February 15, 2037 (2017 Junior Convertible Debt)	2.250%	7.4%	\$321.1	686.3	686.3
Total Convertible Debt				4,481.3	4,481.3
Gross long-term debt including current maturities				12,314.3	4,481.3
Less: Debt discount <sup>(2)</sup>				(1,327.0 )	(1,372.9 )
Less: Debt issuance costs <sup>(3)</sup>				(101.2 )	(40.1 )
Net long-term debt including current maturities				10,886.1	3,068.3
Less: Current maturities <sup>(4)</sup>				(1,335.0 )	(1,309.9 )
Net long-term debt				\$9,551.1	\$1,758.4

<sup>(1)</sup> As each of the convertible instruments may be settled in cash upon conversion, for accounting purposes, they were bifurcated into a liability component and an equity component, which are both initially recorded at fair value. The amount allocated to the equity component is the difference between the principal value of the instrument and the fair value of the liability component at issuance. The resulting debt discount is being amortized to interest expense at the respective effective interest rate over the contractual term of the debt.

<sup>(2)</sup> The unamortized discount includes the following (in millions):

	September 30, 2018	March 31, 2018
2023 Senior Secured Notes	\$(4.9 )	\$—
2021 Senior Secured Notes	(4.7 )	—
2017 Senior Convertible Debt	(589.4 )	(616.3 )
2015 Senior Convertible Debt	(376.2 )	(400.3 )
2017 Junior Convertible Debt	(351.8 )	(356.3 )

Total unamortized discount    \$(1,327.0) \$(1,372.9)

<sup>(3)</sup> Debt issuance costs include the following (in millions):

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	September 30, 2018	March 31, 2018
Senior Credit Facility	\$ (16.5 )	\$ (5.9 )
Term Loan Facility	(30.0 )	—
2023 Senior Secured Notes	(11.4 )	—
2021 Senior Secured Notes	(10.8 )	—
2017 Senior Convertible Debt	(15.4 )	(16.1 )
2015 Senior Convertible Debt	(13.8 )	(14.8 )
2017 Junior Convertible Debt	(3.3 )	(3.3 )
Total debt issuance costs	\$ (101.2 )	\$ (40.1 )

<sup>(4)</sup> Current maturities include the full balance of the 2015 Senior Convertible Debt.

Expected maturities relating to the Company's long-term debt (including current maturities) as of September 30, 2018 are as follows (in millions):

Fiscal year ending March 31,	Expected Maturities
2019	\$—
2020	—
2021	—
2022	1,000.0
2023	—
Thereafter	11,314.3
Total	\$ 12,314.3

Ranking of Convertible Debt - The Senior Subordinated Convertible Debt and Junior Subordinated Convertible Debt (collectively, the Convertible Debt) are unsecured obligations which are subordinated in right of payment to the amounts outstanding under the Company's Credit Facility and Senior Secured Notes (as defined below). The Junior Subordinated Convertible Debt is expressly subordinated in right of payment to any existing and future senior debt of the Company (including the Credit Facility, the Senior Secured Notes, and the Senior Subordinated Convertible Debt) and is structurally subordinated in right of payment to the liabilities of the Company's subsidiaries. The Senior Subordinated Convertible Debt is subordinated to the Credit Facility and the Senior Secured Notes; ranks senior to the Company's indebtedness that is expressly subordinated in right of payment to it, including the Junior Subordinated Convertible Debt; ranks equal in right of payment to any of the Company's unsubordinated indebtedness that does not provide that it is senior to the Senior Subordinated Convertible Debt; ranks junior in right of payment to any of the Company's secured, unsubordinated indebtedness to the extent of the value of the assets securing such indebtedness; and is structurally subordinated to all indebtedness and other liabilities of the Company's subsidiaries.

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Summary of Conversion Features - Each series of Convertible Debt is convertible, subject to certain conditions, into cash, shares of the Company's common stock or a combination thereof, at the Company's election, at specified Conversion Rates (see table below), adjusted for certain events including the declaration of cash dividends. Except during the three-month period immediately preceding the maturity date of the applicable series of Convertible Debt, each series of Convertible Debt is convertible only upon the occurrence of (1) such time as the closing price of the Company's common stock exceeds the Conversion Price (see table below) by 130% for 20 days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter or (2) during the 5 business day period after any 10 consecutive trading day period, or the measurement period, in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day or (3) upon the occurrence of certain corporate events specified in the indenture of such series of Convertible Debt. In addition, for each series, if at the time of conversion the applicable price of the Company's common stock exceeds the applicable Conversion Price at such time, the applicable Conversion Rate will be increased by up to an additional maximum incremental shares rate, as determined pursuant to a formula specified in the indenture for the applicable series of Convertible Debt, and as adjusted for cash dividends paid since the issuance of such series of Convertible Debt. However, in no event will the applicable Conversion Rate exceed the applicable Maximum Conversion Rate specified in the indenture for the applicable series of Convertible Debt (see table below). The following table sets forth the applicable Conversion Rates adjusted for dividends declared since issuance of such series of Convertible Debt and the applicable Incremental Share Factors and Maximum Conversion Rates as adjusted for dividends paid since the applicable issuance date:

Dividend adjusted rates as of September 30,  
2018

Conversion Rate, adjusted	Approximate Conversion Price, adjusted	Incremental Share Factor, adjusted	Maximum Conversion Rate, adjusted
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2017 Senior Convertible Debt	10.2005	\$ 98.03	5.1002	14.5357
2015 Senior Convertible Debt	15.9069	\$ 62.87	7.9535	22.2697
2017 Junior Convertible Debt	10.3827	\$ 96.31	5.1914	14.5357

As of September 30, 2018, the holders of the 2015 Senior Convertible Debt have the right to convert their debentures between October 1, 2018 and December 31, 2018 because the Company's common stock price has exceeded the Conversion Price by 130% for the specified period of time during the quarter ended September 30, 2018. As of September 30, 2018, the 2015 Senior Convertible Debt is convertible and had a value if converted above par of \$660.3 million. The 2015 Senior Convertible Debt is included in the current portion of long-term debt.

The Company may not redeem any series of Convertible Debt prior to the relevant maturity date and no sinking fund is provided for any series of Convertible Debt. Upon the occurrence of a fundamental change as defined in the applicable indenture of such series of Convertible Debt, holders of such series may require the Company to purchase all or a portion of their Convertible Debt for cash at a price equal to 100% of the principal amount plus any accrued and unpaid interest.

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Interest expense related to long-term debt includes the following (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
Interest expense on convertible debt				
Debt issuance amortization	\$0.9	\$0.9	\$1.8	\$1.8
Amortization of debt discount - non cash interest expense	27.9	26.3	55.4	52.3
Coupon interest expense	19.3	19.4	38.6	38.8
Total interest expense on convertible debt	48.1	46.6	95.8	92.9
Interest expense on Term Loan Facility and Senior Secured Notes				
Debt issuance amortization	3.6	—	4.9	—
Interest expense	51.7	—	70.0	—
Total interest expense on Term Loan Facility and Senior Secured Notes	55.3	—	74.9	—
Total interest expense on convertible debt, Term Loan Facility, and Senior Secured Notes	\$103.4	\$46.6	\$170.7	\$92.9

The remaining period over which the unamortized debt discount will be recognized as non-cash interest expense is 8.38 years, 6.38 years, and 18.38 years for the 2017 Senior Convertible Debt, 2015 Senior Convertible Debt, and 2017 Junior Convertible Debt, respectively.

In November 2017, the Company called for redemption \$14.6 million in principal value of the remaining outstanding 2007 Junior Convertible Debt with an effective redemption date of December 15, 2017 for which substantially all holders submitted requests to convert. Prior to the call, conversion requests were received in both the second and third quarters of fiscal 2018. Total conversions for fiscal 2018 were for a principal amount of \$32.5 million for which the Company settled the principal amount in cash and issued 0.5 million shares of its common stock in respect of the conversion value in excess of the principal amount for the conversions occurring prior to the redemption notice and \$41.0 million in cash for the conversion value in excess of the principal amount for the conversion requests received after the notice of redemption. A loss on total conversions was recorded for \$2.2 million.

In June 2017, the Company exchanged in privately negotiated transactions \$111.3 million aggregate principal amount of its 2007 Junior Convertible Debt for (i) \$111.3 million principal amount of 2017 Junior Convertible Debt with a market value of \$119.3 million plus (ii) the issuance of 3.2 million shares of the Company's common stock with a value of \$254.6 million, of which \$56.3 million was allocated to the fair value of the liability and \$321.1 million was allocated to the reacquisition of the equity component for total consideration of \$374.0 million. The transaction resulted in a loss on settlement of the 2007 Junior Convertible Debt of approximately \$13.8 million, which represented the difference between the fair value of the liability component at time of repurchase and the sum of the carrying values of the debt component and any unamortized debt issuance costs. The debt discount on the new 2017 Junior Convertible Debt was the difference between the par value and the fair value of the debt resulting in a debt discount of \$55.1 million which will be amortized to interest expense using the effective interest method over the term of the debt.

In February 2017, the Company issued the 2017 Senior Convertible Debt and 2017 Junior Convertible Debt for net proceeds of \$2.04 billion and \$567.7 million, respectively. In connection with the issuance of these instruments, the Company incurred issuance costs of \$33.7 million, of which \$17.8 million and \$3.4 million was recorded as two convertible debt issuance costs related to the 2017 Senior Convertible Debt and 2017 Junior Convertible Debt, respectively, and will be amortized using the effective interest method over the term of the debt. The balance of \$12.5



million in fees was recorded to equity. Interest on both instruments is payable semi-annually on February 15 and August 15 of each year.

In February 2015, the Company issued the 2015 Senior Convertible Debt for net proceeds of approximately \$1.69 billion. In connection with the issuance, the Company incurred issuance costs of \$30.3 million, of which \$20.4 million was recorded as debt issuance costs and will be amortized using the effective interest method over the term of the debt. The balance of \$9.9 million was recorded to equity.

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The Company utilized the proceeds from the issuances of the 2017 Senior Convertible Debt, 2017 Junior Convertible Debt, and 2015 Senior Convertible Debt to reduce amounts borrowed under its Credit Facility and to settle a portion of the 2007 Junior Convertible Debt in privately negotiated transactions. In February 2017 and February 2015, the Company settled \$431.3 million and \$575.0 million, respectively, in aggregate principal of its 2007 Junior Convertible Debt. The 2015 repurchase consisted solely of cash. In February 2017, the Company used cash of \$431.3 million and an aggregate of 12.0 million in shares of the Company's common stock valued at \$862.7 million for total consideration of \$1,293.9 million to repurchase \$431.3 million of the 2007 Junior Convertible Debt, of which \$188.0 million was allocated to the liability component and \$1,105.9 million was allocated to the equity component. In addition, in February 2017, there was an inducement fee of \$5.0 million which was recorded in the consolidated statements of income in loss on settlement of convertible debt. The consideration transferred in February 2015 was \$1,134.6 million, of which \$238.3 million was allocated to the liability component and \$896.3 million was allocated to the equity component. In the case of both settlements of the 2007 Junior Convertible Debt, the consideration was allocated to the liability and equity components using the equivalent rate that reflected the borrowing rate for a similar non-convertible debt prior to the retirement. The transactions resulted in a loss on settlement of convertible debt of approximately \$43.9 million and \$50.6 million in fiscal 2017 and fiscal 2015, respectively, which represented, in each case, the difference between the fair value of the liability component at time of repurchase and the sum of the carrying values of the debt component and any unamortized debt issuance costs.

## Senior Secured Notes

Issuances and Settlements of Senior Secured Notes - In May 2018, the Company issued \$1.00 billion aggregate principal amount of 3.922% Senior Secured Notes due 2021 (the "2021 Notes") and \$1.00 billion aggregate principal amount of 4.333% Senior Secured Notes due 2023 (the "2023 Notes", and together with the 2021 Notes, the "Senior Secured Notes") to qualified institutional buyers in a Rule 144A offering. In connection with the issuance of these instruments, the Company incurred issuance costs of \$24.4 million and recorded a debt discount of \$10.5 million for fees deducted from the proceeds, which will both be amortized using the effective interest method over the term of the debt. The 2021 Notes mature on June 1, 2021 and the 2023 Notes mature on June 1, 2023. Interest on the 2021 Notes accrues at a rate of 3.922% per annum, payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2018. Interest on the 2023 Notes accrues at a rate of 4.333% per annum, payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2018.

The Company may, at its option, redeem some or all of the 2021 Notes prior to June 1, 2021 at a price equal to the greater of (a) 100% of the principal amount of the 2021 Notes redeemed or (b) the sum of the present value of all remaining scheduled payments of principal and interest (discounted in accordance with the indenture for the 2021 Notes) that would have been due on the redeemed 2021 Notes, in each case, plus accrued and unpaid interest to, but excluding, the redemption date. The Company may, at its option, redeem some or all of the 2023 Notes, (i) if prior to May 1, 2023 (one month prior to the maturity date of the 2023 Notes), at a price equal to the greater of (a) 100% of the principal amount of the 2023 Notes redeemed or (b) the sum of the present value of all remaining scheduled payments of principal and interest (discounted in accordance with the indenture for the 2023 Notes) that would have been due on the redeemed 2023 Notes, in each case, plus accrued and unpaid interest to, but excluding, the redemption date, and (ii) if on or after May 1, 2023 (one month prior to maturity of the 2023 Notes), at a redemption price equal to 100% of the principal amount of the notes redeemed, plus accrued and unpaid interest to, but excluding, the redemption date.

If the Company experiences a specified change of control triggering event, the Company must offer to repurchase the Notes at a price equal to 101% of the principal amount of the Notes repurchased, plus accrued and unpaid interest, if any, to, but excluding, the repurchase date.

The Notes are guaranteed by certain of the Company's subsidiaries (each such guarantee, a "Note Guarantee") that have also guaranteed the obligations under the Company's Credit Facility and under the Term Loan Facility (the Term Loan Facility together with the Credit Facility, the "Senior Credit Facilities") that was entered into in connection with the Microsemi Merger.

The Notes and the Note Guarantees are secured, on a pari passu first lien basis with the Senior Credit Facilities, by substantially all of the tangible and intangible assets (other than certain excluded assets) of the Company and the guarantors that secure obligations under the Senior Credit Facilities, in each case subject to certain thresholds, exceptions and permitted liens, as set forth in the indenture for the Senior Secured Notes and the Security Agreement, dated May 29, 2018, by and among the Company, the subsidiary guarantors party thereto and the Collateral Agent (the "Security Agreement").

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### Credit Facility

In May 2018, the Company amended and restated the Credit Facility to, among other things, increase the size of the Revolving Loan Facility (as defined below) thereunder to \$3.84 billion from \$3.12 billion at March 31, 2018. In connection with the amendment and restatement of the Credit Facility, the Company incurred issuance costs of \$13.6 million which will be amortized using the effective interest method over the term of the debt. In the three months ended September 30, 2018, the Company terminated the commitments for the 2020 Revolving Loans which decreased the capacity of the Revolving Loan Facility to \$3.60 billion.

The Credit Facility provides for a revolving loan facility (the "Revolving Loan Facility") in an aggregate principal amount of approximately \$3.60 billion, with a \$250.0 million foreign currency sublimit, a \$50.0 million letter of credit sublimit and a \$25.0 million swingline loan sublimit. The Credit Facility consists of approximately \$3.60 billion of revolving loan commitments that terminate on May 18, 2023 (the "2023 Maturity Date"). The \$244.3 million of revolving loan commitments (the "2020 Revolving Loans") that would terminate on February 4, 2020 were canceled in the three months ended September 30, 2018. The Revolving Loans bear interest, at the Company's option, at the base rate plus a spread of 0.00% to 1.00% or an adjusted LIBOR rate (based on one, two, three or six-month interest periods) plus a spread of 1.00% to 2.00%, in each case with such spread being determined based on the consolidated senior leverage ratio for the preceding four fiscal quarter period.

The Credit Facility permits the Company to add one or more incremental term loan facilities (in addition to the Term Loans) and/or increase the commitments under the Revolving Loan Facility from time to time, subject, in each case, to the receipt of additional commitments from existing and/or new lenders and pro forma compliance with a consolidated senior leverage ratio set forth in the Credit Facility.

The Company's obligations under the Credit Facility are guaranteed by certain of its subsidiaries meeting materiality thresholds set forth in the Credit Facility. To secure the Company's obligations under the Credit Facility and the subsidiary guarantors' obligations under the guarantees, the Company and each of the subsidiary guarantors has granted a security interest in substantially all its assets, subject to certain exceptions and limitations.

In May 2018, the Company borrowed \$3.0 billion aggregate principal amount of loans under the Term Loan Facility ("Term Loans"). In connection with such borrowings, the Company incurred issuance costs of \$34.7 million which will be amortized using the effective interest method over the term of the debt. The Credit Facility provides for quarterly amortization payments of the Term Loans on the last business day of each March, June, September and December, commencing with the last business day of the first full fiscal quarter to occur after the Merger effective date, equal to 0.25% of the aggregate original principal amount of the Term Loans. In addition, the Credit Facility requires mandatory prepayments of the Term Loans from the incurrence of debt not otherwise permitted to be incurred under the Credit Facility, certain asset sales and certain excess cash flow. Mandatory prepayments with excess cash flow (as defined in the Credit Facility) are required to be made beginning with the Company's fiscal year ending March 30, 2020 in an amount equal to 50%, 25% or 0% of the excess cash flow for such fiscal year, depending on the Company's senior leverage ratio. The Company may prepay the Term Loans at any time without premium or penalty. Term Loans repaid or prepaid may not be reborrowed. The Company voluntarily prepaid \$267.0 million of principal on the Term Loan Facility in the second quarter of fiscal 2019 which effectively paid off all of the quarterly amortizing principal payments mentioned above, in advance. The Company de-recognized \$2.9 million in deferred financing fees in connection with the payoff.

Interest is due and payable in arrears quarterly for loans bearing interest at the base rate and at the end of an interest period (or at each three-month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. Interest expense related to the Credit Facility was approximately

\$34.7 million and \$49.5 million in the three and six months ended September 30, 2018, respectively, compared to \$2.3 million and \$5.0 million for the three and six months ended September 30, 2017, respectively. Principal, together with all accrued and unpaid interest, is due and payable on the 2023 Maturity Date in the case of revolving loans under the credit facility and May 29, 2025 in the case of the term loans. The Company pays a quarterly commitment fee on the available but unused portion of its line of credit which is calculated on the average daily available balance during the period. The Company may prepay the loans and terminate the commitments, in whole or in part, at any time without premium or penalty, subject to certain conditions including minimum amounts in the case of commitment reductions and reimbursement of certain costs in the case of prepayments of LIBOR loans.

The Credit Facility contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries' ability to, among other things, incur subsidiary indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into certain transactions with affiliates, pay dividends or make distributions, repurchase stock, enter into restrictive agreements and enter into sale and leaseback transactions, in each

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case subject to customary exceptions for a credit facility of this size and type. The Company is also required to maintain compliance with a senior leverage ratio, a total leverage ratio and an interest coverage ratio, all measured quarterly and calculated on a consolidated basis. At September 30, 2018, the Company was in compliance with these financial covenants.

The financial covenants include limits on the Company's consolidated total leverage ratio and senior ratio. The maximum Total Leverage Ratio (capitalized terms not otherwise defined in this Form 10-Q have the meaning of the defined terms in the applicable agreements) cannot exceed (a) 6.75 to 1.00 for any such period ended on or after the Microsemi Acquisition Closing Date to (but excluding) the first anniversary of the Microsemi Acquisition Closing Date, (b) 6.25 to 1.00 for any such period ended on or after the first anniversary of the Microsemi Acquisition Closing Date to (but excluding) the second anniversary of the Microsemi Acquisition Closing Date and (c) 5.75 to 1.00 for any such period ended on or after the second anniversary of the Microsemi Acquisition Closing Date. The total leverage ratio is calculated as Consolidated Total Indebtedness, excluding the Junior Convertible Debt up to a \$700 million maximum, to Consolidated EBIDTA for a period of four consecutive quarters. The Credit Facility also requires that the Senior Leverage Ratio not exceed (a) 4.75 to 1.00 for any such period ended from (and including) the Microsemi Acquisition Closing Date to (but excluding) the first anniversary of the Microsemi Acquisition Closing Date, (b) 4.25 to 1.00 for any such period ended on or after the first anniversary of the Microsemi Acquisition Closing Date to (but excluding) the second anniversary of the Microsemi Acquisition Closing Date and (c) 3.75 to 1.00 for any such period ended on or after the second anniversary of the Microsemi Acquisition Closing Date. The senior leverage ratio is calculated as Consolidated Senior Indebtedness to Consolidated EBIDTA for four consecutive quarters. The Company is also required to comply with a Minimum Interest Coverage Ratio of at least 3.25 to 1.00 for any period ended on or after the Microsemi Acquisition Closing Date, measured quarterly.

The Credit Facility includes customary events of default that include, among other things, non-payment defaults, inaccuracy of representations and warranties, covenant defaults, cross default to material indebtedness, bankruptcy and insolvency defaults, material judgment defaults, ERISA defaults and a change of control default. The occurrence of an event of default could result in the acceleration of the obligations under the Credit Facility. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Credit Facility at a per annum rate equal to 2.00% above the applicable interest rate for any overdue principal and 2.00% above the rate applicable for base rate loans for any other overdue amounts.

### Note 14. Pension Plans

The Company has defined benefit pension plans that cover certain French and German employees. Most of these acquired defined pension plans are unfunded; however, one of the pension plans in Germany is insured and the Company has pledged the insurance contracts to the pensioners. Accordingly, the contracts are now considered to be a plan asset. As the plan assets are insurance contracts, the Company does not control the investment strategy and thus cannot influence the return on investments. The insurance payments are guaranteed by the insurer and should the insurer default on its obligation, the security fund for insurance companies in Germany would assume the contracts. Plan benefits are provided in accordance with local statutory requirements. Benefits are based on years of service and employee compensation levels. Pension liabilities and charges are based upon various assumptions, updated annually, including discount rates, future salary increases, employee turnover, and mortality rates. The Company's French pension plan provides for termination benefits paid to covered French employees only at retirement, and consists of approximately one to five months of salary. The Company's German pension plan provides for defined benefit payouts for covered German employees following retirement.

The aggregate net pension expense relating to these plans is as follows (in millions):

	Three Months Ended September 30, 2018		Six Months Ended September 30, 2017	
Service costs	\$0.4	\$0.4	\$0.8	\$0.8
Interest costs	0.2	0.2	0.5	0.4
Amortization of actuarial loss	0.2	0.2	0.5	0.4
Net pension period cost	\$0.8	\$0.8	\$1.8	\$1.6

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Interest costs and amortization of actuarial losses are recorded in the other income, net line item in the statements of income. The Company's net periodic pension cost for fiscal 2019 is expected to be approximately \$3.2 million. Cash funding for benefits paid was \$0.2 million and \$0.4 million for the three and six months ended September 30, 2018, respectively, and \$0.2 million and \$0.3 million, respectively, for the three and six months ended September 30, 2017. The Company expects total contributions to these plans to be approximately \$1.1 million in fiscal 2019.

### Note 15. Contingencies

In the ordinary course of the Company's business, it is exposed to various liabilities as a result of contracts, product liability, customer claims and other matters. Additionally, the Company is involved in a limited number of legal actions, both as plaintiff and defendant. Consequently, the Company could incur uninsured liability in any of those actions. The Company also periodically receives notifications from various third parties alleging infringement of patents or other intellectual property rights, or from customers requesting reimbursement for various costs. With respect to pending legal actions to which the Company is a party and other claims, although the outcomes are generally not determinable, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on its financial position, cash flows or results of operations. Litigation and disputes relating to the semiconductor industry are not uncommon, and the Company is, from time to time, subject to such litigation and disputes. As a result, no assurances can be given with respect to the extent or outcome of any such litigation or disputes in the future.

As a result of its acquisition of Atmel, which closed on April 4, 2016, the Company became involved with the following legal matters:

**Continental Claim ICC Arbitration.** On December 29, 2016, Continental Automotive GmbH ("Continental") filed a Request for Arbitration with the ICC, naming as respondents the Company's subsidiaries Atmel Corporation, Atmel SARL, Atmel Global Sales Ltd., and Atmel Automotive GmbH (collectively, "Atmel"). The Request alleges that a quality issue affecting Continental airbag control units in certain recalled vehicles stems from allegedly defective Atmel application specific integrated circuits ("ASICs"). Continental seeks to recover from Atmel all related costs and damages incurred as a result of the vehicle manufacturers' airbag control unit-related recalls, currently alleged to be \$227.7 million. The Company's Atmel subsidiaries intend to defend this action vigorously.

**Individual Labor Actions by former LFR Employees.** In June 2010, Atmel Rousset sold its wafer manufacturing business in Rousset, France to LFoundry GmbH ("LF"), the German parent of LFoundry Rousset ("LFR"). LFR then leased the Atmel Rousset facility to conduct the manufacture of wafers. More than three years later, LFR became insolvent and later liquidated. In the wake of LFR's insolvency and liquidation, over 500 former employees of LFR have filed individual labor actions against Atmel Rousset in a French labor court. The Company's Atmel Rousset subsidiary believes that each of these actions is entirely devoid of merit, and, further, that any assertion by any of the Claimants of a co-employment relationship with the Atmel Rousset subsidiary is based substantially on the same specious arguments that the Paris Commercial Court summarily rejected in 2014 in related proceedings. The Company's Atmel Rousset subsidiary therefore intends to defend vigorously against each of these claims.

Additionally, complaints have been filed in a regional court in France on behalf of the same group of employees against Microchip Technology Rousset, Atmel Switzerland Sarl, Atmel Corporation and Microchip Technology Incorporated alleging that the sale of the Atmel Rousset production unit to LF was fraudulent and should be voided. These claims are specious and the defendant entities therefore intend to defend vigorously against these claims. In connection with its acquisition of Microsemi, which closed on May 29, 2018, the Company became involved with the following legal matters:

**Federal Shareholder Class Action Litigation.** Beginning on September 14, 2018, we and certain of our officers were named in two putative shareholder class action lawsuits filed in the United States District Court for the District of Arizona, captioned Jackson v. Microchip Technology Inc., et al., Case No. 2:18-cv-02914-JJT and Maknissian v.



Microchip Technology Inc., et al., Case No. 2:18-cv-02924-JJT. The Jackson complaint is allegedly brought on behalf of a putative class of purchasers of Microchip common stock between March 2, 2018 and August 9, 2018, and the Maknissian complaint is allegedly brought on behalf of a putative class of purchasers of Microchip securities between May 31, 2018 and August 9, 2018. The complaints assert claims for alleged violations of the federal securities laws and generally allege that the defendants issued materially false and misleading statements and failed to disclose material adverse facts about our business, operations, and prospects during the putative class periods. The complaints seek, among other things, compensatory damages and attorneys' fees and costs on behalf of the putative classes. We anticipate that the two actions will be consolidated. We intend to vigorously defend this litigation.

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Peterson, et al. v. Sanghi, et al. On October 9, 2018, four former officers of Microsemi Corporation filed a lawsuit in the Superior Court of California in Orange County against us and four of our officers asserting claims for slander per se, libel per se, trade libel, and violations of California Business and Professions Code Section 17200. The complaint seeks unspecified compensatory and punitive damages and attorneys' fees and costs. We intend to vigorously defend this litigation.

The Company accrues for claims and contingencies when losses become probable and reasonably estimable. As of the end of each applicable reporting period, the Company reviews each of its matters and, where it is probable that a liability has been or will be incurred, the Company accrues for all probable and reasonably estimable losses. Where the Company can reasonably estimate a range of losses it may incur regarding such a matter, the Company records an accrual for the amount within the range that constitutes its best estimate. If the Company can reasonably estimate a range but no amount within the range appears to be a better estimate than any other, the Company uses the amount that is the low end of such range. As of September 30, 2018, the Company's estimate of the aggregate potential liability that is possible but not probable is approximately \$100 million in excess of amounts accrued.

The Company's technology license agreements generally include an indemnification clause that indemnifies the licensee against liability and damages (including legal defense costs) arising from any claims of patent, copyright, trademark or trade secret infringement by the Company's proprietary technology. The terms of these indemnification provisions approximate the terms of the outgoing technology license agreements, which are typically perpetual unless terminated by either party for breach. The possible amount of future payments the Company could be required to make based on agreements that specify indemnification limits, if such indemnifications were required on all of these agreements, is approximately \$163.7 million. There are some licensing agreements in place that do not specify indemnification limits. As of September 30, 2018, the Company had not recorded any liabilities related to these indemnification obligations and the Company believes that any amounts that it may be required to pay under these agreements in the future will not have a material adverse effect on its financial position, cash flows or results of operations.

### Note 16. Derivative Instruments

#### Freestanding Derivative Forward Contracts

The Company has international operations and is thus subject to foreign currency rate fluctuations. Approximately 99% of the Company's sales are U.S. Dollar denominated. However, a significant amount of the Company's expenses and liabilities are denominated in foreign currencies and subject to foreign currency rate fluctuations. To help manage the risk of changes in foreign currency rates, the Company periodically enters into derivative contracts comprised of foreign currency forward contracts to hedge its asset and liability foreign currency exposure and a portion of its foreign currency operating expenses. Foreign exchange rate fluctuations after the effects of hedging activity resulted in an immaterial amount and a net loss of \$4.4 million for the three and six months ended September 30, 2018, respectively, compared to net gains of \$5.0 million and \$9.6 million for the three and six months ended September 30, 2017, respectively. As of September 30, 2018 and March 31, 2018, the Company had no foreign currency forward contracts outstanding. The Company recognized an immaterial amount of net losses and gains on foreign currency forward contracts in each of the three and six months ended September 30, 2018 and 2017. Gains and losses from changes in the fair value of these foreign currency forward contracts and foreign currency exchange rate fluctuations are credited or charged to other income (expense). The Company does not apply hedge accounting to its foreign currency derivative instruments.

#### Commodity Price Risk

The Company is exposed to fluctuations in prices for energy that it consumes, particularly electricity and natural gas. The Company also enters into variable-priced contracts for some purchases of electricity and natural gas, on an index basis. The Company seeks, or may seek, to partially mitigate these exposures through fixed-price contracts. These contracts meet the characteristics of derivative instruments, but generally qualify for the “normal purchases or normal sales” exception under authoritative guidance and require no mark-to-market adjustment.

Note 17. Comprehensive Income (Loss)

The following table presents the changes in the components of accumulated other comprehensive income (loss) (AOCI), net of tax, for the six months ended September 30, 2018 (in millions):

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	Unrealized holding gains (losses) available-for-sale debt securities	Defined benefit pension plans	Foreign Currency	Total
Accumulated other comprehensive income (loss) at March 31, 2018	\$ 1.9	\$(10.1 )	\$(9.4 )	\$(17.6 )
Impact of change in accounting principle	(1.7 )	—	—	(1.7 )
Opening Balance as of April 1, 2018	0.2	(10.1 )	(9.4 )	(19.3 )
Other comprehensive (loss) income before reclassifications	(5.6 )	3.5	(1.4 )	(3.5 )
Amounts reclassified from accumulated other comprehensive loss	5.6	0.5	—	6.1
Net other comprehensive income (loss)	—	4.0	(1.4 )	2.6
Accumulated other comprehensive income (loss) at September 30, 2018	\$ 0.2	\$(6.1 )	\$(10.8 )	\$(16.7 )

The table below details where reclassifications of realized transactions out of AOCI are recorded on the condensed consolidated statements of income (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,		Related Statement of Income Line
Description of AOCI Component	2018	2017	2018	2017	
Unrealized losses on available-for-sale debt securities	\$ —	\$ —	\$ 5.6	\$ —	Other income (loss)
Amortization of actuarial loss	0.2	—	0.5	—	Other income (loss)
Reclassification of realized transactions, net of taxes	\$ 0.2	\$ —	\$ 6.1	\$ —	Net income

## Note 18. Share-Based Compensation

The following table presents the details of the Company's share-based compensation expense (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
Cost of sales <sup>(1)</sup>	\$3.9	\$3.7	\$7.5	\$7.1
Research and development	19.7	10.6	33.8	20.9
Selling, general and administrative	17.8	9.3	29.5	18.0
Special charges and other, net	1.2	—	17.1	—
Pre-tax effect of share-based compensation	42.6	23.6	87.9	46.0
Income tax benefit <sup>(2)</sup>	9.0	7.8	19.1	15.3
Net income effect of share-based compensation	\$33.6	\$15.8	\$68.8	\$30.7

<sup>(1)</sup> During the three and six months ended September 30, 2018, \$4.4 million and \$7.9 million, respectively, of share-based compensation expense was capitalized to inventory and \$3.9 million and \$7.5 million, respectively, of previously capitalized share-based compensation expense in inventory was sold. During the three and six months ended September 30, 2017, \$3.1 million and \$5.8 million, respectively, of share-based compensation expense was capitalized to inventory and \$3.7 million and \$7.1 million of previously capitalized share-based compensation expense

in inventory was sold.

<sup>(2)</sup> Amounts exclude excess tax benefits related to share-based compensation of \$4.0 million and \$9.0 million, respectively, for the three and six months ended September 30, 2018 and \$8.2 million and \$14.1 million, respectively, for the three and six months ended September 30, 2017.

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## Microsemi Acquisition-related Equity Awards

In connection with its acquisition of Microsemi, the Company assumed certain restricted stock units (RSUs), stock appreciation rights (SARs), and stock options granted by Microsemi. The assumed awards were measured at the acquisition date based on the estimated fair value, which was a total of \$175.4 million. A portion of that fair value, \$53.9 million, which represented the pre-acquisition vested service provided by employees to Microsemi, was included in the total consideration transferred as part of the acquisition. As of the acquisition date, the remaining portion of the fair value of those awards was \$121.5 million, representing post-acquisition share-based compensation expense that will be recognized as these employees provide service over the remaining vesting periods. During the six months ended September 30, 2018, the Company recognized \$40.2 million of share-based compensation expense in connection with the acquisition of Microsemi, of which \$1.6 million was capitalized into inventory and \$17.1 million was due to the accelerated vesting of outstanding equity awards upon termination of certain Microsemi employees.

## Note 19. Net Income Per Common Share

The following table sets forth the computation of basic and diluted net income per common share (in millions, except per share amounts):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$ 96.3	\$ 189.2	\$ 132.0	\$ 359.7
Weighted average common shares outstanding	235.8	233.3	235.5	231.4
Dilutive effect of stock options and RSUs	4.3	4.5	4.2	4.4
Dilutive effect of 2007 Junior Convertible Debt	—	0.7	—	2.4
Dilutive effect of 2015 Senior Convertible Debt	11.7	6.3	12.3	5.6
Dilutive effect of 2017 Senior Convertible Debt	—	—	—	—
Dilutive effect of 2017 Junior Convertible Debt	—	—	—	—
Weighted average common and	251.8	244.8	252.0	243.8

potential  
common shares  
outstanding

Basic net					
income per	\$	0.41	\$	0.81	
common share			\$	0.56	
Diluted net				\$	1.55
income per	\$	0.38	\$	0.77	
common share			\$	0.52	
				\$	1.48

The Company computed basic net income per common share using net income and the weighted average number of common shares outstanding during the period. The Company computed diluted net income per common share using net income and the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period.

Potentially dilutive common shares from employee equity incentive plans are determined by applying the treasury stock method to the assumed exercise of outstanding stock options and the assumed vesting of outstanding RSUs. Weighted average common shares exclude the effect of option shares which are not dilutive. There were no anti-dilutive option shares for the three and six months ended September 30, 2018 and 2017.

Diluted net income income per common share for three and six months ended September 30, 2018 includes 11.7 million shares and 12.3 million shares issuable upon the exchange of the Company's 2015 Senior Convertible Debt. There were no shares issuable upon the exchange of the Company's 2017 Junior Convertible Debt or the Company's 2017 Senior Convertible Debt. The Company's 2007 Junior Convertible Debt was fully settled as of December 31, 2017. Diluted net income per common share for the three and six months ended September 30, 2017 included 0.7 million shares and 2.4 million shares issuable upon the exchange of the Company's 2007 Junior Convertible Debt and 6.3 million shares and 5.6 million shares issuable upon the exchange of the Company's 2015 Senior Convertible Debt, respectively (see Note 13 for details on the convertible debt). The convertible debt has no impact on diluted net income per common share unless the average price of the Company's common stock exceeds the conversion price because the principal amount of the debentures will be settled in cash upon conversion. Prior to conversion, the Company will include, in the diluted net income per common share calculation, the effect of the additional shares that may be issued when the Company's common stock price exceeds the conversion price using the treasury stock method. The following is the weighted average conversion price per share used in calculating the dilutive effect (See Note 13 for details on the convertible debt):

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	Three Months Ended September 30, 2018		Six Months Ended September 30, 2017	
2007 Junior Convertible Debt <sup>(1)</sup>	\$—	\$23.58	\$—	\$23.64
2015 Senior Convertible Debt	\$63.02	\$64.06	\$63.14	\$64.21
2017 Senior Convertible Debt	\$98.27	\$99.90	\$98.47	\$100.13
2017 Junior Convertible Debt	\$96.55	\$98.15	\$96.74	\$98.37

<sup>(1)</sup> No longer outstanding as of December 31, 2017.

## Note 20. Stock Repurchase

The Company's Board of Directors previously approved a share repurchase program under which up to 15.0 million shares of common stock may be repurchased in the open market or in privately negotiated transactions. There were no repurchases of common stock during the three and six months ended September 30, 2018. There is no expiration date associated with this repurchase program. As of September 30, 2018, the Company held approximately 17.0 million shares as treasury shares.

## Note 21. Dividends

A quarterly cash dividend of \$0.3640 per share was paid on September 4, 2018 in the aggregate amount of \$85.9 million. A quarterly cash dividend of \$0.3645 per share was declared on November 7, 2018 and will be paid on December 5, 2018 to stockholders of record as of November 21, 2018. The Company expects the December 5, 2018 payment of its quarterly cash dividend to be approximately \$86.3 million.



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

This report, including "Part I – Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II - Item 1A Risk Factors" contains certain forward-looking statements that involve risks and uncertainties, including statements regarding our strategy, financial performance and revenue sources. We use words such as "anticipate," "believe," "plan," "expect," "future," "continue," "intend" and similar expressions to identify forward-looking statements. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth under "Risk Factors," beginning at page 57 and elsewhere in this Form 10-Q. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. We disclaim any obligation to update information contained in any forward-looking statement. These forward-looking statements include, without limitation, statements regarding the following:

- The effects that uncertain global economic conditions and fluctuations in the global credit and equity markets may have on our financial condition and results of operations;
- The effects and amount of competitive pricing pressure on our product lines and modest pricing declines in certain of our more mature proprietary product lines;
- Our ability to moderate future average selling price declines;
- The effect of product mix, capacity utilization, yields, fixed cost absorption, competition and economic conditions on gross margin;
- The amount of, and changes in, demand for our products and those of our customers;
- Our expectation that in the future we will acquire additional businesses that we believe will complement our existing businesses;
- Our expectation that in the future we will enter into joint development agreements or other business or strategic relationships with other companies;
- The level of orders that will be received and shipped within a quarter;
- Our expectation that our December 2018 days of inventory levels will be flat to up 10 days compared to the September 2018 levels. Our belief that our existing level of inventory will allow us to maintain competitive lead times and provide strong delivery performance to our customers;
- The effect that distributor and customer inventory holding patterns will have on us;
- Our belief that customers recognize our products and brand name and use distributors as an effective supply channel;
- Anticipating increased customer requirements to meet voluntary criteria related to the reduction or elimination of substances in our products;
- Our belief that deferred cost of sales are recorded at their approximate carrying value and will have low risk of material impairment;
- Our belief that our direct sales personnel combined with our distributors provide an effective means of reaching our customer base;
- The accuracy of our estimates of the useful life and values of our property, assets and other liabilities;
- Our ability to increase the proprietary portion of our analog and interface product lines and the effect of such an increase;
- Our belief that our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs;
- The impact of any supply disruption we may experience;
- Our ability to effectively utilize our facilities at appropriate capacity levels and anticipated costs;
- That we adjust capacity utilization to respond to actual and anticipated business and industry-related conditions;
- That our existing facilities will provide sufficient capacity to respond to increases in demand with modest incremental capital expenditures;

- That manufacturing costs will be reduced by transition to advanced process technologies;
- Our ability to maintain manufacturing yields;
- Continuing our investments in new and enhanced products;
- The cost effectiveness of using our own assembly and test operations;
- Our anticipated level of capital expenditures;
- Continuation and amount of quarterly cash dividends;
- That our acquisition of Microsemi is expected to expand our range of solutions, products and capabilities by extending our served available market;
- Our reliance on government contracts could have a material adverse effect on results of operations;

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- The sufficiency of our existing sources of liquidity to finance anticipated capital expenditures and otherwise meet our anticipated cash requirements, and the effects that our contractual obligations are expected to have on them;
- The impact of seasonality on our business;
- The accuracy of our estimates used in valuing employee equity awards;
- That the resolution of legal actions will not have a material effect on our business, and the accuracy of our assessment of the probability of loss and range of potential loss;
- The recoverability of our deferred tax assets;
- The adequacy of our tax reserves to offset any potential tax liabilities, having the appropriate support for our income tax positions and the accuracy of our estimated tax rate;
- That we intend to pay the one-time transition tax over a period of eight years;
- Our belief that the expiration of any tax holidays will not have a material impact on our overall tax expense or effective tax rate;
- Our belief that the estimates used in preparing our consolidated financial statements are reasonable;
- Our actions to vigorously and aggressively defend and protect our intellectual property on a worldwide basis;
- Our ability to obtain patents and intellectual property licenses and minimize the effects of litigation;
- The level of risk we are exposed to for product liability claims or indemnification claims;
- The effect of fluctuations in currency rates;
- That a significant portion of our future cash generation will be in our foreign subsidiaries;
- Our intention to satisfy the lesser of the principal amount or the conversion value of our debentures in cash;
- Changes to the taxation of undistributed foreign earnings could change our future intentions regarding reinvestment of such earnings;
- That each of these new tax provisions will have an impact on our tax expense for fiscal 2019 and future periods and the increase in the tax expense for Global Intangible Low-Taxed Income will be the most significant;
- Our intent to maintain a high-quality investment portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield; and
- Our ability to collect accounts receivable.

We begin our Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) with a summary of our overall business strategy to give the reader an overview of the goals of our business and the overall direction of our business and products. This is followed by a discussion of the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. We then discuss our Results of Operations for the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017. We then provide an analysis of changes in our balance sheet and cash flows, and discuss our financial commitments in sections titled "Liquidity and Capital Resources," "Contractual Obligations" and "Off-Balance Sheet Arrangements."

## Strategy

Our goal is to be a worldwide leader in providing specialized semiconductor products for a wide variety of embedded control applications. Our strategic focus is on embedded control solutions, including general purpose and specialized microcontrollers, development tools and related software, analog, interface, mixed signal and timing products, wired and wireless connectivity products, field-programmable gate array (FPGA) products, timing systems, memory products and Flash-IP licensing. We provide highly cost-effective embedded control solutions that also offer the advantages of small size, high performance, extreme low power usage, wide voltage range operation, mixed signal integration and ease of development, thus enabling timely and cost-effective integration of our solutions by our customers in their end products. We license our SuperFlash technology and other technologies to wafer foundries, integrated device manufacturers and design partners throughout the world for use in the manufacture of advanced microcontroller products, gate array, radio frequency (RF) and analog products that require embedded non-volatile

memory.

We sell our products to a broad base of domestic and international customers across a variety of industries. The principal markets that we serve include consumer, automotive, industrial, aerospace, office communication, and computing. Our business is subject to fluctuations based on economic conditions within these markets.

Our manufacturing operations include wafer fabrication, wafer probe and assembly and test. The ownership of a substantial portion of our manufacturing resources is an important component of our business strategy, enabling us to maintain a high level of manufacturing control resulting in us being one of the lowest cost producers in the embedded control industry. By owning wafer fabrication facilities and assembly and test operations, and by employing statistical process control

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techniques, we have been able to achieve and maintain high production yields. Direct control over manufacturing resources allows us to shorten our design and production cycles. This control also allows us to capture a portion of the wafer manufacturing and the assembly and test profit margin. We do outsource a significant portion of our manufacturing requirements to third parties. Our acquisition of Microsemi significantly increased the amount of our outsourced manufacturing requirements.

We employ proprietary design and manufacturing processes in developing our embedded control products. We believe our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs. While many of our competitors develop and optimize separate processes for their logic and memory product lines, we use a common process technology for both microcontroller and non-volatile memory products. This allows us to more fully leverage our process research and development costs and to deliver new products to market more rapidly. Our engineers utilize advanced computer-aided design (CAD) tools and software to perform circuit design, simulation and layout, and our in-house photomask and wafer fabrication facilities enable us to rapidly verify design techniques by processing test wafers quickly and efficiently.

We are committed to continuing our investment in new and enhanced products, including development systems, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. Our current research and development activities focus on the design of new microcontrollers, digital signal controllers, memory, analog and mixed-signal products, FPGA's, timing systems, Flash-IP, development systems, software and application-specific software libraries. We are also developing new design and process technologies to achieve further cost reductions and performance improvements in our products.

We market and sell our products worldwide primarily through a network of direct sales personnel and distributors. Our distributors focus primarily on servicing the product and technical support requirements of a broad base of diverse customers. We believe that our direct sales personnel combined with our distributors provide an effective means of reaching this broad and diverse customer base. Our direct sales force focuses primarily on major strategic accounts in three geographical markets: the Americas, Europe and Asia. We currently maintain sales and support centers in major metropolitan areas in North America, Europe and Asia. We believe that a strong technical service presence is essential to the continued development of the embedded control market. Many of our client engagement managers (CEMs), embedded system engineers (ESEs), and sales management personnel have technical degrees and have been previously employed in an engineering environment. We believe that the technical knowledge of our sales force is a key competitive advantage in the sale of our products. The primary mission of our ESE team is to provide technical assistance to strategic accounts and to conduct periodic training sessions for CEMs and distributor sales teams. ESEs also frequently conduct technical seminars for our customers in major cities around the world, and work closely with our distributors to provide technical assistance and end-user support.

See "Our operating results are impacted by both seasonality and the wide fluctuation of supply and demand in the semiconductor industry," on page 61 for discussion of the impact of seasonality on our business.

### Acquisition of Microsemi

On May 29, 2018, we completed our acquisition of Microsemi Corporation, a publicly traded company headquartered in Aliso Viejo, California. We paid an aggregate of approximately \$8.19 billion in cash to the stockholders of Microsemi. The total consideration transferred in the acquisition, including approximately \$53.9 million of non-cash consideration for the exchange of certain share-based payment awards of Microsemi for stock awards of Microchip, was approximately \$8.24 billion. In addition to the consideration transferred, we recognized in our consolidated financial statements \$3.15 billion in liabilities of Microsemi consisting of debt, taxes payable and deferred, pension obligations, restructuring, and contingent and other liabilities of which \$2.06 billion of existing debt was paid off. We financed the purchase price using approximately \$8.10 billion of borrowings consisting of \$3.10 billion under our

amended and restated revolving line of credit (the "Credit Facility"), \$3.00 billion under the term loan feature of the Credit Facility ("Term Loan Facility"), and \$2.00 billion in newly issued senior secured notes. We incurred \$22.0 million in costs related to the acquisition. As a result of the acquisition, Microsemi became a wholly owned subsidiary of Microchip. Microsemi offers a comprehensive portfolio of semiconductor and system solutions for aerospace and defense, communications, data center and industrial markets. Our primary reason for this acquisition was to expand our range of solutions, products and capabilities by extending our served available market.

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### Critical Accounting Policies and Estimates

#### General

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. We review the accounting policies we use in reporting our financial results on a regular basis. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, business combinations, share-based compensation, inventories, income taxes, senior and junior subordinated convertible debt and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Our results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. We review these estimates and judgments on an ongoing basis. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

#### Revenue Recognition - Distributors (prior to our adoption of ASC 606 on April 1, 2018)

Our distributors worldwide generally had broad price protection and product return rights which prevented the sales pricing from being fixed or determinable at the time of shipment to our distributors. Therefore, revenue recognition was deferred until the pricing uncertainty was resolved, which generally occurred when the distributor sold the product to their customer. At the time of shipment to these distributors, we recorded a trade receivable for the selling price as there was a legally enforceable right to payment, relieved inventory for the carrying value of goods shipped since legal title had passed to the distributor, and recorded the gross margin in deferred income on shipments to distributors on our condensed consolidated balance sheets.

Deferred income on shipments to distributors effectively represented the gross margin on the sale to the distributor; however, the amount of gross margin that we recognized in the subsequent periods was less than the deferred margin as a result of credits granted to distributors on specifically identified products and customers to allow the distributors to earn a competitive gross margin on the sale of our products to their end customers and price protection concessions related to market pricing conditions.

We sold the majority of the items in our product catalog to our distributors worldwide at a uniform list price. However, distributors resold our products to end customers at a broad range of individually negotiated price points. The majority of our distributors' resales required a reduction from the original list price paid. Often, under these circumstances, we remitted back to the distributor a portion of their original purchase price after the resale transaction was completed in the form of a credit against the distributors' outstanding accounts receivable balance. The credits were on a per unit basis and were not given to the distributor until they provided information to us regarding the sale to their end customer. The price reductions varied significantly based on the customer, product, quantity ordered, geographic location and other factors. Discounts to a price less than our cost have historically been rare. The effect of granting these credits established the net selling price to our distributors for the product and resulted in the net revenue recognized by us when the product was sold by the distributors to their end customers. Thus, a portion of the "deferred income on shipments to distributors" balance represented the amount of distributors' original purchase price that was credited back to the distributors in the subsequent periods. We did not reduce deferred income on shipments to distributors or accounts receivable by anticipated concessions; rather, price concessions were typically recorded against deferred income on shipments to distributors and accounts receivable

when incurred, which was generally at the time the distributor sold the product. At March 31, 2018, we had approximately \$479.6 million of deferred revenue and \$145.8 million in deferred cost of sales recognized as \$333.8 million of deferred income on shipments to distributors. The deferred income on shipments to distributors that was ultimately recognized in our income statement was lower than the amount reflected on the balance sheet at March 31, 2018 due to additional price credits that were granted to the distributors when the product was sold to their customers. These additional price credits historically have resulted in the deferred income approximating the overall gross margins that we recognized in the distribution channel of our business.

Distributor advances, reflected as a reduction of deferred income on shipments to distributors on our condensed consolidated balance sheets, totaled \$203.9 million at March 31, 2018. On sales to distributors, our payment terms generally require the distributor to settle amounts owed to us for an amount in excess of their ultimate cost. The sales price to our distributors may be higher than the amount that the distributors will ultimately owe us because distributors often negotiate price reductions after purchasing products from us and such reductions are often significant. It is our practice to apply these negotiated price discounts to future purchases, requiring the distributor to settle receivable balances, on a current basis,



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generally within 30 days, for amounts originally invoiced. This practice has an adverse impact on the working capital of our distributors. As such, we have entered into agreements with certain distributors whereby we advance cash to the distributors to reduce the distributors' working capital requirements. These advances are reconciled at least on a quarterly basis and are estimated based on the amount of ending inventory as reported by the distributor multiplied by a negotiated percentage. Such advances had no impact on our revenue recognition or our condensed consolidated statements of income. We processed discounts taken by distributors against our deferred income on shipments to distributors' balance and true-up the advanced amounts generally after the end of each completed fiscal quarter. The terms of these advances are set forth in binding legal agreements and are unsecured, bear no interest on unsettled balances and are due upon demand. The agreements governing these advances can be canceled by us at any time.

We reduced product pricing through price protection based on market conditions, competitive considerations and other factors. Price protection was granted to distributors on the inventory they had on hand at the date the price protection was offered. When we reduced the price of our products, it allowed the distributor to claim a credit against its outstanding accounts receivable balances based on the new price of the inventory it had on hand as of the date of the price reduction. There was no immediate revenue impact from the price protection, as it was reflected as a reduction of the deferred income on shipments to distributors' balance.

Products returned by distributors and subsequently scrapped have historically been immaterial to our consolidated results of operations. We routinely evaluated the risk of impairment of the deferred cost of sales component of the deferred income on shipments to distributors account. Because of the historically immaterial amounts of inventory that have been scrapped, and historically rare instances where discounts given to a distributor resulted in a price less than our cost, we believe the deferred costs were recorded at their approximate carrying value.

### Revenue Recognition (subsequent to our adoption of ASC 606 on April 1, 2018)

We generate revenue primarily from sales of our semiconductor products to distributors and non-distributor customers (direct customers) and, to a lesser extent, from royalties paid by licensees of our intellectual property. We apply the following five-step approach to determine the timing and amount of revenue recognition: (1) identify the contract with the customer, (2) identify performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when the performance obligation is satisfied.

Sales to our distributors are governed by a distributor agreement, a purchase order, and an order acknowledgment. Sales to distributors do not meet the definition of a contract, as defined by ASC 606, until the distributor has sent in a purchase order, we have acknowledged the order, we have deemed the collectability of the consideration to be probable, and legally enforceable rights and obligations have been created; this generally occurs 30 days prior to the estimated ship date. As is customary in the semiconductor industry, we offer price concessions and stock rotation rights to many of our distributors. As these are forms of variable consideration, we estimate the amount of consideration to which we will be entitled using recent historical data and applying the expected value method. Usually, there is only a single performance obligation in the contract, and therefore the entire transaction price is allocated to the single performance obligation. After the transaction price has been allocated, we recognize revenue when the performance obligation is satisfied. Substantially all of the revenue generated from contracts with distributors is recognized at the time risk and title of the inventory transfers to the end customer.

Sales to our direct customers are generally governed by a purchase order and an order acknowledgment. Sales to direct customers usually do not meet the definition of a contract, as defined by ASC 606, until shipment of the product occurs. Generally, the transaction price associated with contracts with direct customers is set at the standalone selling price and is not variable. Usually, there is only a single performance obligation in the contract, and therefore the entire

transaction price is allocated to the single performance obligation. After the transaction price has been allocated, we recognize revenue when the performance obligation is satisfied. Substantially all of the revenue generated from contracts with direct customers is recognized at the time risk and title of the inventory transfers to the customer.

Revenue generated from our licensees is governed by licensing agreements. Our primary performance obligation related to these agreements is to provide the licensee the right to use the intellectual property. The final transaction price is determined by multiplying the usage of the license by the royalty, which is fixed in the licensing agreement. Revenue is recognized as usage of the license occurs.

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### Business Combinations

All of our business combinations are accounted for at fair value under the acquisition method of accounting. Under the acquisition method of accounting, (i) acquisition-related costs, except for those costs incurred to issue debt or equity securities, will be expensed in the period incurred; (ii) non-controlling interests will be valued at fair value at the acquisition date; (iii) in-process research and development will be recorded at fair value as an intangible asset at the acquisition date and amortized once the technology reaches technological feasibility; (iv) restructuring costs associated with a business combination will be expensed subsequent to the acquisition date; and (v) changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date will be recognized through income tax expense or directly in contributed capital. The measurement of the fair value of assets acquired and liabilities assumed requires significant judgment. The valuation of intangible assets, in particular, requires that we use valuation techniques such as the income approach. The income approach includes the use of a discounted cash flow model, which includes discounted cash flow scenarios and requires the following significant estimates: revenue, expenses, capital spending and other costs, and discount rates based on the respective risks of the cash flows. Under the acquisition method of accounting, the aggregate amount of consideration we pay for a company is allocated to net tangible assets and intangible assets based on their estimated fair values as of the acquisition date. The excess of the purchase price over the value of the net tangible assets and intangible assets is recorded to goodwill. On an annual basis, we test goodwill for impairment and, through September 30, 2018, we have never recorded an impairment charge against our goodwill balance.

### Share-based Compensation

We measure at fair value and recognize compensation expense for all share-based payment awards, including grants of employee stock options, restricted stock units (RSUs) and employee stock purchase rights, to be recognized in our financial statements based on their respective grant date fair values. For the past several years, we have utilized RSUs as our primary equity incentive compensation instrument for employees. Share-based compensation cost is measured on the grant date based on the fair market value of our common stock discounted for expected future dividends and is recognized as expense on a straight-line basis over the requisite service periods. Total share-based compensation during the six months ended September 30, 2018 was \$87.9 million, of which \$80.4 million was reflected in operating expenses and \$7.5 million was reflected in cost of sales. Total share-based compensation included in our inventory balance was \$8.6 million at September 30, 2018.

We recognize forfeitures as they occur. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees or we assume unvested equity awards in connection with acquisitions.

### Inventories

Inventories are valued at the lower of cost or net realizable value using the first-in, first-out method. We write down our inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated net realizable value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we projected, additional inventory write-downs may be required. Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable. In estimating our inventory obsolescence, we primarily evaluate estimates of demand over a 12-month period and record impairment charges for inventory on hand in excess of the estimated 12-month demand. Estimates

for projected 12-month demand are generally based on the average shipments of the prior three-month period, which are then annualized to adjust for any potential seasonality in our business. The estimated 12-month demand is compared to our most recently developed sales forecast to further reconcile the 12-month demand estimate. Management reviews and adjusts the estimates as appropriate based on specific situations. For example, demand can be adjusted up for new products for which historic sales are not representative of future demand. Alternatively, demand can be adjusted down to the extent any existing products are being replaced or discontinued.

In periods where our production levels are substantially below our normal operating capacity, the reduced production levels of our manufacturing facilities are charged directly to cost of sales. There was no charge to cost of sales for reduced production levels in each of the six month periods ended September 30, 2018 and 2017.

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### Income Taxes

As part of the process of preparing our condensed consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our condensed consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income within the relevant jurisdiction and to the extent we believe that recovery is not likely, we must establish a valuation allowance. We provided valuation allowances for certain of our deferred tax assets, including state net operating loss carryforwards and state tax credits, where it is more likely than not that some portion, or all of such assets, will not be realized. We provided valuation allowances for certain deferred tax assets related to Microsemi. Due to the Tax Cuts and Jobs Act (the "Act"), we released our valuation allowance on foreign tax credits during the period ending March 31, 2018, which was provisional. We are still evaluating how the Act impacts our valuation allowance on state net operating loss carryforwards and state tax credits, and we may report an adjustment to the valuation allowances under Staff Accounting Bulletin ("SAB") 118 in the subsequent quarter. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Various taxing authorities in the U.S. and other countries in which we do business scrutinize the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. We are currently being audited by the tax authorities in the United States and in various foreign jurisdictions. At this time, we do not know what the outcome of these audits will be. We record benefits for uncertain tax positions based on an assessment of whether it is more likely than not that the tax positions will be sustained based on their technical merits under currently enacted law. If this threshold is not met, no tax benefit of the uncertain tax position is recognized. If this threshold is met, we recognize the largest amount of the tax benefit that is more likely than not to be realized upon ultimate settlement.

The accounting model as defined in Accounting Standards Codification ("ASC") 740 related to the valuation of uncertain tax positions requires us to presume that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information and that each tax position will be evaluated without consideration of the possibility of offset or aggregation with other positions. The recognition requirement for the liability exists even if we believe the possibility of examination by a taxing authority or discovery of the related risk matters is remote or where we have a long history of the taxing authority not performing an exam or not challenging an issue. We will record an adjustment to a previously recorded position if new information or facts related to the position are identified in a subsequent period. All adjustments to the positions are recorded in the income statement. Generally, adjustments will be recorded in periods subsequent to the initial recognition if the taxing authority has completed an audit of the period or if the statute of limitation expires. Due to the inherent uncertainty in the estimation process and in consideration of the criteria of the accounting model, amounts recognized in the financial statements in periods subsequent to the initial recognition may significantly differ from the estimated exposure of the position under the accounting model.

On December 22, 2017, the Act was enacted into law. The Act provides for numerous significant tax law changes and modifications including the reduction of the U.S. federal corporate income tax rate from 35.0% to 21.0%, the requirement for companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and the creation of new taxes on certain foreign-sourced earnings. As a fiscal year-end taxpayer, certain provisions of the Act began to impact us in our third quarter of fiscal 2018, while other provisions have become effective for us in fiscal 2019.

In addition to the impacts of tax reform on fiscal 2018, the Act also establishes new tax laws that are effective for our fiscal 2019, including, but not limited to, (1) a new provision designed to tax low-taxed income of foreign subsidiaries ("GILTI"), which allows for the possibility of using foreign tax credits ("FTCs") and a deduction of up to 50% to offset the income tax liability (subject to some limitations); (2) limitations on the deductibility of certain executive compensation; (3) limitations on the deductibility of interest expense; and (4) limitations on the use of FTCs to reduce the U.S. income tax liability. While each of these provisions will have an impact on our tax expense for fiscal 2019 and future periods, the increase in tax expense for GILTI is the most significant. In addition, we expect to be impacted by the limitations on the deductibility of interest expense, which we expect to generate disallowed interest expense carryforwards in future periods, causing an increase in our overall deferred tax asset position.

Due to the complexity of the new tax on low-taxed income of foreign subsidiaries, we are continuing to evaluate this provision of the Act and the application of ASC 740. Based on recent FASB deliberations, it appears we will be allowed to

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make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income as a current-period expense when incurred or (2) factoring such amounts into our measurement of our deferred taxes. Our selection of an accounting policy will depend, in part, on analyzing our facts to determine what the impact is expected to be under each method. As of September 30, 2018, we are still evaluating which accounting policy to utilize.

### Senior and Junior Subordinated Convertible Debt

We separately account for the liability and equity components of our senior and junior subordinated convertible debt in a manner that reflects our nonconvertible debt (unsecured debt) borrowing rate when interest cost is recognized. This results in a bifurcation of a component of the debt, classification of that component in equity and the accretion of the resulting discount on the debt to be recognized as part of interest expense in our condensed consolidated statements of income. Lastly, we include the dilutive effect of the shares of our common stock issuable upon conversion of the outstanding senior and junior subordinated convertible debt in our diluted income per share calculation regardless of whether the market price triggers or other contingent conversion features have been met. We apply the treasury stock method as we have the intent and have adopted an accounting policy to settle the principal amount of the senior and junior subordinated convertible debentures in cash. This method results in incremental dilutive shares when the average fair value of our common stock for a reporting period exceeds the conversion prices per share and adjusts as dividends are recorded in the future.

### Contingencies

In the ordinary course of our business, we are exposed to various liabilities as a result of contracts, product liability, customer claims and other matters. Additionally, we are involved in a limited number of legal actions, both as plaintiff and defendant. Consequently, we could incur uninsured liability in any of those actions. We also periodically receive notifications from various third parties alleging infringement of patents or other intellectual property rights, or from customers requesting reimbursement for various costs. With respect to pending legal actions to which we are a party and other claims, although the outcomes are generally not determinable, we believe that the ultimate resolution of these matters will not have a material adverse effect on our financial position, cash flows or results of operations. Litigation and disputes relating to the semiconductor industry are not uncommon, and we are, from time to time, subject to such litigation and disputes. As a result, no assurances can be given with respect to the extent or outcome of any such litigation or disputes in the future.

We accrue for claims and contingencies when losses become probable and reasonably estimable. As of the end of each applicable reporting period, we review each of our matters and, where it is probable that a liability has been or will be incurred, we accrue for all probable and reasonably estimable losses. Where we can reasonably estimate a range of losses we may incur regarding such a matter, we record an accrual for the amount within the range that constitutes our best estimate. If we can reasonably estimate a range but no amount within the range appears to be a better estimate than any other, we use the amount that is the low end of such range. Contingencies of an acquired company that exist as of the date of the acquisition are measured at fair value if determinable, which generally is based on a probability weighted model. If fair value is not determinable, contingencies of an acquired company are recognized when they become probable and reasonably estimable.

### Results of Operations

The following table sets forth certain operational data as a percentage of net sales for the periods indicated:

Three Months Ended September 30,	Six Months Ended September 30,
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	2018	2017	2018	2017
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	51.9	39.3	49.7	39.6
Gross profit	48.1	60.7	50.3	60.4
Research and development	15.5	13.2	14.9	13.3
Selling, general and administrative	12.3	11.3	12.9	11.5
Amortization of acquired intangible assets	11.9	11.9	11.5	12.2
Special charges and other, net	1.2	2.0	2.1	0.9
Operating income	7.2	% 22.3	% 8.9	% 22.5



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## Net Sales

We operate in two industry segments and engage primarily in the design, development, manufacture and sale of semiconductor products as well as the licensing of our SuperFlash and other technologies. We sell our products to distributors and original equipment manufacturers, referred to as OEMs, in a broad range of markets, perform ongoing credit evaluations of our customers and generally require no collateral. In certain circumstances, a customer's financial condition may require collateral, and, in such cases, the collateral would be typically provided by letters of credit.

The following table summarizes our net sales for the periods covered by this report (dollars in millions):

	Three Months Ended September 30,			Six Months Ended September 30,		
	2018	2017	% Change	2018	2017	% Change
Net sales	\$1,432.5	\$1,012.1	41.5 %	\$2,644.9	\$1,984.3	33.3 %

The increases in net sales in the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017 were due primarily to our acquisition of Microsemi. We sell a large number of products to a large and diverse customer base and, excluding the impact of our Microsemi acquisition, there was not any product, customer or market that accounted for a material portion of the change. The overall average selling price of our products increased significantly during the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017 due to our acquisition of Microsemi, whose average selling price is higher than the average selling price of our historical business due to the types of products they offer and the types of customers and markets they serve.

As discussed in the following paragraphs, there were revenue gains across our product lines. Key factors impacting the amount of net sales during the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017 include:

- our acquisition of Microsemi, which closed on May 29, 2018;
- global economic conditions in the markets we serve;
- semiconductor industry conditions;
- adoption of the new revenue recognition standard (ASC 606) on April 1, 2018
- our new product offerings that have increased our served available market;
- customers' increasing needs for the flexibility offered by our programmable solutions;
- inventory holding patterns of our customers;
- increasing semiconductor content in our customers' products; and
- continued market share gains in the segments of the markets we address.

Net sales by product line for the three and six months ended September 30, 2018 and 2017 were as follows (dollars in millions):

	Three Months Ended September 30, (unaudited)				Six Months Ended September 30, (unaudited)			
	2018	%	2017	%	2018	%	2017	%
Microcontrollers	\$778.6	54.3 %	\$665.2	65.9 %	\$1,500.9	56.7 %	\$1,300.8	65.5 %
	419.2	29.3	239.2	23.6	751.1	28.4	478.2	24.1

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Analog, interface, mixed signal and timing  
products

Memory products	48.1	3.4	52.1	5.1	98.1	3.7	101.6	5.1
Field-programmable gate array products	70.8	4.9	—	—	108.7	4.1	—	—
Technology licensing	38.2	2.7	25.8	2.5	64.9	2.5	50.8	2.6
Multi-market and other	77.6	5.4	29.8	2.9	121.2	4.6	52.9	2.7
Total net sales	\$1,432.5	100.0%	\$1,012.1	100.0%	\$2,644.9	100.0%	\$1,984.3	100.0%

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### Microcontrollers

Our microcontroller product line represents the largest component of our total net sales. Microcontrollers and associated application development systems accounted for approximately 54.3% and 56.7% of our net sales for the three and six months ended September 30, 2018, respectively, compared to approximately 65.9% and 65.5% of our net sales for the three and six months ended September 30, 2017, respectively. The decrease is due to our acquisition of Microsemi, whose microcontroller product line accounted for a relatively lower percentage of its total net sales.

Net sales of our microcontroller products increased 17.0% and 15.4% in the three and six months ended September 30, 2018, respectively, compared to the three and six months ended September 30, 2017. These sales increases were due primarily to our acquisition of Microsemi.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller products have remained relatively constant over time due to the proprietary nature of these products. We have experienced, and expect to continue to experience, moderate pricing pressure in certain microcontroller product lines, primarily due to competitive conditions. We have in the past been able to, and expect in the future to be able to, moderate average selling price declines in our microcontroller product lines by introducing new products with more features and higher prices. We may be unable to maintain average selling prices for our microcontroller products as a result of increased pricing pressure in the future, which would adversely affect our operating results. The average selling price of our microcontroller products is affected by these trends; however, variations in our product and geographic mix of sales can cause wider fluctuations in the average selling price of our microcontroller products in any given period.

### Analog, Interface, Mixed Signal and Timing Products

Sales of our analog, interface, mixed signal and timing products accounted for approximately 29.3% and 28.4% of our net sales for the three and six months ended September 30, 2018, respectively, compared to approximately 23.6% and 24.1% of our net sales for the three and six months ended September 30, 2017, respectively. The increase is due to our acquisition of Microsemi, whose analog, interface, mixed signal and timing product line accounted for a relatively higher percentage of its total net sales.

Net sales of our analog, interface, mixed signal and timing products increased 75.3% and 57.1% in the three and six months ended September 30, 2018, respectively, compared to the three and six months ended September 30, 2017. These sales increases were due primarily to our acquisition of Microsemi.

Analog, interface, mixed signal and timing products can be proprietary or non-proprietary in nature. Currently, we consider a majority of our analog, interface, mixed signal and timing products to be proprietary in nature, where prices are relatively stable, similar to the pricing stability experienced in our microcontroller products. The non-proprietary portion of our analog, interface, mixed signal and timing business will experience price fluctuations driven primarily by the current supply and demand for those products. We may be unable to maintain the average selling prices of our analog, interface, mixed signal and timing products as a result of increased pricing pressure in the future, which would adversely affect our operating results. We anticipate the proprietary portion of our analog, interface, mixed signal and timing products will increase over time.

### Memory Products

Sales of our memory products accounted for approximately 3.4% and 3.7% of our net sales for the three and six months ended September 30, 2018, respectively, compared to approximately 5.1% of our net sales for each of the

three and six months ended September 30, 2017, respectively.

Net sales of our memory products decreased 7.7% and 3.4% in the three and six months ended September 30, 2018, respectively, compared to the three and six months ended September 30, 2017. These sales decreases were due primarily to customer demand conditions.

Memory product pricing has historically been cyclical in nature, with steep price declines followed by periods of relative price stability, driven by changes in industry capacity at different stages of the business cycle. We have experienced, and expect to continue to experience, varying degrees of competitive pricing pressures in our memory products. We may be unable to maintain the average selling prices of our memory products as a result of increased pricing pressure in the future, which could adversely affect our operating results.

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### Field-Programmable Gate Array (FPGA) Products

Our FPGA product line was primarily acquired as part of our acquisition of Microsemi on May 29, 2018. Sales of our FPGA products accounted for approximately 4.9% and 4.1%, respectively, of our net sales in the three and six months ended September 30, 2018.

### Technology Licensing

Technology licensing revenue includes a combination of royalties associated with licenses for the use of our SuperFlash and other technologies, sales of our intellectual property, and fees for engineering services. Technology licensing accounted for approximately 2.7% and 2.5% of our net sales for the three and six months ended September 30, 2018, respectively, compared to approximately 2.5% and 2.6% of our net sales for the three and six months ended September 30, 2017, respectively.

Net sales related to our technology licensing increased 48.1% and 27.8% in the three and six months ended September 30, 2018, respectively, compared to the three and six months ended September 30, 2017. Revenue from technology licensing can fluctuate over time based on the production activities of our licensees, the sales of intellectual property, and general economic and semiconductor industry conditions.

### Multi-market and Other

Multi-market and Other (MMO) consists of manufacturing services (wafer foundry and assembly and test subcontracting), legacy application specific integrated circuits, and products for aerospace applications. Revenue from these services and products accounted for approximately 5.4% and 4.6% of our net sales for the three and six months ended September 30, 2018, respectively, compared to approximately 2.9% and 2.7% of our net sales for the three and six months ended September 30, 2017, respectively.

Net sales related to these services and products increased 160.4% and 129.1% in the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017. These increases were due primarily to our acquisition of Microsemi, which significantly increased our portfolio of timing systems products.

MMO net sales can fluctuate over time based on general economic and semiconductor industry conditions as well as changes in demand for our manufacturing services (wafer foundry and assembly and test subcontracting).

### Distribution

Distributors accounted for approximately 49.7% and 51.3% of our net sales in the three and six months ended September 30, 2018 and approximately 53.5% and 54.5% of our net sales in the three and six months ended September 30, 2017. The decreases in these percentages in the periods ended September 30, 2018 compared to the periods ended September 30, 2017 are due to our acquisition of Microsemi, whose distributors accounted for a smaller portion of net sales than Microchip's historical business. Our distributors focus primarily on servicing the product requirements of a broad base of diverse customers. We believe that distributors provide an effective means of reaching this broad and diverse customer base. We believe that customers recognize Microchip for its products and brand name and use distributors as an effective supply channel.

Generally, we do not have long-term agreements with our distributors and we, or our distributors, may terminate our relationships with each other with little or no advance notice. The loss of, or the disruption in the operations of, one or more of our distributors could reduce our future net sales in a given quarter and could result in an increase in inventory returns.

At September 30, 2018, our distributors maintained 37 days of inventory of our products compared to 36 days of inventory at our distributors at March 31, 2018. Our acquisition of Microsemi initially caused an increase in our overall days of inventory maintained by our distributors, however, inventory levels at Microsemi's distributors have decreased since the completion of the acquisition, bringing the overall days of inventory back to our historical levels. Over the past five fiscal years, the days of inventory maintained by our distributors have fluctuated between 31 days and 40 days. Prior to our adoption of ASU 2014-09-Revenue from Contracts with Customers (Topic 606) on April 1, 2018, we did not believe that inventory holding patterns at our distributors materially impacted our net sales due to the fact that we recognized revenue based on when the distributor sold the product to their customer. Upon our adoption of Topic 606 on April 1, 2018, we are required to recognize revenue from distributors at the time our products are sold to the distributor. As a result, beginning April 1, 2018, inventory holding patterns at our distributors may have a material impact on our net sales.

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## Sales by Geography

Sales by geography for the three and six months ended September 30, 2018 and 2017 were as follows (dollars in millions):

	Three Months Ended September 30, (unaudited)				Six Months Ended September 30, (unaudited)			
	2018	%	2017	%	2018	%	2017	%
Americas	\$350.2	24.4	\$182.1	18.0	\$621.2	23.5	\$364.4	18.4
Europe	329.2	23.0	243.5	24.0	618.2	23.4	469.2	23.6
Asia	753.1	52.6	586.5	58.0	1,405.5	53.1	1,150.7	58.0
Total net sales	\$1,432.5	100.0	\$1,012.1	100.0	\$2,644.9	100.0	\$1,984.3	100.0

Americas sales include sales to customers in the U.S., Canada, Central America and South America. Sales to foreign customers accounted for approximately 80% and 82% of our total net sales in the three and six months ended September 30, 2018 compared to approximately 84% of our total net sales in each of the three and six months ended September 30, 2017. Substantially all of our foreign sales are U.S. dollar denominated. Sales to customers in Asia have generally increased over time due to many of our customers transitioning their manufacturing operations to Asia and growth in demand from the emerging Asian market; however, sales to Asia as a percentage of our total net sales decreased in the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017 due to our acquisition of Microsemi, whose sales to customers in Asia accounted for a smaller portion of their total net sales than Microchip's historical business. Sales to customers in Americas increased as a percentage of total sales in the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017 due to our acquisition of Microsemi, which had more concentration in the aerospace and defense industry in the Americas. Our sales force in the Americas and Europe supports a significant portion of the design activity for products which are ultimately shipped to Asia.

## Gross Profit

Our gross profit in the three months ended September 30, 2018 was \$689.3 million, or 48.1% of net sales, compared to \$614.1 million, or 60.7% of net sales, in the three months ended September 30, 2017. Our gross profit in the six months ended September 30, 2018 was \$1,331.3 million, or 50.3% of net sales, compared to \$1,198.5 million, or 60.4% of net sales, in the six months ended September 30, 2017.

The most significant factors affecting our gross profit percentage in the periods covered by this Form 10-Q were:

- charges of approximately \$182.1 million and \$289.7 million, respectively, in the three and six months ended September 30, 2018, related to the recognition of acquired inventory at fair value as a result of our acquisition of Microsemi which increased the value of our acquired inventory and subsequently increased our cost of sales and reduced our gross margins when the related revenue was recognized;
- inventory write-downs being lower than the gross margin impact of sales of inventory that was previously written down in the three and six months ended September 30, 2017;
- inventory write-downs being higher than the gross margin impact of sales of inventory that was previously written down in the three and six months ended September 30, 2018; and
- fluctuations in the product mix of microcontrollers, analog, interface, mixed signal and timing products, memory products and technology licensing.

Other factors that impacted our gross profit percentage in the periods covered by this Form 10-Q include:

• continual cost reductions in wafer fabrication and assembly and test manufacturing, such as new manufacturing technologies and more efficient manufacturing techniques;  
• lower depreciation as a percentage of cost of sales;  
• decreases in the level of wafer fabrication, assembly and test operations performed at our internal facilities compared to wafer fabrication, assembly and test operations performed by our third-party contractors, which increases our manufacturing costs; and  
• favorable market conditions and product mix.



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We adjust our wafer fabrication and assembly and test capacity utilization as required to respond to actual and anticipated business and industry-related conditions. When production levels are below normal capacity, which we measure as a percentage of the capacity of the installed equipment, we charge cost of sales for the unabsorbed capacity. During the three and six months ended September 30, 2018, we operated at below normal capacity levels resulting in an unabsorbed capacity charge of \$5.0 million. During the three and six months ended September 30, 2017, our wafer fabrication facilities and assembly and test facilities operated at normal capacity levels.

The process technologies utilized in our wafer fabrication facilities impact our gross margins. Our wafer fabrication facility located in Tempe, Arizona (Fab 2) currently utilizes various manufacturing process technologies, but predominantly utilizes our 0.5 micron to 1.0 micron processes. Our wafer fabrication facility located in Gresham, Oregon (Fab 4) predominantly utilizes our 0.13 micron to 0.5 micron processes. We continue to transition products to more advanced process technologies to reduce future manufacturing costs. All of our production in Fab 2 and Fab 4 has been on 8-inch wafers during the periods covered by this report. We consider normal capacity at Fab 2 and Fab 4 to be 90% to 95%. Our wafer fabrication facility in Colorado Springs, Colorado (Fab 5) currently utilizes processes between 0.25 micron and 1.0 micron that run on 6-inch wafers. We consider normal capacity at Fab 5 to be 70% to 75%. As a result of our acquisition of Micrel in August 2015, we acquired a 6-inch wafer fabrication facility in San Jose, California and have since transitioned products previously manufactured at this facility to our Fab 2, Fab 4 and Fab 5 facilities. During the quarter ended December 31, 2016, we decommissioned this San Jose facility and, in June 2017, we completed the sale of these assets for proceeds of \$10.0 million.

Our overall inventory levels were \$836.7 million at September 30, 2018, compared to \$476.2 million at March 31, 2018. Our overall inventory levels increased since March 31, 2018 because of our acquisition of Microsemi, which had \$320.9 million of inventory as of September 30, 2018, including approximately \$120.1 million of remaining acquired inventory fair value mark-up. We maintained 103 days of inventory on our balance sheet at September 30, 2018 compared to 112 days of inventory at March 31, 2018. Excluding the \$120.1 million of remaining acquired inventory fair value mark-up from our Microsemi acquisition, we would have maintained 117 days of inventory on our balance sheet at September 30, 2018 compared to 112 days of inventory at March 31, 2018. We expect our days of inventory levels in the December 2018 quarter to be flat to up 10 days compared to the September 2018 levels. We believe our existing level of inventory will allow us to maintain competitive lead times and provide strong delivery performance to our customers.

We anticipate that our gross margins will fluctuate over time, driven primarily by capacity utilization levels, the overall product mix of microcontroller, analog, interface, mixed signal and timing products, memory products and technology licensing revenue and the percentage of net sales of each of these products in a particular quarter, as well as manufacturing yields, fixed cost absorption, and competitive and economic conditions in the markets we serve.

We operate assembly and test facilities in Thailand, the Philippines, and other locations throughout the world. Approximately 36% and 37% of our assembly requirements were performed in our internal assembly facilities in the three and six months ended September 30, 2018, respectively, compared to approximately 38% and 37% during the three and six months ended September 30, 2017, respectively. Approximately 45% and 48% of our test requirements were performed in our internal test facilities during the three and six months ended September 30, 2018, respectively, compared to approximately 63% and 60% during the three and six months ended September 30, 2017, respectively. Third-party contractors located primarily in Asia perform the balance of our assembly and test operations. The percentage of our assembly and test operations that are performed internally fluctuates over time based on supply and demand conditions in the semiconductor industry, our internal capacity capabilities and our acquisition activities. The decreases in the percentage of assembly and test work that was performed internally in the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017 were primarily due to our acquisition of Microsemi, which outsources substantially all of its assembly and test requirements. We believe that the

assembly and test operations performed at our internal facilities provide us with significant cost savings compared to contractor assembly and test costs, as well as increased control over these portions of the manufacturing process.

We rely on outside wafer foundries for a significant portion of our wafer fabrication requirements. Approximately 58% and 54% of our net sales came from products that were produced at outside wafer foundries in the three and six months ended September 30, 2018, respectively, compared to 42% in each of the three and six months ended September 30, 2017.

Our use of third parties involves some reduction in our level of control over the portions of our business that we subcontract. While we review the quality, delivery and cost performance of our third-party contractors, our future operating results could suffer if any third-party contractor is unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels.

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### Research and Development (R&D)

R&D expenses for the three months ended September 30, 2018 were \$221.9 million, or 15.5% of net sales, compared to \$133.6 million, or 13.2% of net sales, for the three months ended September 30, 2017. R&D expenses for the six months ended September 30, 2018 were \$393.8 million, or 14.9% of net sales, compared to \$264.0 million, or 13.3% of net sales, for the six months ended September 30, 2017. We are committed to investing in new and enhanced products, including development systems software, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. R&D costs are expensed as incurred. Assets purchased to support our ongoing research and development activities are capitalized when related to products which have achieved technological feasibility or that have alternative future uses and are amortized over their expected useful lives. R&D expenses include labor, depreciation, masks, prototype wafers, and expenses for the development of process technologies, new packages, and software to support new products and design environments.

R&D expenses increased \$88.3 million, or 66.1%, for the three months ended September 30, 2018 over the same period last year. R&D expenses increased \$129.8 million, or 49.2%, for the six months ended September 30, 2018 over the same period last year. The primary reasons for the increases in R&D costs were additional costs from our acquisition of Microsemi.

R&D expenses fluctuate over time, primarily due to revenue and operating expense investment levels.

### Selling, General and Administrative

Selling, general and administrative expenses for the three months ended September 30, 2018 were \$176.6 million, or 12.3% of net sales, compared to \$114.3 million, or 11.3% of net sales, for the three months ended September 30, 2017. Selling, general and administrative expenses for the six months ended September 30, 2018 were \$340.7 million, or 12.9% of net sales, compared to \$228.6 million, or 11.5% of net sales, for the six months ended September 30, 2017. Our goal is to continue to be more efficient with our operating expenses as our revenue increases. Selling, general and administrative expenses include salary expenses related to field sales, marketing and administrative personnel, advertising and promotional expenditures and legal expenses. Selling, general and administrative expenses also include costs related to our direct sales force, CEMs and ESEs who work in sales offices worldwide to stimulate demand by assisting customers in the selection and use of our products.

Selling, general and administrative expenses increased \$62.3 million, or 54.5%, for the three months ended September 30, 2018 over the same period last year. Selling, general and administrative expenses increased \$112.1 million, or 49.0%, for the six months ended September 30, 2018 over the same period last year. The primary reasons for the increases in selling, general and administrative expenses were additional costs from our acquisition of Microsemi, including approximately \$5.2 million and \$31.6 million of acquisition-related legal and professional service expenses in the three and six months ended September 30, 2018, respectively.

Selling, general and administrative expenses fluctuate over time, primarily due to revenue and operating expense investment levels.

### Amortization of Acquired Intangible Assets

Amortization of acquired intangible assets for the three and six months ended September 30, 2018 was \$169.9 million and \$303.6 million, respectively, compared to \$120.9 million and \$241.8 million for the three and six months ended September 30, 2017, respectively. The primary reason for the increases in acquired intangible asset amortization was increased amortization from our acquisition of Microsemi partially offset by decreased amortization of intangible

assets from our prior acquisitions.

#### Special Charges and Other, Net

During the three and six months ended September 30, 2018, we incurred special charges and other, net of \$18.2 million and \$58.3 million, respectively. The special charges and other, net incurred in the three and six months ended September 30, 2018 is comprised primarily of \$12.1 million and \$57.2 million, respectively, of employee separation costs related to the Microsemi acquisition and impairment losses of \$1.5 million and \$3.5 million, respectively. During the three and six months ended September 30, 2017, we incurred special charges and other, net of \$19.9 million and \$17.1 million, respectively, comprised primarily of a \$19.5 million charge for fees associated with transitioning from a public utility provider to a lower cost direct access provider. Our restructuring activities include workforce, property and other operating expense rationalizations as well as combining product roadmaps and manufacturing operations. In connection with these activities, we

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incurred employee separations costs, contract exit costs, other operating expenses and intangible asset impairment losses. The impairment charges in the three and six months ended September 30, 2018 were recognized as a result of writing off intangible assets purchased from Microsemi prior to the close of the acquisition and other intangible assets that were impaired as a result of combining and prioritizing the project roadmaps of the combined companies.

### Other Income (Expense)

Interest income in the three and six months ended September 30, 2018 was \$0.9 million and \$6.6 million, respectively, compared to \$4.6 million and \$8.1 million, respectively, for the three and six months ended September 30, 2017. The primary reason for the decreases in interest income relates to lower average cash and investment balances during the three and six months ended September 30, 2018 compared to the three and six months ended September 30, 2017. During the six months ended September 30, 2018, we used a substantial portion of our cash to help finance the purchase price of our acquisition of Microsemi, which closed on May 29, 2018.

Interest expense in the three and six months ended September 30, 2018 was \$138.6 million and \$229.0 million, respectively, compared to \$49.5 million and \$98.9 million for the three and six months ended September 30, 2017, respectively. The primary reason for the increases in interest expense relates to our additional borrowings to help finance our acquisition of Microsemi.

During the three and six months ended September 30, 2018, we de-recognized \$4.1 million in deferred financing fees in connection with early pay downs of a portion of the outstanding balance on our Term Loan Facility and our Revolving Credit Facility. During the six months ended September 30, 2017, we exchanged in privately negotiated transactions \$111.3 million aggregate principal amount of our 2007 Junior Convertible Debt for (i) \$111.3 million principal amount of our 2017 Junior Convertible Debt (2017 Junior Debt) with a market value of \$119.3 million plus (ii) the issuance of 3.2 million shares of our common stock with a value of \$254.6 million resulting in a loss on settlement of convertible debt of \$13.8 million.

Other loss, net in the three and six months ended September 30, 2018 was \$0.2 million and \$10.0 million, respectively. Other income, net in the three and six months ended September 30, 2017 was \$5.8 million and \$10.1 million. The primary reason for these changes relates to foreign currency exchange rate fluctuations.

### Provision for Income Taxes

Our provision for income taxes reflects tax on foreign earnings and federal and state tax on U.S. earnings. Our effective tax rate for the six months ended September 30, 2018 was not meaningful due to the amount of pre-tax income and the tax benefits recorded during the period. We had a negative effective tax rate of 2.1% for the six months ended September 30, 2017.

In fiscal 2019, approximately 23% of our net sales are expected to be generated in the U.S. at a combined federal and state effective tax rate that is higher than our overall effective tax rate. We are also subject to taxation in many other jurisdictions where we have operations. The effective tax rates that we pay in these jurisdictions vary widely, but they are generally lower than our combined U.S. federal and state effective tax rate. Our domestic statutory tax rate for the six months ended September 30, 2018 was approximately 22.2% and our domestic statutory tax rate for fiscal 2018 was approximately 32.6%. Our non-U.S. blended statutory tax rates for the six months ended September 30, 2018 and fiscal 2018 were much lower than this amount. The difference in rates applicable in foreign jurisdictions results from a number of factors, including lower statutory rates, historical loss carry-forwards, financing arrangements and other factors. Our effective tax rate has been, and will continue to be, impacted by the geographical dispersion of our earnings and losses.

Our foreign tax rate differential benefit primarily relates to our operations in Thailand, Malta and Ireland. Our Thailand manufacturing operations are currently subject to numerous tax holidays granted to us based on our investment in property, plant and equipment in Thailand. Our tax holiday periods in Thailand expire at various times in the future, however, we actively seek to obtain new tax holidays or we will be subject to tax at the statutory tax rate of 20%. We do not expect the future expiration of any of our tax holiday periods in Thailand to have a material impact on our effective tax rate. Our Microsemi operations in Malaysia are also subject to a tax holiday that effectively reduces Microsemi's Malaysia net income tax rate to zero in that jurisdiction. Microsemi's tax holiday in Malaysia was granted in 2009 and is effective through December 2019, subject to continued compliance with the tax holiday's requirements. The remaining material components of foreign income taxed at a rate lower than the U.S. are earnings accrued in Ireland at a 12.5% statutory tax rate and earnings accrued in Malta at a 0% effective tax rate.

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Various taxing authorities in the U.S. and other countries in which we do business are increasing their scrutiny of the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. For U.S. federal, and in general for U.S. state tax returns, our fiscal 2005 and later tax returns remain open for examination by the taxing authorities. We are currently being audited by the tax authorities in the United States and in various foreign jurisdictions. At this time, we do not know what the outcome of these audits will be. We record benefits for uncertain tax positions based on an assessment of whether it is more likely than not that the tax positions will be sustained based on their technical merits under currently enacted law. If this threshold is not met, no tax benefit of the uncertain tax position is recognized. If the threshold is met, we recognize the largest amount of the tax benefit that is more than 50% likely to be realized upon ultimate settlement.

## Liquidity and Capital Resources

We had \$464.2 million in cash, cash equivalents and short-term investments at September 30, 2018, a decrease of \$1.73 billion from the March 31, 2018 balance. The decrease in cash, cash equivalents and short-term investments over this time period is primarily attributable to \$1.74 billion in cash and \$8.40 billion from additional debt to fund our acquisition of Microsemi and payoff Microsemi's existing debt, partially offset by proceeds from new debt issuances of \$4.99 billion, net borrowings of \$3.33 billion on our credit facility and cash generated by operating activities.

Net cash provided from operating activities was \$789.9 million in the six months ended September 30, 2018, compared to \$695.1 million in the six months ended September 30, 2017. The increase in net cash provided by operating activities was primarily due to higher cash provided by our acquisition of Microsemi in the six months ended September 30, 2018.

During the six months ended September 30, 2018, net cash used in investing activities was \$6.74 billion compared to \$592.0 million in the six months ended September 30, 2017. In the six months ended September 30, 2018, investing cash flows included net cash and cash equivalents used to finance our acquisition of Microsemi of \$7.85 billion net of \$340.0 million of cash and cash equivalents acquired, offset by net cash inflows of \$1.28 billion due to the sale of available-for-sale debt securities to fund our acquisition of Microsemi, and capital expenditures of \$161.4 million. During the six months ended September 30, 2017, net investing activities resulted in a use of cash of \$592.0 million primarily the net change in our investments, capital purchases and sale of assets.

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the six months ended September 30, 2018 were \$161.4 million compared to \$82.0 million in the six months ended September 30, 2017. Capital expenditures were primarily for the expansion of production capacity, the addition of research and development equipment and new office buildings. Capital expenditures in the first half of fiscal 2018 were relatively less than we had experienced in recent years as we delayed certain purchases until we had finalized and developed plans following our acquisition of Atmel regarding technology platforms and other manufacturing activities. We currently intend to spend approximately \$170.0 million during the next twelve months to invest in equipment and facilities. We believe that the capital expenditures anticipated to be incurred over the next twelve months will provide sufficient manufacturing capacity to support the growth of our production capabilities for our new products and technologies and to bring in-house more of the assembly and test operations that are currently outsourced. We expect to finance our capital expenditures through our existing cash balances and cash flows from operations.

Net cash provided by financing activities was \$5.50 billion in the six months ended September 30, 2018 compared to net cash used in financing activities of \$185.4 million in the six months ended September 30, 2017. The cash flows

provided by financing activities during the six months ended September 30, 2018, were favorably impacted by net proceeds from amounts borrowed to fund our acquisition of Microsemi. Significant transactions affecting our net financing cash flows include:

- net proceeds of \$3.63 billion from borrowings under our Credit Facility;
- net proceeds of \$1.99 billion from the issuance of our Senior Secured Notes;
- \$3.0 billion of proceeds under our new Term Loan Facility;
- \$2.06 billion of cash used to pay off Microsemi's existing debt;
- \$799.5 million of cash used to pay down principal on the Term Loan Facility and the Credit Facility, and
- cash dividends paid to our stockholders of \$171.4 million and \$167.4 million during the six months ended September 30, 2018 and 2017, respectively.

On May 29, 2018, we completed the acquisition of Microsemi Corporation, a publicly traded company headquartered in Aliso Viejo, California. We paid an aggregate of approximately \$8.19 billion in cash to the stockholders of Microsemi. The



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total consideration transferred in the acquisition, including approximately \$53.9 million of non-cash consideration for the exchange of certain share-based payment awards of Microsemi for stock awards for our stock, was approximately \$8.24 billion. In addition to the consideration transferred, we recognized \$3.15 billion in liabilities in our consolidated financial statements of Microsemi consisting of debt, taxes payable and deferred, pension obligations, restructuring, and contingent and other liabilities of which \$2.06 billion of existing debt was paid off. We financed the purchase price using approximately \$8.10 billion of borrowings consisting of \$3.10 billion under our Credit Facility, \$3.00 billion under the term loan feature of the Credit Facility ("Term Loan Facility"), and \$2.00 billion in newly issued senior secured notes. We incurred \$22.0 million in acquisition costs related to the acquisition. As a result of the acquisition, Microsemi became a wholly owned subsidiary of Microchip. Microsemi offers a comprehensive portfolio of semiconductor and system solutions for aerospace and defense, communications, data center and industrial markets. Our primary reason for this acquisition was to expand our range of solutions, products and capabilities by extending our served available market.

In May 2018, we entered into an amended and restated credit agreement which provides for a revolving loan facility in an aggregate principal amount of approximately \$3.84 billion, which was reduced to \$3.6 billion in the second quarter of fiscal 2019 through the canceling of the 2020 Tranche, with a \$250.0 million foreign currency sublimit, a \$50.0 million letter of credit sublimit and a \$25.0 million swingline loan sublimit. The revolving loan facility consists of approximately \$3.60 billion of revolving loan commitments (the "2023 Revolving Loans") that terminate on May 18, 2023 (the "2023 Maturity Date"). The Revolving Loans bear interest, at our option, at the base rate plus a spread of 0.00% to 1.00% or an adjusted LIBOR rate plus a spread of 1.00% to 2.00%, in each case, with such spread being determined based on the consolidated senior leverage ratio for the preceding four fiscal quarter period.

In June 2017, in connection with the settlement of \$111.3 million of our convertible debt, we amended our credit agreement to (i) extend the time period during which we are permitted to repurchase, redeem or exchange our 2007 Junior Convertible Debt and (ii) amend the maximum total leverage ratio covenant to extend the time period for permitted refinancings or exchanges of the 2007 Junior Convertible Debt that may be excluded from the calculation of the ratio, subject to certain conditions.

In February 2017, we amended our Credit Facility to, among other things, increase certain covenant compliance ratios. The February 2017 amendment included a new collateral agreement that secures our borrowings with all assets of our guarantor subsidiaries with the exception of real property. Proceeds of loans made under our Credit Facility may be used for working capital and general corporate purposes. At September 30, 2018, we had \$3.10 billion of outstanding borrowings under the revolving line of credit which has a capacity of \$3.60 billion, and no borrowings at March 31, 2017. See Note 13 of the notes to our condensed consolidated financial statements for more information regarding our Credit Facility.

The enactment of the Act in December 2017 imposed a tax on all previously untaxed earnings of non-U.S. subsidiaries of U.S. corporations. Due to this change, the jurisdiction in which our cash is at any given point in time, no longer has a significant impact on our liquidity. Future distributions of non-U.S. assets to the U.S. will no longer be subject to U.S. federal taxation. As a result of the Act, as of March 31, 2018, we recognized a one-time transition tax expense of \$644.7 million on accumulated unrepatriated foreign earnings, of which we expected cash payments of approximately \$363.5 million after offsets by the utilization of various tax credit carryforwards in the United States. This value is identified as provisional in our condensed consolidated financial statements for the period ended March 31, 2018, and is subject to future measurement period adjustments in accordance with SEC Staff Accounting Bulletin ("SAB") 118. We intend to elect to pay this tax over a period of eight years, with 8% of the transition tax paid each year for fiscal 2019 through fiscal 2023, and 15%, 20%, and 25%, respectively, to be paid during fiscal 2024, 2025, and 2026.

We enter into derivative transactions from time to time in an attempt to reduce our exposure to currency rate fluctuations. Although none of the countries in which we conduct significant foreign operations has had a highly inflationary economy in the last five years, there is no assurance that inflation rates or fluctuations in foreign currency rates in countries where we conduct operations will not adversely affect our operating results in the future. At September 30, 2018, we had no foreign currency forward contracts outstanding.

There were no repurchases of common stock during the six months ended September 30, 2018. As of September 30, 2018, we held approximately 17.0 million shares as treasury shares.

On October 28, 2002, we announced that our Board of Directors had approved and instituted a quarterly cash dividend on our common stock. A quarterly dividend of \$0.3640 per share was paid on September 4, 2018 in the aggregate amount of \$85.9 million. A quarterly dividend of \$0.3645 per share was declared on November 7, 2018 and will be paid on December 5, 2018 to stockholders of record as of November 21, 2018. We expect the aggregate cash dividend for December 2018 to be approximately \$86.3 million. Our Board is free to change our dividend practices at any time and to increase or decrease the

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dividend paid, or not to pay a dividend on our common stock on the basis of our results of operations, financial condition, cash requirements and future prospects, and other factors deemed relevant by our Board. Our current intent is to provide for ongoing quarterly cash dividends depending upon market conditions, our results of operations, and potential changes in tax laws.

We believe that our existing sources of liquidity combined with cash generated from operations and borrowings under our Credit Facility will be sufficient to meet our currently anticipated cash requirements for at least the next 12 months. However, the semiconductor industry is capital intensive. In order to remain competitive, we must constantly evaluate the need to make significant investments in capital equipment for both production and research and development. We may increase our borrowings under our Credit Facility or seek additional equity or debt financing from time to time to maintain or expand our wafer fabrication and product assembly and test facilities, for cash dividends, for share repurchases or for acquisitions or other purposes. The timing and amount of any such financing requirements will depend on a number of factors, including our level of dividend payments, changes in tax laws and regulations regarding the repatriation of offshore cash (including the impact of the Act), demand for our products, changes in industry conditions, product mix, competitive factors and our ability to identify suitable acquisition candidates. There can be no assurance that such financing will be available on acceptable terms, and any additional equity financing would result in incremental ownership dilution to our existing stockholders.

## Contractual Obligations

There have not been any material changes in our contractual obligations from what we disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, other than those obligations at September 30, 2018 that resulted from our acquisition of Microsemi including amounts borrowed to fund such acquisition. The following table summarizes our significant contractual obligations at September 30, 2018, and the effect such obligations are expected to have on our liquidity and cash flows in future periods. This table excludes amounts already recorded on our balance sheet as current liabilities at September 30, 2018 (in millions):

	Payments Due by Period				
	Total	Less than 1 year	1 – 3 years	3 – 5 years	More than 5 years
Operating lease obligations <sup>(1)</sup>	\$158.9	\$32.8	\$79.9	\$34.4	\$11.8
Capital purchase obligations <sup>(2)</sup>	46.7	46.7	—	—	—
Other purchase obligations and commitments <sup>(3)</sup>	78.6	78.6	—	—	—
Term Loan Facility <sup>(4)</sup>	3,518.0	58.7	235.9	235.5	2,987.9
Line of credit <sup>(5)</sup>	3,709.4	65.9	263.5	263.5	3,116.5
Senior Secured Notes	2,334.4	41.3	165.1	1,106.3	1,021.7
2017 Senior Convertible Debt <sup>(6)</sup>	2,356.0	16.8	67.3	67.3	2,204.6
2015 Senior Convertible Debt <sup>(7)</sup>	1,907.3	14.0	56.1	56.1	1,781.1
2017 Junior Convertible Debt <sup>(8)</sup>	972.0	7.7	30.9	30.9	902.5
Pension obligations <sup>(9)</sup>	16.8	0.9	2.1	3.2	10.6
Transition tax obligation <sup>(10)</sup>	328.5	22.7	58.2	83.2	164.4
Total contractual obligations <sup>(11)</sup>	\$15,426.6	\$386.1	\$959.0	\$1,880.4	\$12,201.1

<sup>(1)</sup> Operating lease obligations include \$21.9 million of future lease payments which is recorded as a liability on the balance sheet as of September 30, 2018. This obligation is due under an operating lease from the acquisition of Atmel for a building in San Jose, California.

(2) Capital purchase obligations represent commitments for construction or purchases of property, plant and equipment. These obligations were not recorded as liabilities on our balance sheet as of September 30, 2018, as we have not yet received the related goods or taken title to the property.

Other purchase obligations and commitments include payments due under various types of licenses and

(3) outstanding purchase commitments with our wafer foundries of approximately \$78.6 million for delivery of wafers in fiscal 2019.

(4) The Term Loan Facility matures on May 18, 2023.

(5) For purposes of this table we have assumed that the principal of our 2023 revolving loans outstanding at September 30, 2018 will be paid on May 18, 2023, which is the maturity date of such borrowings.

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(6) For purposes of this table we have assumed that the principal of our 2017 Senior Convertible Debt will be paid on February 15, 2027, which is the maturity date of such debt.

(7) For purposes of this table we have assumed that the principal of our 2015 Senior Convertible Debt will be paid on February 15, 2025, which is the maturity date of such debt.

(8) For purposes of this table we have assumed that the principal of our 2017 Junior Convertible Debt will be paid on February 15, 2037, which is the maturity date of such debt.

(9) For purposes of this table pension obligations due in more than 5 years represent the expected pension payments from 2023 through 2027. It excludes pension obligations subsequent to 2027.

(10) During fiscal 2018, we recognized a provisional one-time transition tax on accumulated unrepatriated foreign earnings, estimated at \$644.7 million, as a result of the recent U.S. tax reform. Our first payment on this obligation of \$35.0 million was made in the quarter ended September 30, 2018 and we expect future cash payments of approximately \$328.5 million. This one-time transition tax is identified as provisional in our consolidated financial statements for the period ended March 31, 2018, and is subject to future measurement period adjustments in accordance with SAB 118. We intend to elect to pay this tax over a period of eight years, with 8% of the transition tax paid each year for fiscal 2019 through fiscal 2023, and 15%, 20%, and 25%, respectively, to be paid during fiscal 2024, 2025, and 2026.

(11) Total contractual obligations do not include contractual obligations recorded on our balance sheet as current liabilities, or certain purchase obligations as discussed below. The contractual obligations also do not include amounts related to uncertain tax positions because reasonable estimates cannot be made.

Purchase orders or contracts for the purchase of raw materials and other goods and services, with the exception of commitments to our wafer foundries, are not included in the table above. We are not able to determine the aggregate amount of such purchase orders that represent contractual obligations, as purchase orders may represent authorizations to purchase rather than binding agreements. For the purpose of this table, contractual obligations for the purchase of goods or services are defined as agreements that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Our purchase orders are based on our current manufacturing needs and are fulfilled by our vendors with short time horizons. We do not have significant agreements for the purchase of raw materials or other goods specifying minimum quantities or set prices that exceed our expected requirements for three months. We also enter into contracts for outsourced services; however, the obligations under these contracts were not significant and the contracts generally contain clauses allowing for cancellation without significant penalty.

The expected timing of payment of the obligations discussed above is estimated based on current information. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services or changes to agreed-upon amounts for some obligations.

Off-Balance Sheet Arrangements (Including Guarantees)

As of September 30, 2018, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K. In the ordinary course of business, we may provide standby letters of credit or other guarantee instruments to certain parties as required for certain transactions initiated by us or our subsidiaries. We have not recorded any liability in connection with these guarantee arrangements. Based on historical experience and information currently available, we believe we will not be required to make any payments under these guarantee arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2018, our long-term debt (including current maturities) totaled \$12.31 billion. We have no interest rate exposure to rate changes on our fixed rate debt, which totaled \$6.49 billion as of September 30, 2018. We do have interest rate exposure with respect to the \$5.83 billion balance of our variable interest rate debt outstanding as of September 30, 2018. A 50 basis point increase in interest rates would impact our expected annual interest expense for the next 12 months by approximately \$29.2 million.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, as required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Securities Exchange Act of 1934, as amended, we evaluated under the supervision of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended). Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

Changes in Internal Control over Financial Reporting

On May 29, 2018, we completed our acquisition of Microsemi which operated under its own set of systems and internal controls. During the three months ended September 30, 2018, we transitioned certain of Microsemi's processes to our internal control processes and we expect to transition more of such processes throughout the remainder of fiscal 2019.

Other than with respect to our transition of Microsemi to our systems and control environment as described above, during the three months ended September 30, 2018, there was no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 15 to our condensed consolidated financial statements for information regarding legal proceedings.

Item 1A. Risk Factors

When evaluating Microchip and its business, you should give careful consideration to the factors listed below, in addition to the information provided elsewhere in this Form 10-Q and in other documents that we file with the Securities and Exchange Commission.

Our operating results are impacted by global economic conditions and may fluctuate in the future due to a number of factors that could reduce our net sales and profitability.

Our operating results are affected by a wide variety of factors that could reduce our net sales and profitability, many of which are beyond our control. Some of the factors that may affect our operating results include:

- general economic, industry or political conditions in the U.S. or internationally;
- changes in demand or market acceptance of our products and products of our customers, and market fluctuations in the industries into which such products are sold;
- changes in tax regulations and policies in the U.S. and other countries in which we do business including the impact of the Tax Cuts and Jobs Act of 2017 (the Act);
- new accounting pronouncements or changes in existing accounting standards and practices, including the impact of the new revenue recognition standard (ASC 606) on our financial statements;
- our ability to continue to realize the expected benefits of our acquisitions including our recent acquisition of Microsemi;
- our ability to ramp our factory capacity to meet customer demand;
- our ability to secure sufficient wafer foundry, assembly and testing capacity;
- changes or fluctuations in customer order patterns and seasonality;
- changes in utilization of our manufacturing capacity and fluctuations in manufacturing yields;
- the mix of inventory we hold and our ability to satisfy orders from our inventory;
- levels of inventories held by our customers;
- risk of excess and obsolete inventories;
- competitive developments including pricing pressures;
- unauthorized copying of our products resulting in pricing pressure and loss of sales;
- availability of raw materials and equipment;
- our ability to successfully transition products to more advanced process technologies to reduce manufacturing costs;
- the level of orders that are received and can be shipped in a quarter;
- the level of sell-through of our products through distribution;
- fluctuations in our mix of product sales;
- announcements of other significant acquisitions by us or our competitors;
- disruptions in our business or our customers' businesses due to terrorist activity, armed conflict, war, worldwide oil prices and supply, public health concerns, natural disasters or disruptions in the transportation system;
- constrained availability from other electronic suppliers impacting our customers' ability to ship their products, which in turn may adversely impact our sales to those customers;



costs and outcomes of any current or future tax audits or any litigation or claims involving intellectual property, customers or other issues;  
fluctuations in commodity or energy prices; and  
property damage or other losses, whether or not covered by insurance.

We believe that period-to-period comparisons of our operating results are not necessarily meaningful and that you should not rely upon any such comparisons as indications of our future performance. In future periods, our operating results may fall below our public guidance or the expectations of public market analysts and investors, which would likely have a negative effect on the price of our common stock. Uncertain global economic conditions, the ongoing economic recovery and uncertainty surrounding the strength and duration of such recovery have caused our operating results to fluctuate significantly and make comparability between periods less meaningful.

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We may not fully realize the anticipated benefits of our completed or future acquisitions or divestitures including our recent acquisition of Microsemi.

We have acquired, and expect in the future to acquire, additional businesses that we believe will complement or augment our existing businesses. On May 29, 2018, we completed our acquisition of Microsemi, which is our largest and most complex acquisition ever. In addition, in April 2016, we completed our acquisition of Atmel; and in August 2015, we completed our acquisition of Micrel. The integration process for our acquisitions is complex and may be costly and time consuming and include unanticipated issues, expenses and liabilities. We may not be able to successfully or profitably integrate, operate, maintain and manage any newly acquired operations or employees. We may not be able to maintain uniform standards, procedures and policies and we may be unable to realize the expected synergies and cost savings from the integration. There may be increased risk due to integrating financial reporting and internal control systems. We may have difficulty in developing, manufacturing and marketing the products of a newly acquired company, or in growing the business at the rate we anticipate. Following an acquisition, we may not achieve the revenue or net income levels that justify the acquisition. We may suffer loss of key employees, customers and strategic partners of acquired companies and it may be difficult to implement our corporate culture at acquired companies. We have been and may in the future be subject to claims from terminated employees, shareholders of Microchip or the acquired companies and other third parties related to the transaction. In particular, in connection with our Microsemi and Atmel acquisitions, we became involved with third-party claims, litigation and disputes related to such businesses and transactions. See Note 15 to our condensed consolidated financial statements for information regarding pending litigation. Acquisitions may also result in charges (such as acquisition-related expenses, write-offs, restructuring charges, or future impairment of goodwill), contingent liabilities, adverse tax consequences, additional share-based compensation expense and other charges that adversely affect our operating results. To fund our acquisition of Microsemi, we used a significant portion of our cash balances and incurred approximately \$8.1 billion of additional debt. We may fund future acquisitions of new businesses or strategic alliances by utilizing cash, borrowings under our Credit Facility, raising debt, issuing shares of our common stock, or other mechanisms.

Further, if we decide to divest assets or a business, we may encounter difficulty in finding or completing divestiture opportunities or alternative exit strategies on acceptable terms or in a timely manner. These circumstances could delay the achievement of our strategic objectives or cause us to incur additional expenses with respect to assets or a business that we want to dispose of, or we may dispose of assets or a business at a price or on terms that are less favorable than we had anticipated. Even following a divestiture, we may be contractually obligated with respect to certain continuing obligations to customers, vendors, landlords or other third parties. We may also have continuing obligations for pre-existing liabilities related to the assets or businesses. Such obligations may have a material adverse impact on our results of operations and financial condition.

In addition to acquisitions, we have in the past, and expect in the future, to enter into joint development agreements or other business or strategic relationships with other companies. These transactions are subject to a number of risks similar to those we face with our acquisitions including our ability to realize the expected benefits of any such transaction, to successfully market and sell any products resulting from such transactions or to successfully integrate any technology developed through such transactions.

Our financial condition and results of operations could be adversely affected if we do not effectively manage our current or future debt.

As of September 30, 2018, the principal amount of our outstanding indebtedness was \$12.31 billion. In connection with our acquisition of Microsemi, which closed on May 29, 2018, we incurred additional debt consisting of \$3.10 billion under our revolving line of credit, \$3.00 billion under our new term loan facility, and \$2.00 billion in newly

issued senior secured notes. At September 30, 2018, we had \$3.10 billion in outstanding borrowings under our Credit Facility which was comprised of \$3.60 billion of revolving loan commitments that terminate in 2023. In February 2017, we issued \$2,645.0 million of aggregate principal value of senior and junior convertible debt.

As a result of such transactions, we have a substantially greater amount of debt than we had maintained in the past. Our maintenance of substantial levels of debt could adversely affect our ability to take advantage of corporate opportunities and could adversely affect our financial condition and results of operations. We may need or desire to refinance our convertible debt, senior debt, term loan debt or any other future indebtedness and there can be no assurance that we will be able to refinance any of our indebtedness on commercially reasonable terms, if at all.

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Servicing our current debt will require a significant amount of cash, and we may not have sufficient cash flow from our business to fund future payments.

Our ability to make scheduled payments of principal, to pay interest on or to refinance our indebtedness, including our outstanding convertible debt and debt incurred to finance our acquisition of Microsemi, depends on our future performance, which is subject to economic, financial, competitive and other factors. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and to fund capital expenditures, dividend payments, share repurchases or acquisitions. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time.

We are dependent on orders that are received and shipped in the same quarter and therefore have limited visibility to future product shipments.

Our net sales in any given quarter depend upon a combination of shipments from backlog and customer orders that are both received and shipped in that same quarter, which we refer to as turns orders. We measure turns orders at the beginning of a quarter based on the orders needed to meet the shipment targets that we set entering the quarter. Historically, we have relied on our ability to respond quickly to customer orders as part of our competitive strategy, resulting in customers placing orders with relatively short delivery schedules. Shorter lead times generally mean that turns orders as a percentage of our business are relatively high in any particular quarter and reduce our backlog visibility on future product shipments. Turns orders correlate to overall semiconductor industry conditions and product lead times. Because turns orders are difficult to predict, varying levels of turns orders make it more difficult to forecast net sales. As a significant portion of our products are manufactured at foundries, foundry lead times may affect our ability to satisfy certain turns orders. If we do not achieve a sufficient level of turns orders in a particular quarter relative to our revenue targets, our revenue and operating results will likely suffer.

Intense competition in the markets we serve may lead to pricing pressures, reduced sales of our products or reduced market share.

The semiconductor industry is intensely competitive and has been characterized by price erosion and rapid technological change. We compete with major domestic and international semiconductor companies, many of which have greater market recognition and substantially greater financial, technical, marketing, distribution and other resources than we do. The semiconductor industry has experienced significant merger and acquisition activity and consolidation in recent years which has resulted in several of our competitors becoming much larger in terms of revenue, product offerings and scale. We may be unable to compete successfully in the future, which could harm our business. Our ability to compete successfully depends on a number of factors both within and outside our control, including, but not limited to:

- the quality, performance, reliability, features, ease of use, pricing and diversity of our products;
- our success in designing and manufacturing new products including those implementing new technologies;
- our ability to ramp production and increase capacity, as needed, at our wafer fabrication and assembly and test facilities;
- the rate at which customers incorporate our products into their own applications and the success of such applications;
- the rate at which the markets that we serve redesign and change their own products;
- our ability to obtain adequate foundry and assembly and test capacity and supplies of raw materials and other supplies at acceptable prices;
-

changes in demand in the markets that we serve and the overall rate of growth or contraction of such markets, including but not limited to the automotive, personal computing and consumer electronics markets;

product introductions by our competitors;

the number, nature and success of our competitors in a given market;

our ability to protect our products and processes by effective utilization of intellectual property rights;

our ability to remain price competitive against companies that have copied our proprietary product lines, especially in countries where intellectual property rights protection is difficult to achieve and maintain;

our ability to address the needs of our customers; and

general market and economic conditions.

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Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The average selling prices of our microcontroller and proprietary analog, interface, mixed signal and timing products have remained relatively constant, while average selling prices of our memory and non-proprietary analog, interface, mixed signal and timing products have declined over time. The overall average selling price of our products is affected by these trends; however, variations in our product and geographic mix of sales can cause wider fluctuations in our overall average selling price in any given period.

We have experienced, and expect to continue to experience, modest pricing declines in certain of our more mature proprietary product lines, primarily due to competitive conditions. We have been able to moderate average selling price declines in many of our proprietary product lines by continuing to introduce new products with more features and higher prices. However, there can be no assurance that we will be able to do so in the future. We have experienced in the past, and expect to continue to experience in the future, varying degrees of competitive pricing pressures in our memory and non-proprietary analog, interface, mixed signal and timing products. We may be unable to maintain average selling prices for our products as a result of increased pricing pressure in the future, which could adversely impact our operating results.

We are dependent on wafer foundries and other contractors to perform key manufacturing functions for us, and our licensees of our SuperFlash and other technologies also rely on foundries and other contractors.

We rely on outside wafer foundries for a significant portion of our wafer fabrication needs. Specifically, during the first six months of fiscal 2019, approximately 54% of our net sales came from products that were produced at outside wafer foundries compared to 42% of our net sales in fiscal 2018. We also use several contractors located primarily in Asia for a portion of the assembly and testing of our products. Specifically, during the first six months of fiscal 2019, approximately 63% of our assembly requirements and 52% of our test requirements were performed by third party contractors compared to approximately 58% of our assembly requirements and 36% of our test requirements during fiscal 2018. Our reliance on third party contractors and foundries increased as a result of our acquisitions of Microsemi, Atmel, Micrel, SMSC, Supertex and ISSC. The disruption or termination of any of our contractors could harm our business and operating results.

Our use of third parties somewhat reduces our control over the subcontracted portions of our business. Our future operating results could suffer if any contractor were to experience financial, operational or production difficulties or situations when demand exceeds capacity, or if they were unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels, or if the countries in which such contractors are located were to experience political upheaval or infrastructure disruption. If these third parties are unable or unwilling to timely deliver products or services conforming to our quality standards, we may not be able to qualify additional manufacturing sources for our products in a timely manner on terms favorable to us, or at all. Additionally, these subcontractors could abandon fabrication processes that are important to us, or fail to adopt advanced manufacturing technologies that we desire to control costs. In any such event, we could experience an interruption in production, an increase in manufacturing and production costs or a decline in product reliability, and our business and operating results could be adversely affected. Further, our use of subcontractors increases the risks of potential misappropriation of our intellectual property.

Certain of our SuperFlash and other technology licensees also rely on outside wafer foundries for wafer fabrication services. If our licensees were to experience any disruption in supply from outside wafer foundries, this would reduce the revenue we receive in our technology licensing business and would harm our operating results.

Our operating results will suffer if we ineffectively utilize our manufacturing capacity or fail to maintain manufacturing yields.

The manufacture and assembly of integrated circuits, particularly non-volatile, erasable CMOS memory and logic devices such as those that we produce, are complex processes. These processes are sensitive to a wide variety of factors, including the level of contaminants in the manufacturing environment, impurities in the materials used, the performance of our wafer fabrication and assembly and test personnel and equipment, and other quality issues. As is typical in the semiconductor industry, we have from time to time experienced lower than anticipated manufacturing yields. Our operating results will suffer if we are unable to maintain yields at or above approximately the current levels. This could include delays in the recognition of revenue, loss of revenue or future orders, and customer-imposed penalties for our failure to meet contractual shipment deadlines. Our operating results are also adversely affected when we operate at less than optimal capacity. During the three and six months ended September 30, 2018, we operated at below normal capacity levels resulting in an unabsorbed capacity charge of \$5.0 million. We operated at normal capacity levels during fiscal 2018.

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Our operating results are impacted by both seasonality and the wide fluctuations of supply and demand in the semiconductor industry.

The semiconductor industry is characterized by seasonality and wide fluctuations of supply and demand. Historically, since a significant portion of our revenue is from consumer markets and international sales, our business tends to generate stronger revenues in the first and second quarters and comparatively weaker revenues in the third and fourth quarters of our fiscal year. Broad fluctuations in our overall business, changes in semiconductor industry and global economic conditions, and our acquisition activity (including our acquisition of Microsemi) have had and can have a more significant impact on our results than seasonality. As a result, in periods when these broad fluctuations, changes in business conditions or acquisitions occur, it is difficult to assess the impact of seasonal factors on our business. The semiconductor industry has also experienced significant economic downturns, characterized by diminished product demand and production over-capacity. We have sought to reduce our exposure to this industry cyclically by selling proprietary products, that cannot be easily or quickly replaced, to a geographically diverse customer base across a broad range of market segments. However, we have experienced substantial period-to-period fluctuations in operating results and expect, in the future, to experience period-to-period fluctuations in operating results due to general industry or economic conditions.

Our business is dependent on selling through distributors.

Sales through distributors accounted for approximately 51% of our net sales in the first six months of fiscal 2019 and approximately 54% of our net sales in fiscal 2018. We do not have long-term agreements with our distributors, and we and our distributors may each terminate our relationship with little or no advance notice.

Any future adverse conditions in the U.S. or global economies or in the U.S. or global credit markets could materially impact the operations of our distributors. Any deterioration in the financial condition of our distributors or any disruption in the operations of our distributors could adversely impact the flow of our products to our end customers and adversely impact our results of operation. In addition, during an industry or economic downturn, it is possible there will be an oversupply of products and a decrease in demand for our products from our distributors, which could reduce our net sales in a given period and result in an increase in inventory returns. Violations of the Foreign Corrupt Practices Act, or similar laws, by our distributors or other channel partners could have a material adverse impact on our business.

Our success depends on our ability to introduce new products on a timely basis.

Our future operating results depend on our ability to develop and timely introduce new products that compete effectively on the basis of price and performance and which address customer requirements. The success of our new product introductions depends on various factors, including, but not limited to:

- effective new product selection;
- timely completion and introduction of new product designs;
- procurement of licenses for intellectual property rights from third parties under commercially reasonable terms;
- timely filing and protection of intellectual property rights for new product designs;
- availability of development and support tools and collateral literature that make complex new products easy for engineers to understand and use; and
- market acceptance of our customers' end products.

Because our products are complex, we have experienced delays from time to time in completing new product development. In addition, our new products may not receive or maintain substantial market acceptance. We may be



unable to timely design, develop and introduce competitive products, which could adversely impact our future operating results.

Our success also depends upon our ability to develop and implement new design and process technologies. Semiconductor design and process technologies are subject to rapid technological change and require significant R&D expenditures. We and other companies in the industry have, from time to time, experienced difficulties in effecting transitions to advanced process technologies and, consequently, have suffered reduced manufacturing yields or delays in product deliveries. Our future operating results could be adversely affected if any transition to future process technologies is substantially delayed or inefficiently implemented.

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We may lose sales if suppliers of raw materials, components or equipment fail to meet our or our customers' needs or increase costs.

Our semiconductor manufacturing operations require raw and processed materials and equipment that must meet exacting standards. We generally have more than one source for these supplies, but there are only a limited number of suppliers capable of delivering various materials and equipment that meet our standards. The materials and equipment necessary for our business could become more difficult to obtain as worldwide use of semiconductors in product applications increases. Additionally, consolidation in our supply chain due to mergers and acquisitions may reduce the number of suppliers or change the relationships that we have with our suppliers. Also, the application of trade restrictions or tariffs by the U.S. or other countries may adversely impact the industry supply chain. This could impair sourcing flexibility or increase costs. We have experienced supply shortages from time to time in the past, and on occasion our suppliers have told us they need more time than expected to fill our orders or that they will no longer support certain equipment with updates or spare and replacement parts. In particular, we have recently experienced longer lead times for equipment which we need for capacity expansion at certain of our manufacturing facilities. An interruption of any materials or equipment sources, or the lack of supplier support for a particular piece of equipment, could harm our business.

Our customers may also be adversely affected by these same issues. The materials, components and equipment necessary for their businesses could become more difficult to obtain for various reasons not limited to business interruptions of suppliers, consolidation in their supply chain due to mergers and acquisitions, or application of trade restrictions or tariffs that impair sourcing flexibility or increase costs. If our customers are not able to produce their products, then their need for our products will decrease. Such interruptions of our customers' businesses could harm our business.

Our reported financial results may be adversely affected by new accounting pronouncements or changes in existing accounting standards and practices, including ASC 606 which impacts our revenue recognition.

We prepare our financial statements in conformity with accounting principles generally accepted in the U.S. These accounting principles are subject to interpretation or changes by the FASB and the SEC. New accounting pronouncements and varying interpretations of accounting standards and practices have occurred in the past and are expected to occur in the future. New accounting pronouncements or a change in the interpretation of existing accounting standards or practices may have a significant effect on our reported financial results and may even affect our reporting of transactions completed before the change is announced or effective. In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 - Revenue from Contracts with Customers (Topic 606), which supersedes nearly all existing revenue recognition guidance under generally accepted accounting principles in the United States of America (US GAAP). The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. Since our adoption of ASU 2014-09, which began with our fiscal year commencing on April 1, 2018, we no longer defer revenue until sale by the distributor to the end customer, but rather, are required to estimate the effects of returns and allowances provided to distributors and record revenue at the time of sale to the distributor. Refer to Note 2 to our condensed consolidated financial statements for additional information on the new guidance and its impact on us.

Business interruptions to our operations or the operations of our key vendors, subcontractors, licensees or customers, whether due to natural disasters or other events, could harm our business.

Operations at any of our facilities, at the facilities of any of our wafer fabrication or assembly and test subcontractors, or at any of our significant vendors or customers may be disrupted for reasons beyond our control. These reasons may

include work stoppages, power loss, cyber attacks, incidents of terrorism or security risk, political instability, public health issues, telecommunications, transportation or other infrastructure failure, radioactive contamination, fire, earthquake, floods, volcanic eruptions or other natural disasters. We have taken steps to mitigate the impact of some of these events should they occur; however, we cannot be certain that our actions will be effective to avoid a significant impact on our business in the event of a disaster or other business interruption.

In particular, Thailand has experienced periods of severe flooding in recent years. While our facilities in Thailand have continued to operate normally, there can be no assurance that any future flooding in Thailand would not have a material adverse impact on our operations. If operations at any of our facilities, or our subcontractors' facilities are interrupted, we may not be able to shift production to other facilities on a timely basis, and we may need to spend significant amounts to repair or replace our facilities and equipment. If we experienced business interruptions, we would likely experience delays in shipments of products to our customers and alternate sources for production may be unavailable on acceptable terms. This could result in reduced revenues and profits and the cancellation of orders or loss of customers. Although we maintain business interruption

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insurance, such insurance will likely not be enough to compensate us for any losses that may occur and any losses or damages incurred by us as a result of business interruptions could significantly harm our business.

Additionally, operations at our customers and licensees may be disrupted for a number of reasons. In the event of customer disruptions, sales of our products may decline and our revenue, profitability and financial condition could suffer. Likewise, if our licensees are unable to manufacture and ship products incorporating our technology, or if there is a decrease in product demand due to a business disruption, our royalty revenue may decline.

Our technology licensing business exposes us to various risks.

Our technology licensing business is based on our SuperFlash and other technologies. The success of our licensing business depends on the continued market acceptance of these technologies and on our ability to further develop and enhance such technologies and to introduce new technologies in the future. To be successful, any such technology must be able to be repeatably implemented by licensees, provide satisfactory yield rates, address licensee and customer requirements, and perform competitively. The success of our technology licensing business depends on various other factors, including, but not limited to:

- proper identification of licensee requirements;
- timely development and introduction of new or enhanced technology;
- our ability to protect and enforce our intellectual property rights for our licensed technology;
- our ability to limit our liability and indemnification obligations to licensees;
- availability of sufficient development and support services to assist licensees in their design and manufacture of products integrating our technology;
- availability of foundry licensees with sufficient capacity to support original equipment manufacturers (OEM) production; and
- market acceptance of our customers' end products.

Because our licensed technologies are complex, there may be delays from time to time in developing and enhancing such technologies. There can be no assurance that our existing or any enhanced or new technology will achieve or maintain substantial market acceptance. Our licensees may experience disruptions in production or lower than expected production levels which would adversely affect the revenue that we receive from them. Our technology license agreements generally include an indemnification clause that indemnifies the licensee against liability and damages (including legal defense costs) arising from intellectual property matters. We could be exposed to substantial liability for claims or damages related to intellectual property matters or indemnification claims. Any claim, with or without merit, could result in significant legal fees and require significant attention from our management. Any of the foregoing issues may adversely impact the success of our licensing business and adversely affect our future operating results.

We are exposed to various risks related to legal proceedings or claims.

We are currently, and in the future may be, involved in legal proceedings or claims regarding patent infringement, other intellectual property rights, product failures, contracts and other matters. As is typical in the semiconductor industry, we receive notifications from third parties from time to time who believe that we owe them indemnification or other obligations related to claims made against us, our direct or indirect customers or our licensees. These legal proceedings and claims, even if meritless, could result in substantial costs to us and divert our resources. If we are not able to resolve a claim, settle a matter, obtain necessary licenses on commercially reasonable terms, reengineer our products or processes to avoid infringement, provide a cost-effective remedy, or successfully prosecute or defend our position, we could incur uninsured liability in any of them, be required to take an appropriate charge to operations, be

enjoined from selling a material portion of our products or using certain processes, suffer a reduction or elimination in the value of our inventories, and our business, financial condition or results of operations could be harmed.

It is also possible that from time to time we may be subject to claims related to the manufacture, performance or use of our products. These claims may be due to injuries, economic damage or environmental exposures related to manufacturing, a product's nonconformance to our specifications or specifications agreed upon with the customer, changes in our manufacturing processes, or unexpected customer system issues due to the integration of our products or insufficient design or testing by our customers. We could incur significant expenses related to such matters, including, but not limited to:

- costs related to writing off the value of our inventory of nonconforming products;
- recalling nonconforming products;
- providing support services, product replacements, or modifications to products and the defense of such claims;
- diversion of resources from other projects;

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- lost revenue or a delay in the recognition of revenue due to cancellation of orders or unpaid receivables;
- customer imposed fines or penalties for failure to meet contractual requirements; and
- a requirement to pay damages or penalties.

Because the systems into which our products are integrated have a higher cost of goods than the products we sell, the expenses and damages we are asked to pay may be significantly higher than the sales and profits we received from the products involved. While we specifically exclude consequential damages in our standard terms and conditions, certain of our contracts may not exclude such liabilities. Further, our ability to avoid such liabilities may be limited by applicable law. We do have liability insurance which covers certain damages arising out of product defects, but we do not expect that insurance will cover all claims or be of a sufficient amount to fully protect against such claims. Costs or payments we may make in connection with these customer claims may adversely affect the results of our operations.

Further, we sell to customers in industries such as automotive, aerospace, defense, safety, security, and medical, where failure of the systems in which our products are integrated could cause damage to property or persons. We may be subject to claims if our products, or the integration of our products, cause system failures. We will face increased exposure to claims if there are substantial increases in either the volume of our sales into these applications or the frequency of system failures integrating our products.

Failure to adequately protect our intellectual property could result in lost revenue or market opportunities.

Our ability to obtain patents, licenses and other intellectual property rights covering our products and manufacturing processes is important for our success. To that end, we have acquired certain patents and patent licenses and intend to continue to seek patents on our technology and manufacturing processes. The process of seeking patent protection can be long and expensive, and patents may not be issued from currently pending or future applications. In addition, our existing and new patents, trademarks and copyrights that issue may not have sufficient scope or strength to provide meaningful protection or commercial advantage to us. We may be subject to, or may ourselves initiate, interference proceedings in the U.S. Patent and Trademark Office, patent offices of a foreign country or U.S. or foreign courts, which can require significant financial and management resources. In addition, the laws of certain foreign countries do not protect our intellectual property rights to the same extent as the laws of the U.S. Infringement of our intellectual property rights by a third party could result in uncompensated lost market and revenue opportunities for us. Although we continue to vigorously and aggressively defend and protect our intellectual property on a worldwide basis, there can be no assurance that we will be successful in our endeavors.

Our operating results may be adversely impacted if economic conditions impact the financial viability of our licensees, customers, distributors, or suppliers.

We regularly review the financial performance of our licensees, customers, distributors and suppliers. However, any downturn in global economic conditions may adversely impact the financial viability of our licensees, customers, distributors or suppliers. The financial failure of a large licensee, customer or distributor, an important supplier, or a group thereof, could have an adverse impact on our operating results and could result in our not being able to collect our accounts receivable balances, higher reserves for doubtful accounts, write-offs for accounts receivable, and higher operating costs as a percentage of net sales.

We are highly dependent on foreign sales and operations, which exposes us to foreign political and economic risks.

Sales to foreign customers account for a substantial portion of our net sales. During the first six months of fiscal 2019, approximately 82% of our net sales were made to foreign customers, including 23% in China, 14% in Taiwan, and 10% in Germany. During fiscal 2018, approximately 85% of our net sales were made to foreign customers, including 30% in China, 11% in Taiwan, and 8% in Germany. During the first six months of fiscal 2019, our acquisition of Microsemi and our transition to sell-in revenue recognition contributed to the changes in net sales by country.

A strong position in the Chinese market is a key component of our global growth strategy. The market for integrated circuit products in China is highly competitive, and both international and domestic competitors are aggressively seeking to increase their market share. Increased competition or economic weakness in the China market may make it difficult for us to achieve our desired sales volumes in China. In particular, economic conditions in China remain uncertain and we are unable to predict whether such uncertainty will continue or worsen in future periods.

We purchase a substantial portion of our raw materials and equipment from foreign suppliers. In addition, we own product assembly and testing facilities near Bangkok, Thailand, which has experienced periods of political instability in the past. A large portion of our finished goods inventory is maintained in Thailand. From time to time, Thailand has also

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experienced periods of severe flooding. There can be no assurance that any future flooding or political instability in Thailand would not have a material adverse impact on our operations. As part of our Atmel acquisition, we acquired a test facility in Calamba, Philippines. We use various foundries and other foreign contractors for a significant portion of our assembly and testing and wafer fabrication requirements.

Our reliance on foreign operations, foreign suppliers, maintenance of substantially all of our finished goods inventory at foreign locations and significant foreign sales exposes us to foreign political and economic risks, including, but not limited to:

- political, social and economic instability;
- potentially adverse tax consequences;
- economic uncertainty in the worldwide markets served by us;
- trade restrictions and changes in tariffs;
- import and export license requirements and restrictions;
- changes in rules and laws related to taxes, environmental, health and safety, technical standards and consumer protection in various jurisdictions;
- currency fluctuations and foreign exchange regulations;
- difficulties in staffing and managing international operations;
- employment regulations;
- disruptions in international transport or delivery;
- public health conditions; and
- difficulties in collecting receivables and longer payment cycles.

If any of these risks materialize, or are worse than we anticipate, our sales could decrease and our operating results could suffer.

Our contractual relationships with our customers expose us to risks and liabilities.

We do not typically enter into long-term contracts with our non-distributor customers, and therefore we cannot be certain about future order levels from our customers. When we do enter into customer contracts, the contract is generally cancelable at the convenience of the customer. Even though we had over 123,000 customers and our ten largest direct customers made up approximately 10% of our total revenue for the six months ended September 30, 2018 and six of our top ten direct customers are contract manufacturers that perform manufacturing services for many customers, cancellation of customer contracts could have an adverse impact on our revenue and profits.

We have contracts with certain customers that differ from our standard terms of sale. For several of the significant markets that we sell into, such as the automotive and personal computer markets, our current or potential customers may possess significant leverage over us in negotiating the terms and conditions of supply as a result of their market size and position. For example, under certain contracts we may commit to supply specific quantities of products on scheduled delivery dates, or agree to extend our obligations for certain liabilities such as warranties or indemnification for quality issues or claims of intellectual property infringement. If we are unable to supply the customer as required under the contract, the customer may incur additional production costs, lost revenues due to subsequent delays in their own manufacturing schedule, or quality-related issues. We may be liable for the customer's costs, expenses and damages associated with their claims and we may be obligated to defend the customer against claims of intellectual property infringement and pay the associated legal fees. While we try to minimize the number of contracts which contain such provisions, manage the risks underlying such liabilities, and set caps on our liability exposure, sometimes we are not able to do so. In order to win important designs, avoid losing business to competitors, maintain existing



business, or be permitted to bid on new business, we have been, and may in the future be, forced to agree to uncapped liability for such items as intellectual property infringement, product failure, or confidentiality. Such provisions expose us to risk of liability far exceeding the purchase price of the products we sell under such contracts, the lifetime revenues we receive from such products, or various forms of potential consequential damages. Further, where we do not have negotiated contracts with our customers, the terms of our customer's orders may govern the transaction and contain terms that are not favorable to us. These significant additional risks could result in a material adverse impact on our results of operations and financial condition.

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Reliance on government contracts and sales to governmental agencies could have a material adverse effect on our results of operations.

With respect to our acquisition of Microsemi, a significant portion of their sales are from or are derived from government agencies or customers whose principal sales are to U.S. government agencies. Such sales are subject to uncertainties regarding governmental spending levels, spending priorities and policy changes. Future sales to U.S. government agencies or customers are also subject to uncertain government appropriations and national defense policies and priorities, including the constraints of the budgetary process, changes in the timing and potential spending priorities and the impact of any future sequestrations. Such sales are also subject to uncertainties related to monetary, regulatory, tax and trade policies implemented by current or future administrations or by Congress. The U.S. government and its contractors may terminate their contracts with Microsemi or us at any time. For example, in 2014, Microsemi had a \$75 million contract terminated for convenience by the U.S. government. Uncertainty with respect to government spending and termination of contracts associated with government related projects could have a material adverse impact on the revenue and other benefits we achieve from our Microsemi acquisition. Our business related to U.S. governmental agencies or customers requires us to comply with applicable governmental regulations, particularly for our facilities, systems and personnel that service such customers. Maintaining compliance with these regulations, including any audit requirements, requires that we devote significant resources to such matters in terms of training, personnel, information technology and facilities. Any failure to maintain compliance with these requirements may result in fines and penalties and loss of current or future business that may materially and adversely affect our operating results.

We must attract and retain qualified personnel to be successful, and competition for qualified personnel can be intense.

Our success depends upon the efforts and abilities of our senior management, engineering, manufacturing and other personnel. The competition for qualified engineering and management personnel can be intense. We may be unsuccessful in retaining our existing key personnel or in attracting and retaining additional key personnel that we require. The loss of the services of one or more of our key personnel or the inability to add key personnel could harm our business. The loss of, or any inability to attract personnel, even if not key personnel, if experienced in sufficient numbers could harm our business. We have no employment agreements with any member of our senior management team.

Fluctuations in foreign currency exchange rates could adversely impact our operating results.

We use forward currency exchange contracts in an attempt to reduce the adverse earnings impact from the effect of exchange rate fluctuations on our non-U.S. dollar net balance sheet exposures. Nevertheless, in periods when the U.S. dollar significantly fluctuates in relation to the non-U.S. currencies in which we transact business, the value of our non-U.S. dollar transactions can have an adverse effect on our results of operations and financial condition. In particular, in periods when a foreign currency significantly declines in value in relation to the U.S. dollar, customers transacting in that foreign currency may find it more difficult to fulfill their previously committed contractual obligations or to undertake new obligations to make payments or purchase products. In periods when the U.S. dollar is significantly declining in relation to the British pound, Euro and Thai baht, the operational costs in our European and Thailand subsidiaries are adversely affected. Although our business has not been materially adversely impacted by recent changes in the value of the U.S. dollar, there can be no assurance as to the future impact that any weakness or strength in the U.S. dollar will have on our business or results of operations.

Interruptions in our information technology systems, or improper handling of data, could adversely affect our business.

We rely on the efficient and uninterrupted operation of complex information technology systems and networks to operate our business. Any significant disruption to our systems or networks, including, but not limited to, new system implementations, computer viruses, security breaches, facility issues, natural disasters, terrorism, war, telecommunication failures or energy blackouts could have a material adverse impact on our operations, sales and operating results. Such disruption could result in a loss of our intellectual property or the release of sensitive competitive information or supplier, customer or employee personal data. Any loss of such information could harm our competitive position, result in a loss of customer confidence, and cause us to incur significant costs to remedy the damages caused by any such disruptions or security breaches. Additionally, any failure to properly manage the collection, handling, transfer or disposal of personal data of employees and customers may result in regulatory penalties, enforcement actions, remediation obligations, litigation, fines and other sanctions.

From time to time, we have experienced verifiable attacks on our data, attempts to breach our security and attempts to introduce malicious software into our IT systems; however, such attacks have not previously resulted in any material damage to us. Were future attacks successful, we may be unaware of the incident, its magnitude, or its effects until significant harm is done. In recent years, we have implemented improvements to our protective measures which are not limited to the following:

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firewalls, antivirus measures, patches, log monitors, event correlation tools, routine backups with offsite retention of storage media, system audits, data partitioning and routine password modifications. There can be no assurance that such system improvements will be sufficient to prevent or limit the damage from any future cyber attacks or disruptions. Any such attack or disruption could result in additional costs related to rebuilding of our internal systems, defending litigation, responding to regulatory actions, or paying damages. Such attacks or disruptions could have a material adverse impact on our business, operations and financial results.

Third-party service providers, such as wafer foundries, assembly and test contractors, distributors, credit card processors and other vendors have access to certain portions of our and our customers' sensitive data. In the event that these service providers do not properly safeguard the data that they hold, security breaches and loss of data could result. Any such loss of data by our third-party service providers could negatively impact our business, operations and financial results, as well as our relationship with our customers.

The occurrence of events for which we are self-insured, or which exceed our insurance limits, may adversely affect our profitability and liquidity.

We have insurance contracts with independent insurance companies related to many different types of risk; however, we self-insure for some potentially significant risks and obligations. In these circumstances, we believe that it is more cost effective for us to self-insure certain risks than to pay the high premium costs. The risks and exposures that we self-insure include, but are not limited to certain property, product defects, employment risks, environmental matters, political risks, and intellectual property matters. Should there be a loss or adverse judgment or other decision in an area for which we are self-insured, then our financial condition, results of operations and liquidity may be adversely affected.

If we fail to maintain proper and effective internal control or remediate current or future deficiencies, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, our ability to operate our business and investors' views of us.

Ensuring that we have adequate internal financial and accounting controls and procedures so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with United States generally accepted accounting principles. We are required to comply with Section 404 of the Sarbanes-Oxley Act of 2002 which requires annual management assessment of the effectiveness of our internal control over financial reporting and a report by our independent auditors. Although we have never identified a material weakness in our internal control over financial reporting, we have from time to time identified significant deficiencies. If we fail to remediate these significant deficiencies or to maintain proper and effective internal control over financial reporting in the future, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, harm our ability to operate our business and reduce the trading price of our stock.

We are subject to stringent environmental and other regulations, which may force us to incur significant expenses.

We must comply with all applicable federal, state, local and foreign governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous substances used in our products and manufacturing processes. Our failure to comply with applicable regulations could result in fines, suspension of production, cessation of operations or future liabilities. Such environmental regulations have required us in the past, and could require us in the future, to buy costly equipment or to incur significant expenses to comply with such regulations. Our failure to control the use of, or adequately restrict the discharge of, hazardous substances could

impact the health of our employees and others and could impact our ability to operate. Such failure could also restrict our ability to ship certain products to certain countries, require us to modify our operations' logistics, or require us to incur other significant costs and expenses. There is a continuing expansion in environmental laws with a focus on reducing or eliminating hazardous substances and substances of high concern in electronic products and shipping materials. These and other future environmental regulations could require us to reengineer certain of our existing products and may make it more expensive for us to manufacture, sell and ship our products. In addition, the number and complexity of laws focused on the energy efficiency of electronic products and accessories, the recycling of electronic products, and the reduction in the quantity and the recycling of packing materials have expanded significantly. It may be difficult for us to timely comply with these laws and we may not have sufficient quantities of compliant products to meet customers' needs, thereby adversely impacting our sales and profitability. We may also have to write off inventory in the event that we hold unsaleable inventory as a result of changes to regulations or customer requirements. We expect these risks and trends to continue. In addition, we anticipate increased customer requirements to meet voluntary criteria related to the reduction or elimination of substances of high concern in our products, energy efficiency measures, and supplier practices

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associated with sourcing and manufacturing. These requirements may increase our own costs, as well as those passed on to us by our supply chain.

Customer demands for us to implement business practices that are more stringent than existing legal requirements may reduce our revenue opportunities or cause us to incur higher costs.

Some of our customers and potential customers are requiring that we implement operating practices that are more stringent than what is required by applicable laws with respect to workplace and labor requirements, the type of materials we use in our products, environmental matters or other items. To comply with such requirements, we may have to pass these same operating practices on to our suppliers. Our suppliers may refuse to implement these operating practices, or may charge us more for complying with them. The cost to implement such practices may cause us to incur higher costs and reduce our profitability, and if we choose not to implement such practices, such customers may disqualify us as a supplier, resulting in decreased revenue opportunities. Developing, administering, monitoring and auditing these customer-requested practices at our own sites and those in our supply chain will increase our costs and may require that we hire more personnel.

Customer demands and regulations related to conflict-free minerals may force us to incur additional expenses.

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, in August 2012, the SEC released investigation, disclosure and reporting requirements regarding the use of "conflict" minerals mined from the Democratic Republic of Congo and adjoining countries and which are necessary to the functionality or production of products. We filed a report on Form SD with the SEC regarding such matters on May 23, 2018. Other countries are considering similar regulations. If we cannot certify that we are using conflict-free minerals, customers may demand that we change the sourcing of minerals and other materials used in the manufacture of our products, even if the costs for compliant minerals and materials significantly increases and availability is limited. If we make changes to materials or suppliers, there will likely be costs associated with qualifying new suppliers and production capacity and quality could be negatively impacted. Our relationships with customers and suppliers may be adversely affected if we are unable to certify that our products are "conflict-free." We have incurred, and expect in the future to incur, additional costs associated with complying with these new disclosure requirements, such as costs related to determining the source of any conflict minerals used in our products. We may also encounter challenges to satisfy those customers who require that all of the components of our products be certified as conflict free in a materially different manner than advocated by the Responsible Minerals Initiative or the Dodd-Frank Wall Street Reform and Consumer Protection Act. If we are not able to meet customer requirements, customers may choose to disqualify us as a supplier and we may have to write off inventory in the event that it cannot be sold.

Regulatory authorities in jurisdictions into which we ship our products could levy fines or restrict our ability to export or transfer products.

A significant portion of our sales are made through the exporting and importing of products. In addition to local jurisdictions' trade regulations, our U.S.-manufactured products or products based on U.S. technology are subject to U.S. laws and regulations governing international trade, including, but not limited to the Foreign Corrupt Practices Act, Export Administration Regulations (EAR), International Traffic in Arms Regulations (ITAR) and trade sanctions against embargoed countries and denied entities administered by the U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC). Licenses or proper license exceptions are required for the shipment of our products to certain countries. A determination by the U.S. or foreign government that we have failed to comply with trade or export regulations or anti-bribery regulations can result in penalties which may include denial of export privileges, fines, civil or criminal penalties, and seizure of products. Such penalties could have a material adverse effect on our business, sales and earnings. Further, a change in these laws and regulations could restrict our ability to transfer

product to previously permitted countries, customers, distributors or other third parties. Any one or more of these sanctions or a change in laws or regulations could have a material adverse effect on our business, financial condition and results of operations.

The outcome of future examinations of our income tax returns could have an adverse effect on our results of operations.

We are subject to examination of our income tax returns by the IRS and other tax authorities for fiscal 2005 and later. We are subject to certain income tax examinations in foreign jurisdictions for fiscal 2007 and later.

We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from the current examinations. There can be no assurance that the final determination of any of these or any future examinations will not have an adverse effect on our effective tax rates, financial position and results of operations.

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Exposure to greater than anticipated income tax liabilities, changes in tax rules and regulations (including the Act), changes in the interpretation of tax rules and regulations, or unfavorable assessments from tax audits could affect our effective tax rates, financial condition and results of operations

We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. Our income tax obligations could be affected by many factors, including but not limited to changes to our corporate operating structure, intercompany arrangements and tax planning strategies.

Our income tax expense is computed based on tax rates at the time of the respective financial period. Our future effective tax rates, financial condition and results from operations could be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, by changes in the tax rules and regulations or the interpretation of tax rules and regulations in the jurisdictions in which we do business or by changes in the valuation of our deferred tax assets.

Currently, a majority of our revenue is generated from customers located outside the U.S., and a substantial portion of our assets, including employees, are located outside of the U.S. Recently enacted U.S. tax legislation significantly changed the taxation of U.S.-based multinational corporations, by, among other things, reducing the U.S. corporate income tax rate, adopting elements of a territorial tax system, assessing a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and creating new taxes on certain foreign-sourced earnings. The new legislation is unclear in some respects and will require interpretations and implementing regulations by the Internal Revenue Service, as well as state tax authorities, and the legislation could be subject to potential amendments and technical corrections, any of which could lessen or increase certain adverse impacts of the legislation. A significant portion of our earnings are earned by our subsidiaries outside the U.S. Changes to the taxation of certain foreign earnings resulting from the newly enacted U.S. tax legislation, along with the state tax impact of these changes and potential future cash distributions, will likely have an adverse effect on our effective tax rate. Furthermore, changes to the taxation of undistributed foreign earnings could change our future intentions regarding reinvestment of such earnings. The foregoing items could have a material adverse effect on our business, cash flow, results of operations or financial conditions.

The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors.

The market price of our common stock has fluctuated significantly in the past and is likely to fluctuate in the future. The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors, many of which are beyond our control, including, but not limited to:

- quarterly variations in our operating results or the operating results of other technology companies;
- our ability to realize the expected benefits of our recent acquisition of Microsemi;
- general conditions in the semiconductor industry;
- global economic and financial conditions;
- changes in our financial guidance or our failure to meet such guidance;
- changes in analysts' estimates of our financial performance or buy/sell recommendations;
- any other acquisitions we pursue or complete; and
- actual or anticipated announcements of technical innovations or new products by us or our competitors.

In addition, the stock market has from time to time experienced significant price and volume fluctuations that have affected the market prices for many companies and that often have been unrelated to the operating performance of such companies. These broad market fluctuations and other factors have harmed and may harm the market price of our



common stock. Some or all of the foregoing factors could also cause the market price of our convertible debentures to decline or fluctuate substantially.

Anti-takeover defenses in our charter documents and under Delaware law could discourage takeover attempts, which could also reduce the market price of our common stock.

Our certificate of incorporation and bylaws contain provisions that could delay or prevent a change in control of Microchip. These provisions could also make it difficult for stockholders to elect directors that are not nominated by the current members of our board of directors or take other corporate actions, including effecting changes in our management. These provisions include:

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the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquiror;

the right of our board of directors to elect a director to fill a vacancy created by the expansion of our board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

the requirement that a special meeting of stockholders may be called only by the holders of 50% or more of the combined voting power of all classes of our capital stock, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;

the ability of our board of directors, by majority vote, to amend the bylaws, which may allow our board of directors to take additional actions to prevent an unsolicited takeover and inhibit the ability of an acquiror to amend the bylaws to facilitate an unsolicited takeover attempt; and

advance notice procedures with which stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of us.

In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us for a certain period of time. The application of Section 203 also could have the effect of delaying or preventing a change in control of us.

Any of these provisions could, under certain circumstances, depress the market price of our common stock.

As a result of our acquisition activity, our goodwill and intangible assets have increased significantly in recent years and we may in the future incur impairments to goodwill or intangible assets.

When we acquire a business, a substantial portion of the purchase price of the acquisition is allocated to goodwill and other identifiable intangible assets. The amount of the purchase price which is allocated to goodwill is determined by the excess of the purchase price over the net identifiable assets acquired. As of September 30, 2018, we had goodwill of \$6.79 billion and net intangible assets of \$6.83 billion. In connection with the completion of our acquisition of Microsemi in May 2018, our balance of goodwill and intangible assets increased significantly. We review our indefinite-lived intangible assets, including goodwill, for impairment annually in the fourth fiscal quarter or whenever events or changes in circumstances indicate that the carrying amount of those assets is more likely than not impaired. Factors that may be considered in assessing whether goodwill or intangible assets may be impaired include a decline in our stock price or market capitalization, reduced estimates of future cash flows and slower growth rates in our industry. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. Because we operate in highly competitive environments, projections of our future operating results and cash flows may vary significantly from our actual results. No goodwill impairment charges were recorded in fiscal 2019 or in fiscal 2018. In the six months ended September 30, 2018, we recognized \$3.5 million of intangible asset impairment charges. No material intangible asset impairment charges were recorded in fiscal 2018. If in future periods, we determine that our goodwill or intangible assets are impaired, we will be required to write down these assets which would have a negative effect on our consolidated financial statements.

Our foreign pension plans are unfunded, and any requirement to fund these plans in the future could negatively affect our cash position and operating capital.

In connection with our acquisitions of Microsemi and Atmel, we assumed defined benefit pension plans that cover certain of our French and German employees. Plan benefits are managed in accordance with local statutory requirements. Benefits are based on years of service and employee compensation levels. The projected benefit obligation totaled \$64.8 million at September 30, 2018. Most of these plans are unfunded in compliance with local statutory regulations, and we have no immediate intention of funding these plans. Benefits are paid when amounts become due, commencing when participants retire. We expect to pay approximately \$1.1 million in fiscal 2019 for benefits earned. Should legislative regulations require complete or partial funding of these plans in the future, it could negatively affect our cash position and operating capital.

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From time to time we receive grants from governments, agencies and research organizations. If we are unable to comply with the terms of those grants, we may not be able to receive or recognize grant benefits or we may be required to repay grant benefits previously paid to us and recognize related charges, which would adversely affect our operating results and financial position.

From time to time, we receive economic incentive grants and allowances from European governments, agencies and research organizations targeted at increasing employment at specific locations. The subsidy grant agreements typically contain economic incentive, headcount, capital and research and development expenditure and other covenants that must be met to receive and retain grant benefits, and these programs can be subjected to periodic review by the relevant governments. Noncompliance by us with the conditions of the grants could result in our forfeiture of all or a portion of any future amounts to be received, as well as the repayment of all or a portion of amounts received to date.

Conversion of our debentures will dilute the ownership interest of our existing stockholders.

The conversion of some or all of our outstanding debentures will dilute the ownership interest of existing stockholders to the extent we deliver common stock upon conversion of the debentures. Upon conversion, we may satisfy our conversion obligation by delivering cash, shares of common stock or any combination, at our option. If upon conversion we elect to deliver cash for the lesser of the conversion value and principal amount of the debentures, we would pay the holder the cash value of the applicable number of shares of our common stock. Upon conversion, we intend to satisfy the lesser of the principal amount or the conversion value of the debentures in cash. If the conversion value of a debenture exceeds the principal amount of the debenture, we may also elect to deliver cash in lieu of common stock for the conversion value in excess of the one thousand dollars principal amount (i.e., the conversion spread). There would be no adjustment to the numerator in the net income per common share computation for the cash settled portion of the debentures as that portion of the debt instrument will always be settled in cash. The conversion spread will be included in the denominator for the computation of diluted net income per common share. Any sales in the public market of any common stock issuable upon conversion of our debentures could adversely affect prevailing market prices of our common stock. In addition, the existence of the debentures may encourage short selling by market participants because the conversion of the debentures could be used to satisfy short positions, or anticipated conversion of the debentures into shares of our common stock could depress the price of our common stock.

Climate change regulations and sustained adverse climate change pose regulatory and physical risks that could harm our results of operations or affect the way we conduct business.

Climate change regulations at the federal, state or local level or in international jurisdictions could require us to limit emissions, change our manufacturing processes, obtain substitute materials which may cost more or be less available, increase our investment in control technology for greenhouse gas emissions, fund offset projects or undertake other costly activities. These regulations could significantly increase our costs and restrict our manufacturing operations by virtue of requirements for new equipment. New permits may be required for our current operations, or expansions thereof. Failure to timely receive permits could result in fines, suspension of production, or cessation of operations at one or more facilities. In addition, restrictions on carbon dioxide or other greenhouse gas emissions could result in significant costs such as higher energy costs, and utility companies passing down carbon taxes, emission cap and trade programs and renewable portfolio standards. The cost of complying, or of failing to comply, with these and other climate change and emissions regulations could have an adverse effect on our operating results.

Further, any sustained adverse change in climate could have a direct adverse economic impact on us, such as water and power shortages, and higher costs of water or energy to control the temperature of our facilities. Certain of our operations are located in arid or tropical regions, such as Arizona, Thailand, and the Philippines. Some environmental experts predict that these regions may become vulnerable to storms, severe floods and droughts due to climate change.

While we maintain business recovery plans that are intended to allow us to recover from natural disasters or other events that can interrupt our business, we cannot be certain that our plans will protect us from all such disasters or events.

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

We did not repurchase any shares of our common stock in the three months ended September 30, 2018.

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## Item 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference			Included Herewith
		Form	File Number	Exhibit Filing Date	
4.1	<u>2001 Employee Stock Purchase Plan as Amended Through October 1, 2018</u>				X
31.1	<u>Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act)</u>				X
31.2	<u>Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act)</u>				X
32	<u>Certifications Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *</u>				X
101.INS	XBRL Instance Document				
101.SCH	XBRL Taxonomy Extension Schema Document				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				

\* Furnished herewith.

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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.

MICROCHIP TECHNOLOGY INCORPORATED

Date: November 7, 2018 By: /s/ J. Eric Bjornholt  
J. Eric Bjornholt  
Vice President and Chief Financial Officer  
(Duly Authorized Officer, and  
Principal Financial and Accounting Officer)