

SILICON LABORATORIES INC  
Form 10-Q  
July 25, 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 June 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: 000-29823

**SILICON LABORATORIES INC.**

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(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**74-2793174**

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

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

(Address of principal executive offices)

**78701**

(Zip Code)

**(512) 416-8500**

(Registrant's telephone number, including area code)

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

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

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

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

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

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

As of July 17, 2018, 43,351,408 shares of common stock of Silicon Laboratories Inc. were outstanding.

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## Cautionary Statement

*Except for the historical financial information contained herein, the matters discussed in this report on Form 10-Q (as well as documents incorporated herein by reference) may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include declarations regarding the intent, belief or current expectations of Silicon Laboratories Inc. and its management and may be signified by the words believe, estimate, expect, intend, anticipate, plan, project, will or similar language. You are cautioned that any such*

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*forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Factors that could cause or contribute to such differences include those discussed under Risk Factors and elsewhere in this report. Silicon Laboratories disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

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

|  | <b>June 30,<br/>2018</b> | <b>December 30,<br/>2017</b> |
|--|--------------------------|------------------------------|
| <b>Assets</b>  |                          |                              |
| Current assets:  |                          |                              |
| Cash and cash equivalents  | \$ 194,864               | \$ 269,366                   |
| Short-term investments   | 347,416                  | 494,657                      |
| Accounts receivable, net   | 93,830                   | 71,367                       |
| Inventories  | 87,163                   | 73,132                       |
| Prepaid expenses and other current assets  | 52,642                   | 39,120                       |
| Total current assets   | 775,915                  | 947,642                      |
| Property and equipment, net  | 132,021                  | 127,682                      |
| Goodwill   | 396,689                  | 288,227                      |
| Other intangible assets, net   | 192,601                  | 83,144                       |
| Other assets, net  | 95,385                   | 88,387                       |
| Total assets   | \$ 1,592,611             | \$ 1,535,082                 |
| <b>Liabilities and Stockholders Equity</b>   |                          |                              |
| Current liabilities:   |                          |                              |
| Accounts payable   | \$ 40,323                | \$ 38,851                    |
| Deferred revenue and returns liability   | 24,503                   |                              |
| Deferred income on shipments to distributors   |                          | 50,115                       |
| Other current liabilities  | 74,254                   | 73,359                       |
| Total current liabilities  | 139,080                  | 162,325                      |
| Convertible debt   | 348,233                  | 341,879                      |
| Other non-current liabilities  | 76,830                   | 77,862                       |
| Total liabilities  | 564,143                  | 582,066                      |
| Commitments and contingencies  |                          |                              |
| Stockholders equity:   |                          |                              |
| Preferred stock \$0.0001 par value; 10,000 shares authorized; no shares issued   |                          |                              |
| Common stock \$0.0001 par value; 250,000 shares authorized; 43,350 and 42,707 shares issued and outstanding at June 30, 2018 and December 30, 2017, respectively | 4                        | 4                            |
| Additional paid-in capital   | 111,984                  | 102,862                      |
| Retained earnings  | 918,440                  | 851,307                      |
| Accumulated other comprehensive loss   | (1,960)                  | (1,157)                      |
| Total stockholders equity  | 1,028,468                | 953,016                      |
| Total liabilities and stockholders equity  | \$ 1,592,611             | \$ 1,535,082                 |

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

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

|   | Three Months Ended |                 | Six Months Ended |                 |
|---|--------------------|-----------------|------------------|-----------------|
|   | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| Revenues                                    | \$ 217,106         | \$ 190,098      | \$ 422,490       | \$ 369,126      |
| Cost of revenues                            | 85,814             | 76,906          | 166,961          | 150,773         |
| Gross margin                                | 131,292            | 113,192         | 255,529          | 218,353         |
| Operating expenses:                         |                    |                 |                  |                 |
| Research and development                    | 59,495             | 52,432          | 114,323          | 104,756         |
| Selling, general and administrative         | 53,796             | 39,826          | 99,490           | 79,981          |
| Operating expenses                          | 113,291            | 92,258          | 213,813          | 184,737         |
| Operating income                            | 18,001             | 20,934          | 41,716           | 33,616          |
| Other income (expense):                     |                    |                 |                  |                 |
| Interest income and other, net              | 1,609              | 1,595           | 4,811            | 2,171           |
| Interest expense                            | (4,888)            | (4,699)         | (9,771)          | (4,501)         |
| Income before income taxes                  | 14,722             | 17,830          | 36,756           | 31,286          |
| Provision (benefit) for income taxes        | 442                | 1,261           | (3,929)          | (709)           |
| Net income                                  | \$ 14,280          | \$ 16,569       | \$ 40,685        | \$ 31,995       |
| Earnings per share:                         |                    |                 |                  |                 |
| Basic                                       | \$ 0.33            | \$ 0.39         | \$ 0.94          | \$ 0.76         |
| Diluted                                     | \$ 0.32            | \$ 0.38         | \$ 0.92          | \$ 0.74         |
| Weighted-average common shares outstanding: |                    |                 |                  |                 |
| Basic                                       | 43,312             | 42,478          | 43,138           | 42,287          |
| Diluted                                     | 44,294             | 43,178          | 44,106           | 43,104          |

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

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

|  | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|--|---------------------------|-------------------------|--------------------------|-------------------------|
|  | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| Net income   | \$ 14,280                 | \$ 16,569               | \$ 40,685                | \$ 31,995               |
| Other comprehensive income (loss), before tax              |                           |                         |                          |                         |
| Net changes to available-for-sale securities               |                           |                         |                          |                         |
| Unrealized gains (losses) arising during the period        | 396                       | 163                     | (363)                    | 408                     |
| Reclassification for losses included in net income         |                           |                         | 49                       |                         |
| Net changes to cash flow hedges                            |                           |                         |                          |                         |
| Unrealized losses arising during the period                | (397)                     |                         | (420)                    |                         |
| Reclassification for (gains) losses included in net income | 33                        |                         | 33                       | (1,808)                 |
| Other comprehensive income (loss), before tax              | 32                        | 163                     | (701)                    | (1,400)                 |
| Provision (benefit) for income taxes                       | 7                         | 57                      | (148)                    | (490)                   |
| Other comprehensive income (loss)                          | 25                        | 106                     | (553)                    | (910)                   |
| Comprehensive income                                       | \$ 14,305                 | \$ 16,675               | \$ 40,132                | \$ 31,085               |

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



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

|   | <b>Six Months Ended</b>  |                         |
|---|--------------------------|-------------------------|
|   | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| <b>Operating Activities</b>   |                          |                         |
| Net income  | \$ 40,685                | \$ 31,995               |
| Adjustments to reconcile net income to cash provided by operating activities: |                          |                         |
| Depreciation of property and equipment  | 7,643                    | 7,308                   |
| Amortization of other intangible assets and other assets                      | 18,366                   | 13,571                  |
| Amortization of debt discount and debt issuance costs                         | 6,354                    | 3,907                   |
| Stock-based compensation expense  | 24,311                   | 21,652                  |
| Deferred income taxes   | (5,830)                  | (6,242)                 |
| Changes in operating assets and liabilities:                                  |                          |                         |
| Accounts receivable   | (16,705)                 | (887)                   |
| Inventories   | (565)                    | (7,737)                 |
| Prepaid expenses and other assets   | (1,759)                  | 12,539                  |
| Accounts payable  | 2,980                    | 2,363                   |
| Other current liabilities and income taxes                                    | (17,249)                 | 14                      |
| Deferred income, deferred revenue and returns liability                       | (4,193)                  | 3,251                   |
| Other non-current liabilities   | (3,260)                  | (1,169)                 |
| Net cash provided by operating activities                                     | 50,778                   | 80,565                  |
| <b>Investing Activities</b>   |                          |                         |
| Purchases of available-for-sale investments                                   | (148,437)                | (389,234)               |
| Sales and maturities of available-for-sale investments                        | 295,405                  | 92,307                  |
| Purchases of property and equipment   | (11,406)                 | (8,390)                 |
| Purchases of other assets   | (5,893)                  | (1,784)                 |
| Acquisition of business, net of cash acquired                                 | (239,729)                | (13,658)                |
| Net cash used in investing activities   | (110,060)                | (320,759)               |
| <b>Financing Activities</b>   |                          |                         |
| Proceeds from issuance of long-term debt, net                                 |                          | 389,468                 |
| Payments on debt  |                          | (72,500)                |
| Repurchases of common stock   | (3,397)                  |                         |
| Payment of taxes withheld for vested stock awards                             | (18,408)                 | (14,101)                |
| Proceeds from the issuance of common stock                                    | 6,585                    | 6,836                   |
| Net cash provided by (used in) financing activities                           | (15,220)                 | 309,703                 |
| Increase (decrease) in cash and cash equivalents                              | (74,502)                 | 69,509                  |
| Cash and cash equivalents at beginning of period                              | 269,366                  | 141,106                 |
| Cash and cash equivalents at end of period                                    | \$ 194,864               | \$ 210,615              |

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



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**Silicon Laboratories Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Significant Accounting Policies**

*Basis of Presentation and Principles of Consolidation*

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

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

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

*Use of Estimates*

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

*Reclassifications*

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

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)***Adoption of New Revenue Accounting Standard*

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

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

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

| <b>Financial Statement Line Item*</b>              | <b>Increase (Decrease)</b>                  |   |
|--|---|---|
|  | <b>Three Months Ended<br/>June 30, 2018</b> | <b>Six Months Ended<br/>June 30, 2018</b> |
| <b>Condensed Consolidated Statements of Income</b> |   |   |
| Revenues   | \$ 7,464                                    | \$ 8,162                                  |
| Cost of revenues                                   | \$ 2,233                                    | \$ 1,983                                  |
| Net income   | \$ 4,507                                    | \$ 4,897                                  |
| <b>Earnings per share:</b>                         |   |   |
| Basic  | \$ 0.10                                     | \$ 0.11                                   |
| Diluted  | \$ 0.10                                     | \$ 0.11                                   |

| <b>Condensed Consolidated Balance Sheet**</b> | <b>June 30, 2018</b> |  |
|---|----------------------|--|
| Prepaid expenses and other current assets     | \$ 2,959             |  |
| Goodwill                                      | \$ (2,842)           |  |
| Other assets, net                             | \$ (3,559)           |  |
| Deferred revenue and returns liability        | \$ 24,503            |  |
| Deferred income on shipments to distributors  | \$ (64,936)          |  |
| Other current liabilities                     | \$ 5,485             |  |

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|                   |    |        |  |
|-------------------|----|--------|--|
| Retained earnings | \$ | 31,092 |  |
|-------------------|----|--------|--|

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

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

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

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**Silicon Laboratories Inc.**

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

**(Unaudited)**

*Revenue Recognition*

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

Performance Obligations

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

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

Transaction Price

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

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

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

### Contract Balances

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



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**Silicon Laboratories Inc.**

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

**(Unaudited)**

*Recent Accounting Pronouncements*

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

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

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

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

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



Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****2. Earnings Per Share**

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

|   | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|---|---------------------------|-------------------------|--------------------------|-------------------------|
|   | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| Net income  | \$ 14,280                 | \$ 16,569               | \$ 40,685                | \$ 31,995               |
| Shares used in computing basic earnings per share   | 43,312                    | 42,478                  | 43,138                   | 42,287                  |
| Effect of dilutive securities:                      |                           |                         |                          |                         |
| Stock-based awards                                  | 982                       | 700                     | 968                      | 817                     |
| Shares used in computing diluted earnings per share | 44,294                    | 43,178                  | 44,106                   | 43,104                  |
| Earnings per share:                                 |                           |                         |                          |                         |
| Basic   | \$ 0.33                   | \$ 0.39                 | \$ 0.94                  | \$ 0.76                 |
| Diluted   | \$ 0.32                   | \$ 0.38                 | \$ 0.92                  | \$ 0.74                 |

The Company intends to settle the principal amount of its convertible senior notes in cash and any excess value in shares in the event of a conversion. Accordingly, shares issuable upon conversion of the principal amount have been excluded from the calculation of diluted earnings per share. If the market value of the notes under certain prescribed conditions exceeds the conversion amount, the excess is included in the denominator for the computation of diluted earnings per share using the treasury stock method. As of June 30, 2018, approximately 0.1 million shares were included in the denominator for the calculation of diluted earnings per share. See Note 7, *Debt*, to the Condensed Consolidated Financial Statements for additional information.

**3. Fair Value of Financial Instruments**

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

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

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

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

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## Silicon Laboratories Inc.

## Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

| Description                    | Fair Value Measurements at June 30, 2018 Using                 |   |   | Total      |
|--------------------------------|--|---|---|------------|
|                                | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |            |
| <b>Assets:</b>                 |  |   |   |            |
| <b>Cash equivalents:</b>       |  |   |   |            |
| Money market funds             | \$ 82,111  | \$  | \$  | \$ 82,111  |
| Corporate debt securities      |  | 23,906  |   | 23,906     |
| Government debt securities     |  | 8,359   |   | 8,359      |
| Total cash equivalents         | \$ 82,111  | \$ 32,265                                     | \$  | \$ 114,376 |
| <b>Short-term investments:</b> |  |   |   |            |
| Government debt securities     | \$ 71,459  | \$ 124,322                                    | \$  | \$ 195,781 |
| Corporate debt securities      |  | 151,635                                       |   | 151,635    |
| Total short-term investments   | \$ 71,459  | \$ 275,957                                    | \$  | \$ 347,416 |
| <b>Other assets, net:</b>      |  |   |   |            |
| Auction rate securities        | \$   | \$  | \$ 5,642                                  | \$ 5,642   |
| Total                          | \$   | \$  | \$ 5,642                                  | \$ 5,642   |
| <b>Total</b>                   | \$ 153,570   | \$ 308,222                                    | \$ 5,642                                  | \$ 467,434 |

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

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|                           |    |         |    |         |          |            |
|---------------------------|----|---------|----|---------|----------|------------|
| <b>Other assets, net:</b> |    |         |    |         |          |            |
| Auction rate securities   | \$ |         | \$ | 5,681   | \$ 5,681 |            |
| Total                     | \$ |         | \$ | 5,681   | \$ 5,681 |            |
| <b>Total</b>              | \$ | 254,237 | \$ | 412,766 | \$ 5,681 | \$ 672,684 |

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

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

Available-for-sale investments

The Company's investments are reported at fair value, with unrealized gains and losses, net of tax, recorded as a component of accumulated other comprehensive loss in the Consolidated Balance Sheet. The following summarizes the contractual underlying maturities of the Company's available-for-sale investments at June 30, 2018 (in thousands):

|                                      | <b>Cost</b> | <b>Fair Value</b> |
|--------------------------------------|-------------|-------------------|
| Due in one year or less              | \$ 313,832  | \$ 313,333        |
| Due after one year through ten years | 131,655     | 130,420           |
| Due after ten years                  | 24,042      | 23,681            |
|                                      | \$ 469,529  | \$ 467,434        |

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

|                            | <b>Less Than 12 Months</b> |                                | <b>12 Months or Greater</b> |                                | <b>Total</b>      |                                |
|----------------------------|----------------------------|--------------------------------|-----------------------------|--------------------------------|-------------------|--------------------------------|
|                            | <b>Fair Value</b>          | <b>Gross Unrealized Losses</b> | <b>Fair Value</b>           | <b>Gross Unrealized Losses</b> | <b>Fair Value</b> | <b>Gross Unrealized Losses</b> |
| <b>As of June 30, 2018</b> |                            |                                |                             |                                |                   |                                |
| Government debt securities | \$ 153,566                 | \$ (893)                       | \$ 3,269                    | \$ (6)                         | \$ 156,835        | \$ (899)                       |
| Corporate debt securities  | 126,879                    | (790)                          | 11,152                      | (70)                           | 138,031           | (860)                          |
| Auction rate securities    |                            |                                | 5,642                       | (358)                          | 5,642             | (358)                          |
|                            | \$ 280,445                 | \$ (1,683)                     | \$ 20,063                   | \$ (434)                       | \$ 300,508        | \$ (2,117)                     |

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



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

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

The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the severity and duration of the impairment, changes in underlying credit ratings, forecasted recovery, the Company's intent to sell or the likelihood that it would be required to sell the investment before its anticipated recovery in market value and the probability that the scheduled cash payments will continue to be made. As of June 30, 2018, the Company has determined that no other-than-temporary impairment losses existed.

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

Level 3 fair value measurements

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

Auction rate securities

| Fair Value at<br>June 30, 2018<br>(000s) | Valuation Technique  | Unobservable Input      | Weighted Average |
|--|----------------------|-------------------------|------------------|
| \$ 5,642                                 | Discounted cash flow | Estimated yield         | 2.56%            |
|  |                      | Expected holding period | 10 years         |
|  |                      | Estimated discount rate | 3.82%            |

The Company has followed an established internal control procedure used in valuing auction rate securities. The procedure involves the analysis of valuation techniques and evaluation of unobservable inputs commonly used by market participants to price similar instruments, and which have been demonstrated to provide reasonable estimates of prices obtained in actual market transactions. Outputs from the valuation process are assessed against various market sources when they are available, including marketplace quotes, recent trades of similar illiquid securities,

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benchmark indices and independent pricing services. The technique and unobservable input parameters may be recalibrated periodically to achieve an appropriate estimation of the fair value of the securities.

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

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

The following summarizes the activity in Level 3 financial instruments for the three and six months ended June 30, 2018 (in thousands):

**Assets**

|  | <b>Three Months<br/>Ended</b> | <b>Six Months<br/>Ended</b> |
|--|-------------------------------|-----------------------------|
| <b>Auction Rate Securities</b>                   |                               |                             |
| Beginning balance                                | \$ 5,609                      | \$ 5,681                    |
| Gain (loss) included in other comprehensive loss | 33                            | (39)                        |
| Balance at June 30, 2018                         | \$ 5,642                      | \$ 5,642                    |

**Fair values of other financial instruments**

The Company's debt is recorded at cost, but is measured at fair value for disclosure purposes. The fair value of the Company's convertible senior notes is determined using observable market prices. The notes are traded in less active markets and are therefore classified as a Level 2 fair value measurement. As of June 30, 2018 and December 30, 2017, the fair value of the convertible senior notes was \$488.7 million and \$466.2 million, respectively.

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

**4. Derivative Financial Instruments**

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

**Cash Flow Hedges**

*Foreign Currency Forward Contracts*

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

The Company entered into foreign currency forward contracts in March 2018 for a portion of its forecasted operating expenses denominated in the Norwegian Krone. As of June 30, 2018, the contracts had maturities of one to twelve months and an aggregate notional value of \$8.4 million. The fair value of the contracts was not material as of June 30, 2018. Contract losses recognized in other comprehensive income during the three and six months ended June 30, 2018 as well as losses expected to be reclassified into earnings in the next 12 months were not material. The amounts reclassified from accumulated other comprehensive loss into earnings were not material for any of the periods presented.

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

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

**Non-designated Hedges***Foreign Currency Forward Contracts*

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

As of June 30, 2018 and July 1, 2017, the Company held one foreign currency forward contract denominated in the Norwegian Krone with a notional value of \$1.6 million and \$3.6 million, respectively. The fair value of the contracts was not material as of June 30, 2018 or July 1, 2017. The contract held as of June 30, 2018 has a maturity date of September 27, 2018 and it was not designated as a hedging instrument.

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

| Gain (Loss) Recognized in Income   | Three Months Ended |                 | Six Months Ended |                 | Location                       |
|------------------------------------|--------------------|-----------------|------------------|-----------------|--------------------------------|
|                                    | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |                                |
| Foreign currency forward contracts | \$ 114             | \$ (35)         | \$ (9)           | \$ (129)        | Interest income and other, net |

**5. Balance Sheet Details**

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

*Inventories*

|                  | <b>June 30,<br/>2018</b> |    | <b>December 30,<br/>2017</b> |  |
|------------------|--------------------------|----|------------------------------|--|
| Work in progress | \$ 57,570                | \$ | 46,698                       |  |
| Finished goods   | 29,593                   |    | 26,434                       |  |
|                  | \$ 87,163                | \$ | 73,132                       |  |

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****6. Acquisitions***Z-Wave*

On April 18, 2018, the Company completed the acquisition of the Z-Wave business from Sigma Designs, Inc. for \$243 million in cash. Z-Wave is an Internet of Things (IoT) technology for smart home solutions.

This strategic acquisition expands the Company's IoT connectivity portfolio in the connected home market, while further scaling the Company's engineering team. These factors contributed to a purchase price that was in excess of the fair value of the net assets acquired and, as a result, the Company recorded goodwill. A portion of the goodwill is deductible for tax purposes. The purchase price was allocated as follows (in thousands):

|                                     | Amount     | Weighted-Average<br>Amortization Period<br>(Years) |
|-------------------------------------|------------|--|
| <b>Intangible assets:</b>           |            |  |
| In-process research and development | \$ 20,900  | Not amortized                                      |
| Developed technology                | 69,875     | 7  |
| Customer relationships              | 25,000     | 4  |
| Trademarks                          | 9,900      | 7  |
|                                     | 125,675    |  |
| Cash and cash equivalents           | 2,841      |  |
| Accounts receivable                 | 5,311      |  |
| Inventory                           | 15,581     |  |
| Other current assets                | 329        |  |
| Goodwill                            | 108,461    |  |
| Other non-current assets            | 2,587      |  |
| Accounts payable                    | (3,306)    |  |
| Other current liabilities           | (8,917)    |  |
| Other non-current liabilities       | (5,993)    |  |
| Total purchase price                | \$ 242,569 |  |

In-process research and development (IPR&D) represents acquired smart home technology that had not achieved technological feasibility as of the acquisition date. The fair value of IPR&D was determined using the income approach. The discount rate applied to the projected cash flows was 15.0%, which reflects the risks related to the projects. The allocation of the purchase price is preliminary and subject to change, primarily

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for the valuation of intangible assets and product warranty accruals and the finalization of income tax matters.

Revenues attributable to the Z-Wave business from the date of acquisition to June 30, 2018 were \$7.6 million. The Company recorded approximately \$4.9 million of acquisition-related costs in selling, general and administrative expenses during the six months ended June 30, 2018.



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

The following unaudited pro forma financial information presents combined results of operations for each of the periods presented, giving effect to the acquisition as if it had been completed on January 1, 2017. The pro forma financial information includes charges for the fair value write-up associated with acquired inventory, adjustments for amortization expense of acquired intangible assets and tax-related expenses. The pro forma results of operations are presented for informational purposes only and are not necessarily indicative of the results of operations that would have been achieved if the acquisition had taken place on January 1, 2017 or of results that may occur in the future (in thousands, except per share data):

|                     | Three Months Ended |                 | Six Months Ended |                 |
|---------------------|--------------------|-----------------|------------------|-----------------|
|                     | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| Revenues            | \$ 218,145         | \$ 202,697      | \$ 436,333       | \$ 396,911      |
| Net income          | \$ 18,281          | \$ 9,156        | \$ 41,221        | \$ 20,093       |
| Earnings per share: |                    |                 |                  |                 |
| Basic               | \$ 0.42            | \$ 0.22         | \$ 0.96          | \$ 0.48         |
| Diluted             | \$ 0.41            | \$ 0.21         | \$ 0.93          | \$ 0.47         |

**7. Debt**1.375% Convertible Senior Notes

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

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

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shares of the Company's common stock or a combination of cash and shares, at the Company's election.

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

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

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

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

|                                 | June 30,<br>2018 | December 30,<br>2017 |
|---------------------------------|------------------|----------------------|
| <b>Liability component</b>      |                  |                      |
| Principal                       | \$ 400,000       | \$ 400,000           |
| Unamortized debt discount       | (44,979)         | (50,499)             |
| Unamortized debt issuance costs | (6,788)          | (7,622)              |
| Net carrying amount             | \$ 348,233       | \$ 341,879           |
| <b>Equity component</b>         |                  |                      |
| Net carrying amount             | \$ 57,735        | \$ 57,735            |

The liability component of the Notes is recorded in convertible debt on the Consolidated Balance Sheet. The equity component of the Notes is recorded in additional paid-in capital. The effective interest rate for the liability component was 4.75%. As of June 30, 2018, the remaining period over which the debt discount and debt issuance costs will be amortized was 3.7 years.

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

|                                     | Three Months Ended |                 | Six Months Ended |                 |
|-------------------------------------|--------------------|-----------------|------------------|-----------------|
|                                     | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| Contractual interest expense        | \$ 1,375           | \$ 1,375        | \$ 2,765         | \$ 1,757        |
| Amortization of debt discount       | 2,767              | 2,640           | 5,520            | 3,395           |
| Amortization of debt issuance costs | 418                | 398             | 834              | 512             |
|                                     | \$ 4,560           | \$ 4,413        | \$ 9,119         | \$ 5,664        |

Amended Credit Agreement

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

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

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**Silicon Laboratories Inc.**

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

**(Unaudited)**

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

The Second Amended Credit Agreement contains various conditions, covenants and representations with which the Company must be in compliance in order to borrow funds and to avoid an event of default, including financial covenants that the Company must maintain a leverage ratio (funded debt/EBITDA) of no more than 3.00 to 1 and a minimum fixed charge coverage ratio (EBITDA/interest payments, income taxes and capital expenditures) of no less than 1.25 to 1. As of June 30, 2018, the Company was in compliance with all covenants of the Second Amended Credit Agreement. The Company's obligations under the Second Amended Credit Agreement are guaranteed by the Guarantors and are secured by a security interest in substantially all assets of the Company and the Guarantors.

**8. Commitments and Contingencies**

*Securities Litigation*

On March 15, 2018, a purported class action lawsuit was filed by Ann Noyes on behalf of the stockholders of Sigma Designs, Inc. in the United States District Court in the Northern District of California against Sigma Designs, certain current and former Sigma Designs board members and the Company (collectively, the Defendants). The lawsuit alleged violations of Section 14(a) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 14a-9 arising out of Sigma Designs attempt to sell its Z-Wave business to the Company. The lawsuit claimed that the Defendants filed a materially incomplete and misleading preliminary proxy statement in connection with the proposed sale of the Z-Wave business. The lawsuit was voluntarily dismissed on May 17, 2018.

*Patent Litigation Cresta Technology*

On January 28, 2014, Cresta Technology Corporation (Cresta Technology), a Delaware corporation, filed a lawsuit against the Company (among others) in the United States District Court in the District of Delaware, alleging infringement of three United States Patents (the Cresta Patents). Cresta Technology declared bankruptcy in 2016. The

U.S. District Court approved the plaintiff's voluntary dismissal of the Delaware lawsuit on April 3, 2018.

On July 16, 2014, the Company filed a lawsuit against Cresta Technology in the United States District Court in the Northern District of California alleging infringement of six United States Patents. The Northern District of California lawsuit is currently stayed. At this time, the Company cannot predict the outcome of this matter or the resulting financial impact to it, if any.

*Patent Litigation Bandspeed*

On June 21, 2018, Bandspeed, LLC ( Bandspeed ), a Texas limited liability company, filed a lawsuit against the Company in the United States District Court of the Western District of Texas, Austin Division, alleging infringement of eight United States Patents. The Company is reviewing the Bandspeed complaint and intends to defend the matter vigorously. **At this time, the Company cannot predict the outcome of the Bandspeed matter or the resulting financial impact to it, if any.**

*Other*

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

Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****9. Stockholders' Equity***Common Stock*

The Company issued 0.7 million shares of common stock during the six months ended June 30, 2018.

*Share Repurchase Programs*

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

| <b>Program Authorization Date</b> | <b>Program Termination Date</b> | <b>Program Amount</b> |
|-----------------------------------|---------------------------------|-----------------------|
| October 2017                      | December 2018                   | \$ 100,000            |
| January 2017                      | December 2017                   | \$ 100,000            |

These programs allow for repurchases to be made in the open market or in private transactions, including structured or accelerated transactions, subject to applicable legal requirements and market conditions. The Company repurchased 36 thousand shares of its common stock for \$3.4 million during the six months ended June 30, 2018. These shares were retired upon repurchase. The Company did not repurchase any shares of its common stock during the six months ended July 1, 2017.

*Reclassifications From Accumulated Other Comprehensive Loss*

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

| <b>Reclassification</b> | <b>Three Months Ended</b> |                     | <b>Six Months Ended</b> |                     |
|-------------------------|---------------------------|---------------------|-------------------------|---------------------|
|                         | <b>June 30, 2018</b>      | <b>July 1, 2017</b> | <b>June 30, 2018</b>    | <b>July 1, 2017</b> |
|                         |                           |                     |                         |                     |

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|  |    |      |    |  |      |      |          |
|--|----|------|----|--|------|------|----------|
| Losses on available-for-sales securities to: |    |      |    |  |      |      |          |
| Interest income and other, net               | \$ |      | \$ |  | \$   | (49) | \$       |
| Gains (losses) on cash flow hedges to:       |    |      |    |  |      |      |          |
| Interest expense                             |    | (33) |    |  | (33) |      | 1,808    |
|  |    | (33) |    |  | (82) |      | 1,808    |
| Income tax expense (benefit)                 |    | 7    |    |  | 17   |      | (633)    |
| Total reclassifications                      | \$ | (26) | \$ |  | \$   | (65) | \$ 1,175 |



Table of Contents**Silicon Laboratories Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****10. Revenues**

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

|                    | Three Months Ended |                    | Six Months Ended |                    |
|--------------------|--------------------|--------------------|------------------|--------------------|
|                    | June 30,<br>2018   | July 1,<br>2017(1) | June 30,<br>2018 | July 1,<br>2017(1) |
| Internet of Things | \$ 116,023         | \$ 97,727          | \$ 219,114       | \$ 185,575         |
| Infrastructure     | 51,520             | 38,221             | 100,940          | 74,202             |
| Broadcast          | 34,172             | 36,655             | 70,237           | 73,982             |
| Access             | 15,391             | 17,495             | 32,199           | 35,367             |
| Revenues           | \$ 217,106         | \$ 190,098         | \$ 422,490       | \$ 369,126         |

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

A portion of the Company's sales are made to distributors under agreements allowing certain rights of return and/or price protection related to the final selling price to the end customers. These factors impact the timing and uncertainty of revenues and cash flows. The Company recognized revenue of \$15.4 million and \$22.7 million during the three and six months ended June 30, 2018, respectively, from performance obligations that were satisfied in previous reporting periods. The following disaggregates the Company's revenue by sales channel (in thousands):

|                  | Three Months Ended |                    | Six Months Ended |                    |
|------------------|--------------------|--------------------|------------------|--------------------|
|                  | June 30,<br>2018   | July 1,<br>2017(1) | June 30,<br>2018 | July 1,<br>2017(1) |
| Distributors     | \$ 154,032         | \$ 135,795         | \$ 304,303       | \$ 261,539         |
| Direct customers | 63,074             | 54,303             | 118,187          | 107,587            |
|                  | \$ 217,106         | \$ 190,098         | \$ 422,490       | \$ 369,126         |

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

**11. Stock-Based Compensation**

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

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

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

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

|                                     | Three Months Ended |                 | Six Months Ended |                 |
|-------------------------------------|--------------------|-----------------|------------------|-----------------|
|                                     | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| Cost of revenues                    | \$ 294             | \$ 264          | \$ 590           | \$ 522          |
| Research and development            | 5,669              | 5,503           | 11,438           | 10,750          |
| Selling, general and administrative | 6,156              | 5,399           | 12,283           | 10,380          |
|                                     | 12,119             | 11,166          | 24,311           | 21,652          |
| Income tax benefit                  | 1,677              | 3,175           | 6,896            | 8,457           |
|                                     | \$ 10,442          | \$ 7,991        | \$ 17,415        | \$ 13,195       |

The Company had approximately \$84.9 million of total unrecognized compensation costs related to granted stock options and awards as of June 30, 2018 that are expected to be recognized over a weighted-average period of approximately 2.2 years. There were no significant stock-based compensation costs capitalized into assets in any of the periods presented.

**12. Income Taxes**

Provision (benefit) for income taxes includes both domestic and foreign income taxes at the applicable tax rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences. Income tax expense (benefit) was \$0.4 million and \$1.3 million for the three months ended June 30, 2018 and July 1, 2017, resulting in effective tax rates of 3.0% and 7.1%, respectively. Income tax expense (benefit) was \$(3.9) million and \$(0.7) million for the six months ended June 30, 2018 and July 1, 2017, resulting in effective tax rates of (10.7)% and (2.3)%, respectively. The effective tax rate for the three and six months ended June 30, 2018 decreased from the prior periods primarily due to a decrease in the U.S. statutory tax rate from 35% to 21%. This decrease was partially offset by a decrease in the foreign tax rate benefit.

**U.S. Tax Reform**

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate income tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries previously deferred from tax and creates a

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new provision designed to tax global intangible low-taxed income ( GILTI ). Also on December 22, 2017, the U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 ( SAB 118 ) which provides for a measurement period of up to one year from the enactment for companies to complete their accounting for the Act. The Company is applying the guidance in SAB 118 when accounting for the enactment-date effects of the Act.

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

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**Silicon Laboratories Inc.**

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

**(Unaudited)**

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

The Act subjects a U.S. shareholder to tax on GILTI earned by certain foreign subsidiaries. Under U.S. GAAP, the Company is permitted to make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred as a period expense only. Given the complexity of the GILTI provisions, the Company is still evaluating the effects of the GILTI provisions and has not yet made its accounting policy election. At June 30, 2018, because the Company is still evaluating the GILTI provisions, the Company has included tax expense related to GILTI for the current year in its estimated annual effective tax rate and has not provided additional GILTI on deferred items.

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

**Uncertain Tax Positions**

As of June 30, 2018, the Company had gross unrecognized tax benefits of \$2.6 million, of which \$2.0 million would affect the effective tax rate if recognized. During the six months ended June 30, 2018, the Company released \$1.5 million of unrecognized tax benefits as a result of a lapse in the statute of limitations.

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

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

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

Tax years 2013 through 2018 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company is not currently under audit in any major taxing jurisdiction.

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

### **13. Subsequent Event**

On July 24, 2018, the U.S. Court of Appeals for the Ninth Circuit reversed the decision of the U.S. Tax Court in *Altera Corp. v. Commissioner* related to the treatment of stock-based compensation in an intercompany cost-sharing arrangement. The Company is currently evaluating the impact of this decision and such impact could be material to its financial statements.

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related notes thereto included elsewhere in this report. This discussion contains forward-looking statements. Please see the Cautionary Statement above and Risk Factors below for discussions of the uncertainties, risks and assumptions associated with these statements. Our fiscal year-end financial reporting periods are a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2018 will have 52 weeks and fiscal 2017 had 52 weeks. Our second quarter of fiscal 2018 ended June 30, 2018. Our second quarter of fiscal 2017 ended July 1, 2017.

**Overview**

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

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

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

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

Ethernet (PoE) devices.

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

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



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**Current Period Highlights**

Revenues increased \$27.0 million in the recent quarter compared to the second quarter of fiscal 2017, primarily due to increased revenues from our IoT and Infrastructure products offset by decreased revenues from our Broadcast and Access products. Gross margin increased \$18.1 million during the same period due primarily to increased product sales. Gross margin as a percent of revenues increased to 60.5% in the recent quarter compared to 59.5% in the second quarter of fiscal 2017 primarily due to variations in product mix. Operating expenses increased by \$21.0 million in the recent quarter compared to the second quarter of fiscal 2017 due primarily to increased personnel-related expenses, legal fees, amortization of intangible assets and new product introduction costs. Operating income in the recent quarter was \$18.0 million compared to \$20.9 million in the second quarter of fiscal 2017.

We ended the second quarter with \$542.3 million in cash, cash equivalents and short-term investments. Net cash provided by operating activities was \$50.8 million during the recent six-month period. Accounts receivable was \$93.8 million at June 30, 2018, representing 39 days sales outstanding (DSO). Inventory was \$87.2 million at June 30, 2018, representing 91 days of inventory (DOI).

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

In the first six months of fiscal 2018, we introduced timing solutions to meet the high-performance requirements of 56G/112G SerDes clocking applications; new multiprotocol software for our Wireless Gecko portfolio, enabling Bluetooth® Low Energy (LE) connectivity with sub-GHz IoT devices; a proven reference design for ITU-T G.8262-compliant Synchronous Ethernet (SyncE) applications; a multiprotocol mesh networking solution for the IoT jointly created with Wirepas; low-power PCI Express® (PCIe®) Gen 4 clock buffers for 1.5 V and 1.8 V applications; two new Power over Ethernet (PoE) Powered Device (PD) families for a wide range of IoT applications; new Tiny Gecko MCUs that extend battery life for IoT connected devices; and a new Wi-Fi® portfolio to simplify the design of power-sensitive, battery-operated Wi-Fi products. We plan to continue to introduce products that increase the content we provide for existing applications, thereby enabling us to serve markets we do not currently address and expand our total available market opportunity.

During the six months ended June 30, 2018, we had no customer that represented more than 10% of our revenues. In addition to direct sales to customers, some of our end customers purchase products indirectly from us through distributors and contract manufacturers. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer. Two of our distributors who sell to our customers, Arrow Electronics and Edom Technology, each represented more than 10% of our revenues during the six months ended June 30, 2018. There were no contract manufacturers that accounted for more than 10% of our revenues during the six months ended June 30, 2018.

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

The percentage of our revenues derived from outside of the United States was 82% during the six months ended June 30, 2018. All of our revenues to date have been denominated in U.S. dollars. We believe that a majority of our revenues will continue to be derived from customers outside of the United States.

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**Results of Operations**

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

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

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

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

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

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

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

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

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

|                                      | Three Months Ended |                 | Six Months Ended |                 |
|--------------------------------------|--------------------|-----------------|------------------|-----------------|
|                                      | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| Revenues                             | 100.0%             | 100.0%          | 100.0%           | 100.0%          |
| Cost of revenues                     | 39.5               | 40.5            | 39.5             | 40.8            |
| Gross margin                         | 60.5               | 59.5            | 60.5             | 59.2            |
| Operating expenses:                  |                    |                 |                  |                 |
| Research and development             | 27.4               | 27.6            | 27.1             | 28.4            |
| Selling, general and administrative  | 24.8               | 20.9            | 23.5             | 21.7            |
| Operating expenses                   | 52.2               | 48.5            | 50.6             | 50.1            |
| Operating income                     | 8.3                | 11.0            | 9.9              | 9.1             |
| Other income (expense):              |                    |                 |                  |                 |
| Interest income and other, net       | 0.8                | 0.8             | 1.1              | 0.6             |
| Interest expense                     | (2.3)              | (2.4)           | (2.3)            | (1.2)           |
| Income before income taxes           | 6.8                | 9.4             | 8.7              | 8.5             |
| Provision (benefit) for income taxes | 0.2                | 0.7             | (0.9)            | (0.2)           |
| Net income                           | 6.6%               | 8.7%            | 9.6%             | 8.7%            |

**Revenues**

| (in millions)      | Three Months Ended |                 |         |             | Six Months Ended |                 |         |             |
|--------------------|--------------------|-----------------|---------|-------------|------------------|-----------------|---------|-------------|
|                    | June 30,<br>2018   | July 1,<br>2017 | Change  | %<br>Change | June 30,<br>2018 | July 1,<br>2017 | Change  | %<br>Change |
| Internet of Things | \$ 116.0           | \$ 97.7         | \$ 18.3 | 18.7%       | \$ 219.1         | \$ 185.6        | \$ 33.5 | 18.1%       |
| Infrastructure     | 51.5               | 38.2            | 13.3    | 34.8%       | 100.9            | 74.2            | 26.7    | 36.0%       |
| Broadcast          | 34.2               | 36.7            | (2.5)   | (6.8)%      | 70.3             | 74.0            | (3.7)   | (5.1)%      |
| Access             | 15.4               | 17.5            | (2.1)   | (12.0)%     | 32.2             | 35.3            | (3.1)   | (9.0)%      |
|                    | \$ 217.1           | \$ 190.1        | \$ 27.0 | 14.2%       | \$ 422.5         | \$ 369.1        | \$ 53.4 | 14.5%       |

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

- Increased revenues of \$18.3 million for our IoT products, due primarily to increased demand for our wireless products and the addition of revenues from acquisitions.
- Increased revenues of \$13.3 million for our Infrastructure products, due primarily to increased demand for our isolation products and timing products.
- Decreased revenues of \$2.5 million for Broadcast products, due primarily to decreases in the market for our consumer products and decreased demand for our automotive products.

- Decreased revenues of \$2.1 million for our Access products, due primarily to decreased demand for our VoIP products and decreases in the market for such products.

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

- Increased revenues of \$33.5 million for our IoT products, due primarily to increased demand for our wireless products and the addition of revenues from acquisitions.
- Increased revenues of \$26.7 million for our Infrastructure products, due primarily to increased demand for our isolation products and timing products.
- Decreased revenues of \$3.7 million for Broadcast products, due primarily to decreases in the market for our consumer products.
- Decreased revenues of \$3.1 million for our Access products, due primarily to decreased demand for our VoIP products and decreases in the market for such products.

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Unit volumes of our products increased by 16.9% and average selling prices decreased by 2.5% compared to the three months ended July 1, 2017. Unit volumes of our products increased by 16.9% and average selling prices decreased by 2.2% compared to the six months ended July 1, 2017. The average selling prices of our products may fluctuate significantly from period to period due to changes in product mix and other factors. In general, as our products become more mature, we expect to experience decreases in average selling prices. We anticipate that newly announced, higher priced, next generation products and product derivatives will offset some of these decreases.

**Gross Margin**

| (in millions)      | Three Months Ended |                 |         | Six Months Ended |                 |         |
|--------------------|--------------------|-----------------|---------|------------------|-----------------|---------|
|                    | June 30,<br>2018   | July 1,<br>2017 | Change  | June 30,<br>2018 | July 1,<br>2017 | Change  |
| Gross margin       | \$ 131.3           | \$ 113.2        | \$ 18.1 | \$ 255.5         | \$ 218.4        | \$ 37.1 |
| Percent of revenue | 60.5%              | 59.5%           | 1.0%    | 60.5%            | 59.2%           | 1.3%    |

The increased dollar amount of gross margin in the recent three month period was due to increases in gross margin of \$10.5 million for our Internet of Things products and \$10.1 million for our Infrastructure products, offset by decreases in gross margin of \$2.0 million for our Broadcast products and \$0.5 million for our Access products. The increased dollar amount of gross margin in the recent six month period was due to increases in gross margin of \$20.9 million for our Internet of Things products and \$20.4 million for our Infrastructure products, offset by decreases in gross margin of \$3.4 million for our Broadcast products and \$0.8 million for our Access products. Gross margin increased during the recent three and six month periods due primarily to increased product sales. Gross margin in the recent three and six month periods included \$2.1 million in acquisition-related charges for the fair value write-up associated with acquired inventory. Gross margin as a percent of revenues increased during the recent three and six month periods primarily due to a higher mix of Infrastructure products sold in the recent periods.

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

**Research and Development**

| (in millions)            | June 30,<br>2018 | Three Months Ended |        |             | %<br>Change | June 30,<br>2018 | Six Months Ended |        |             |
|--------------------------|------------------|--------------------|--------|-------------|-------------|------------------|------------------|--------|-------------|
|                          |                  | July 1,<br>2017    | Change | %<br>Change |             |                  | July 1,<br>2017  | Change | %<br>Change |
| Research and development | \$ 59.5          | \$ 52.4            | \$ 7.1 | 13.5%       | \$ 114.3    | \$ 104.8         | \$ 9.5           | 9.1%   |             |
| Percent of revenue       | 27.4%            | 27.6%              |        |             | 27.1%       | 28.4%            |                  |        |             |

The increase in research and development expense in the three and six month periods was primarily due to increases of \$3.6 million and \$6.2 million, respectively, for personnel-related expenses, including costs associated with increased headcount and acquisitions, \$1.9 million and \$1.8 million, respectively, for the amortization of intangible assets, and \$0.8 million and \$0.8 million, respectively, for new product introduction costs. The decrease in research and development expense as a percent of revenues in the recent three and six month periods was due to our increased revenues. We expect that research and development expense will increase in absolute dollars in the third quarter of fiscal 2018 due to costs associated with increased headcount and costs incurred in connection with the acquisition of the Z-Wave business.



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

| (in millions)                       | Three Months Ended |                 |         |             | Six Months Ended |                 |         |             |
|-------------------------------------|--------------------|-----------------|---------|-------------|------------------|-----------------|---------|-------------|
|                                     | June 30,<br>2018   | July 1,<br>2017 | Change  | %<br>Change | June 30,<br>2018 | July 1,<br>2017 | Change  | %<br>Change |
| Selling, general and administrative | \$ 53.8            | \$ 39.8         | \$ 14.0 | 35.1%       | \$ 99.5          | \$ 80.0         | \$ 19.5 | 24.4%       |
| Percent of revenue                  | 24.8%              | 20.9%           |         |             | 23.5%            | 21.7%           |         |             |

The increase in selling, general and administrative expense in the three and six month periods was primarily due to increases of \$6.8 million and \$12.1 million, respectively, for personnel-related expenses, including costs associated with increased headcount and acquisitions, \$3.6 million and \$4.1 million, respectively, for legal fees, primarily related to acquisition-related costs, and \$1.1 million and \$1.0 million, respectively, for the amortization of intangible assets. We expect that selling, general and administrative expense will decrease in absolute dollars in the third quarter of fiscal 2018.

**Interest Income and Other, Net**

Interest income and other, net for the three and six months ended June 30, 2018 was \$1.6 million and \$4.8 million, respectively, compared to \$1.6 million and \$2.2 million for the three and six months ended July 1, 2017, respectively. The increase in interest income and other, net in the recent six month period was primarily due to increased interest income earned as a result of higher market interest rates and a gain of \$1.0 million recorded in connection with a fair value adjustment to an equity investment.

**Interest Expense**

Interest expense for the three and six months ended June 30, 2018 was \$4.9 million and \$9.8 million, respectively, compared to \$4.7 million and \$4.5 million for the three and six months ended July 1, 2017, respectively. The increase in interest expense in the recent six month period was primarily due to increased interest expense of \$3.5 million on our convertible debt, including amortization of the debt discount and debt issuance costs, and a \$2.0 million gain recorded in the prior six month period in connection with the termination of our interest rate swap agreement.

**Provision (Benefit) for Income Taxes**

| (in millions)                        | Three Months Ended |                 |          |             | Six Months Ended |                 |          |             |
|--------------------------------------|--------------------|-----------------|----------|-------------|------------------|-----------------|----------|-------------|
|                                      | June 30,<br>2018   | July 1,<br>2017 | Change   | %<br>Change | June 30,<br>2018 | July 1,<br>2017 | Change   | %<br>Change |
| Provision (benefit) for income taxes | \$ 0.4             | \$ 1.3          | \$ (0.9) | (69.2)%     | \$ (3.9)         | \$ (0.7)        | \$ (3.2) | (457.1)%    |
| Effective tax rate                   | 3.0%               | 7.1%            |          |             | (10.7)%          | (2.3)%          |          |             |

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We have generated a tax benefit in both the six months ended June 30, 2018 and July 1, 2017 primarily due to the recognition of excess tax benefits from stock-based compensation. The effective tax rate for the three and six months ended June 30, 2018 decreased from the prior periods primarily due to a decrease in the U.S. statutory tax rate from 35% to 21%. This decrease was partially offset by a decrease in the foreign tax rate benefit.

The effective tax rates for each of the periods presented differ from the U.S. federal statutory tax rates of 21% and 35%, respectively, due to the amount of income earned in foreign jurisdictions where the tax rate may be higher or lower than the federal statutory tax rate, as well as other permanent items including research and development tax credits, and the tax effects of stock-based compensation.

Table of Contents**Business Outlook**

The following represents our business outlook for the third quarter of fiscal 2018.

| Income Statement Item        | Estimate                       |
|------------------------------|--------------------------------|
| Revenues                     | \$224 million to \$230 million |
| Gross margin                 | 58.5%                          |
| Operating expenses           | \$111.0 million                |
| Effective tax rate *         | 0.0%                           |
| Diluted earnings per share * | \$0.40 to \$0.46               |

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\* Does not reflect any potential impact resulting from the U.S. Court of Appeals for the Ninth Circuit's decision on July 24, 2018 on the Altera Tax Court case involving the treatment of stock-based compensation in an intercompany cost-sharing arrangement. The Company is currently evaluating the impact of this decision and such impact could be material to its financial statements.

**Liquidity and Capital Resources**

Our principal sources of liquidity as of June 30, 2018 consisted of \$542.3 million in cash, cash equivalents and short-term investments, of which approximately \$418.4 million was held by our U.S. entities. The remaining balance was held by our foreign subsidiaries. Our cash equivalents and short-term investments consisted of government debt securities, which include agency bonds, municipal bonds, U.S. government bonds, international government bonds, international agency commercial paper and variable-rate demand notes; corporate debt securities, which include asset-backed securities, corporate bonds, commercial paper and certificates of deposit; and money market funds. Our long-term investments consisted of auction-rate securities. As of June 30, 2018, we held \$6.0 million par value auction-rate securities, all of which have experienced failed auctions because sell orders exceeded buy orders. See Note 3, *Fair Value of Financial Instruments*, to the Condensed Consolidated Financial Statements for additional information.

*Operating Activities*

Net cash provided by operating activities was \$50.8 million during the six months ended June 30, 2018, compared to net cash provided of \$80.6 million during the six months ended July 1, 2017. Operating cash flows during the six months ended June 30, 2018 reflect our net income of \$40.7 million, adjustments of \$50.8 million for depreciation, amortization, stock-based compensation and deferred income taxes, and a net cash outflow of \$40.7 million due to changes in our operating assets and liabilities.

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Accounts receivable increased to \$93.8 million at June 30, 2018 from \$71.4 million at December 30, 2017. The increase in accounts receivable resulted primarily from normal variations in the timing of collections and billings. Our average DSO was 39 days at June 30, 2018 and 32 days at December 30, 2017.

Inventory increased to \$87.2 million at June 30, 2018 from \$73.1 million at December 30, 2017. A portion of the increase was due to inventory acquired from the Z-Wave business acquisition, which included a write-up adjustment to record the inventory at fair value. Our inventory level is primarily impacted by our need to make purchase commitments to support forecasted demand and variations between forecasted and actual demand. Our DOI was 91 days at June 30, 2018 and 81 days at December 30, 2017.

### *Investing Activities*

Net cash used in investing activities was \$110.0 million during the six months ended June 30, 2018, compared to net cash used of \$320.8 million during the six months ended July 1, 2017. The decrease in cash outflows was principally due to a decrease of \$443.9 million in net purchases of marketable securities, offset by an increase of \$226.1 million in net payments for the acquisition of businesses. See Note 6, *Acquisitions*, to the Condensed Consolidated Financial Statements for additional information.

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We anticipate capital expenditures of approximately \$34 to \$38 million for fiscal 2018. Additionally, as part of our growth strategy, we expect to evaluate opportunities to invest in or acquire other businesses, intellectual property or technologies that would complement or expand our current offerings, expand the breadth of our markets or enhance our technical capabilities.

*Financing Activities*

Net cash used in financing activities was \$15.2 million during the six months ended June 30, 2018, compared to net cash provided of \$309.7 million during the six months ended July 1, 2017. The decrease in cash inflows was principally due to \$389.5 million in net proceeds from the issuance of long-term debt during the six months ended July 1, 2017, offset by a decrease of \$72.5 million in payments on debt. In October 2017, the Board of Directors authorized a program to repurchase up to \$100 million of our common stock from January 2018 through December 2018.

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

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

**Critical Accounting Policies and Estimates**

The preparation of financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles requires that we make estimates and assumptions that affect the amounts reported. Changes in facts and circumstances could have a significant impact on the resulting estimated amounts included in the financial statements. We believe the following critical accounting policies affect our more complex judgments and estimates.

*Inventory valuation* We assess the recoverability of inventories through the application of a set of methods, assumptions

and estimates. In determining net realizable value, we write down inventory that may be slow moving or have some form of obsolescence, including inventory that has aged more than 12 months. We also adjust the valuation of inventory when its manufacturing cost exceeds the estimated selling price less costs of completion, disposal and transportation. We assess the potential for any unusual customer returns based on known quality or business issues and write-off inventory losses for scrap or non-saleable material. Inventory not otherwise identified to be written down is compared to an assessment of our 12-month forecasted demand. The result of this methodology is compared against the product life cycle and competitive situations in the marketplace to determine the appropriateness of the resulting inventory levels. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those that we project. In the event that actual demand is lower or market conditions are worse than originally projected, additional inventory write-downs may be required.

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

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

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

*Investments in auction-rate securities* We determine the fair value of our investments in auction-rate securities using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, amount of cash flows, expected holding periods of the securities and a discount to reflect our inability to liquidate the securities. For available-for-sale auction-rate securities, if the calculated value is below the carrying amount of the securities, we then determine if the decline in value is other-than-temporary. We consider various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, changes in underlying credit ratings, forecasted recovery, our intent to sell or the likelihood that we would be required to sell the investment before its anticipated recovery in market value and the probability that the scheduled cash payments will continue to be made. When we conclude that an other-than-temporary impairment has occurred, we assess whether we intend to sell the security or if it is more likely than not that we will be required to sell the security before recovery. If either of these two conditions is met, we recognize a charge in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If we do not intend to sell a security and it is not more likely than not that we will be required to sell the security before recovery, the unrealized loss is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recorded in accumulated other comprehensive loss.

*Revenue recognition* We recognize revenue when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. In order to achieve this core principle, we apply a five-step process. As part of this process, we analyze the performance obligations in a customer contract and estimate the consideration we expect to receive. The evaluation of performance obligations requires that we identify the promised goods and services in the contract. For contracts that contain more than one promised good and service, we then must determine whether the promises are capable of being distinct and if they are separately identifiable from other promises in the contract. Additionally, for our sales to distributors, we must estimate the impact that price adjustments and rights of return will have on consideration. We make these estimates based on available information, including recent sales activity and pricing data. If our evaluation of performance obligations is incorrect, we may recognize revenue sooner or later than is appropriate. If our estimates of consideration are inaccurate, we may recognize too much or too little revenue in a period.



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*Stock-based compensation* We recognize the fair-value of stock-based compensation transactions in the Consolidated Statements of Income. The fair value of our full-value stock awards (with the exception of market-based performance awards) equals the fair market value of our stock on the date of grant. The fair value of our market-based performance awards is estimated at the date of grant using a Monte-Carlo simulation. The fair value of our stock option and employee stock purchase plan grants is estimated at the date of grant using the Black-Scholes option pricing model. In addition, we are required to estimate the expected forfeiture rate of our stock grants and only recognize the expense for those shares expected to vest. If our actual experience differs significantly from the assumptions used to compute our stock-based compensation cost, or if different assumptions had been used, we may have recorded too much or too little stock-based compensation cost. See Note 11, *Stock-Based Compensation*, to the Condensed Consolidated Financial Statements for additional information.

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

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

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

**Recent Accounting Pronouncements**

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

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

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**Quantitative and Qualitative Disclosures about Market Risk**

*Interest Income*

Our investment portfolio includes cash, cash equivalents, short-term investments and long-term investments. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Our interest income is sensitive to changes in the general level of U.S. interest rates. A 100 basis point decline in yield on our investment portfolio holdings as of June 30, 2018 would decrease our future annual interest income by approximately \$4.9 million. We believe that our investment policy, which defines the duration, concentration, and minimum credit quality of the allowable investments, meets our investment objectives.

*Interest Expense*

We are exposed to interest rate fluctuations in the normal course of our business, including through our Credit Facility. The interest rate on the Credit Facility consists of a variable-rate of interest and an applicable margin. While we have drawn from the Credit Facility in the past, we have no borrowings as of June 30, 2018. If we borrow from the Credit Facility in the future, we will again be exposed to interest rate fluctuations.

*Foreign currency exchange rate risk*

We are exposed to foreign currency exchange rate risk primarily through assets, liabilities and operating expenses of our subsidiaries denominated in currencies other than the U.S. dollar. Our foreign subsidiaries are considered to be extensions of the U.S. parent. The functional currency of the foreign subsidiaries is the U.S. dollar. Accordingly, gains and losses resulting from remeasuring transactions denominated in currencies other than U.S. dollars are recorded in the Consolidated Statements of Income. We use foreign currency forward contracts to manage exposure to foreign exchange risk. Gains and losses on foreign currency forward contracts are recognized in earnings in the same period during which the hedged transaction is recognized.

*Investments in Auction-rate Securities*

As of June 30, 2018, we held \$6.0 million par value auction-rate securities, all of which have experienced failed auctions because sell orders exceeded buy orders. We are unable to predict if these funds will become available before their maturity dates. Additionally, if we determine that an other-than-temporary decline in the fair value of any of our available-for-sale auction-rate securities has occurred, we may be required to adjust the carrying value of the investments through an impairment charge.

**Available Information**

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

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

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

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**Item 4. Controls and Procedures**

We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of June 30, 2018 to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Such disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosures. There was no change in our internal controls during the fiscal quarter ended June 30, 2018 that materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

**Part II. Other Information**

**Item 1. Legal Proceedings**

Information regarding legal proceedings is provided in Note 8, *Commitments and Contingencies*, to the Condensed Consolidated Financial Statements. Such information is incorporated by reference herein.

**Item 1A. Risk Factors**

**Risks Related to our Business**

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

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

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

- The timing and volume of orders received from our customers;
- The timeliness of our new product introductions and the rate at which our new products may cannibalize our older products;
- The rate of acceptance of our products by our customers, including the acceptance of new products we may develop for integration in the products manufactured by such customers, which we refer to as "design wins";
- The time lag and realization rate between "design wins" and production orders;
- The demand for, and life cycles of, the products incorporating our mixed-signal solutions;
- The rate of adoption of mixed-signal products in the markets we target;
- Deferrals or reductions of customer orders in anticipation of new products or product enhancements from us or our competitors or other providers of mixed-signal ICs;
- Changes in product mix;

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- The average selling prices for our products could drop suddenly due to competitive offerings or competitive predatory pricing;
- The average selling prices for our products generally decline over time;
- Changes in market standards;
- Impairment charges related to inventory, equipment or other long-lived assets;
- The software used in our products, including software provided by third parties, may not meet the needs of our customers;
- Our customers may not be able to obtain other components such as capacitors (which are currently in short supply) that they need to incorporate in conjunction with our products, leading to potential downturn in the demand for our products;
- Significant legal costs to defend our intellectual property rights or respond to claims against us; and
- The rate at which new markets emerge for products we are currently developing or for which our design expertise can be utilized to develop products for these new markets.

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

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

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

- Requirements of customers;
- Accurate prediction of market and technical requirements;
- Timely completion and introduction of new designs;
- Timely qualification and certification of our products for use in our customers' products;
- Commercial acceptance and volume production of the products into which our ICs will be incorporated;
- Availability of foundry, assembly and test capacity;
- Achievement of high manufacturing yields;
- Quality, price, performance, power use and size of our products;
- Availability, quality, price and performance of competing products and technologies;



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- Our customer service, application support capabilities and responsiveness;
- Successful development of our relationships with existing and potential customers;
- Technology, industry standards or end-user preferences; and
- Cooperation of third-party software providers and our semiconductor vendors to support our chips within a system.

We cannot provide any assurance that products which we recently have developed or may develop in the future will achieve market acceptance. We have introduced to market or are in development of many products. If our products fail to achieve market acceptance, or if we fail to develop new products on a timely basis that achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected. The growth of the IoT market is dependent on the adoption of industry standards to permit devices to connect and communicate with each other. If the industry cannot agree on a common set of standards, then the growth of the IoT market may be slower than expected.

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

Our products serve as components and solutions in electronic devices in various markets. As a result, we have devoted and expect to continue to devote a large amount of resources to develop products based on new and emerging technologies and standards that will be commercially introduced in the future. Research and development expense during the six months ended June 30, 2018 was \$114.3 million, or 27.1% of revenues. A number of companies are actively involved in the development of these new technologies and standards. Should any of these companies delay or abandon their efforts to develop commercially available products based on new technologies and standards, our research and development efforts with respect to these technologies and standards likely would have no appreciable value. In addition, if we do not correctly anticipate new technologies and standards, or if the products that we develop based on these new technologies and standards fail to achieve market acceptance, our competitors may be better able to address market demand than we would. Furthermore, if markets for these new technologies and standards develop later than we anticipate, or do not develop at all, demand for our products that are currently in development would suffer, resulting in lower sales of these products than we currently anticipate.

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

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. From time to time, we receive letters from various industry participants alleging infringement of patents, trademarks or misappropriation of trade secrets or

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

- Cease selling or manufacturing products that use the challenged intellectual property;
- Obtain from the owner of the infringed intellectual property a right to a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all;

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- Redesign those products that use infringing intellectual property; or
- Pursue legal remedies with third parties to enforce our indemnification rights, which may not adequately protect our interests.

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

As part of our growth and product diversification strategy, we continue to evaluate opportunities to acquire other businesses, intellectual property or technologies that would complement our current offerings, expand the breadth of our markets or enhance our technical capabilities. On April 18, 2018, we acquired the Z-Wave business from Sigma Designs. This is acquisition and other acquisitions that we have made and may make in the future entail a number of risks that could materially and adversely affect our business and operating results, including:

- Problems integrating the acquired operations, technologies or products with our existing business and products;
- Diversion of management's time and attention from our core business;
- Need for financial resources above our planned investment levels;
- Difficulties in retaining business relationships with suppliers and customers of the acquired company;
- Risks associated with entering markets in which we lack prior experience;
- Risks associated with the transfer of licenses of intellectual property;
- Increased operating costs due to acquired overhead;

- Tax issues associated with acquisitions;
- Acquisition-related disputes, including disputes over earn-outs and escrows;
- Potential loss of key employees of the acquired company; and
- Potential impairment of related goodwill and intangible assets.

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

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

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

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

The future growth of our business will depend in large part on our ability to manage our relationships with current and future distributors and sales representatives, develop additional channels for the distribution and sale of our products and manage these relationships. During the six months ended June 30, 2018, 72% of our revenue was derived from distributors. As we execute our indirect sales strategy, we must manage the potential conflicts that may arise with our direct sales efforts. For example, conflicts with a distributor may arise when a customer begins purchasing directly from us rather than through the distributor. The inability to successfully execute or manage a multi-channel sales strategy could impede our future growth. In addition, relationships with our distributors often involve the use of price protection and inventory return rights. This often requires a significant amount of sales management's time and system resources to manage properly.

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

The loss of any of our key customers, or a significant reduction in sales to any one of them, would significantly reduce our revenues and adversely affect our business. During the six months ended June 30, 2018, our ten largest customers accounted for 19% of our revenues. Some of the markets for our products are dominated by a small number of potential customers. Therefore, our operating results in the foreseeable future will continue to depend on our ability to sell to these dominant customers, as well as the ability of these customers to sell products that incorporate our IC products. In the future, these customers may decide not to purchase our products at all, purchase fewer products than they did in the past or alter their purchasing patterns, particularly because:

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

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

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

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

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

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

Should problems occur in the operation or performance of our products, we may experience delays in meeting key introduction dates or scheduled delivery dates to our customers. These errors could also cause significant re-engineering costs, the diversion of our engineering personnel's attention from our product development efforts and cause significant customer relations and business reputation problems. Any defects could result in refunds, product replacement, product recall or other liability. Any of the foregoing could impose substantial costs and harm our business.

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

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

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

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

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

- Failure by us, our customers or their end customers to qualify a selected supplier;
- Potential insolvency of the third-party subcontractors;
- Reduced control over delivery schedules and quality;
- Limited warranties on wafers or products supplied to us;
- Potential increases in prices or payments in advance for capacity;
- Increased need for international-based supply, logistics and financial management;
- Their inability to supply or support new or changing packaging technologies; and



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- Low test yields.

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

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

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

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

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

We have established international subsidiaries and have opened offices in international markets to support our activities in Asia, the Americas and Europe. This has included the establishment of a headquarters in Singapore for non-U.S. operations. The percentage of our revenues derived from outside of the United States was 82% during the six months ended June 30, 2018. We may not be able to maintain or increase global market demand for our products. Our international operations are subject to a number of risks, including:

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

- Protectionist laws and business practices, including trade restrictions, tariffs, quotas and other trade barriers;
- Difficulties related to the protection of our intellectual property rights in some countries;
- Multiple, conflicting and changing tax and other laws and regulations that may impact both our international and domestic tax and other liabilities and result in increased complexity and costs, including the impact of the Tax Cuts and Jobs Act;
- Longer sales cycles;
- Greater difficulty in accounts receivable collection and longer collection periods;

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- High levels of distributor inventory subject to price protection and rights of return to us;
- Political and economic instability;
- Greater difficulty in hiring and retaining qualified personnel; and
- The need to have business and operations systems that can meet the needs of our international business and operating structure.

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

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

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

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

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

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

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

- A decline in demand for any of our more significant products;
- Failure of our products to achieve continued market acceptance;
- Competitive products;

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- New technological standards or changes to existing standards that we are unable to address with our products;
- A failure to release new products or enhanced versions of our existing products on a timely basis; and
- The failure of our new products to achieve market acceptance.

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

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

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

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

**Any dispositions could harm our financial condition**

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

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

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**Our stock price may be volatile**

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

- Actual or anticipated fluctuations in our operating results;
- Changes in financial estimates by securities analysts or our failure to perform in line with such estimates;
- Changes in market valuations of other technology companies, particularly semiconductor companies;
- Announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Introduction of technologies or product enhancements that reduce the need for our products;
- The loss of, or decrease in sales to, one or more key customers;
- A large sale of stock by a significant shareholder;
- Dilution from the issuance of our stock in connection with acquisitions;
- The addition or removal of our stock to or from a stock index fund;
- Departures of key personnel;

- The required expensing of stock awards; and
- The required changes in our reported revenue and revenue recognition accounting policy under ASC Topic 606, *Revenue from Contracts with Customers*.

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

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

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

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



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

The manufacturing of our products is a highly complex and technologically demanding process. Although we work closely with our foundries and assemblers to minimize the likelihood of reduced manufacturing yields, we have from time to time experienced lower than anticipated manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials could result in lower than anticipated manufacturing yields or unacceptable performance deficiencies, which could lower our gross margins. If our foundries fail to deliver fabricated silicon wafers of satisfactory quality in a timely manner, we will be unable to meet our customers' demand for our products in a timely manner, which would adversely affect our operating results and damage our customer relationships.

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

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

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

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

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

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

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

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

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

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

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

**We have limited resources compared to some of our current and potential competitors and we may not be able to compete effectively and increase market share**

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

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

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

- The division of our Board of Directors into three classes to be elected on a staggered basis, one class each year;

- The ability of our Board of Directors to issue shares of our preferred stock in one or more series without further authorization of our stockholders;
- A prohibition on stockholder action by written consent;
- Elimination of the right of stockholders to call a special meeting of stockholders;
- A requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders; and
- A requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation.

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

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**Risks related to our industry**

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

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

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

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

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

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

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

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

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**We may be the victim of business disruptions and security breaches, including cyber-attacks, which could lead to liability or could damage our reputation and financial results**

Information technology system and/or network disruptions, regardless of the cause, but including acts of sabotage, error, or other actions, could harm the company's operations. Failure to effectively prevent, detect, and recover from security breaches, including cyber-attacks, could result in the misuse of company assets, disruption to the company, diversion of management resources, regulatory inquiries, legal claims or proceedings, reputational damage, loss of sales and other costs to the company. We routinely face attacks that attempt to breach our security protocols, gain access to or disrupt our computerized systems or steal proprietary company, customer, partner or employee information. These attacks are sometimes successful. These attacks may be due to security breaches, employee error, theft, malfeasance, phishing schemes, ransomware, faulty password or data security management, or other irregularities. The theft, loss, destruction, unavailability or misuse of personal or business data collected, used, stored or transferred by us to run our business could result in increased security costs or costs related to defending legal claims. Industrial espionage, theft or loss of our intellectual property data could lead to counterfeit products or harm the competitive position of our products and services. Costs to implement, test and maintain measures to promote compliance with applicable privacy and data security laws as well as to protect the overall security of our system could be significant. Attempted or successful attacks against our products and services could damage our reputation with customers or users and reduce demand for our products and services.

**Changes in the Privacy and Data Security/Protection Laws Could Have an Adverse Effect on our Operations**

Federal, state and international privacy-related or data protection laws and regulations could have an adverse effect on our operations. Complying with these laws and the possibility of proceedings against us by governmental entities or others in relation to these laws could increase operational costs. In May 2018, the European Union's General Data Protection Regulation (GDPR) goes into effect, replacing the EU's 1995 Data Protection Directive. The costs of compliance with the GDPR and the potential for fines and penalties in the event of a breach of the GDPR may have an adverse effect on our operations.

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

We rely on information technology for the effective operation of our business. Our systems are subject to damage or interruption from a number of potential sources, including natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, computer viruses, theft, physical or electronic break-ins, cyber-attacks, sabotage, vandalism, or similar events or disruptions. Our security measures may not detect or prevent such security breaches. Any such compromise of our information security could result in the theft or unauthorized publication or use of our confidential business or proprietary information, result in the unauthorized release of customer, supplier or employee data, result in a violation of privacy or other laws, expose us to a risk of litigation or damage our reputation. In addition, our inability to use or access information systems at critical points in time could unfavorably impact the timely and efficient operation of our business, which could negatively affect our business and operating results.

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

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

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



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

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

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

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

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

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

The following table summarizes repurchases of our common stock during the three months ended June 30, 2018 (in thousands, except per share amounts):

| Period         | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total Number<br>of Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs | Approximate<br>Dollar Value of<br>Shares that May<br>Yet Be Purchased<br>Under the Plans<br>or Programs |
|----------------|---|---------------------------------------|--|---|
| April 1, 2018  |   |                                       |  |   |
| April 28, 2018 |   | \$                                    |  | \$ 100,000  |
| April 29, 2018 |   |                                       |  |   |
| May 26, 2018   | 36  | \$ 93.81                              | 36   | \$ 96,604   |

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|               |    |    |       |           |
|---------------|----|----|-------|-----------|
| May 27, 2018  |    |    |       |           |
| June 30, 2018 |    | \$ |       | \$ 96,604 |
| Total         | 36 | \$ | 93.81 | 36        |

In October 2017, the Board of Directors authorized a program to repurchase up to \$100 million of our common stock from January 2018 through December 2018. The program allows for repurchases to be made in the open market or in private transactions, including structured or accelerated transactions, subject to applicable legal requirements and market conditions.

**Item 3. Defaults Upon Senior Securities**

Not applicable

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**Item 4. Mine Safety Disclosures**

Not applicable

**Item 5. Other Information**

Not applicable

**Item 6. Exhibits**

The following exhibits are filed as part of this report:

**Exhibit  
Number**

|         |  |
|---------|--|
| 2.1*    | <u>Agreement and Plan of Merger, dated December 7, 2017, by and among Silicon Laboratories Inc., Seguin Merger Subsidiary, Inc. and Sigma Designs, Inc. (filed as Exhibit 2.1 to the Form 8-K filed on December 8, 2017)</u>                                     |
| 3.1*    | <u>Form of Fourth Amended and Restated Certificate of Incorporation of Silicon Laboratories Inc. (filed as Exhibit 3.1 to the Registration Statement on Form S-1 (Securities and Exchange Commission File No. 333-94853) (the IPO Registration Statement )).</u> |
| 3.2*    | <u>Fourth Amended and Restated Bylaws of Silicon Laboratories Inc. (filed as Exhibit 3.2 to the Form 8-K filed on January 27, 2017).</u>   |
| 4.1*    | <u>Specimen certificate for shares of common stock (filed as Exhibit 4.1 to the IPO Registration Statement).</u>   |
| 4.2*    | <u>Indenture between Silicon Laboratories Inc. and Wilmington Trust, National Association, as trustee, dated March 6, 2017 (filed as Exhibit 4.1 to the Form 8-K filed on March 6, 2017).</u>  |
| 4.3*    | <u>Form of 1.375% Convertible Senior Note due 2022 (filed as Exhibit 4.2 to the Form 8-K filed on March 6, 2017).</u>  |
| 31.1    | <u>Certification of the Principal Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.</u>   |
| 31.2    | <u>Certification of the Principal Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.</u>   |
| 32.1    | <u>Certification as required by Section 906 of the Sarbanes-Oxley Act of 2002.</u>   |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |

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|         |  |
|---------|--|
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |

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\* Incorporated herein by reference to the indicated filing.

+ Management contract or compensatory plan or arrangement

Table of Contents

**SIGNATURES**

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

SILICON LABORATORIES INC.

July 25, 2018  
Date

/s/ G. Tyson Tuttle  
G. Tyson Tuttle  
*President and  
Chief Executive Officer  
(Principal Executive Officer)*

July 25, 2018  
Date

/s/ John C. Hollister  
John C. Hollister  
*Senior Vice President and  
Chief Financial Officer  
(Principal Financial and Accounting Officer)*