

MICROCHIP TECHNOLOGY INC

Form 10-Q

November 08, 2013

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013.

OR

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

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

Commission File Number: 0-21184

MICROCHIP TECHNOLOGY INCORPORATED

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

86-0629024

(IRS Employer Identification No.)

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

(480) 792-7200

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

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

Indicate by check mark whether the registrant has submitted electronically 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

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

|                         |                                     |                           |                          |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |

(Do not check if a smaller reporting company)

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

Yes  No

Shares Outstanding of Registrant's Common Stock

Class

Outstanding at October 31, 2013

Common Stock, \$0.001 par value

198,368,386 shares

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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## Item 1. Financial Statements

## MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

## ASSETS

|  | September 30,<br>2013 | March 31,<br>2013 |
|--|-----------------------|-------------------|
| Cash and cash equivalents  | \$344,202             | \$528,334         |
| Short-term investments   | 807,709               | 1,050,263         |
| Accounts receivable, net   | 230,493               | 229,955           |
| Inventories  | 275,124               | 242,334           |
| Prepaid expenses   | 34,318                | 37,439            |
| Deferred tax assets  | 70,383                | 80,687            |
| Other current assets   | 58,677                | 67,358            |
| Total current assets   | 1,820,906             | 2,236,370         |
| Property, plant and equipment, net   | 518,191               | 514,544           |
| Long-term investments  | 829,656               | 257,450           |
| Goodwill   | 268,570               | 271,348           |
| Intangible assets, net   | 480,679               | 530,136           |
| Other assets   | 47,149                | 41,557            |
| Total assets   | \$3,965,151           | \$3,851,405       |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                   |
| Accounts payable   | \$77,768              | \$75,551          |
| Accrued liabilities  | 101,701               | 127,108           |
| Short-term borrowings  | 8,375                 | —                 |
| Deferred income on shipments to distributors   | 151,049               | 138,952           |
| Total current liabilities  | 338,893               | 341,611           |
| Junior convertible debentures  | 367,533               | 363,385           |
| Long-term line of credit   | 290,000               | 620,000           |
| Long-term borrowings, net  | 340,379               | —                 |
| Long-term income tax payable   | 192,007               | 182,723           |
| Deferred tax liability   | 379,761               | 388,250           |
| Other long-term liabilities  | 38,039                | 21,966            |
| Stockholders' equity:  |                       |                   |
| Preferred stock, \$0.001 par value; authorized 5,000,000 shares; no shares issued or outstanding   | —                     | —                 |
| Common stock, \$0.001 par value; authorized 450,000,000 shares; 218,789,994 shares issued and 198,362,359 shares outstanding at September 30, 2013; 218,789,994 shares issued and 196,472,856 shares outstanding at March 31, 2013 | 198                   | 196               |
| Additional paid-in capital   | 1,255,419             | 1,255,627         |
| Common stock held in treasury: 20,427,635 shares at September 30, 2013; 22,317,138 shares at March 31, 2013  | (626,102)             | (682,220)         |
| Accumulated other comprehensive (loss) income  | (2,525)               | 6,935             |
| Retained earnings  | 1,391,549             | 1,352,932         |
| Total stockholders' equity   | 2,018,539             | 1,933,470         |
| Total liabilities and stockholders' equity   | \$3,965,151           | \$3,851,405       |

See accompanying notes to condensed consolidated financial statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(unaudited)

|   | Three Months Ended |           | Six Months Ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | September 30,      |           | September 30,    |           |
|   | 2013               | 2012      | 2013             | 2012      |
| Net sales   | \$492,669          | \$383,298 | \$955,461        | \$735,432 |
| Cost of sales (1)   | 203,806            | 189,103   | 400,024          | 336,440   |
| Gross profit  | 288,863            | 194,195   | 555,437          | 398,992   |
| Operating expenses:                                       |                    |           |                  |           |
| Research and development (1)                              | 78,254             | 64,082    | 151,339          | 112,908   |
| Selling, general and administrative (1)                   | 69,368             | 71,767    | 135,078          | 127,359   |
| Amortization of acquired intangible assets                | 23,744             | 27,858    | 51,421           | 31,904    |
| Special (income) charges                                  | (11                | ) 22,394  | 1,690            | 22,394    |
|   | 171,355            | 186,101   | 339,528          | 294,565   |
| Operating income  | 117,508            | 8,094     | 215,909          | 104,427   |
| Losses on equity method investments                       | (101               | ) (32     | ) (361           | ) (153    |
| Other income (expense):                                   |                    |           |                  |           |
| Interest income   | 4,010              | 3,744     | 7,935            | 8,076     |
| Interest expense  | (12,354            | ) (10,758 | ) (24,210        | ) (19,906 |
| Other income, net   | 2,143              | 1,071     | 2,269            | 539       |
| Income before income taxes                                | 111,206            | 2,119     | 201,542          | 92,983    |
| Income tax provision                                      | 11,400             | 23,303    | 23,157           | 35,457    |
| Net income (loss)   | \$99,806           | \$(21,184 | ) \$178,385      | \$57,526  |
| Basic net income (loss) per common share                  | \$0.50             | \$(0.11   | ) \$0.90         | \$0.30    |
| Diluted net income (loss) per common share                | \$0.46             | \$(0.11   | ) \$0.83         | \$0.28    |
| Dividends declared per common share                       | \$0.3540           | \$0.3510  | \$0.7075         | \$0.7010  |
| Basic common shares outstanding                           | 197,825            | 194,060   | 197,388          | 193,756   |
| Diluted common shares outstanding                         | 216,475            | 194,060   | 214,371          | 204,627   |
| (1) Includes share-based compensation expense as follows: |                    |           |                  |           |
| Cost of sales   | \$1,864            | \$2,614   | \$3,833          | \$3,924   |
| Research and development                                  | 6,931              | 6,358     | 12,621           | 10,390    |
| Selling, general and administrative                       | 6,205              | 11,581    | 11,202           | 16,225    |

See accompanying notes to condensed consolidated financial statements

Table of ContentsMICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

|  | Three Months Ended<br>September 30, |            | Six Months Ended<br>September 30, |          |   |
|--|-------------------------------------|------------|-----------------------------------|----------|---|
|  | 2013                                | 2012       | 2013                              | 2012     |   |
| Net income (loss)  | \$99,806                            | \$(21,184) | ) \$178,385                       | \$57,526 |   |
| Components of other comprehensive income (loss):   |                                     |            |                                   |          |   |
| Available-for-sale securities:   |                                     |            |                                   |          |   |
| Unrealized holding gain (losses), net of tax effect of (\$11), (\$61), \$497 and \$36, respectively      | 1,928                               | 2,615      | (8,070                            | ) 2,618  |   |
| Reclassification of realized transactions, net of tax effect of \$776, \$0, \$776 and \$51, respectively | (1,340                              | ) (29      | ) (1,390                          | ) (170   | ) |
| Change in net foreign currency translation adjustment  | —                                   | 1,140      | —                                 | 1,140    |   |
| Other comprehensive income (loss), net of taxes  | 588                                 | 3,726      | (9,460                            | ) 3,588  |   |
| Total comprehensive income (loss)  | \$100,394                           | \$(17,458) | ) \$168,925                       | \$61,114 |   |

See accompanying notes to condensed consolidated financial statements

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

|   | Six Months Ended<br>September 30, |            |
|---|-----------------------------------|------------|
|   | 2013                              | 2012       |
| Cash flows from operating activities:   |                                   |            |
| Net income  | \$ 178,385                        | \$ 57,526  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |            |
| Depreciation and amortization   | 98,462                            | 76,456     |
| Deferred income taxes   | 11,872                            | (9,425 )   |
| Share-based compensation expense related to equity incentive plans                | 27,656                            | 24,593     |
| Excess tax benefit from share-based compensation                                  | —                                 | (112 )     |
| Convertible debt derivatives - revaluation and amortization                       | (248 )                            | 589 )      |
| Amortization of debt discount on convertible debentures                           | 4,396                             | 4,017      |
| Amortization of debt issuance costs   | 872                               | 109        |
| Losses on equity method investments   | 361                               | 153        |
| Gain on sale of assets  | —                                 | (16 )      |
| Impairment of intangible assets   | 350                               | —          |
| Unrealized impairment loss on available-for-sale investments                      | —                                 | 334        |
| Special income, net   | (237 )                            | —          |
| Changes in operating assets and liabilities:                                      |                                   |            |
| Increase in accounts receivable   | (693 )                            | (116 )     |
| (Increase) decrease in inventories  | (32,103 )                         | 22,334 )   |
| Increase in deferred income on shipments to distributors                          | 12,097                            | 3,037      |
| Decrease in accounts payable and accrued liabilities                              | (2,006 )                          | (27,670 )  |
| Change in other assets and liabilities  | 20,191                            | 40,462     |
| Net cash provided by operating activities   | 319,355                           | 192,271    |
| Cash flows from investing activities:   |                                   |            |
| Purchases of available-for-sale investments                                       | (710,197 )                        | (443,106 ) |
| Sales and maturities of available-for-sale investments                            | 370,806                           | 350,593    |
| Acquisition of SMSC, net of cash acquired   | —                                 | (731,746 ) |
| Other business acquisitions, net of cash acquired                                 | (2,174 )                          | (20,556 )  |
| Investments in other assets   | (2,951 )                          | (2,204 )   |
| Proceeds from sale of assets  | 16,200                            | 66         |
| Capital expenditures  | (55,206 )                         | (26,212 )  |
| Net cash used in investing activities   | (383,522 )                        | (873,165 ) |
| Cash flows from financing activities:   |                                   |            |
| Repayments of revolving loan under previous credit facility                       | (650,000 )                        | (80,000 )  |
| Repayments of revolving loan under new credit facility                            | (70,000 )                         | —          |
| Proceeds from borrowings on revolving loan under previous credit facility         | 30,000                            | 680,000    |
| Proceeds from borrowings on revolving loan under new credit facility              | 360,000                           | —          |
| Proceeds from issuance of long-term borrowings                                    | 350,000                           | —          |
| Deferred financing costs  | (7,515 )                          | —          |
| Payment of cash dividends   | (139,768 )                        | (135,895 ) |
| Proceeds from sale of common stock  | 22,196                            | 16,318     |
| Contingent consideration payment  | (14,700 )                         | —          |



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|   |           |              |
|---|-----------|--------------|
| Capital lease payments  | (178      | ) —          |
| Excess tax benefit from share-based compensation                      | —         | 112          |
| Net cash (used in) provided by financing activities                   | (119,965  | ) 480,535    |
| Effect of foreign exchange rate changes on cash and cash equivalents  | —         | 1,339        |
| Net decrease in cash and cash equivalents                             | (184,132  | ) (199,020 ) |
| Cash and cash equivalents at beginning of period                      | 528,334   | 635,755      |
| Cash and cash equivalents at end of period                            | \$344,202 | \$436,735    |
| See accompanying notes to condensed consolidated financial statements |           |              |

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

(1)Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Microchip Technology Incorporated and its wholly-owned subsidiaries (the Company). All intercompany balances and transactions have been eliminated in consolidation. The Company owns 100% of the outstanding stock in all of its subsidiaries.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The information furnished herein reflects all adjustments which are, in the opinion of management, of a normal recurring nature and necessary for a fair statement of the results for the interim periods reported. Certain information and footnote disclosures normally included in audited consolidated financial statements have been condensed or omitted pursuant to such SEC rules and regulations. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2013. The results of operations for the six months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2014 or for any other period.

(2)Business Acquisitions

Acquisition of SMSC

On August 2, 2012, the Company acquired SMSC, a publicly traded company based in Hauppauge, New York. The acquisition was accounted for under the acquisition method of accounting. The Company retained an independent third-party appraiser to assist management in its valuation. The table below represents the allocation of the purchase price, including adjustments to the purchase price allocation from the previously reported figures at March 31, 2013, to the net assets acquired based on their estimated fair values as of August 2, 2012. The purchase price was finalized as of August 2, 2013. All adjustments shown in the table below were recorded during the three months ended June 30, 2013 (amounts in thousands):

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| Assets acquired                              | Previously Reported<br>March 31, 2013 | Adjustments | September 30, 2013 |   |
|--|---------------------------------------|-------------|--------------------|---|
| Cash and cash equivalents                    | \$ 180,925                            | \$—         | \$ 180,925         |   |
| Accounts receivable, net                     | 58,441                                | —           | 58,441             |   |
| Inventories                                  | 86,244                                | —           | 86,244             |   |
| Prepaid expenses                             | 5,617                                 | —           | 5,617              |   |
| Deferred tax assets                          | 15,843                                | —           | 15,843             |   |
| Other current assets                         | 17,578                                | —           | 17,578             |   |
| Property, plant and equipment, net           | 35,608                                | —           | 35,608             |   |
| Long-term investments                        | 24,275                                | —           | 24,275             |   |
| Goodwill                                     | 169,065                               | (3,473      | ) 165,592          |   |
| Intangible assets, net                       | 10,214                                | —           | 10,214             |   |
| Purchased intangible assets                  | 517,800                               | —           | 517,800            |   |
| Other assets                                 | 3,835                                 | —           | 3,835              |   |
| Total assets acquired                        | 1,125,445                             | (3,473      | ) 1,121,972        |   |
| Liabilities assumed                          |                                       |             |                    |   |
| Accounts payable                             | (28,035                               | ) —         | (28,035            | ) |
| Accrued liabilities                          | (62,038                               | ) (209      | ) (62,247          | ) |
| Deferred income on shipments to distributors | (11,376                               | ) —         | (11,376            | ) |
| Long-term income tax payable                 | (72,781                               | ) —         | (72,781            | ) |
| Deferred tax liability                       | (21,079                               | ) 4,397     | (16,682            | ) |
| Other liabilities                            | (10,535                               | ) (715      | ) (11,250          | ) |
| Total liabilities assumed                    | (205,844                              | ) 3,473     | (202,371           | ) |
| Purchase price allocated                     | \$919,601                             | \$—         | \$919,601          |   |

**(3) Recently Issued Accounting Pronouncements**

In the first quarter of fiscal 2014, the Company adopted the provisions of Accounting Standard Update 2013-02 Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which required the disclosure of amounts reclassified out of accumulated other comprehensive income (AOCI) to net income. The adoption of this amendment did not have a material impact on the Company's consolidated financial statements and related disclosures (See Note 18).

**(4) Special (Income) Charges**

During the three months ended September 30, 2013, the Company incurred special charges of \$0.8 million for an additional liability related to the acquisition of Roving Networks and \$0.4 million of severance-related, office closing, and other costs associated with the acquisition of SMSC which were offset by \$1.1 million of special income related to the release of an accrued bonus for a milestone that was not met for a business that SMSC had acquired prior to the Company's acquisition of SMSC. During the six months ended September 30, 2013, the Company incurred special charges of \$1.4 million due to the increase in the fair value of contingent consideration related to one of its acquisitions, \$0.8 million for an additional liability related to the acquisition of Roving Networks and \$0.7 million of severance-related, office closing, and other costs associated with the acquisition of SMSC which were offset by \$1.1 million of special income related to the release of an accrued bonus for a milestone that was not met for a business that SMSC had acquired prior to the Company's acquisition of SMSC.

During the three and six months ended September 30, 2012, the Company incurred approximately \$10.9 million of severance related, office closing, and other costs associated with the acquisition of SMSC. Also, during the three and six months ended September 30, 2012, the Company incurred legal settlement costs of approximately \$11.5 million for certain legal matters related to Silicon Storage Technology, Inc. (which the Company acquired in April 2010) in excess of previously accrued amounts.

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## (5) Segment Information

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

The following table represents net sales and gross profit for each segment for the three and six months ended September 30, 2013 (amounts in thousands):

|                        | Three Months Ended<br>September 30, 2013 |              | Six Months Ended<br>September 30, 2013 |              |
|------------------------|--|--------------|--|--------------|
|                        | Net Sales                                | Gross Profit | Net Sales                              | Gross Profit |
| Semiconductor products | \$467,843                                | \$264,037    | \$908,117                              | \$508,093    |
| Technology licensing   | 24,826                                   | 24,826       | 47,344                                 | 47,344       |
|                        | \$492,669                                | \$288,863    | \$955,461                              | \$555,437    |

The following table represents net sales and gross profit for each segment for the three and six months ended September 30, 2012 (amounts in thousands):

|                        | Three Months Ended<br>September 30, 2012 |              | Six Months Ended<br>September 30, 2012 |              |
|------------------------|--|--------------|--|--------------|
|                        | Net Sales                                | Gross Profit | Net Sales                              | Gross Profit |
| Semiconductor products | \$363,177                                | \$174,074    | \$695,029                              | \$358,589    |
| Technology licensing   | 20,121                                   | 20,121       | 40,403                                 | 40,403       |
|                        | \$383,298                                | \$194,195    | \$735,432                              | \$398,992    |

## (6) Investments

The Company's investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations, and delivers an appropriate yield in relationship to the Company's investment guidelines and market conditions. The following is a summary of available-for-sale securities at September 30, 2013 (amounts in thousands):

|                          | Available-for-sale Securities |                              |                               |                         |
|--------------------------|-------------------------------|------------------------------|-------------------------------|-------------------------|
|                          | Adjusted<br>Cost              | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
| Government agency bonds  | \$781,230                     | \$269                        | \$(5,467)                     | ) \$776,032             |
| Municipal bonds          | 54,286                        | 60                           | (575)                         | ) 53,771                |
| Auction rate securities  | 9,829                         | —                            | —                             | ) 9,829                 |
| Corporate bonds and debt | 796,035                       | 2,902                        | (1,204)                       | ) 797,733               |
|                          | \$1,641,380                   | \$3,231                      | \$(7,246)                     | ) \$1,637,365           |

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The following is a summary of available-for-sale and marketable equity securities at March 31, 2013 (amounts in thousands):

|                              | Available-for-sale Securities |                        |                         | Estimated Fair Value |
|------------------------------|-------------------------------|------------------------|-------------------------|----------------------|
|                              | Adjusted Cost                 | Gross Unrealized Gains | Gross Unrealized Losses |                      |
| Government agency bonds      | \$558,116                     | \$335                  | \$(298)                 | ) \$558,153          |
| Municipal bonds              | 25,000                        | 146                    | (8)                     | ) 25,138             |
| Auction rate securities      | 33,459                        | 332                    | —                       | ) 33,791             |
| Corporate bonds and debt     | 680,144                       | 5,137                  | (159)                   | ) 685,122            |
| Marketable equity securities | 5,270                         | 239                    | —                       | ) 5,509              |
|                              | \$1,301,989                   | \$6,189                | \$(465)                 | ) \$1,307,713        |

At September 30, 2013, the Company's available-for-sale debt securities are presented on the condensed consolidated balance sheets as short-term investments of \$807.7 million and long-term investments of \$829.7 million. At March 31, 2013, the Company's available-for-sale debt securities and marketable equity securities are presented on the condensed consolidated balance sheets as short-term investments of \$1,050.3 million and long-term investments of \$257.5 million.

At September 30, 2013, the Company evaluated its investment portfolio and noted unrealized losses of \$7.2 million on its debt securities which were due primarily to higher interest rates and resulting declines in market prices. Management does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of September 30, 2013 and the Company's intent is to hold these investments until these assets are no longer impaired, except for certain auction rate securities (ARS). For those debt securities not scheduled to mature until after September 30, 2014, such recovery is not anticipated to occur in the next year and these investments have been classified as long-term investments.

The amortized cost and estimated fair value of the available-for-sale securities at September 30, 2013, by contractual maturity, excluding corporate debt of \$6.2 million, which have no contractual maturity, are shown below (amounts in thousands). Expected maturities can differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations.

|  | Adjusted Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--|---------------|------------------------|-------------------------|----------------------|
| Available-for-sale                         |               |                        |                         |                      |
| Due in one year or less                    | \$234,539     | \$1,133                | \$(7)                   | ) \$235,665          |
| Due after one year and through five years  | 1,280,074     | 2,098                  | (2,973)                 | ) 1,279,199          |
| Due after five years and through ten years | 110,748       | —                      | (4,266)                 | ) 106,482            |
| Due after ten years                        | 9,829         | —                      | —                       | ) 9,829              |
|  | \$1,635,190   | \$3,231                | \$(7,246)               | ) \$1,631,175        |

The Company had a realized gain of \$1.0 million from the sale of available-for-sale marketable equity securities during the three and six-month periods ended September 30, 2013. The Company had net realized gains of \$1.1 million and \$1.2 million from the sale of available-for-sale debt securities during the three and six-month periods ended September 30, 2013, respectively. The Company had no material realized gains or losses from the sale of available-for-sale marketable equity securities or debt securities during the three or six-month periods ended September 30, 2012.

(7) Fair Value Measurements

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

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

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

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

## Marketable Debt Instruments

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

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

Assets and liabilities measured at fair value on a recurring basis at September 30, 2013 are as follows (amounts in thousands):

|  | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total<br>Balance |
|--|--|---|--|------------------|
| <b>Assets</b>                            |  |   |  |                  |
| Money market mutual funds                | \$49,949   | \$—   | \$—  | \$49,949         |
| Corporate bonds and debt                 | —  | 791,543   | 6,190  | 797,733          |
| Government agency bonds                  | —  | 776,032   | —  | 776,032          |
| Deposit accounts                         | —  | 294,253   | —  | 294,253          |
| Municipal bonds                          | —  | 53,771  | —  | 53,771           |
| Auction rate securities                  | —  | —   | 9,829  | 9,829            |
| Total assets measured at fair value      | \$49,949   | \$1,915,599   | \$16,019   | \$1,981,567      |
| <b>Liabilities</b>                       |  |   |  |                  |
| Contingent consideration                 | \$—  | \$—   | \$1,022  | \$1,022          |
| Total liabilities measured at fair value | \$—  | \$—   | \$1,022  | \$1,022          |



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Assets measured at fair value on a recurring basis at March 31, 2013 are as follows (amounts in thousands):

|  | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total<br>Balance |
|--|--|---|--|------------------|
| <b>Assets</b>                            |  |   |  |                  |
| Money market fund deposits               | \$100,878  | \$—   | \$—  | \$100,878        |
| Marketable equity securities             | 5,509  | —   | —  | 5,509            |
| Corporate bonds and debt                 | —  | 678,932   | 6,190  | 685,122          |
| Government agency bonds                  | —  | 558,153   | —  | 558,153          |
| Deposit accounts                         | —  | 427,456   | —  | 427,456          |
| Municipal bonds                          | —  | 25,138  | —  | 25,138           |
| Auction rate securities                  | —  | —   | 33,791   | 33,791           |
| Total assets measured at fair value      | \$106,387  | \$1,689,679   | \$39,981   | \$1,836,047      |
| <b>Liabilities</b>                       |  |   |  |                  |
| Contingent consideration                 | \$—  | \$—   | \$19,100   | \$19,100         |
| Total liabilities measured at fair value | \$—  | \$—   | \$19,100   | \$19,100         |

There were no transfers between Level 1 and Level 2 during the three and six-month periods ended September 30, 2013 or the year ended March 31, 2013.

At September 30, 2013, the Company's ARS for which recent auctions were unsuccessful are made up of securities related to the insurance industry valued at \$9.8 million. At March 31, 2013, the Company's ARS for which recent auctions were unsuccessful were made up of bonds related to the insurance sector valued at \$9.8 million, securities related to the energy and telecommunications sectors valued at \$5.3 million, and student loan securities valued at \$18.7 million.

The Company estimated the fair value of its ARS, which are classified as Level 3 securities, based on the following: (i) the underlying structure of each security; (ii) the present value of future principal and interest payments discounted at rates considered to reflect current market conditions; (iii) consideration of the probabilities of default, auction failure, or repurchase at par for each period; and (iv) estimates of the recovery rates in the event of default for each security. The significant unobservable inputs used in the fair value measurement of the insurance sector ARS were estimated risk free discount rates, liquidity risk premium, and the liquidity horizon. The risk free discount rate applied to these securities was 2% to 2.5% adjusted for the liquidity risk premium which ranged from 9.1% to 29.5%. The anticipated liquidity horizon ranged from 7 to 10 years. A significant increase in the liquidity premium or discount rate, in isolation, would lead to a significantly lower fair value measurement. A significant increase in the liquidity horizon, in isolation, would lead to a significantly lower fair value measurement. Each quarter the Company investigates material changes in the fair value measurements of its ARS.

Level 3 liabilities include contingent consideration from the Company's Roving Networks acquisition, of which the majority was paid in the three months ended September 30, 2013. The Company evaluates the estimated fair value of its contingent consideration on a quarterly basis based on certain revenue and gross margin performance criteria and records fair value adjustments as necessary. The final measurement date for the contingent consideration was June 30, 2013 and there will be no further adjustments to such liability.



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The following tables present a reconciliation for all assets and liabilities measured at fair value on a recurring basis, excluding accrued interest components, using significant unobservable inputs (Level 3) for the six months ended September 30, 2013, and the year ended March 31, 2013 (amounts in thousands):

|   |                         |                |                          |                      |
|---|-------------------------|----------------|--------------------------|----------------------|
| Six months ended September 30, 2013               | Auction Rate Securities | Corporate Debt | Contingent Consideration | Total Gains (Losses) |
| Balance at March 31, 2013                         | \$33,791                | \$6,190        | \$(19,100)               | ) \$—                |
| Total gains or losses (realized and unrealized):  |                         |                |                          |                      |
| Included in earnings                              | 1,105                   | —              | (1,392)                  | ) (287)              |
| Included in other comprehensive income            | (332)                   | ) —            | —                        | (332)                |
| Purchases, sales, issuances, and settlements, net | (24,735)                | ) —            | 19,470                   | —                    |
| Balance at September 30, 2013                     | \$9,829                 | \$6,190        | \$(1,022)                | ) \$(619)            |
| Year ended March 31, 2013                         | Auction Rate Securities | Corporate Debt | Contingent Consideration | Total Gains (Losses) |
| Balance at March 31, 2012                         | \$10,246                | \$4,625        | \$—                      | \$—                  |
| Total gains or losses (realized and unrealized):  |                         |                |                          |                      |
| Included in earnings                              | (412)                   | ) —            | (4,400)                  | ) \$(4,813)          |
| Included in other comprehensive income            | 332                     | —              | —                        | 332                  |
| Purchases, sales, issuances, and settlements, net | (650)                   | ) 1,565        | —                        | —                    |
| Acquisition-related                               | 24,275                  | —              | (14,700)                 | ) —                  |
| Balance at March 31, 2013                         | \$33,791                | \$6,190        | \$(19,100)               | ) \$(4,481)          |

Assets measured at fair value on a recurring basis are presented/classified on the condensed consolidated balance sheets at September 30, 2013 as follows (amounts in thousands):

|                                     | Quoted Prices in Active Markets for Identical Instruments (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Balance |
|-------------------------------------|---|---|---|---------------|
| Assets                              |   |   |   |               |
| Cash and cash equivalents           | \$49,949  | \$294,253                                     | \$—                                       | \$344,202     |
| Short-term investments              | —   | 807,709                                       | —   | 807,709       |
| Long-term investments               | —   | 813,637                                       | 16,019                                    | 829,656       |
| Total assets measured at fair value | \$49,949  | \$1,915,599                                   | \$16,019                                  | \$1,981,567   |

Assets measured at fair value on a recurring basis are presented/classified in the consolidated balance sheets at March 31, 2013 as follows (amounts in thousands):

|                           | Quoted Prices in Active Markets for Identical Instruments (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Balance |
|---------------------------|---|---|---|---------------|
| Assets                    |   |   |   |               |
| Cash and cash equivalents | \$100,878   | \$427,456                                     | \$—                                       | \$528,334     |

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|                                     |            |              |           |              |
|-------------------------------------|------------|--------------|-----------|--------------|
| Short-term investments              | —          | 1,050,263    | —         | 1,050,263    |
| Long-term investments               | 5,509      | 211,960      | 39,981    | 257,450      |
| Total assets measured at fair value | \$ 106,387 | \$ 1,689,679 | \$ 39,981 | \$ 1,836,047 |

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## Financial Assets Not Recorded at Fair Value on a Recurring Basis

The Company's non-marketable equity and cost method investments are not recorded at fair value on a recurring basis. These investments are monitored on a quarterly basis for impairment charges. The investments will only be recorded at fair value when an impairment charge is recognized. There were no impairment charges recognized on these investments in the three and six months ended September 30, 2013 and September 30, 2012. These investments are included in other assets on the condensed consolidated balance sheet.

## (8) Fair Value of Financial Instruments

The carrying amount of cash equivalents approximates fair value because their maturity is less than three months. Management believes the carrying amount of the equity and cost-method investments materially approximated fair value at September 30, 2013 based upon unobservable inputs. The fair values of these investments have been determined as Level 3 fair value measurements. The fair values of the Company's line of credit, short-term and long-term borrowings are estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements and approximate carrying value. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of the Company's line of credit and long-term borrowings at September 30, 2013 approximated book value and are considered Level 2 in the fair value hierarchy described in Note 7. The carrying amount of accounts receivable, accounts payable and accrued liabilities approximates fair value due to the short-term maturity of the amounts. The fair value of the Company's junior subordinated convertible debentures was \$1.804 billion at September 30, 2013 and \$1.639 billion at March 31, 2013 based on observable market prices for these debentures, which are traded in less active markets and are therefore classified as a Level 2 fair value measurement.

## (9) Accounts Receivable

Accounts receivable consists of the following (amounts in thousands):

|                                      | September 30, 2013 | March 31, 2013 |
|--------------------------------------|--------------------|----------------|
| Trade accounts receivable            | \$231,208          | \$230,469      |
| Other                                | 1,994              | 2,250          |
|                                      | 233,202            | 232,719        |
| Less allowance for doubtful accounts | 2,709              | 2,764          |
|                                      | \$230,493          | \$229,955      |

## (10) Inventories

The components of inventories consist of the following (amounts in thousands):

|                 | September 30, 2013 | March 31, 2013 |
|-----------------|--------------------|----------------|
| Raw materials   | \$8,690            | \$9,020        |
| Work in process | 211,917            | 181,750        |
| Finished goods  | 54,517             | 51,564         |
|                 | \$275,124          | \$242,334      |

Inventories are valued at the lower of cost or market using the first-in, first-out method. Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable.

## (11) Property, Plant and Equipment

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

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|  | September 30, 2013 | March 31, 2013 |
|--|--------------------|----------------|
| Land   | \$55,464           | \$47,102       |
| Building and building improvements             | 395,971            | 396,611        |
| Machinery and equipment                        | 1,421,806          | 1,377,814      |
| Projects in process                            | 69,753             | 76,158         |
|  | 1,942,994          | 1,897,685      |
| Less accumulated depreciation and amortization | 1,424,803          | 1,383,141      |
|  | \$518,191          | \$514,544      |

Depreciation expense attributed to property, plant and equipment was \$23.0 million and \$44.4 million for the three and six months ended September 30, 2013, respectively, and \$22.4 million and \$43.1 million for the three and six months ended September 30, 2012, respectively.

**(12) Accrued Liabilities**

Accrued liabilities consist of the following (amounts in thousands):

|  | September 30, 2013 | March 31, 2013 |
|--|--------------------|----------------|
| Acquisition related contingent consideration | \$1,022            | \$19,100       |
| Other accrued expenses                       | 100,679            | 108,008        |
|  | \$101,701          | \$127,108      |

**(13) Income Taxes**

The provision for income taxes reflects tax on foreign earnings and federal and state tax on U.S. earnings. The Company had an effective tax rate of 11.5% for the six-month period ended September 30, 2013 and 38.1% for the six-month period ended September 30, 2012. The Company's effective tax rate is lower than statutory rates in the U.S. due primarily to its mix of earnings in foreign jurisdictions with lower tax rates. The Company's effective tax rate was higher in the September 30, 2012 period due to certain tax expenses associated with the acquisition of SMSC.

At September 30, 2013, the Company had \$192.0 million of unrecognized tax benefits. Unrecognized tax benefits increased by \$9.3 million compared to March 31, 2013 primarily as a result of the ongoing accrual for uncertain tax positions and the accrual of deficiency interest on these positions.

The Company files U.S. federal, U.S. state, and foreign income tax returns. For U.S. federal, and in general for U.S. state tax returns, the fiscal 2009 and later tax years remain open for examination by tax authorities. The Internal Revenue Service (IRS) is currently auditing the Company's fiscal years ended March 31, 2009 and 2010 tax years as well as SMSC's 2011 and 2012 tax years. For foreign tax returns, the Company is generally no longer subject to income tax examinations for years prior to fiscal 2005.

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

The Company believes that it maintains appropriate reserves to offset any potential income tax liabilities that may arise upon final resolution of matters for open tax years. If such reserve amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no

longer deemed necessary. If such amounts prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined. Although the timing of the resolution and/or closure of audits is highly uncertain, the Company does not believe it is reasonably possible that its unrecognized tax benefits would materially change in the next 12 months.



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## (14) 2.125% Junior Subordinated Convertible Debentures

The Company's \$1.15 billion principal amount of 2.125% junior subordinated convertible debentures due December 15, 2037, are subordinated in right of payment to any future senior debt of the Company and are effectively subordinated in right of payment to the liabilities of the Company's subsidiaries. The debentures are convertible, subject to certain conditions, into shares of the Company's common stock at an initial conversion rate of 29.2783 shares of common stock per \$1,000 principal amount of debentures, representing an initial conversion price of approximately \$34.16 per share of common stock. As of September 30, 2013, the holders of the debentures had the right to convert their debentures between July 1, 2013 and September 30, 2013 because for at least 20 trading days during the 30 consecutive trading day period ending on September 30, 2013, the Company's common stock had a last reported sale price greater than 130% of the conversion price. As of September 30, 2013, a holder could realize more economic value by selling its debentures in the over the counter market than from converting its debentures. As a result of cash dividends paid since the issuance of the debentures, the conversion rate has been adjusted to 38.0436 shares of common stock per \$1,000 of principal amount of debentures, representing a conversion price of approximately \$26.29 per share of common stock.

As the debentures can be settled in cash upon conversion, for accounting purposes, the debentures were bifurcated into a liability component and an equity component, which are both initially recorded at fair value. The carrying value of the equity component at September 30, 2013 and at March 31, 2013 was \$822.4 million. The estimated fair value of the liability component of the debentures at the issuance date was \$327.6 million, resulting in a debt discount of \$822.4 million. The unamortized debt discount was \$781.8 million at September 30, 2013 and \$786.2 million at March 31, 2013. The carrying value of the debentures was \$367.5 million at September 30, 2013 and \$363.4 million at March 31, 2013. The remaining period over which the unamortized debt discount will be recognized as non-cash interest expense is 24.25 years. In the three and six months ended September 30, 2013, the Company recognized \$2.2 million and \$4.4 million, respectively, in non-cash interest expense related to the amortization of the debt discount. In the three and six months ended September 30, 2012, the Company recognized \$2.0 million and \$4.0 million, respectively, in non-cash interest expense related to the amortization of the debt discount. The Company recognized \$6.1 million and \$12.2 million of interest expense related to the 2.125% coupon on the debentures in each of the three and six-month periods ended September 30, 2013 and September 30, 2012, respectively.

## (15) Credit Facility

On June 27, 2013, the Company entered into a \$2.0 billion credit agreement among the Company, the lenders from time to time that are parties thereto and JPMorgan Chase Bank, N.A., as administrative agent (the "Credit Agreement"). The Credit Agreement provides for a \$350 million term loan and a \$1.65 billion revolving credit facility, with a \$125 million foreign currency sublimit, a \$35 million letter of credit sublimit and a \$25 million swingline loan sublimit, terminating on June 27, 2018 (the "Maturity Date"). The Credit Agreement also contains an increase option permitting the Company, subject to certain requirements, to arrange with existing lenders and/or new lenders for them to provide up to an aggregate of \$300 million in additional commitments, which may be for revolving loans or term loans. Proceeds of loans made under the Credit Agreement may be used for working capital and general corporate purposes. The Credit Agreement replaced another credit agreement the Company had in place since August 2011. At September 30, 2013, \$640.0 million of borrowings were outstanding under the Credit Agreement consisting of \$290.0 million of a revolving line of credit and \$350.0 million of a term loan, net of \$1.2 million of debt discount resulting from amounts paid to the lenders.

The loans under the Credit Agreement bear interest, at the Company's option, at the base rate plus a spread of 0.25% to 1.25% or an adjusted LIBOR rate (based on one, two, three, or six-month interest periods) plus a spread of 1.25% to 2.25%, in each case with such spread being determined based on the consolidated leverage ratio for the preceding

four fiscal quarter period. The base rate means the highest of JPMorgan Chase Bank, N.A.'s prime rate, the federal funds rate plus a margin equal to 0.50% and the adjusted LIBOR rate for a 1-month interest period plus a margin equal to 1.00%. Swingline loans accrue interest at a per annum rate based on the base rate plus the applicable margin for base rate loans. Base rate loans may only be made in U.S. dollars. The Company is also obligated to pay other customary administration fees and letter of credit fees for a credit facility of this size and type.

Interest is due and payable in arrears quarterly for loans bearing interest at the base rate and at the end of an interest period (or at each three-month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. Interest expense related to the Credit Agreement was approximately \$4.0 million in the three months ended September 30, 2013 and \$7.5 million in the six months ended September 30, 2013. Interest expense related to the Company's prior credit agreement was approximately \$2.3 million and \$3.0 million in the three and six months ended September 30, 2012, respectively. Principal, together with all accrued and unpaid interest, is due and payable on the maturity date. The Company may prepay the loans and terminate the commitments, in whole or in part, at any time without

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premium or penalty, subject to certain conditions including minimum amounts in the case of commitment reductions and reimbursement of certain costs in the case of prepayments of LIBOR loans.

The Company's obligations under the Credit Agreement are guaranteed by certain of its subsidiaries meeting materiality thresholds set forth in the Credit Agreement. To secure the Company's obligations under the Credit Agreement, the Company and its domestic subsidiaries will be required to pledge the equity securities of certain of their respective material subsidiaries, subject to certain exceptions and limitations.

The Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries' ability to, among other things, incur subsidiary indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into certain transactions with affiliates, pay dividends or make distributions, repurchase stock, enter into restrictive agreements and enter into sale and leaseback transactions, in each case subject to customary exceptions for a credit facility of this size and type. The Company is also required to maintain compliance with a consolidated leverage ratio and a consolidated interest coverage ratio. At September 30, 2013, the Company was in compliance with these covenants.

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

(16)Contingencies

In the ordinary course of the Company's business, it is involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. The Company also periodically receives notifications from various third parties alleging infringement of patents, intellectual property rights or other matters. With respect to pending legal actions to which the Company is a party, although the outcomes of these actions are not generally determinable, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on its financial position, cash flows or results of operations. Litigation relating to the semiconductor industry is not uncommon, and the Company is, and from time to time has been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

The Company's technology license agreements generally include an indemnification clause that indemnifies the licensee against liability and damages (including legal defense costs) arising from any claims of patent, copyright, trademark or trade secret infringement by the Company's proprietary technology. The terms of these indemnification provisions approximate the terms of the outgoing technology license agreements, which are typically perpetual unless terminated by either party for breach. The possible amount of future payments the Company could be required to make based on agreements that specify indemnification limits, if such indemnifications were required on all of these agreements, is approximately \$119 million. There are some licensing agreements in place that do not specify indemnification limits. The Company had not recorded any liabilities related to these indemnification obligations as of September 30, 2013.

Contingent liabilities in the amount of \$13.0 million were recorded in connection with the Company's April 10, 2010 acquisition of Silicon Storage Technology Inc. (SST) as an adverse outcome was determined to be probable and estimable. One of the contingent liabilities associated with the SST acquisition was resolved in the second quarter of

fiscal 2013 with legal settlement costs of approximately \$11.5 million for certain legal matters related to SST in excess of previously accrued amounts, for which were expensed as special charges in the statement of income. At September 30, 2013, \$5.7 million of the original contingent liabilities recorded were still outstanding.

(17) Derivative Instruments

The Company has international operations and is thus subject to foreign currency rate fluctuations. To manage the risk of changes in foreign currency rates, the Company periodically enters into derivative contracts comprised of foreign currency forward contracts to hedge its asset and liability foreign currency exposure and a portion of its foreign currency operating expenses. Approximately 99% of the Company's sales are U.S. dollar denominated. To date, the exposure related to foreign exchange rate volatility has not been material to the Company's operating results. As of September 30, 2013, the Company had no foreign currency forward contracts outstanding. As of March 31, 2013, the Company had foreign currency forward

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contracts with notional amounts of \$6.0 million to economically hedge certain balance sheet exposures related to the Japanese yen. As these contracts were executed at or near the end of the respective periods, there were no unrecognized gains or losses on these contracts at March 31, 2013. The Company recognized an immaterial amount of net realized gains and losses on foreign currency forward contracts in each of the three and six months ended September 30, 2013 and 2012. Gains and losses from changes in the fair value of these foreign currency forward contracts are credited or charged to Other Income (Expense). The Company does not apply hedge accounting to its foreign currency derivative instruments.

## (18) Comprehensive Income

The following table presents the changes in the components of accumulated other comprehensive income (AOCI) for the six months ended September 30, 2013 (amounts in thousands):

|  | Unrealized<br>holding gains (losses)<br>available-for-sale<br>securities | Minimum<br>pension<br>liability | Foreign<br>Currency | Total      |
|--|--|---------------------------------|---------------------|------------|
| Balance at March 31, 2013  | \$5,444  | \$52                            | \$1,439             | \$6,935    |
| Other comprehensive loss before<br>reclassifications                       | (8,070   | ) —                             | —                   | (8,070 )   |
| Amounts reclassified from accumulated other<br>comprehensive income (loss) | (1,390   | ) —                             | —                   | (1,390 )   |
| Net other comprehensive loss   | (9,460   | ) —                             | —                   | (9,460 )   |
| Balance at September 30, 2013  | \$(4,016   | ) \$52                          | \$1,439             | \$(2,525 ) |

The table below details where reclassifications of realized transactions out of AOCI are recorded on the Consolidated Statements of Income.

| Description of AOCI Component                                 | Three Months Ended<br>September 30, |      | Six Months Ended<br>September 30, |       | Related Statement of<br>Income Line |
|---|-------------------------------------|------|-----------------------------------|-------|-------------------------------------|
|   | 2013                                | 2012 | 2013                              | 2012  |                                     |
| Unrealized gains (losses) on<br>available-for-sale securities | \$2,116                             | \$29 | \$2,166                           | \$221 | Other income                        |
| Taxes   | (776                                | ) —  | (776                              | ) (51 | ) Provision for income<br>taxes     |
| Reclassification of realized<br>transactions, net of taxes    | \$1,340                             | \$29 | \$1,390                           | \$170 | Net Income                          |

## (19) Share-Based Compensation

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

|   | Three Months Ended<br>September 30, |             | Six Months Ended<br>September 30, |             |     |
|---|-------------------------------------|-------------|-----------------------------------|-------------|-----|
|   | 2013                                | 2012        | 2013                              | 2012        |     |
| Cost of sales                                 | \$1,864                             | (1) \$2,614 | (1) \$3,833                       | (1) \$3,924 | (1) |
| Research and development                      | 6,931                               | 6,358       | 12,621                            | 10,390      |     |
| Selling, general and administrative           | 6,205                               | 11,581      | 11,202                            | 16,225      |     |
| Pre-tax effect of share-based<br>compensation | 15,000                              | 20,553      | 27,656                            | 30,539      |     |

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|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Income tax benefit                            | 1,589    | 3,419    | 2,991    | 4,741    |
| Net income effect of share-based compensation | \$13,411 | \$17,134 | \$24,665 | \$25,798 |

(1) During the three and six months ended September 30, 2013, \$2.4 million and \$3.8 million, respectively, of share-based compensation expense was capitalized to inventory and \$1.9 million and \$3.8 million, respectively, of previously capitalized share-based compensation expenses in inventory was sold. During the three and six months ended September 30, 2012, \$1.8 million and \$3.5 million of share-based compensation expense was capitalized to inventory and

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\$2.6 million and \$3.9 million, respectively, of previously capitalized share-based compensation expense in inventory was sold.

**(20) Net Income (Loss) Per Common Share**

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

|   | Three Months Ended |            | Six Months Ended |          |
|---|--------------------|------------|------------------|----------|
|   | September 30,      |            | September 30,    |          |
|   | 2013               | 2012       | 2013             | 2012     |
| Net income (loss)   | \$99,806           | \$(21,184) | ) \$178,385      | \$57,526 |
| Weighted average common shares outstanding                      | 197,825            | 194,060    | 197,388          | 193,756  |
| Dilutive effect of stock options and RSUs                       | 4,144              | —          | 3,908            | 3,701    |
| Dilutive effect of convertible debt                             | 14,506             | —          | 13,075           | 7,170    |
| Weighted average common and potential common shares outstanding | 216,475            | 194,060    | 214,371          | 204,627  |
| Basic net income (loss) per common share                        | \$0.50             | \$(0.11)   | ) \$0.90         | \$0.30   |
| Diluted net income (loss) per common share                      | \$0.46             | \$(0.11)   | ) \$0.83         | \$0.28   |

Diluted net income per common share for the three and six months ended September 30, 2013 includes 14,506,100 shares and 13,075,168 shares, respectively, issuable upon the exchange of debentures (see Note 14). Diluted net income per common share for the six months ended September 30, 2012 includes 7,169,730 shares issuable upon the exchange of debentures. The debentures have no impact on diluted net income per common share unless the average price of the Company's common stock exceeds the conversion price because the principal amount of the debentures will be settled in cash upon conversion. Prior to conversion, the Company will include, in the diluted net income per common share calculation, the effect of the additional shares that may be issued when the Company's common stock price exceeds the conversion price using the treasury stock method. The weighted average conversion price per share used in calculating the dilutive effect of the convertible debt for the three and six-month periods ended September 30, 2013 was \$26.42 and \$26.54, respectively. The weighted average conversion price per share used in calculating the dilutive effect of the convertible debt for the six-month period ended September 30, 2012 was \$27.65.

Weighted average common shares exclude the effect of option shares which are not dilutive. There were no antidilutive option shares for the three and six months ended September 30, 2013. For the three and six months ended September 30, 2012, the number of option shares that were antidilutive was 3,367,634 and 110,021, respectively.

**(21) Dividends**

A quarterly cash dividend of \$0.3540 per share was paid on September 4, 2013 in the aggregate amount of \$70.1 million. Through the first six months of fiscal 2014, cash dividends of \$0.7075 per share have been paid in the aggregate of \$139.8 million. A quarterly cash dividend of \$0.3545 per share was declared on October 30, 2013 and will be paid on December 5, 2013 to stockholders of record as of November 21, 2013. The Company expects the December 2013 payment of its quarterly cash dividend to be approximately \$70.4 million.

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

This report, including "Part I – Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II - Item 1A Risk Factors" contains certain forward-looking statements that involve risks and uncertainties, including statements regarding our strategy, financial performance and revenue sources. We use words such as "anticipate," "believe," "plan," "expect," "future," "intend" and similar expressions to identify forward-looking statements. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth under "Risk Factors," beginning at page 36 and elsewhere in this Form 10-Q. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. We disclaim any obligation to update information contained in any forward-looking statement. These forward-looking statements include, without limitation, statements regarding the following:

- The effects that adverse global economic conditions and fluctuations in the global credit and equity markets may have on our financial condition and results of operations;
- The effects and amount of competitive pricing pressure on our product lines;
- Our ability to moderate future average selling price declines;
- The effect of product mix, capacity utilization, yields, fixed cost absorption, competition and economic conditions on gross margin;
- The amount of, and changes in, demand for our products and those of our customers;
- The level of orders that will be received and shipped within a quarter;
- Our expectation that our inventory levels will be relatively flat to up modestly in the December 2013 quarter compared to the September 2013 quarter and that it will allow us to maintain competitive lead times;
- The effect that distributor and customer inventory holding patterns will have on us;
- Our belief that customers recognize our products and brand name and use distributors as an effective supply channel;
- Our belief that deferred cost of sales are recorded at their approximate carrying value and will have low risk of material impairment;
- Our belief that our direct sales personnel combined with our distributors provide an effective means of reaching our customer base;
- Our ability to increase the proprietary portion of our analog and interface product lines and the effect of such an increase;
- Our belief that our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs;
- The impact of any supply disruption we may experience;
- Our ability to effectively utilize our facilities at appropriate capacity levels and anticipated costs;
- That we adjust capacity utilization to respond to actual and anticipated business and industry-related conditions;
- That our existing facilities will provide sufficient capacity to respond to increases in demand with modest incremental capital expenditures;
- That manufacturing costs will be reduced by transition to advanced process technologies;
- Our ability to maintain manufacturing yields;
- Continuing our investments in new and enhanced products;
- The cost effectiveness of using our own assembly and test operations;
- Our anticipated level of capital expenditures;
- Continuation and amount of quarterly cash dividends;
- The sufficiency of our existing sources of liquidity to finance anticipated capital expenditures and otherwise meet our anticipated cash requirements, and the effects that our contractual obligations are expected to have on them;
- The impact of seasonality on our business;



- The accuracy of our estimates used in valuing employee equity awards;
- That the resolution of legal actions will not have a material effect on our business, and the accuracy of our assessment of the probability of loss and range of potential loss;
- The recoverability of our deferred tax assets;
- The adequacy of our tax reserves to offset any potential tax liabilities, having the appropriate support for our income tax positions and the accuracy of our estimated tax rate;
- Our belief that the expiration of any tax holidays will not have a material impact on our overall tax expense or effective tax rate;
- Our belief that the estimates used in preparing our consolidated financial statements are reasonable;

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- Our belief that recently issued accounting pronouncements listed in this document will not have a significant impact on our consolidated financial statements;
- Our actions to vigorously and aggressively defend and protect our intellectual property on a worldwide basis;
- Our ability to obtain patents and intellectual property licenses and minimize the effects of litigation;
- The level of risk we are exposed to for product liability claims or indemnification claims;
  - The effect of fluctuations in market interest rates on our income and/or cash flows;
- The effect of fluctuations in currency rates;
- The accuracy of our estimates of market information that determines the value of our Auction Rate Securities (ARS), and that the lack of markets for the ARS will not have a material impact on our liquidity, cash flow, or ability to fund operations;
- That our offshore earnings are considered to be permanently reinvested offshore and that we could determine to repatriate some of our offshore earnings in future periods to fund stockholder dividends, share repurchases, acquisitions or other corporate activities;
- That a significant portion of our future cash generation will be in our foreign subsidiaries;
- Our intention to indefinitely reinvest undistributed earnings of certain non-US subsidiaries in those subsidiaries;
- Our intent to maintain a high-quality investment portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield; and
- Our ability to collect accounts receivable.

We begin our Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) with a summary of Microchip's overall business strategy to give the reader an overview of the goals of our business and the overall direction of our business and products. This is followed by a discussion of the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. We then discuss our Results of Operations for the three and six months ended September 30, 2013 compared to the three and six months ended September 30, 2012. We then provide an analysis of changes in our balance sheet and cash flows, and discuss our financial commitments in sections titled "Liquidity and Capital Resources," "Contractual Obligations" and "Off-Balance Sheet Arrangements."

Strategy

Our goal is to be a worldwide leader in providing specialized semiconductor products for a wide variety of embedded control applications. Our strategic focus is on the embedded control market, which includes microcontrollers, high-performance linear and mixed signal devices, power management and thermal management devices, connectivity devices, interface devices, Serial EEPROMs, SuperFlash memory products, our patented KeeLoq<sup>®</sup> security devices and Flash IP solutions. We provide highly cost-effective embedded control products that also offer the advantages of small size, high performance, low voltage/power operation and ease of development, enabling timely and cost-effective embedded control product integration by our customers. We license SuperFlash technology to foundries, integrated device manufacturers and design partners throughout the world for use in the manufacture of advanced microcontroller products.

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

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

control industry. By owning our wafer fabrication facilities and our assembly and test operations, and by employing statistical process control techniques, we have been able to achieve and maintain high production yields. Direct control over manufacturing resources allows us to shorten our design and production cycles. This control also allows us to capture a portion of the wafer manufacturing and the assembly and test profit margin. We do outsource a significant portion of our wafer fabrication and assembly and test requirements to third parties.

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

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photomask and wafer fabrication facilities enable us to rapidly verify design techniques by processing test wafers quickly and efficiently.

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

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

## Critical Accounting Policies and Estimates

### General

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

### Revenue Recognition - Distributors

Our distributors worldwide generally have broad price protection and product return rights, so we defer revenue recognition until the distributor sells the product to their customer. Revenue is recognized when the distributor sells the product to an end-customer, at which time the sales price becomes fixed or determinable. Revenue is not recognized upon shipment to our distributors since, due to discounts from list price as well as price protection rights, the sales price is not substantially fixed or determinable at that time. At the time of shipment to these distributors, we record a trade receivable for the selling price as there is a legally enforceable right to payment, relieve inventory for the carrying value of goods shipped since legal title has passed to the distributor, and record the gross margin in deferred income on shipments to distributors on our condensed consolidated balance sheets.

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

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We sell the majority of the items in our product catalog to our distributors worldwide at a uniform list price. However, distributors resell our products to end customers at a very broad range of individually negotiated price points. The majority of our distributors' resales require a reduction from the original list price paid. Often, under these circumstances, we remit back to the distributor a portion of their original purchase price after the resale transaction is completed in the form of a credit against the distributors' outstanding accounts receivable balance. The credits are on a per unit basis and are not given to the distributor until they provide information to us regarding the sale to their end customer. The price reductions vary significantly based on the customer, product, quantity ordered, geographic location and other factors, and discounts to a price less than our cost have historically been rare. The effect of granting these credits establishes the net selling price to our distributors for the product and results in the net revenue recognized by us when the product is sold by the distributors to their end customers. Thus, a portion of the "deferred income on shipments to distributors" balance represents the amount of distributors' original purchase price that will be credited back to the distributor in the future. The wide range and variability of negotiated price concessions granted to distributors does not allow us to accurately estimate the portion of the balance in the deferred income on shipments to distributor's account that will be credited back to the distributors. Therefore, we do not reduce deferred income on shipments to distributors or accounts receivable by anticipated future concessions; rather, price concessions are typically recorded against deferred income on shipments to distributors and accounts receivable when incurred, which is generally at the time the distributor sells the product. At September 30, 2013, we had approximately \$225.5 million of deferred revenue and \$74.5 million in deferred cost of sales recognized as \$151.0 million of deferred income on shipments to distributors. At March 31, 2013, we had approximately \$201.8 million of deferred revenue and \$62.8 million in deferred cost of sales recognized as \$139.0 million of deferred income on shipments to distributors. The deferred income on shipments to distributors that will ultimately be recognized in our income statement will be lower than the amount reflected on the balance sheet due to additional price credits to be granted to the distributors when the product is sold to their customers. These additional price credits historically have resulted in the deferred income approximating the overall gross margins that we recognize in the distribution channel of our business.

Distributor advances, reflected as a reduction of deferred income on shipments to distributors on our condensed consolidated balance sheets, totaled \$97.9 million at September 30, 2013 and \$70.1 million at March 31, 2013. On sales to distributors, our payment terms generally require the distributor to settle amounts owed to us for an amount in excess of their ultimate cost. The sales price to our distributors may be higher than the amount that the distributors will ultimately owe us because distributors often negotiate price reductions after purchasing the product from us and such reductions are often significant. It is our practice to apply these negotiated price discounts to future purchases, requiring the distributor to settle receivable balances, on a current basis, generally within 30 days, for amounts originally invoiced. This practice has an adverse impact on the working capital of our distributors. As such, we have entered into agreements with certain distributors whereby we advance cash to the distributors to reduce the distributor's working capital requirements. These advances are reconciled at least on a quarterly basis and are estimated based on the amount of ending inventory as reported by the distributor multiplied by a negotiated percentage. Such advances have no impact on our revenue recognition or our condensed consolidated statements of income. We process discounts taken by distributors against our deferred income on shipments to distributors' balance and true-up the advanced amounts generally after the end of each completed fiscal quarter. The terms of these advances are set forth in binding legal agreements and are unsecured, bear no interest on unsettled balances and are due upon demand. The agreements governing these advances can be canceled by us at any time.

We reduce product pricing through price protection based on market conditions, competitive considerations and other factors. Price protection is granted to distributors on the inventory they have on hand at the date the price protection is offered. When we reduce the price of our products, it allows the distributor to claim a credit against its outstanding accounts receivable balances based on the new price of the inventory it has on hand as of the date of the price

reduction. There is no immediate revenue impact from the price protection, as it is reflected as a reduction of the deferred income on shipments to distributors' balance.

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

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### Business Combinations

All of our business combinations are accounted for at fair value under the acquisition method of accounting. Under the acquisition method of accounting, (i) acquisition-related costs, except for those costs incurred to issue debt or equity securities, will be expensed in the period incurred; (ii) non-controlling interests will be valued at fair value at the acquisition date; (iii) in-process research and development will be recorded at fair value as an intangible asset at the acquisition date and amortized once the technology reaches technological feasibility; (iv) restructuring costs associated with a business combination will be expensed subsequent to the acquisition date; and (v) changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date will be recognized through income tax expense or directly in contributed capital. The measurement of fair value of assets accrued and liabilities assumed requires significant judgment. The valuation of intangible assets and acquired investments in privately held companies, in particular, requires that we use valuation techniques such as the income approach. The income approach includes the use of a discounted cash flow model, which includes discounted cash flow scenarios and requires the following significant estimates: revenue, expenses, capital spending and other costs, and discount rates based on the respective risks of the cash flows. The valuation of non-marketable equity investments acquired also takes into account variables such as conditions reflected in the capital markets, recent financing activity by the investees, the investees' capital structure and the terms of the investees' issued interests.

### Share-Based Compensation

We measure fair value and recognize compensation expense for all share-based payment awards, including grants of employee stock options, RSUs, stock appreciation rights, and employee stock purchase rights, to be recognized in our financial statements based on their respective grant date fair values. Total share-based compensation during the six months ended September 30, 2013 was \$27.7 million, of which \$23.8 million was reflected in operating expenses. Total share-based compensation reflected in cost of sales during the six months ended September 30, 2013 was \$3.8 million. Total share-based compensation included in our inventory balance was \$5.3 million at September 30, 2013.

Determining the appropriate fair-value model and calculating the fair value of share-based awards at the date of grant requires judgment. The fair value of our RSUs is based on the fair market value of our common stock on the date of grant discounted for expected future dividends. We use the Black-Scholes option pricing model to estimate the fair value of employee stock options and rights to purchase shares under our employee stock purchase plans. Option pricing models, including the Black-Scholes model, also require the use of input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. We use a blend of historical and implied volatility based on options freely traded in the open market as we believe this is more reflective of market conditions and a better indicator of expected volatility than using purely historical volatility. The expected life of the awards is based on historical and other economic data trended into the future. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our awards. The dividend yield assumption is based on our history and expectation of future dividend payouts. We estimate the number of share-based awards which will be forfeited due to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant effect on reported share-based compensation, as the effect of adjusting the rate for all expense amortization after April 1, 2006 is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate is higher or lower than the estimated forfeiture rate, then an adjustment is made to increase or decrease the estimated forfeiture rate, which will result in a decrease or increase to the expense recognized in our financial statements. If forfeiture adjustments are made, they would affect our gross margin, research and development expenses, and selling, general and administrative expenses. The effect of forfeiture adjustments in the second quarter of fiscal 2014 was immaterial.



We evaluate the assumptions used to value our awards on a quarterly basis. If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees.

#### Inventories

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

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

In periods where our production levels are substantially below our normal operating capacity, the reduced production levels of our manufacturing facilities are charged directly to cost of sales. Approximately \$5.0 million and \$15.4 million was charged to cost of sales in the three and six months ended September 30, 2013, respectively, as a result of decreased production in our wafer fabs compared to approximately \$4.5 million and \$8.3 million in the three and six months ended September 30, 2012, respectively.

## Income Taxes

As part of the process of preparing our condensed consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our condensed consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income within the relevant jurisdiction and to the extent we believe that recovery is not likely, we must establish a valuation allowance. We have provided valuation allowances for certain of our deferred tax assets, including state net operating loss carryforwards, foreign tax credits and state tax credits, where it is more likely than not that some portion, or all of such assets, will not be realized. At September 30, 2013, the valuation allowances totaled \$93.1 million. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. At September 30, 2013, our deferred tax asset, net of valuation allowances, was \$70.4 million.

Various taxing authorities in the U.S. and other countries in which we do business scrutinize the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. We are currently under audit by the U.S. Internal Revenue Service (IRS) for our fiscal years 2009 and 2010 and SMSC is currently under IRS audit for fiscal years 2011 and 2012. We recognize liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon these and other pending audits in the U.S. and other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

## Junior Subordinated Convertible Debentures

We separately account for the liability and equity components of our junior subordinated convertible debentures in a manner that reflects our nonconvertible debt (unsecured debt) borrowing rate when interest cost is recognized. This results in a bifurcation of a component of the debt, classification of that component in equity and the accretion of the resulting discount on the debt to be recognized as part of interest expense in our condensed consolidated statements of income. Additionally, certain embedded features of the debentures qualify as derivatives and are bundled as a

compound embedded derivative that is measured at fair value. Lastly, we include the dilutive effect of the shares of our common stock issuable upon conversion of the outstanding junior subordinated convertible debentures in our diluted income per share calculation regardless of whether the market price trigger or other contingent conversion feature has been met. We apply the treasury stock method as we have adopted an accounting policy to settle the principal amount of the junior subordinated convertible debentures in cash. This method results in incremental dilutive shares when the average fair value of our common stock for a reporting period exceeds the conversion price per share which was \$26.29 at September 30, 2013 and adjusts as dividends are recorded in the future.

#### Contingencies

In the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. We also periodically receive notifications from various third parties alleging infringement of patents, intellectual property rights or other matters. With respect to pending legal actions to which we are a party, although the outcomes of these actions are not generally determinable, we believe that the

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ultimate resolution of these matters will not have a material adverse effect on our financial position, cash flows or results of operations. Litigation relating to the semiconductor industry is not uncommon, and we are, and from time to time have been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

## Results of Operations

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

|  | Three Months Ended |         | Six Months Ended |         |   |  |
|--|--------------------|---------|------------------|---------|---|--|
|  | September 30,      |         | September 30,    |         |   |  |
|  | 2013               | 2012    | 2013             | 2012    |   |  |
| Net sales                                  | 100.0              | % 100.0 | % 100.0          | % 100.0 | % |  |
| Cost of sales                              | 41.4               | 49.3    | 41.9             | 45.7    |   |  |
| Gross profit                               | 58.6               | 50.7    | 58.1             | 54.3    |   |  |
| Research and development                   | 15.9               | 16.7    | 15.8             | 15.4    |   |  |
| Selling, general and administrative        | 14.0               | 18.7    | 14.1             | 17.3    |   |  |
| Amortization of acquired intangible assets | 4.8                | 7.3     | 5.4              | 4.3     |   |  |
| Special charges                            | —                  | 5.9     | 0.2              | 3.1     |   |  |
| Operating income                           | 23.9               | % 2.1   | % 22.6           | % 14.2  | % |  |

## Net Sales

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

Our net sales for the quarter ended September 30, 2013 were \$492.7 million, an increase of 6.5% from the previous quarter's sales of \$462.8 million, and an increase of 28.5% from net sales of \$383.3 million in the quarter ended September 30, 2012. Our net sales for the six months ended September 30, 2013 were \$955.5 million, an increase of 29.9% from net sales of \$735.4 million in the six months ended September 30, 2012. The increase in net sales in the quarter ended September 30, 2013 over the previous quarter was due primarily to general economic and semiconductor industry conditions and market share gains. The increases in net sales in the three and six months ended September 30, 2013 compared to the three and six months ended September 30, 2012 were due primarily to our acquisition of SMSC on August 2, 2012, general economic and semiconductor industry conditions and market share gains. Average selling prices for our semiconductor products were up approximately 6% and 9% for the three and six-month periods ended September 30, 2013, over the corresponding periods of the previous fiscal year. The number of units of our semiconductor products sold was up approximately 21% and 20% for the three and six-month periods ended September 30, 2013 over the corresponding periods of the previous fiscal year. The increases in the number of units of our semiconductor products sold and our average selling prices in the three and six-month periods ended September 30, 2013 compared to the corresponding periods of the previous fiscal year were mainly due to our acquisition of SMSC during the second quarter of fiscal 2013. The average selling prices and the unit volumes of our sales are impacted by the mix of our products sold and overall semiconductor market conditions. Key factors related to the amount of net sales during the three and six-month periods ended September 30, 2013 compared to the three and six-month periods ended September 30, 2012 include:

- our acquisition of SMSC during the second quarter of fiscal 2013;
- global economic conditions in the markets we serve;
- semiconductor industry conditions;
- inventory holding patterns of our customers;
- increasing semiconductor content in our customers' products;
- customers' increasing needs for the flexibility offered by our programmable solutions;
- our new product offerings that have increased our served available market; and
- continued market share gains in the segments of the markets we address.

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Sales by product line for the three and six months ended September 30, 2013 and 2012 were as follows (dollars in thousands):

|  | Three Months Ended<br>September 30,<br>(unaudited) |         |           |         | Six Months Ended<br>September 30,<br>(unaudited) |         |           |         |
|--|--|---------|-----------|---------|--|---------|-----------|---------|
|  | 2013   | %       | 2012      | %       | 2013   | %       | 2012      | %       |
| Microcontrollers                               | \$321,004  | 65.2    | \$253,315 | 66.1    | \$621,309  | 65.0    | \$493,657 | 67.1    |
| Analog, interface and mixed<br>signal products | 108,460  | 22.0    | 70,069    | 18.3    | 211,675  | 22.2    | 117,253   | 15.9    |
| Memory products                                | 34,987   | 7.1     | 36,570    | 9.5     | 68,979   | 7.2     | 77,288    | 10.5    |
| Technology licensing                           | 24,826   | 5.0     | 20,121    | 5.3     | 47,344   | 5.0     | 40,403    | 5.5     |
| Other  | 3,392  | 0.7     | 3,223     | 0.8     | 6,154  | 0.6     | 6,831     | 1.0     |
| Total sales                                    | \$492,669  | 100.0 % | \$383,298 | 100.0 % | \$955,461  | 100.0 % | \$735,432 | 100.0 % |

**Microcontrollers**

Our microcontroller product line represents the largest component of our total net sales. Microcontrollers and associated application development systems accounted for approximately 65.2% of our total net sales for the three-month period ended September 30, 2013 and approximately 65.0% of our total net sales for the six-month period ended September 30, 2013 compared to approximately 66.1% of our total net sales for the three-month period ended September 30, 2012 and approximately 67.1% of our total net sales for the six-month period ended September 30, 2012.

Net sales of our microcontroller products increased approximately 26.7% in the three-month period ended September 30, 2013 and approximately 25.9% in the six-month period ended September 30, 2013 compared to the three and six-month periods ended September 30, 2012. These sales increases were driven primarily by our acquisition of SMSC, market share gains and general economic and semiconductor industry conditions in the end markets that we serve including the consumer, automotive, industrial control, communications and computing markets.

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

**Analog, Interface and Mixed Signal Products**

Sales of our analog, interface and mixed signal products accounted for approximately 22.0% of our total net sales for the three-month period ended September 30, 2013 and approximately 22.2% of our total net sales for the six-month period ended September 30, 2013 compared to approximately 18.3% of our total net sales for the three-month period ended September 30, 2012 and approximately 15.9% of our total net sales for the six-month period ended September 30, 2012.

Net sales of our analog, interface and mixed signal products increased approximately 54.8% in the three-month period ended September 30, 2013 and approximately 80.5% in the six-month period ended September 30, 2013 compared to the three and six-month periods ended September 30, 2012. These sales increases were driven primarily by our acquisition of SMSC, general economic and semiconductor industry conditions and market share gains achieved within the analog, interface and mixed signal market.

Analog, interface and mixed signal products can be proprietary or non-proprietary in nature. Currently, we consider more than 80% of our analog, interface and mixed signal product mix to be proprietary in nature, where prices are relatively stable, similar to the pricing stability experienced in our microcontroller products. The non-proprietary portion of our analog, interface and mixed signal business will experience price fluctuations driven primarily by the current supply and demand for those products. We may be unable to maintain the average selling prices of our analog, interface and mixed signal products as

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a result of increased pricing pressure in the future, which would adversely affect our operating results. We anticipate the proprietary portion of our analog, interface and mixed signal products will increase over time.

### Memory Products

Sales of our memory products accounted for approximately 7.1% of our total net sales for the three-month period ended September 30, 2013 and approximately 7.2% of our total net sales for the six-month period ended September 30, 2013 compared to approximately 9.5% of our total net sales for the three-month period ended September 30, 2012 and approximately 10.5% of our total net sales for the six-month period ended September 30, 2012 .

Net sales of our memory products decreased approximately 4.3% in the three-month period ended September 30, 2013 and approximately 10.8% in the six-month period ended September 30, 2013 compared to the three and six-month periods ended September 30, 2012. These sales decreases were driven primarily by adverse customer demand conditions within the Serial EEPROM and Flash memory markets.

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

### Technology Licensing

Technology licensing revenue includes a combination of royalties associated with technology licensed for the use of our SuperFlash technology and fees for engineering services. Technology licensing accounted for approximately 5.0% of our total net sales for each of the three and six-month periods ended September 30, 2013 compared to approximately 5.3% of our total net sales for the three-month period ended September 30, 2012 and approximately 5.5% of our total net sales for the six-month period ended September 30, 2012 .

Net sales related to our technology licensing increased approximately 23.4% in the three-month period ended September 30, 2013 and approximately 17.2% in the six-month period ended September 30, 2013 compared to the three and six-month periods ended September 30, 2012. These sales increases were driven primarily by the adoption of our technology by more manufacturers of semiconductors as well as semiconductor industry and global economic conditions.

### Other

Revenue from assembly and test subcontracting services performed during the three-month period ended September 30, 2013 accounted for approximately 0.7% of our total net sales compared to approximately 0.8% of our total net sales for the three-month period ended September 30, 2012. During the six-month period ended September 30, 2013, revenue from assembly and test subcontracting services accounted for approximately 0.6% of our total net sales compared to approximately 1.0% of our total net sales for the six-month period ended September 30, 2012.

### Distribution



Distributors accounted for approximately 53.1% of our net sales in the three-month period ended September 30, 2013 and approximately 50.5% of our net sales in the three-month period ended September 30, 2012. Distributors accounted for approximately 53.7% of our net sales in the six-month period ended September 30, 2013 and approximately 54.4% of our net sales in the six-month period ended September 30, 2012. Our distributors focus primarily on servicing the product requirements of a broad base of diverse customers. We believe that distributors provide an effective means of reaching this broad and diverse customer base. We believe that customers recognize Microchip for its products and brand name and use distributors as an effective supply channel.

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

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At September 30, 2013, our distributors maintained 33 days of inventory of our products compared to 30 days at March 31, 2013. Over the past three fiscal years, the days of inventory maintained by our distributors have fluctuated between 27 days and 47 days. We do not believe that inventory holding patterns at our distributors will materially impact our net sales, due to the fact that we recognize revenue based on sell-through for all our distributors.

## Sales by Geography

Sales by geography for the three and six months ended September 30, 2013 and 2012 were as follows (dollars in thousands):

|             | Three Months Ended |         |           |         | Six Months Ended |         |           |         |
|-------------|--------------------|---------|-----------|---------|------------------|---------|-----------|---------|
|             | September 30,      |         |           |         | September 30,    |         |           |         |
|             | (unaudited)        |         |           |         | (unaudited)      |         |           |         |
|             | 2013               | %       | 2012      | %       | 2013             | %       | 2012      | %       |
| Americas    | \$95,185           | 19.3    | \$79,533  | 20.8    | \$182,113        | 19.1    | \$151,536 | 20.6    |
| Europe      | 98,913             | 20.1    | 83,679    | 21.8    | 200,161          | 20.9    | 160,985   | 21.9    |
| Asia        | 298,571            | 60.6    | 220,086   | 57.4    | 573,187          | 60.0    | 422,911   | 57.5    |
| Total sales | \$492,669          | 100.0 % | \$383,298 | 100.0 % | \$955,461        | 100.0 % | \$735,432 | 100.0 % |

Americas sales include sales to customers in the U.S., Canada, Central America and South America. Sales to foreign customers accounted for approximately 84% of our total net sales in each of the three and six-month periods ended September 30, 2013 and approximately 82% of our total net sales in each of the three and six-month periods ended September 30, 2012. Substantially all of our foreign sales are U.S. Dollar denominated. Sales to customers in Asia have generally increased over time due to many of our customers transitioning their manufacturing operations to Asia and growth in demand from the emerging Asian market. Our sales force in the Americas and Europe supports a significant portion of the design activity for products which are ultimately shipped to Asia.

## Gross Profit

Our gross profit was \$288.9 million in the three months ended September 30, 2013 and \$194.2 million in the three months ended September 30, 2012. Our gross profit was \$555.4 million in the six months ended September 30, 2013 and \$399.0 million in the six months ended September 30, 2012. Gross profit as a percent of sales was 58.6% in the three months ended September 30, 2013 and 50.7% in the three months ended September 30, 2012. Gross profit as a percent of sales was 58.1% in the six months ended September 30, 2013 and 54.3% in the six months ended September 30, 2012.

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

charges of approximately \$22.7 million and \$24.2 million in the three and six months ended September 30, 2012, respectively, related to acquired inventory valuation adjustments as a result of our acquisition activity reducing margins below their historical levels;

- production levels being below the range of normal capacity levels, resulting in under absorption of fixed costs, in each of the three and six months ended September 30, 2013 and 2012;

- for the three and six months ended September 30, 2013, inventory write-downs being lower than the gross margin impact of sales of inventory that was previously written down;

- for the three and six months ended September 30, 2012, inventory write-downs being higher than the gross margin impact of sales of inventory that was previously written down; and

- fluctuations in our product mix of microcontrollers, analog products, memory products and technology licensing.

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

- continual cost reductions in wafer fabrication and assembly and test manufacturing, such as new manufacturing technologies and more efficient manufacturing techniques; and
- lower depreciation as a percentage of cost of sales.

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We adjust our wafer fabrication and assembly and test capacity utilization as required to respond to actual and anticipated business and industry-related conditions. When production levels are below normal capacity, we charge cost of sales for the unabsorbed capacity. During each of the three and six-month periods ended September 30, 2013 and 2012, we operated below normal capacity levels, which we typically consider to be 90% to 95% of the actual capacity of our installed equipment, in our wafer fabrication facilities in response to weak global economic conditions and our inventory position. As a result of decreased production in our wafer fabs, approximately \$5.0 million and \$15.4 million was charged to cost of sales during the three and six months ended September 30, 2013, respectively, compared to \$4.5 million and \$8.3 million during the three and six months ended September 30, 2012, respectively. We operated at normal capacity levels in our Thailand assembly and test facility during the three and six months ended September 30, 2013. During the three and six months ended September 30, 2012, we operated below normal capacity levels in our Thailand assembly and test facility which had a negative impact on our gross margin during such periods.

The process technologies utilized in our wafer fabs impact our gross margins. Fab 2 currently utilizes various manufacturing process technologies, but predominantly utilizes our 0.5 to 1.0 micron processes. Fab 4 predominantly utilizes our 0.22 to 0.5 micron processes. We continue to transition products to more advanced process technologies to reduce future manufacturing costs. All of our production has been on 8-inch wafers during the periods covered by this Form 10-Q.

Our overall inventory levels were \$275.1 million at September 30, 2013, compared to \$242.3 million at March 31, 2013. We maintained 123 days of inventory on our balance sheet at September 30, 2013 compared to 116 days of inventory at March 31, 2013. We expect our inventory levels in the December 2013 quarter to be flat to up modestly over those levels at September 30, 2013. We believe our existing level of inventory will allow us to maintain competitive lead times and provide strong delivery performance to our customers and allow us to keep our fiscal 2014 capital expenditures at relatively low levels.

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

During the three months ended September 30, 2013, approximately 49% of our assembly requirements were performed in our Thailand facility compared to approximately 60% of our assembly requirements at September 30, 2012. The percentage of our assembly work that is performed internally fluctuates over time based on supply and demand conditions in the semiconductor industry and our internal capacity capabilities. Third-party contractors located in Asia perform the balance of our assembly operations. During the three months ended September 30, 2013, approximately 86% of our test requirements were performed in our Thailand facility compared to approximately 84% of our test requirements being performed in our Thailand facility at September 30, 2012. The primary reason for the decreased percentages of internal assembly and test production from the levels a year ago is our acquisition of SMSC as SMSC primarily outsourced these manufacturing activities. We believe that the assembly and test operations performed at our Thailand facility provide us with significant cost savings when compared to contractor assembly and test costs, as well as increased control over these portions of the manufacturing process.

We rely on outside wafer foundries for a significant portion of our wafer fabrication requirements. In each of the three and six-month periods ended September 30, 2013, approximately 38% of our total net sales related to wafers purchased from outside foundries. In the three and six months ended September 30, 2012, approximately 31% and 26%, respectively, of our total net sales related to wafers purchased from outside foundries. The primary reason for the increased percentage in the three and six months ended September 30, 2013 is our acquisition of SMSC, as SMSC

relied solely on outside wafer foundries for their wafer fabrication requirements.

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

#### Research and Development (R&D)

R&D expenses for the three months ended September 30, 2013 were \$78.3 million, or 15.9% of net sales, compared to \$64.1 million, or 16.7% of net sales, for the three months ended September 30, 2012. R&D expenses for the six months ended September 30, 2013 were \$151.3 million, or 15.8% of net sales, compared to \$112.9 million, or 15.4% of net sales, for the six months ended September 30, 2012. We are committed to investing in new and enhanced products, including development systems software, and in our design and manufacturing process technologies. We believe these investments are significant

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factors in maintaining our competitive position. R&D costs are expensed as incurred. Assets purchased to support our ongoing research and development activities are capitalized when related to products which have achieved technological feasibility or that have alternative future uses and are amortized over their expected useful lives. R&D expenses include labor, depreciation, masks, prototype wafers, and expenses for the development of process technologies, new packages, and software to support new products and design environments.

R&D expenses increased \$14.2 million, or 22.1%, for the three months ended September 30, 2013 over the same period last year. R&D expenses increased \$38.4 million, or 34.0%, for the six months ended September 30, 2013 over the same period last year. The primary reasons for the increases in R&D costs over these periods were additional costs from our acquisition of SMSC as well as higher headcount and bonus costs.

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

### Selling, General and Administrative

Selling, general and administrative expenses for the three months ended September 30, 2013 were \$69.4 million, or 14.1% of net sales, compared to \$71.8 million, or 18.7% of net sales, for the three months ended September 30, 2012. Selling, general and administrative expenses for the six months ended September 30, 2013 were \$135.1 million, or 14.1% of net sales, compared to \$127.4 million, or 17.3% of net sales, for the six months ended September 30, 2012. Selling, general and administrative expenses include salary expenses related to field sales, marketing and administrative personnel, advertising and promotional expenditures and legal expenses. Selling, general and administrative expenses also include costs related to our direct sales force and field applications engineers who work in sales offices worldwide to stimulate demand by assisting customers in the selection and use of our products.

Selling, general and administrative expenses decreased \$2.4 million, or 3.3%, for the three months ended September 30, 2013 over the same period last year. The primary reasons for the dollar decrease in selling, general and administrative costs in the 2013 period were that higher legal expenses, professional service expenses and share-based compensation were incurred in the three months ended September 30, 2012 related to our acquisition of SMSC and, also, that we had lower SMSC headcount costs in the three months ended September 30, 2013 over the same period last year. Selling, general and administrative expenses increased \$7.7 million, or 6.1%, for the six months ended September 30, 2013 over the same period last year. The primary reasons for the dollar increase in selling, general and administrative costs for this period were higher headcount and bonus costs partially offset by lower acquisition related legal and professional service expenses.

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

### Amortization of Acquired Intangible Assets

Amortization of acquired intangible assets for the three and six months ended September 30, 2013 were \$23.7 million and \$51.4 million, respectively. Amortization of acquired intangible assets for the three and six months ended September 30, 2012 were \$27.9 million and \$31.9 million, respectively. The primary reason for the increases in amortization costs during the three and six months ended September 30, 2013 over the same periods last year were intangible assets acquired as a result of our acquisition of SMSC.

### Special Charges

During the three months ended September 30, 2013, we incurred special charges of \$0.8 million for an additional liability related to our acquisition of Roving Networks and \$0.4 million of severance related, office closing, and other costs associated with our acquisition of SMSC, which were offset by \$1.1 million of special income related to the release of an accrued bonus for a milestone that was not met for a business that SMSC had acquired prior to our acquisition of SMSC. During the six months ended September 30, 2013, we incurred special charges of \$1.4 million due to the increase in the fair value of contingent consideration related to one of our acquisitions, \$0.8 million for an additional liability related to our acquisition of Roving Networks and \$0.7 million of severance related, office closing, and other costs associated with our acquisition of SMSC, which were offset by \$1.1 million of special income related to the release of an accrued bonus for a milestone that was not met for a business that SMSC had acquired prior to our acquisition of SMSC.

During the three and six months ended September 30, 2012, we incurred approximately \$10.9 million of severance related, office closing costs, and other costs associated with the acquisition of SMSC. Also, during the three and six months

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ended September 30, 2012, we incurred legal settlement costs of approximately \$11.5 million for certain legal matters related to Silicon Storage Technology, Inc. (which we acquired in April 2010) in excess of previously accrued amounts.

### Other Income (Expense)

Interest income in the three and six months ended September 30, 2013 was \$4.0 million and \$7.9 million, respectively, compared to interest income of \$3.7 million and \$8.1 million in the three and six months ended September 30, 2012, respectively. Interest expense in the three and six months ended September 30, 2013 was \$12.4 million and \$24.2 million, respectively, compared to \$10.8 million and \$19.9 million in the three and six months ended September 30, 2012, respectively. The primary reason for the increases in interest expense in the three and six months ended September 30, 2013 relates to increased borrowings under our credit facility to partially finance our acquisition of SMSC. Other income, net in the three and six months ended September 30, 2013 was \$2.1 million and \$2.3 million, respectively, compared to other income, net of \$1.1 million and \$0.5 million in the three and six months ended September 30, 2012, respectively. The change in other income, net in the three and six months primarily relates to realized gains of \$2.1 million from the sale of marketable equity and debt securities compared to a prior year gain of \$1.3 million related to the sale of inventory previously considered discontinued and fluctuations on our foreign currency derivatives.

### Provision for Income Taxes

Our provision for income taxes reflects tax on foreign earnings and federal and state tax on U.S. earnings. We had an effective tax rate from continuing operations of 11.5% for the six-month period ended September 30, 2013 and 38.1% for the six-month period ended September 30, 2012. Our effective tax rate is lower than statutory rates in the U.S. due primarily to our mix of earnings in foreign jurisdictions with lower tax rates. Our effective tax rate was higher in the September 30, 2012 period due to certain tax expenses associated with our acquisition of SMSC.

Various taxing authorities in the U.S. and other countries in which we do business are increasing their scrutiny of the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. For U.S. federal, and in general for U.S. state tax returns, our fiscal 2009 and later tax returns remain open for examination by the taxing authorities. The IRS is currently auditing our fiscal 2009 and fiscal 2010 tax returns, and SMSC is currently under IRS audit for fiscal years 2011 and 2012. We recognize liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon these and other pending audits in the U.S. and other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than any final assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

Our Thailand manufacturing operations currently benefit from numerous tax holidays that have been granted to us by the Thailand government based on our investments in property, plant and equipment in Thailand. Our tax holiday periods in Thailand expire at various times in the future. Any expiration of our tax holidays are expected to have a minimal impact on our overall tax expense due to other tax holidays and an increase in income in other taxing jurisdictions with lower statutory rates.

### Liquidity and Capital Resources



We had \$1,981.6 million in cash, cash equivalents and short-term and long-term investments at September 30, 2013, an increase of \$145.6 million from the March 31, 2013 balance. The increase in cash, cash equivalents and short-term and long-term investments over this time period is primarily attributable to cash generated from operating activities offset in part by dividend payments of \$139.8 million.

Net cash provided from operating activities was \$319.4 million for the six-month period ended September 30, 2013 compared to \$192.3 million for the six-month period ended September 30, 2012. The increase in cash flow from operations in the six-month period ended September 30, 2013 compared to the six-month period ended September 30, 2012 was primarily due to higher net income during the six-month period ended September 30, 2013.

During the six months ended September 30, 2013, net cash used in investing activities was \$383.5 million compared to net cash used in investing activities of \$873.2 million for the six months ended September 30, 2012. The decrease in net cash used in investing activities was due primarily to \$731.7 million of cash consideration, net of \$180.9 million of cash and cash equivalents acquired, used in our acquisition of SMSC.

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Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the six months ended September 30, 2013 were \$55.2 million compared to \$26.2 million in the six months ended September 30, 2012. Capital expenditures are primarily for the expansion of production capacity and the addition of research and development equipment. We currently intend to spend approximately \$90 million during the next twelve months to invest in equipment and facilities to maintain, and selectively increase capacity to meet our currently anticipated needs.

We expect to finance our capital expenditures through our existing cash balances and cash flows from operations. We believe that the capital expenditures anticipated to be incurred over the next twelve months will provide sufficient manufacturing capacity to meet our currently anticipated needs.

Net cash used in financing activities was \$120.0 million for the six months ended September 30, 2013 compared to net cash provided by financing activities of \$480.5 million for the six months ended September 30, 2012. We made payments on our borrowings under our credit agreements of \$720.0 and \$80.0 million during the six months ended September 30, 2013 and 2012, respectively. Cash received on borrowings under our credit agreements totaled \$740.0 million and \$680.0 million during the six months ended September 30, 2013 and 2012, respectively. We paid cash dividends to our stockholders of \$139.8 million in the six months ended September 30, 2013 and \$135.9 million in the six months ended September 30, 2012. Proceeds from the exercise of stock options and employee purchases under our employee stock purchase plans were \$22.2 million for the six months ended September 30, 2013 and \$16.3 million for the six months ended September 30, 2012.

On June 27, 2013, we entered into a \$2.0 billion credit agreement with certain lenders. The credit agreement provides for a \$350.0 million term loan and a \$1.65 billion revolving credit facility, with a \$125 million foreign currency sublimit, a \$35 million letter of credit sublimit and a \$25 million swingline loan sublimit, terminating on June 27, 2018. The credit agreement also contains an increase option permitting us, subject to certain requirements, to arrange with existing lenders and/or new lenders for them to provide up to an aggregate of \$300 million in additional commitments, which may be for revolving loans or term loans. Proceeds of loans made under the credit agreement may be used for working capital and general corporate purposes. The new credit agreement replaced another credit agreement we had in place since August 2011. At September 30, 2013, \$640.0 million of borrowings were outstanding under the credit agreement consisting of \$290.0 million of a revolving line of credit and \$350.0 million of a term loan, net of \$1.2 million of debt discount resulting from amounts paid to the lenders. See Note 15 of the notes to condensed consolidated financial statements for more information regarding the credit agreement.

Our total cash, cash equivalents, short-term investments and long-term investments held by our foreign subsidiaries was \$1,963.8 million at September 30, 2013 and \$1,782.0 million at March 31, 2013. Under current tax laws and regulations, if accumulated earnings and profits held by our foreign subsidiaries that U.S. taxes had not previously been provided for were to be distributed to the U.S., in the form of dividends or otherwise, we would be subject to additional U.S. income taxes and foreign withholding taxes. Our balance of cash, cash equivalents, short-term investments and long-term investments available for our U.S. operations as of September 30, 2013 and March 31, 2013 was approximately \$18.0 million and \$100.0 million, respectively. We utilize a variety of tax planning and financing strategies with the objective of having our worldwide cash available in the locations in which it is needed. We consider our offshore earnings to be permanently reinvested offshore. However, we could determine to repatriate some of our offshore earnings in future periods to fund stockholder dividends, share repurchases, acquisitions or other corporate activities in the future. We expect that a significant portion of our future cash generation will be in our foreign subsidiaries.

We enter into derivative transactions from time to time in an attempt to reduce our exposure to currency rate fluctuations. Although none of the countries in which we conduct significant foreign operations has had a highly

inflationary economy in the last five years, there is no assurance that inflation rates or fluctuations in foreign currency rates in countries where we conduct operations will not adversely affect our operating results in the future. At September 30, 2013, we had no foreign currency forward contracts outstanding.

On December 11, 2007, we announced that our Board of Directors had authorized the repurchase of up to 10.0 million shares of our common stock in the open market or in privately negotiated transactions. As of September 30, 2013, we had repurchased 7.5 million shares under this 10.0 million share authorization for a total of \$234.7 million. There is no expiration date associated with this program. The timing and amount of future repurchases will depend upon market conditions, interest rates, and corporate considerations.

As of September 30, 2013, we held approximately 20.4 million shares as treasury shares.

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On October 28, 2002, we announced that our Board of Directors had approved and instituted a quarterly cash dividend on our common stock. A quarterly dividend of \$0.354 per share was paid on September 4, 2013 in the aggregate amount of \$70.1 million. A quarterly dividend of \$0.3545 per share was declared on October 30, 2013 and will be paid on December 5, 2013 to stockholders of record as of November 21, 2013. We expect the aggregate December 2013 cash dividend to be approximately \$70.4 million. Our Board is free to change our dividend practices at any time and to increase or decrease the dividend paid, or not to pay a dividend on our common stock on the basis of our results of operations, financial condition, cash requirements and future prospects, and other factors deemed relevant by our Board. Our current intent is to provide for ongoing quarterly cash dividends depending upon market conditions, our results of operations, and potential changes in tax laws.

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

**Contractual Obligations**

There have not been any material changes in our contractual obligations from what we disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013.

**Off-Balance Sheet Arrangements**

As of September 30, 2013, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

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

Our investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations, and delivers an appropriate yield in relationship to our investment guidelines and market conditions. Our investment portfolio, consisting of fixed income securities, money market funds, cash deposits, and marketable securities that we hold on an available-for-sale basis, was \$1,981.6 million as of September 30, 2013 compared to \$1,836.0 million as of March 31, 2013. The available-for-sale debt securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. We have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize any material adverse impact in income or cash flows if market interest rates increase. The following table provides information about our available-for-sale securities that are sensitive to changes in interest rates. We have aggregated our available-for-sale securities for presentation purposes since they are all very similar in nature. The amounts for fiscal 2014 refer to the remaining six months of the current fiscal year (dollars in thousands):

| Financial instruments maturing during the fiscal year ended March 31, |      |      |      |      |            |
|---|------|------|------|------|------------|
| 2014  | 2015 | 2016 | 2017 | 2018 | Thereafter |

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|                               |            |            |            |            |          |            |
|-------------------------------|------------|------------|------------|------------|----------|------------|
| Available-for-sale securities | \$ 132,977 | \$ 252,586 | \$ 591,421 | \$ 528,034 | \$ 9,846 | \$ 116,611 |
| Weighted-average yield rate   | 1.50       | % 1.47     | % 0.67     | % 0.93     | % 0.74   | % 1.02     |

At September 30, 2013, \$9.8 million of the fair value of our investment portfolio was invested in ARS. With the continuing liquidity issues in the global credit and capital markets, our ARS have experienced multiple failed auctions and are not liquid. While we continue to earn interest on these investments based on a pre-determined formula with spreads tied to particular interest rate indices, the estimated market value for a portion of these ARS no longer approximates the original purchase value. The fair value of the failed ARS of \$9.8 million has been estimated based on market information and estimates determined by management and could change significantly based on market conditions. We evaluated the impairments in the value of these ARS, determining our intent to sell these securities prior to the recovery of our amortized cost basis, which did

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not result in some of the securities being other-than-temporarily impaired nor the need to recognize impairment charges on these investments for the three and six months ended September 30, 2013 compared to impairment charges of \$0.3 million for the three and six months ended September 30, 2012. If the issuers are unable to successfully close future auctions or if their credit ratings deteriorate further, we may be required to further adjust the carrying value of the investments through an additional impairment charge to earnings.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

During the three months ended September 30, 2013, there was no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. We also periodically receive notifications from various third parties alleging infringement of patents, intellectual property rights or other matters. With respect to pending legal actions to which we are a party or of which any of our property is the subject, although the outcomes of these actions are not generally determinable, we believe that the ultimate resolution of these matters will not have a material adverse effect on our financial position, cash flows or results of operations. Litigation relating to the semiconductor industry is not uncommon, and we are, and from time to time have been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

Item 1A. Risk Factors

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

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

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

- general economic, industry or political conditions in the U.S. or internationally;
- changes in demand or market acceptance of our products and products of our customers, and market fluctuations in the industries into which such products are sold;
- changes in utilization of our manufacturing capacity and fluctuations in manufacturing yields;
- the mix of inventory we hold and our ability to satisfy orders from our inventory;
- levels of inventories held by our customers;
- risk of excess and obsolete inventories;
- our ability to secure sufficient wafer foundry, assembly and testing capacity;
- changes or fluctuations in customer order patterns and seasonality;
- our ability to realize the expected benefits of our acquisitions;
  - competitive developments including pricing pressures;
- unauthorized copying of our products resulting in pricing pressure and loss of sales;
- availability of raw materials and equipment;
- the level of orders that are received and can be shipped in a quarter;
- the level of sell-through of our products through distribution;
- fluctuations in the mix of products;
- announcements of significant acquisitions;
- changes in tax regulations and policies in the U.S. and other countries in which we do business;
- disruptions in our business or our customers' businesses due to terrorist activity, armed conflict, war, worldwide oil prices and supply, public health concerns, natural disasters or disruptions in the transportation system;
- constrained availability from other electronic suppliers impacting our customers' ability to ship their products, which in turn may adversely impact our sales to those customers;

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

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



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

The manufacture and assembly of integrated circuits, particularly non-volatile, erasable CMOS memory and logic devices such as those that we produce, are complex processes. These processes are sensitive to a wide variety of factors, including the level of contaminants in the manufacturing environment, impurities in the materials used, the performance of our wafer fabrication and assembly and test personnel and equipment, and other quality issues. As is typical in the semiconductor industry, we have from time to time experienced lower than anticipated manufacturing yields. Our operating results will suffer if we are unable to maintain yields at approximately the current levels. This could include delays in the recognition of revenue, loss of revenue or future orders, and customer-imposed penalties for failure to meet contractual shipment deadlines. Our operating results are also adversely affected when we operate at less than optimal capacity. For example, in the third quarter of fiscal 2012, we reduced wafer starts in both Fab 2 and Fab 4 to help control inventory balances in response to a slowdown in global economic conditions. We continued with the reduced level of wafer starts through the first quarter of fiscal 2013. These actions had a negative impact on our gross profit. We further reduced the wafer starts in our fabs in late September 2012 and again during the quarter ended December 31, 2012 which continued to negatively impact our gross profit through the March 2013 quarter. We increased wafer starts modestly during the first half of fiscal 2014 but are still below normal capacity levels.

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

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

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

The semiconductor industry is intensely competitive and has been characterized by price erosion and rapid technological change. We compete with major domestic and international semiconductor companies, many of which have greater market recognition and substantially greater financial, technical, marketing, distribution and other resources than we do. We may be unable to compete successfully in the future, which could harm our business. Our ability to compete successfully depends on a number of factors both within and outside our control, including, but not limited to:

- the quality, performance, reliability, features, ease of use, pricing and diversity of our products;
- our success in designing and manufacturing new products including those implementing new technologies;
- the rate at which customers incorporate our products into their own applications;
- the rate at which the markets that we serve redesign and change their own products;
-

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

- product introductions by our competitors;
- the number, nature and success of our competitors in a given market;
- our ability to obtain adequate foundry and assembly and test capacity and supplies of raw materials and other supplies at acceptable prices;
- our ability to protect our products and processes by effective utilization of intellectual property rights;
- our ability to remain price competitive against companies that have copied our proprietary product lines, especially in countries where intellectual property rights protection is difficult to achieve and maintain;
- our ability to address the needs of our customers; and
- general market and economic conditions.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller and proprietary analog, interface and mixed signal products have remained

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relatively constant, while average selling prices of our memory and non-proprietary analog, interface and mixed signal products have declined over time.

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

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

We rely on outside wafer foundries for a significant portion of our wafer fabrication needs. We also use several contractors located in Asia for a portion of the assembly and testing of our products. Our reliance on third party contractors and foundries has increased as a result of our acquisition of SMSC. Although we own the majority of our manufacturing resources, the disruption or termination of any of our contractors could harm our business and operating results.

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

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

Our business is dependent on selling through distributors.

Sales through distributors accounted for approximately 54% of our net sales for the first six months of fiscal 2014 and approximately 53% of our net sales in fiscal 2013. We do not have long-term agreements with our distributors and we and our distributors may each terminate our relationship with little or no advance notice.

Any future adverse conditions in the U.S. or global economies or in the U.S. or global credit markets could materially impact the operations of our distributors. Any deterioration in the financial condition of our distributors or any disruption in the operations of our distributors could adversely impact the flow of our products to our end customers and adversely impact our results of operation. In addition, during an industry or economic downturn, it is possible there will be an oversupply of products and a decrease in sell-through of our products by our distributors which could

reduce our net sales in a given period and result in an increase in inventory returns. Violations of the Foreign Corrupt Practices Act, or similar laws, by our distributors or other channel partners could have a material adverse impact on our business.

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

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

- proper new product selection;
- timely completion and introduction of new product designs;
- procurement of licenses for intellectual property rights from third parties under commercially reasonable terms;

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- timely filing and protection of intellectual property rights for new product designs;
- availability of development and support tools and collateral literature that make complex new products easy for engineers to understand and use; and
- market acceptance of our customers' end products.

Because our products are complex, we have experienced delays from time to time in completing development of new products. In addition, our new products may not receive or maintain substantial market acceptance. We may be unable to design, develop and introduce competitive products on a timely basis, which could adversely impact our future operating results.

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

Our technology licensing business exposes us to various risks.

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

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

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

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

The semiconductor industry is characterized by seasonality and wide fluctuations of supply and demand. Since a significant portion of our revenue is from consumer markets and international sales, our business is subject to seasonally lower revenues in the third and fourth quarters of our fiscal year. However, broad fluctuations in our overall business in recent periods and changes in semiconductor industry and global economic conditions have had a more significant impact on our results than seasonality, and have made it difficult to assess the impact of seasonal factors on our business. The industry has also experienced significant economic downturns, characterized by diminished product demand and production over-capacity. We have sought to reduce our exposure to this industry cyclically by selling proprietary products that cannot be easily or quickly replaced to a geographically diverse base of customers across a broad range of market segments. However, we have experienced substantial period-to-period fluctuations in operating results and expect, in the future, to experience period-to-period fluctuations in operating results due to general industry or economic conditions.

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

We have acquired, and expect in the future to acquire, additional businesses that we believe will complement or augment our existing businesses. In this regard, on August 2, 2012, we completed our acquisition of SMSC, a publicly traded semiconductor company. The integration process for our acquisitions may be complex, costly and time consuming and include unanticipated issues, expenses and liabilities. We may not be able to successfully or profitably integrate, operate, maintain and manage any newly acquired operations or employees. We may not be able to maintain uniform standards, procedures and policies and we may be unable to realize the expected synergies and cost savings from the integration. There may be increased risk due to integrating financial reporting and internal control systems. We may have difficulty in developing, manufacturing and marketing the products of a newly acquired company (including SMSC), or in growing the business at the rate we anticipate. Following an acquisition, we may not achieve the revenue or net income levels that justify the acquisition. We may suffer loss of key employees, customers and strategic partners of acquired companies and it may be difficult to implement our corporate culture at acquired companies. We may be subject to claims by terminated employees, shareholders of acquired companies and other third parties related to the transaction. Acquisitions may also result in one-time charges (such as acquisition-related expenses, write-offs, restructuring charges, or future impairment of goodwill), contingent liabilities, adverse tax consequences, additional stock-based compensation expense and other charges that adversely affect our operating results. Additionally, we may fund acquisitions of new businesses or strategic alliances by utilizing cash, borrowings under our credit agreement, raising debt, issuing shares of common stock, or other mechanisms.

Further, when we decide to sell assets or a business, we may encounter difficulty in finding or completing divestiture opportunities or alternative exit strategies on acceptable terms or in a timely manner. These circumstances could delay the accomplishment of our strategic objectives or cause us to incur additional expenses with respect to a business that we want to dispose of, or we may dispose of a business at a price or on terms that are less favorable than we had anticipated. Even following a divestiture, we may be contractually obligated with respect to certain continuing obligations to customers, vendors or other third parties and such obligations may have a material adverse impact on our results of operation and financial condition.

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

We may lose sales if our suppliers of raw materials and equipment fail to meet our needs.

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

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

We are currently, and in the future may be, involved in legal proceedings or claims regarding patent infringement, other intellectual property rights, contracts and other matters. As is typical in the semiconductor industry, we receive notifications from customers or licensees from time to time who believe that we owe them indemnification or other obligations related to infringement claims made against us, the customers or licensees by third parties. These legal proceedings and claims, even if meritless, could result in substantial cost to us and divert our resources. If we are not able to resolve a claim, settle a matter, obtain necessary licenses on commercially reasonable terms, reengineer our products or processes to avoid infringement, and/or successfully prosecute or defend our position, we could incur uninsured liability in any of them, be required to take an appropriate charge to operations, be enjoined from selling a material portion of our products or using certain processes, suffer a reduction or elimination in the value of our inventories, and our business, financial condition or results of operations could be harmed.



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

- costs related to writing off the value of our inventory of nonconforming products;
- recalling nonconforming products;
- providing support services, product replacements, or modifications to products and the defense of such claims;
- diversion of resources from other projects;
- lost revenue or a delay in the recognition of revenue due to cancellation of orders and unpaid receivables;
- customer imposed fines or penalties for failure to meet contractual requirements; and
- a requirement to pay damages.

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

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

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

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

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

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

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We do not typically have long-term contracts with our customers, but where we do, certain terms of such contracts may expose us to risks and liabilities.

We do not typically enter into long-term contracts with our customers and we cannot be certain about future order levels from our customers. When we do enter into customer contracts, the contract is generally cancelable at the convenience of the customer. Even though we had approximately 84,000 customers and our ten largest direct customers made up approximately 10% of our total revenue for the six months ended September 30, 2013, cancellation of customer contracts could have an adverse impact on our revenue and profits.

We have entered into contracts with certain customers that differ from our standard terms of sale. Further, as a result of our acquisition of SMSC, we inherited certain customer contracts that differ from our standard terms of sale. For several of the significant markets that we sell into, such as the automotive and personal computer markets, our current or potential customers may possess significant leverage over us in negotiating the terms and conditions of supply as a result of their market size and position. For example, under certain contracts we may commit to supply specific quantities of products on scheduled delivery dates, or agree to extend our obligations for certain liabilities such as warranties or indemnification for quality issues or claims of intellectual property infringement. If we are unable to supply the customer as required under the contract, the customer may incur additional production costs, lost revenues due to subsequent delays in their own manufacturing schedule, or quality-related issues. We may be liable for the customer's costs, expenses and damages associated with their claims and we may be obligated to defend the customer against claims of intellectual property infringement and pay the associated legal fees. While we try to limit the number of contracts that we sign which contain such special provisions, manage the risks underlying such liabilities, and set caps on our liability exposure, sometimes we may not be able to do so. In order to win important designs, avoid losing business to competitors, maintain existing business, or be permitted to bid on new business, we have been, and may in the future be, forced to agree to uncapped liability for such items as intellectual property infringement or confidentiality. Such provisions expose us to risk of liability far exceeding the purchase price of the products we sell under such contracts, the lifetime revenues we receive from such products, or various forms of potential consequential damages. These significant additional risks could result in a material adverse impact on our results of operation and financial condition.

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

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

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

Operations at any of our facilities, at the facilities of any of our wafer fabrication or assembly and test subcontractors, or at any of our significant vendors or customers may be disrupted for reasons beyond our control. These reasons may include work stoppages, power loss, incidents of terrorism or security risk, political instability, public health issues, telecommunications, transportation or other infrastructure failure, radioactive contamination, fire, earthquake, floods, volcanic eruptions or other natural disasters. We have taken steps to mitigate the impact of some of these events

should they occur; however, we cannot be certain that our actions will be effective to avoid a significant impact on our business in the event of a disaster or other business interruption.

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

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

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

Sales to foreign customers account for a substantial portion of our net sales. During the first six months of fiscal 2014, approximately 84% of our net sales were made to foreign customers, including 29% in China. During fiscal 2013, approximately 83% of our net sales were made to foreign customers, including 27% in China. A strong position in the Chinese market is a key component of our global growth strategy. The market for integrated circuit products in China is highly competitive, and both international and domestic competitors are aggressively seeking to increase their market share. Increased competition in the China market may make it difficult for us to achieve our desired sales volumes in China. We purchase a substantial portion of our raw materials and equipment from foreign suppliers. In addition, we own product assembly and testing facilities located near Bangkok, Thailand, which has experienced periods of political instability in the past. From time to time, Thailand has also experienced periods of severe flooding. There can be no assurance that any future flooding in Thailand would not have a material adverse impact on our operations. We use various foreign contractors for a significant portion of our assembly and testing and wafer fabrication requirements. Substantially all of our finished goods inventory is maintained in Thailand.

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

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

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

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

We use forward currency exchange contracts in an attempt to reduce the adverse earnings impact from the effect of exchange rate fluctuations on our non-U.S. dollar net balance sheet exposures. Nevertheless, in periods when the U.S. dollar significantly fluctuates in relation to the non-U.S. currencies in which we transact business, the value of our

non-U.S. dollar transactions can have an adverse effect on our results of operations and financial condition. In particular, in periods when a foreign currency significantly declines in value in relation to the U.S. dollar, such as past declines in the Euro relative to the U.S. dollar, customers transacting in that foreign currency may find it more difficult to fulfill their previously committed contractual obligations or to undertake new obligations to make payments or purchase products. In periods when the U.S. dollar is significantly declining in relation to the British pound, Euro and Thai baht, the operational costs in our European and Thailand subsidiaries are adversely affected.

Interruptions in our information technology systems could adversely affect our business.

We rely on the efficient and uninterrupted operation of complex information technology systems and networks to operate our business. Any significant disruption to our systems or networks, including, but not limited to, new system implementations, computer viruses, security breaches, facility issues, natural disasters, terrorism, war, telecommunication

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failures or energy blackouts could have a material adverse impact on our operations, sales and operating results. Such disruption could result in a loss of our intellectual property or the release of sensitive competitive information or supplier, customer or employee personal data. Any loss of such information could harm our competitive position, result in a loss of customer confidence, and cause us to incur significant costs to remedy the damages caused by the disruptions or security breaches. Additionally, as there has been increased legislation in the U.S., Europe and elsewhere regarding the handling of personal data, including the data of employees and customers, such a failure may result in regulatory penalties, enforcement actions, remediation obligations and litigation. There is also risk that we may be found not to comply with laws or regulations regarding the collection, consent, handling, transfer, or disposal of personal data. Fines and other sanctions may result.

From time to time, we have experienced verifiable attacks on our data, attempts to breach our security and attempts to introduce malicious software into our IT systems; however, such attacks have not previously resulted in any material damage to us. Were future attacks successful, we may be unaware of the incident, its magnitude, or its effects until significant harm is done. In recent years, we have implemented improvements to our protective measures which are not limited to the following: firewalls, antivirus measures, patches, log monitors, routine backups with offsite retention of storage media, system audits, data partitioning and routine password modifications. There can be no assurance that such system improvements will be sufficient to prevent or limit the damage from any future cyber attack or disruptions. Any such attack or disruption could result in additional costs related to rebuilding of internal systems, defending litigation, responding to regulatory actions, or paying damages. Such attacks or disruption could have a material adverse impact on our business, operations and financial results.

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

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

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

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

We must comply with many federal, state, local and foreign governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous substances used in our products and manufacturing processes. Our failure to comply with applicable regulations could result in fines, suspension of production, cessation of operations or future liabilities. Such environmental regulations have required us in the past, and could require us in the future to buy costly equipment or to incur significant expenses to comply with such regulations. Our failure to control the use of, or adequately restrict the discharge of, hazardous substances could impact the health of our employees and others and could impact our ability to operate. Such failure could also restrict our ability to ship certain products to certain countries, require us to modify our operations logistics, or require us to incur other significant costs and expenses. There is a continuing expansion in environmental laws with a focus on reducing or eliminating hazardous substances and substances of high concern in electronic products and shipping materials. These and other

future environmental regulations could require us to reengineer certain of our existing products and may make it more expensive for us to manufacture, sell and ship our products. In addition, the number and complexity of laws focused on the energy efficiency of electronic products and accessories, the recycling of electronic products, and the reduction in quantity and the recycling of packing materials have expanded significantly. It may be difficult for us to timely comply with these laws and we may not have sufficient quantities of compliant products to meet customers' needs, thereby adversely impacting our sales and profitability. We may also have to write off inventory in the event that we hold inventory that is not saleable as a result of changes to regulations or customer requirements. We expect these risks and trends to continue. In addition, we anticipate increased customer requirements to meet voluntary criteria related to the reduction or elimination of substances of high concern in our products and energy efficiency measures. These requirements may increase our own costs, as well as those passed on to us by our supply chain.



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

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

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

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, in August 2012, the SEC released new disclosure and reporting 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. As we implement these new requirements, if it is determined that we are using other than conflict-free minerals, customers may demand us to change the sourcing of minerals used in the manufacture of semiconductor devices (including our products), even if the costs for acceptable minerals significantly increases and availability is limited. There will likely 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. Also, since our supply chain is complex, we may face reputational challenges if we are unable to sufficiently verify the origins for all metals used in our products through the procedures we may implement. We may also encounter challenges to satisfy those customers who require that all of the components of our products are certified as conflict free. If we are not able to meet customer requirements, customers may choose to disqualify us as a supplier and we may have to write off inventory in the event that it cannot be sold.

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

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

The outcome of currently ongoing and future examinations of our income tax returns by the IRS could have an adverse effect on our results of operations.

We are subject to examination of our income tax returns by the IRS and other tax authorities for fiscal 2009 and later. We are currently being audited by the IRS for fiscal 2009 and 2010, and SMSC is currently under IRS audit for fiscal 2011 and 2012. We are subject to certain income tax examinations in foreign jurisdictions for fiscal 2005 and later. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuing examinations will not have an adverse effect on our future operating results.

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

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

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

In addition, the stock market has from time to time experienced significant price and volume fluctuations that have affected the market prices for many companies and that often have been unrelated to the operating performance of such companies. These broad market fluctuations and other factors have harmed and may harm the market price of our common stock. Some or all of the foregoing factors could also cause the market price of our convertible debentures to decline or fluctuate substantially.

We may in the future incur impairments to goodwill or long-lived assets.

We review our long-lived assets, including goodwill and other intangible assets, for impairment annually in the fourth fiscal quarter or whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. Factors that may be considered in assessing whether goodwill or intangible assets may not be recoverable include a decline in our stock price or market capitalization, reduced estimates of future cash flows and slower growth rates in our industry. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. Because we operate in highly competitive environments, projections of our future operating results and cash flows may vary significantly from our actual results. No goodwill or long-lived asset impairment charges were recorded in fiscal 2012 or fiscal 2013.

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

In June 2013, we entered into a \$2.0 billion credit agreement. At September 30, 2013, we had \$640.0 million in outstanding borrowings under such credit agreement. In December 2007, we sold \$1.15 billion of principal value 2.125% junior subordinated convertible debentures. As a result of such transactions, we have a substantially greater amount of debt than we had maintained in the past. Our maintenance of substantial levels of debt could adversely affect our ability to take advantage of corporate opportunities and could adversely affect our financial condition and results of operations. We may need or desire to refinance all or a portion of our loans under our credit agreement, our debentures or any other future indebtedness and there can be no assurance that we will be able to refinance any of our indebtedness on commercially reasonable terms, if at all.

Conversion of our debentures will dilute the ownership interest of existing stockholders, including holders who had previously converted their debentures.

The conversion of some or all of our outstanding debentures will dilute the ownership interest of existing stockholders to the extent we deliver common stock upon conversion of the debentures. Upon conversion, we may satisfy our conversion obligation by delivering cash, shares of common stock or any combination, at our option. If upon conversion we elect to deliver cash for the lesser of the conversion value and principal amount of the debentures, we would pay the holder the cash value of the applicable number of shares of our common stock. Upon conversion, we intend to satisfy the lesser of the principal amount or the conversion value of the debentures in cash. If the conversion value of a debenture exceeds the principal amount of the debenture, we may also elect to deliver cash in lieu of

common stock for the conversion value in excess of the one thousand dollars principal amount (i.e., the conversion spread). There would be no adjustment to the numerator in the net income per common share computation for the cash settled portion of the debentures as that portion of the debt instrument will always be settled in cash. The conversion spread will be included in the denominator for the computation of diluted net income per common share. Any sales in the public market of any common stock issuable upon conversion of our debentures could adversely affect prevailing market prices of our common stock. In addition, the existence of the debentures may encourage short selling by market participants because the conversion of the debentures could be used to satisfy short positions, or anticipated conversion of the debentures into shares of our common stock could depress the price of our common stock.

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Our reported financial results may be adversely affected by new accounting pronouncements or changes in existing accounting standards and practices.

We prepare our financial statements in conformity with accounting principles generally accepted in the U.S. These accounting principles are subject to interpretation or changes by the FASB and the SEC. New accounting pronouncements and varying interpretations of accounting standards and practices have occurred in the past and are expected to occur in the future. New accounting pronouncements or a change in the interpretation of existing accounting standards or practices may have a significant effect on our reported financial results and may even affect our reporting of transactions completed before the change is announced or effective.

Potential U.S. tax legislation regarding our foreign earnings could materially and adversely impact our business and financial results.

Currently, a majority of our revenue is generated from customers located outside the U.S., and a substantial portion of our assets, including employees, are located outside the U.S. Present U.S. income taxes and foreign withholding taxes have not been provided on undistributed earnings for certain of our non-U.S. subsidiaries, because such earnings are intended to be indefinitely reinvested in the operations of those subsidiaries. In recent years, there have been a number of initiatives proposed by the Obama administration and members of Congress regarding the tax treatment of such undistributed earnings. If adopted, certain of these initiatives would substantially reduce our ability to defer U.S. taxes including repealing the deferral of U.S. taxation of foreign earnings, eliminating utilization of or substantially reducing our ability to claim foreign tax credits, and eliminating various tax deductions until foreign earnings are repatriated to the U.S. Changes in tax law such as these proposals could have a material negative impact on our financial position and results of operations.

Credit conditions have adversely impacted our holdings of auction rate securities (ARS).

At September 30, 2013, \$9.8 million of the fair value of our investment portfolio was invested in ARS. With the continuing liquidity issues in the global credit and capital markets, our ARS have experienced multiple failed auctions and are not liquid. While we continue to earn interest on these investments based on a pre-determined formula with spreads tied to particular interest rate indices, the estimated market value for a portion of these ARS no longer approximates the original purchase value. The fair value of the failed ARS of \$9.8 million has been estimated based on market information and estimates determined by management and could change significantly based on market conditions. If the issuers are unable to successfully close future auctions or if their credit ratings deteriorate further, we may be required to further adjust the carrying value of the investments through an impairment charge to earnings.

The majority of our short and long-term investments are in highly rated government agency bonds and corporate bonds. Other than with respect to our holdings of ARS, we have not experienced any liquidity or impairment issues with such investments. However, there can be no assurance that credit market conditions will not in the future adversely affect the liquidity or value of our non-ARS investments.

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

Climate change regulations could require us to limit emissions, change our manufacturing processes, obtain substitute materials which may cost more or be less available, increase our investment in control technology for greenhouse gas emissions, fund offset projects or undertake other costly activities. These regulations could significantly increase our costs and restrict our manufacturing operations by virtue of requirements for new equipment. New permits may be required for our current operations, or expansions thereof. Failure to timely receive permits could result in fines,

suspension of production, or cessation of operations at one or more facilities. In addition, restrictions on carbon dioxide or other greenhouse gas emissions could result in significant costs such as higher energy costs, and utility companies passing down carbon taxes, emission cap and trade programs and renewable portfolio standards. The cost of complying, or of failing to comply, with these and other climate change and emissions regulations could have an adverse effect on our operating results.

Further, any sustained adverse change in climate could have a direct adverse economic impact on us, such as water and power shortages, higher costs for water or energy to control the temperature inside of our facilities. Certain of our operations are located in arid or tropical regions, such as Thailand and Arizona. Some environmental experts predict that these regions may become vulnerable to storms, severe floods and droughts due to climate change. While we maintain business recovery plans that are intended to allow us to recover from natural disasters or other events that can interrupt business, we cannot be certain that our plans will protect us from all such disasters or events.

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Item 6. Exhibits

- 3.1 Amended and Restated Bylaws of Microchip Technology Incorporated as of October 1, 2013.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS\* XBRL Instance Document
- 101.SCH\* XBRL Taxonomy Extension Schema Document
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

\*XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURES

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

MICROCHIP TECHNOLOGY INCORPORATED

Date: November 8, 2013

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