LUCENT TECHNOLOGIES INC
Form 10-Q
February 14, 2001

AS FILED WITH THE SEC ON FEBRUARY 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2000

OR

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

For the transition period from _____________to _____________

Commission file number 001-11639

LUCENT TECHNOLOGIES INC.

A Delaware Corporation	I.R.S. Employer No. 22-3408857

600 Mountain Avenue, Murray Hill, New Jersey 07974

Telephone Number: 908-582-8500

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

At January 31, 2001, 3,403,607,833 common shares were outstanding.

2

Form 10-Q - Part I

PART 1 - Financial Information

Item 1. Financial Statements

LUCENT TECHNOLOGIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in Millions, Except Per Share Amounts)
(Unaudited)

	Three months Ended December 31,	
	2000	1999
Revenues	$ 5,841	$ 8,065
Costs	4,530	4,307
Gross margin	1,311	3,758
Operating expenses:		
Selling, general and administrative	2,137	1,338
Research and development	1,285	928
Total operating expenses	3,422	2,266
Operating income (loss)	(2,111)	1,492
Other income (expense)- net	(18)	252
Interest expense	129	81
Income (loss) from continuing operations before (benefit)provision for income taxes	(2,258)	1,663
(Benefit) provision for income taxes	(679)	539
Income (loss) from continuing operations	(1,579)	1,124
Income from discontinued operations (net of tax expense of $67)	--	125
Income (loss) before extraordinary item and cumulative effect of accounting change	(1,579)	1,249
Extraordinary gain (net of tax expense of $762)	1,154	--
Cumulative effect of accounting change (net of tax expense of $17)	30	--
Net income (loss)	$ (395)	$ 1,249

Earnings (loss) per common share - basic:

Income (loss) from continuing operations	$ (0.47)	$ 0.36
Net income (loss)	$ (0.12)	$ 0.40
Earnings (loss) per common share - diluted:		
Income (loss) from continuing operations	$ (0.47)	$ 0.34
Net income (loss)	$ (0.12)	$ 0.38
Weighted average number of common shares outstanding - basic	3,387.2	3,154.5
Weighted average number of common shares outstanding - diluted	3,387.2	3,268.0

See Notes to Unaudited Consolidated Financial Statements.

3

Form 10-Q - Part I
LUCENT TECHNOLOGIES INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Millions Except Per Share Amounts)
(Unaudited)

	December 31, 2000	September 30, 2000
ASSETS		
Cash and cash equivalents	$ 3,814	$ 1,467
Receivables less allowances of $551 at December 31, 2000 and $501 at September 30, 2000	7,286	9,558
Inventories	6,879	5,677
Contracts in process, net of contract billings of $7,066 at December 31, 2000 and $6,744 at September 30, 2000	1,691	1,881
Deferred income taxes - net	1,168	1,165
Other current assets	2,071	1,742
Total current assets	22,909	21,490
Property, plant and equipment, net of accumulated depreciation of $7,295 at December 31, 2000 and $7,141 at September 30, 2000	7,138	7,084
Prepaid pension costs	6,422	6,440
Goodwill and other acquired intangibles, net of accumulated amortization of $1,436 at December 31, 2000 and $1,072 at September 30, 2000	9,580	9,945
Other assets	3,992	3,833
Total assets	$50,041	$48,792
LIABILITIES		

Accounts payable	$ 2,628	$ 2,813
Payroll and benefit-related liabilities	1,154	1,210
Debt maturing within one year	5,030	3,483
Other current liabilities	3,661	3,371
Total current liabilities	12,473	10,877
Postretirement and postemployment benefit liabilities	5,214	5,548
Long-term debt	3,099	3,076
Deferred income taxes - net	1,074	1,266
Other liabilities	2,433	1,853
Total liabilities	24,293	22,620
Commitments and contingencies		
SHAREOWNERS' EQUITY		
Preferred stock-par value $1.00 per share Authorized shares: 250,000,000; issued and outstanding shares: none	--	--
Common stock-par value $.01 per share Authorized shares: 10,000,000,000; issued and outstanding shares: 3,391,491,521 at December 31, 2000 and 3,384,332,104 at September 30, 2000	34	34
Additional paid-in capital	20,490	20,390
Guaranteed ESOP obligation	(9)	(16)
Retained earnings	5,668	6,129
Accumulated other comprehensive income (loss)	(435)	(365)
Total shareowners' equity	25,748	26,172
Total liabilities and shareowners' equity	$ 50,041	$ 48,792

See Notes to Unaudited Consolidated Financial Statements.

4

Form 10-Q - Part I

LUCENT TECHNOLOGIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Millions)
(Unaudited)

	Three Months Ended December 31, 2000	1999
Operating Activities:		

Net income (loss)	$ (395)	$ 1,249
Less: Income from discontinued operations	--	125
Extraordinary gain	1,154	--
Cumulative effect of accounting change	30	--
Income (loss) from continuing operations	(1,579)	1,124
Adjustments to reconcile income (loss) from continuing operations to net cash (used in) provided by operating activities:		
Depreciation and amortization	868	455
Provision for uncollectibles and customer financings ...	370	30
Tax benefit from employee stock options	8	456
Deferred income taxes	(139)	118
Pension credit	(348)	(235)
Other adjustments for non-cash items	36	(326)
Changes in operating assets and liabilities:		
Decrease (increase) in receivables	2,073	(196)
Increase in inventories and contracts in process	(1,170)	(297)
Decrease in accounts payable	(180)	(684)
Changes in other operating assets and liabilities	(1,043)	(306)
Net cash (used in) provided by operating activities from continuing operations	(1,104)	139
Investing Activities:		
Capital expenditures	(548)	(508)
Purchases of investments	(41)	(65)
Sales or maturity of investments	1	702
Dispositions of businesses	2,494	9
Other investing activities	3	(31)
Net cash provided by investing activities from continuing operations	1,909	107
Financing Activities:		
Net proceeds from short-term borrowings	1,576	185
Repayments of long-term debt	--	(375)
Proceeds from issuance of common stock	69	557
Dividends paid	(68)	(62)
Net cash provided by financing activities from continuing operations	1,577	305
Effect of exchange rate changes on cash and cash equivalents	(35)	(11)
Net cash provided by continuing operations	2,347	540
Net cash used in discontinued operations	--	(129)
Net increase in cash and cash equivalents	2,347	411
Cash and cash equivalents at beginning of year	1,467	1,686
Cash and cash equivalents at end of period	$ 3,814	$ 2,097

See Notes to Unaudited Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited Consolidated Financial Statements have been prepared by Lucent Technologies Inc. ("Lucent" or the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of the Company, include all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of results of operations, financial position and cash flows as of and for the periods presented.

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the period reported. Actual results could differ from those estimates. Estimates are used in accounting for, among other things, long-term contracts, allowances for uncollectible receivables, inventory obsolescence, product warranty, depreciation, employee benefits, taxes and contingencies. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the Consolidated Financial Statements in the period they are determined to be necessary.

The Company believes that the disclosures made are adequate to keep the information presented from being misleading. The results for the three months ended December 31, 2000 are not necessarily indicative of financial results for the full year. These financial statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto included in Lucent's latest Annual Report on Form 10-K for the year ended September 30, 2000.

The balance sheet at September 30, 2000 has been derived from the audited consolidated financial statements at that date.

The financial information for the three months ended December 31, 1999 has been restated to reflect the spin-off of Avaya Inc. as a discontinued operation (see Note 2). In addition, certain reclassifications have been made to conform to the current period presentation.

2. DISCONTINUED OPERATIONS

On September 30, 2000, Lucent completed the spin-off of Avaya Inc. in a tax-free distribution to its shareowners. Revenues and income from discontinued operations were $1,840 and $125 (net of tax expense of $67), respectively, for the three months ended December 31, 1999. Income from discontinued operations includes an allocation of Lucent's interest expense totaling $18 for the three months ended December 31, 1999, based upon the amount of debt assumed by Avaya.

3. SALE OF POWER SYSTEMS

On December 29, 2000, Lucent completed the sale of its power systems business to

Tyco International Ltd. for $2,500 in cash. In connection with the sale, Lucent recorded an extraordinary gain of $1,154 (net of tax of $762), subject to potential purchase price adjustments to be resolved by the end of fiscal year 2001. Lucent does not expect such adjustments, if any, to be significant to its consolidated results of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

4. ACCOUNTING CHANGE - DERIVATIVE FINANCIAL INSTRUMENTS

Effective October 1, 2000, Lucent adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), and its corresponding amendments under SFAS No. 138. SFAS 133 requires Lucent to measure all derivatives, including certain derivatives embedded in other contracts, at fair value and to recognize them in the Consolidated Balance Sheet as an asset or liability, depending on Lucent's rights or obligations under the applicable derivative contract. For derivatives designated as fair value hedges, the changes in the fair value of both the derivative instrument and the hedged item are recorded in earnings. For derivatives designated as cash flow hedges, the effective portions of changes in fair value of the derivative are reported in other comprehensive income ("OCI") and are subsequently reclassified into earnings when the hedged item affects earnings. Changes in fair value of derivative instruments not designated as hedging instruments and ineffective portions of hedges are recognized in earnings in the current period. The adoption of SFAS 133 as of October 1, 2000, resulted in a cumulative after-tax reduction in net loss of $30 (net of tax of $17) and an $11 credit to OCI. The reduction in net loss is primarily attributable to derivatives not designated as hedging instruments, including foreign currency embedded derivatives, equity warrants and other derivatives. For the three months ended December 31, 2000, the change in fair market value of derivative instruments was recorded in other income (expense) and was not material.

Foreign Currency Risk

Lucent conducts its business on a multinational basis in a wide variety of foreign currencies. To manage this risk, Lucent enters into various foreign exchange forward and option contracts to manage its exposure to changes in those foreign exchange rates. Alternatively, Lucent may hedge foreign exchange risk in certain sales and purchase contracts by embedding terms in the contracts that affect the ultimate amount of cash flows under the contract. Principal currencies hedged are Canadian dollars, Brazilian reals, Australian dollars, British pounds, Japanese yen and Euros.

Lucent has designated certain freestanding foreign currency derivatives as hedging instruments under SFAS 133 against its intercompany and external foreign-currency-denominated loans. These exposures make up a large proportion of the notional value of Lucent's total foreign currency risk and are well

defined as to amounts and timing of repayments. The derivatives hedging these exposures are designated as cash flow hedging instruments for anticipated cash flows not to exceed twelve months. Lucent will continue to hedge all other types of foreign currency risk to preserve the economic cash flows of the Company in accordance with corporate risk management policies but generally does not expect to designate related derivative instruments as hedges for cost/benefit reasons. Accordingly, the changes in fair value of these undesignated freestanding foreign currency derivative instruments are recorded in earnings in the period of change and are not material to Lucent due to the short maturities of these instruments.

Lucent's foreign currency embedded derivatives consist of sales and purchase contracts with cash flows indexed to changes in or denominated in a currency that neither party to the contract uses as their functional currency. Changes in the fair value of these embedded derivatives are recorded in earnings in the current period.

Interest Rate Risk

Lucent manages its ratio of fixed to floating rate debt with the objective of achieving a mix that management believes is appropriate. To manage this mix in a cost-effective manner, Lucent, from time to time, enters into interest rate swap agreements, in which it agrees to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts. The interest rate swaps in effect at December 31, 2000 were designated as fair value hedge instruments and their fair value was not material.

Other Derivatives

From time to time, Lucent may obtain warrants to purchase equity securities in other companies to compliment its investment portfolio. Warrants that provide for net share settlement are considered to be derivative instruments and are generally not eligible to be designated as hedging instruments as there is no corresponding underlying exposure.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

5. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) represents net income (loss) plus the results of certain non-shareowners' equity changes not reflected in the Consolidated Statements of Operations. The components of comprehensive income (loss), net of tax, (except for foreign currency translation adjustments which are not currently adjusted for income taxes since they relate to indefinite investments in non-United States subsidiaries) are as follows:

	Three months ended December 31, 2000	1999
Net income (loss)...................	$ (395)	$ 1,249
Other comprehensive income (loss):		
Foreign currency translation adjustments.....................	12	(81)
Unrealized investment gains (losses) arising during the period........	(92)	45
Cumulative effect of change in accounting principle(SFAS 133) on other comprehensive income....	11	-
Unrealized derivative losses on cash flow hedges.............	(1)	-
Comprehensive income (loss)..........	$ (465)	$ 1,213

6. SUPPLEMENTARY BALANCE SHEET INFORMATION

Inventories:

	December 31, 2000	September 30, 2000
Completed goods................	$ 3,543	$ 2,976
Work in process and raw materials................	3,336	2,701
Total inventories	$ 6,879	$ 5,677

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

7. EARNINGS (LOSS) PER COMMON SHARE

Basic earnings (loss) per common share is calculated by dividing net income

(loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing net income (loss) by the sum of the weighted average number of common shares outstanding plus all additional common shares that would have been outstanding if potentially dilutive securities or common stock equivalents had been issued. As a result of the net loss from continuing operations reported for the three months ended December 31, 2000, approximately 55.5 potential common shares have been excluded from the calculation of diluted earnings (loss) per share because their effect would be anti-dilutive. In addition, options where the exercise price was greater than the average market price of the common shares of 330.1 and 0.8 for the periods ending December 31, 2000 and 1999, respectively, were excluded from the computation of diluted earnings (loss) per share.

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Three months ended December 31, 2000	Three months ended December 31, 1999
Net income (loss)	$ (395)	$ 1,249
Earnings (loss) per common share - basic:		
Income (loss) from continuing operations	$ (0.47)	$ 0.36
Income from discontinued operations	--	0.04
Extraordinary gain	0.34	--
Cumulative effect of accounting change	0.01	--
Net income (loss)	$ (0.12)	$ 0.40
Earnings (loss) per common share - diluted:		
Income (loss) from continuing operations	$ (0.47)	$ 0.34
Income from discontinued operations	--	0.04
Extraordinary gain	0.34	--
Cumulative effect of accounting change	0.01	--
Net income (loss)	$ (0.12)	$ 0.38
Dividends declared per common share	$ 0.02	$ 0.04

Number of Shares	Three months ended December 31, 2000	Three months ended December 31, 1999
Common shares - basic	3,387.2	3,154.5
Effect of dilutive securities:		
Stock options	-	108.1

Other..	-	5.4
Common shares - diluted........................	3,387.2	3,268.0

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

8. OPERATING SEGMENTS

Lucent reclassified the results of operations of Avaya as discontinued operations (see Note 2). This business was previously disclosed as a separate operating segment. The segment data included below has been restated to exclude amounts related to Avaya. In addition, Agere Systems Inc. ("Agere") has filed a Form S-1 registration statement with the SEC in anticipation of an initial public offering. Microelectronics is now being managed internally based on the composition of Agere. The results of Microelectronics presented by Lucent will differ from the information reported by Agere because of different assumptions and allocations required to be made by the two companies. Accordingly, Lucent has revised its segment reporting to reflect this change which resulted in the transfer of the optical fiber business to the Service Provider Networks ("SPN") segment and the transfer of the power systems business to Other and corporate.

Lucent operates in the global telecommunications networking industry and has two reportable operating segments: SPN and Microelectronics. SPN provides public networking systems, software and services to telecommunications service providers and public network operators around the world and optical fiber for applications in the communications and computing industries. Microelectronics provides high-performance optoelectronic components and integrated circuits.

Intersegment transactions that occur are based on current market prices, and all intersegment profit is eliminated in consolidation. Lucent employs shared-service concepts to realize economies of scale and efficient use of resources. The costs of shared services and other corporate center operations managed on a common basis are reflected in the SPN segment.

Performance measurement and resource allocation for the reportable operating segments are based on many factors. The primary financial measure used is operating income, exclusive of goodwill and other acquired intangibles amortization, and other costs from business acquisitions (acquisition/integration-related costs).

The following tables present Lucent's revenues and operating income (loss) by reportable operating segment:

	Three Months Ended December 31, 2000	1999
External Revenues		
Service Provider Networks	$4,336	$6,801
Microelectronics	1,146	763
Total reportable segments	5,482	7,564
Other and corporate (a)	359	501
Total External Revenues	5,841	8,065
Intersegment Revenues		
Service Provider Networks	72	78
Microelectronics	230	217
Total reportable segments	302	295
Other and corporate (a)	(302)	(295)
Total Intersegment Revenues	--	--
Total Revenues		
Service Provider Networks	4,408	6,879
Microelectronics	1,376	980
Total reportable segments	5,784	7,859
Other and corporate (a)	57	206
Total Revenues	$5,841	$8,065

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

	Three Months Ended December 31, 2000	1999
Operating income (loss)		
Service Provider Networks	$(1,904)	$ 1,228
Microelectronics	187	234

Total reportable segments (b)	(1,717)	1,462
Acquisition/integration-related costs	--	(61)
Goodwill and other acquired intangibles amortization	(372)	(50)
Other and corporate (a)	(22)	141
Operating income (loss)	$(2,111)	$ 1,492

(a) Other and corporate primarily includes the results of the power systems business (see Note 3), results from the Company's remaining consumer products business in the prior year quarter and other smaller units, including eliminations of internal business. The remaining consumer products business was sold in the second fiscal quarter of 2000.

(b) Reportable segment operating income (loss) excludes goodwill and other acquired intangibles amortization, and acquisition/integration-related costs.

9. COMMITMENTS AND CONTINGENCIES

In the normal course of business, Lucent is subject to proceedings, lawsuits and other claims, including proceedings under laws and government regulations related to environmental and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at December 31, 2000, cannot be ascertained. While these matters could affect the operating results of any one quarter when resolved in future periods and while there can be no assurance with respect thereto, management believes that after final disposition, any monetary liability or financial impact to Lucent, from matters other than those described in the next paragraph, beyond that provided for at December 31, 2000 would not be material to the annual Consolidated Financial Statements.

In addition, Lucent and certain of its former officers are defendants in several purported shareholder class action lawsuits for alleged violations of federal securities laws. Specifically, the complaints allege, among other things, that beginning in late October 1999, Lucent and certain of its officers misrepresented Lucent's financial condition and failed to disclose material facts that would have an adverse impact on Lucent's future earnings and prospects for growth. These actions seek compensatory and other damages, and costs and expenses associated with the litigation. These actions are in the early stages and the Company is unable to determine their potential impact on the Consolidated Financial Statements. Lucent intends to defend these actions vigorously. Also, Lucent has been served with several derivative complaints filed by individual Lucent shareholders against the current members of Lucent's Board of Directors, a former director and a current officer. These actions make claims for breach of fiduciary duties allegedly owed to the Company, and seek damages against the defendants and in favor of Lucent, as well as costs and expenses associated with litigation for the individual plaintiffs. These derivative actions are in the early stages and the Company is unable to determine their potential impact on the Consolidated Financial Statements.

In connection with the formation of Lucent from certain units of AT&T Corp. and the associated assets and liabilities of those units and AT&T's distribution of its remaining interest in Lucent to its shareowners, Lucent, AT&T and NCR Corporation executed and delivered the Separation and Distribution Agreement, dated as of February 1, 1996, as amended and restated, and certain related agreements. The Separation and Distribution Agreement, among other things, provides that Lucent will indemnify AT&T and NCR for all liabilities relating to

Lucent's

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

business and operations and for all contingent liabilities relating to Lucent's business and operations or otherwise assigned to Lucent. In addition to contingent liabilities relating to the present or former business of Lucent, any contingent liabilities relating to AT&T's discontinued computer operations (other than those of NCR) were assigned to Lucent. The Separation and Distribution Agreement provides for the sharing of contingent liabilities not allocated to one of the parties, in the following proportions: AT&T: 75%, Lucent: 22%, and NCR: 3%. The Separation and Distribution Agreement also provides that each party will share specified portions of contingent liabilities related to the business of any of the other parties that exceed specified levels.

In connection with the spin-off of Avaya, Lucent and Avaya executed and delivered a Contribution and Distribution Agreement which provides for indemnification by each company with respect to contingent liabilities primarily relating to their respective businesses or otherwise assigned to each, subject to certain sharing provisions. In the event the aggregate value of all amounts paid by each company, in respect of any single contingent liability or any set or group of related contingent liabilities, is in excess of $50 each company will share portions in excess of the threshold amount based on agreed-upon percentages. The Contribution and Distribution Agreement also provides for the sharing of certain contingent liabilities, specifically: (1) any contingent liabilities that are not primarily contingent liabilities of Lucent or contingent liabilities associated with the businesses attributed to Avaya; (2) certain specifically identified liabilities, including liabilities relating to terminated, divested or discontinued businesses or operations; and (3) shared contingent liabilities within the meaning of the Separation and Distribution Agreement with AT&T Corp.

Environmental Matters

Lucent's current and historical operations are subject to a wide range of environmental protection laws. In the United States, these laws often require parties to fund remedial action regardless of fault. Lucent has remedial and investigatory activities under way at numerous current and former facilities. In addition, Lucent was named a successor to AT&T as a potentially responsible party ("PRP") at numerous "Superfund" sites pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") or comparable state statutes. Under the Separation and Distribution Agreement, Lucent is responsible for all liabilities primarily resulting from or relating to the operation of Lucent's business as conducted at any time prior to or after the Separation including related businesses discontinued or disposed of prior to the Separation, and Lucent's assets including, without limitation, those associated with these sites. In addition, under such Separation and Distribution Agreement, Lucent is required to pay a portion of contingent liabilities paid

out in excess of certain amounts by AT&T and NCR, including environmental liabilities.

It is often difficult to estimate the future impact of environmental matters, including potential liabilities. Lucent records an environmental reserve when it is probable that a liability has been incurred and the amount of the liability is reasonably estimable. This practice is followed whether the claims are asserted or unasserted. Management expects that the amounts reserved will be paid out over the periods of remediation for the applicable sites, which typically range from five to 30 years. Reserves for estimated losses from environmental remediation are, depending on the site, based primarily on internal or third-party environmental studies and estimates as to the number, participation level and financial viability of any other PRPs, the extent of the contamination and the nature of required remedial actions. Accruals are adjusted as further information develops or circumstances change. The amounts provided for in Lucent's consolidated financial statements for environmental reserves are the gross undiscounted amounts of such reserves, without deductions for insurance or third-party indemnity claims. In those cases where insurance carriers or third-party indemnitors have agreed to pay any amounts and management believes that collectibility of such amounts is probable, the amounts are reflected as receivables in the financial statements. Although Lucent believes that its reserves are adequate, there can be no assurance that the amount of capital expenditures and other expenses which will be required relating to remedial actions and compliance with applicable environmental laws will not exceed the amounts reflected in Lucent's reserves or will not have a material adverse effect on Lucent's financial condition, results of operations or cash flows. Any possible loss or range of possible loss that may be incurred in excess of that provided for at December 31, 2000 cannot be estimated.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions Except Per Share Amounts)
(Unaudited)

10. RECENT PRONOUNCEMENT

In December 1999, the SEC issued Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 provides guidance on the recognition, presentation and disclosure of revenues in financial statements and requires adoption no later than the fourth quarter of fiscal 2001. The Company is currently evaluating the impact of SAB 101 and its related interpretations to determine the effect it will have on the Company's consolidated financial position and results of operations.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

OVERVIEW

Lucent Technologies ("Lucent" or the "Company") designs and delivers the systems, software, silicon and services for next-generation communications networks for service providers and enterprises. Backed by research and development of Bell Labs, Lucent focuses on high-growth areas such as broadband and mobile Internet infrastructure; communications software; communications semiconductors and optoelectronics; Web-based enterprise solutions that link private and public networks; and professional network design and consulting services.

During the fiscal year ended September 30, 2000 and continuing through the first fiscal quarter of 2001, various initiatives were undertaken to reorganize the Company to become more focused and better positioned to capitalize on market opportunities. This reorganization included:

- On September 30, 2000 Lucent completed the spin-off of Avaya Inc., formerly its enterprise networks business.

- In December 2000, Agere Systems Inc. ("Agere"), Lucent's microelectronics business, filed a Form S-1 registration statement with the Securities and Exchange Commission ("SEC") in anticipation of an initial public offering ("IPO") (this report does not constitute the offering of any securities, which will be made only by a prospectus filed with the SEC). Lucent plans to distribute the remaining shares through a tax-free distribution to its shareholders ("Distribution"). The IPO and Distribution are subject to certain conditions, including a favorable tax ruling by the IRS. In connection with the IPO, the Company may be adjusting its capital structure including a possible reduction in the amount of debt outstanding. See additional comments on the Distribution under LIQUIDITY AND CAPITAL RESOURCES.

- On December 29, 2000 Lucent completed the sale of its power systems business to Tyco International Ltd, for $2.5 billion in cash.

- On January 24, 2001, Lucent announced its restructuring program (see Restructuring Plan).

On a total basis, Lucent reported a net loss of $395 million, or $0.12 loss per basic and diluted share for the quarter ended December 31, 2000, as compared with net income in the prior year quarter of $1,249 million, or $0.38 per diluted share. The net loss for the current quarter includes an extraordinary gain of $1,154 million, or $0.34 per basic and diluted share, related to the sale of the power systems business, and a gain from a cumulative effect of accounting change of $30 million, or $0.01 per basic and diluted share, related to the adoption of Statement of Financial Accounting Standard No. 133 ("SFAS 133") - "Accounting for Derivative Instruments and Hedging Activities" (see Note 4 of the accompanying Consolidated Financial Statements). Net income for the prior year quarter includes $125 million from discontinued operations ($0.04 per share-diluted).

RESTRUCTURING PLAN

On January 24, 2001, Lucent announced a restructuring plan to primarily streamline its Service Provider Networks ("SPN") business and corporate operations including reducing its cost structure and improving working capital.

As part of the business-restructuring plan, Lucent expects to record a charge to earnings in the range of $1.2 billion to $1.6 billion in the second fiscal quarter of 2001. The charge relates to headcount reductions, elimination of certain product lines and associated asset writedowns and facility consolidations. As of February 2001, the Company has identified $1.2 billion in restructuring and asset writedown actions and expects to solidify plans for up to an additional $400 million in charges by the end of the fiscal quarter ending March 31, 2001.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

This restructuring plan will allow the Company to concentrate its investments, resources and management attention on optical, data and wireless solutions, along with the network design, consulting and integration services to support them. Lucent will continue to review its internal processes throughout fiscal year 2001, which may result in additional cost structure improvements and associated business restructuring charges as it moves from a multi-divisional company to one with a single focus on the service provider market.

RESULTS OF OPERATIONS - THREE MONTHS ENDED DECEMBER 31, 2000 VERSUS THREE MONTHS ENDED DECEMBER 31, 1999

REVENUES

Total revenues for the current quarter decreased 27.6% to $5,841 million compared with the prior year quarter. Sales within the United States decreased 35.0% and non-U.S. revenues decreased 13.7% compared with the prior year quarter. The non-U.S. sales represented 41.7% of total revenues compared with 35.0% in the prior year quarter. The substantial decline in revenues largely contributed to the substantial loss from continuing operations. The decrease occurred in the Company's SPN segment (see below) and resulted primarily from a significant sales decline in North America due to an overall softening in the competitive local exchange carrier market, slowdown in capital spending by established service providers, lower sales in hardware, significantly lower software sales, a more selective vendor financing program and the Company's move to a fulfillment model with distributors.

Revenues by Segment

Lucent operates in the global telecommunications networking industry and has two reportable operating segments: SPN and Microelectronics. SPN provides public networking systems, software and services to telecommunications service providers and public network operators around the world and optical fiber for

applications in the communications and computing industries. Microelectronics provides high-performance optoelectronic components and integrated circuits.

Agere has filed a Form S-1 registration statement with the SEC in anticipation of an initial public offering. Microelectronics is now being managed internally based on the composition of Agere. Accordingly, Lucent has revised its segment reporting to reflect this change which resulted in the transfer of optical fiber to the SPN segment.

The following table presents Lucent's revenues by segment and the approximate percentage of total revenues for the three months ended December 31, 2000 and 1999 (in millions):

	Three Months Ended December 31,			
	2000		1999	
SPN	$4,336	74%	$6,801	84%
Microelectronics	1,146	20	763	10
Other and Corporate	359	6	501	6
Total Lucent	$5,841	100%	$8,065	100%

Revenues from SPN decreased $2,465 million, or 36.2% compared to the prior year quarter. Revenue decreases were primarily attributable to the factors noted above and a substantial reduction of revenues to one large U.S. customer and the wind down of a major long-term foreign project.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Revenues generated from service providers in the United States decreased 40.1% for the first fiscal quarter of 2001 in comparison to the prior year quarter. Sales generated outside the United States decreased 28.9% over the prior year quarter.

Revenues from Microelectronics increased $383 million, or 50.2% over the prior year quarter, reflecting growth in optoelectronic components, wired and wireless local area network systems and customized chips for computing and high-speed communications products.

Revenues from within the United States increased 42.8% in comparison to the prior year quarter. Revenue from outside the United States increased 55.1% in comparison to the year-ago quarter, reflecting increases in all regions.

Revenues from Other and Corporate decreased $142 million, or 28.3% compared to the prior year quarter. The decrease is largely due to revenues generated in the prior year quarter from the Company's remaining consumer products business, which was sold in the second fiscal quarter of 2000, partially offset by increased revenues in the current quarter from the power systems business, which was sold on December 29, 2000.

GROSS MARGIN

As a percentage of revenue, gross margin decreased to 22.4%, or 24.2 percentage points from 46.6% in the prior year quarter. The lower gross margin was primarily due to decreased sales volumes across all SPN product lines except optical fiber, reduced sales of high-margin software products, costs associated with an infrastructure built to support higher revenue levels and an increasing proportion of lower margin sales as the Company continues to expand into non-U.S. markets.

OPERATING EXPENSES

Selling, general and administrative expenses (SG&A) increased $799 million, or 59.7%, to $2,137 million compared with $1,338 million in the prior year quarter. Approximately $340 million of the increase, which is primarily related to notes receivable, represents reserves for customer financing and uncollectibles reflecting ongoing credit concerns in the emerging service provider market. The remainder of the increase is attributable to amortization of goodwill and other acquired intangibles and costs associated with an infrastructure built to support a higher revenue base.

Amortization of goodwill and other acquired intangibles was $372 million for the quarter compared with $50 million for the prior year quarter. The increase is from acquisitions made subsequent to the first fiscal quarter of 2000. As a result of these acquisitions, amortization of goodwill and other acquired intangibles in fiscal year 2001 will be significantly higher than the prior year.

Research and development expense increased $357 million, or 38.5%, to $1,285 million from $928 million in the prior year quarter. The increase is primarily due to acquisitions made during fiscal year 2000 and new product development, particularly in Internet infrastructure, optical networking, next-generation 3G/UMTS wireless and microelectronics.

OTHER INCOME (EXPENSE) - NET

Other income (expense), net, was an expense of $18 million for the quarter compared to other income of $252 million in the prior year quarter. The change between periods was largely due to foreign exchange losses and lower gains on sales of investments. The prior year quarter included a $189 million gain from the sale of an equity investment.

INTEREST EXPENSE

Interest expense for the quarter increased $48 million to $129 million reflecting higher average short-term debt levels coupled with an increase in weighted average interest rates as compared to the same prior year quarter.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

(BENEFIT) PROVISION FOR INCOME TAXES

For the first fiscal quarter of 2001, the Company recorded a benefit for income taxes of $679 million on a pre-tax loss from continuing operations of $2,258 million, yielding an effective tax benefit rate of 30.1%. This rate is lower than the U.S. statutory rate primarily from the impact of non-tax deductible goodwill amortization on the pre-tax loss from continuing operations offset in part by research and development tax credits. For the prior year quarter, the Company recorded a provision for income taxes of $539 million on pre-tax income from continuing operations of $1,663 million, yielding an effective tax provision rate of 32.4%. This rate is lower than the U.S. statutory rate primarily due to research and development tax credits and the tax impact of non-U.S. activity.

CASH FLOWS - THREE MONTHS ENDED DECEMBER 31, 2000 VERSUS THREE MONTHS ENDED DECEMBER 31, 1999

Operating Activities

Net cash used in operating activities was $1,104 million in the current quarter primarily due to the loss from continuing operations (adjusted for non-cash items) of $784 million, increase in inventories and contracts in process of $1,170 million and changes in other assets and liabilities of $1,043 million. These increases were partially offset by a decrease in receivables of $2,073 million. (see Financial Condition)

Net cash provided by operating activities of $139 million in the prior year quarter was primarily due to net income from continuing operations (adjusted for non-cash items) of $1,622 million offset in part by increases in receivables of $196 million and inventories and contracts in process of $297 million, decrease in accounts payable of $684 million and changes in operating assets and liabilities of $306 million.

Investing Activities

Net cash provided by investing activities was $1,909 million in the current quarter, which primarily consisted of the cash proceeds received from the sale of the power systems business offset in part by capital expenditures of $548 million.

Net cash provided by investing activities was $107 million in the prior year quarter which primarily consisted of proceeds from the sales of investments of $702 million offset by $508 million of capital expenditures.

Financing Activities

Net cash provided by financing activities in the current quarter of $1,577 million is primarily from borrowings of short-term debt which largely consisted of commercial paper issuances and the transfer of $500 million of notes

receivable with recourse that was accounted for as a secured borrowing.

Net cash provided by financing activities in the prior quarter of $305 million was primarily from the proceeds from issuances of common stock related to the exercise of stock options offset by repayments of long-term debt.

FINANCIAL CONDITION

Total assets as of December 31, 2000 increased $1,249 million, or 2.6%, from September 30, 2000 largely due to increases in cash and cash equivalents and inventories, offset by decreases in receivables. Cash and cash equivalents increased $2,347 million primarily as a result of the proceeds received at the end of the quarter from the sale of the power systems business. Receivables decreased $2,272 million, or 23.8% largely as a result of lower sales volume and the sale of $615 million of receivables. Inventories increased $1,202 million, or 21.2% primarily as a result of anticipated sales to customers that were not fully realized in the first fiscal quarter of 2001.

Total liabilities increased $1,673 million, or 7.4%, from September 30, 2000. This increase was primarily due to increases in debt maturing within one year which largely consisted of issuances of commercial paper and $500 million of short-term debt in connection with the transfer of customer notes receivable with recourse that was accounted for as a secured borrowing.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

The Company is currently negotiating new credit facility arrangements with certain financial institutions. It is expected that the facilities will consist of (1) a 364 day facility of $2.0 billion, which replaces an existing $2.0 billion credit facility which expires on February 22, 2001 and (2) a 364 day facility of $2.5 billion, which is anticipated to be initially available to Lucent and assumable by Agere upon the consummation of its IPO. In addition, Lucent expects to amend its existing $2.0 billion five year facility terminating in February 2003 to contain provisions similar to the 364 day facilities. These facilities are expected to be secured by the Company's assets including a pledge by Lucent of its shares of Agere common stock. Some of our other existing and future financings and obligations are expected to be similarly secured. Lucent expects that these credit facilities and some of the other financings and obligations will include customary financial covenants that require Lucent to have minimum net worth, minimum earnings before interest, income taxes, depreciation and amortization, and satisfy a ratio test based on a minimum level of current assets (until the Distribution), and also include customary restrictive covenants. After consummation of the expected Agere IPO and the assumption of $2.5 billion of Lucent debt by Agere, the pledge of Agere's shares held by Lucent will be released if Lucent is in compliance with all of these

covenants. Also, the Distribution is subject to Lucent being in compliance with these covenants at the time of Distribution and Lucent having generated $2.5 billion of additional funds or reduction in debt from non-operating sources, either through a debt/equity exchange in connection with the IPO or from other sources.

At December 31, 2000, Lucent maintained approximately $4.8 billion in credit facilities including $0.8 billion of foreign subsidiary credit facilities, of which a portion is used to support Lucent's commercial paper program. At December 31, 2000, approximately $0.4 billion was drawn by foreign subsidiaries and the remaining $4.4 billion was undrawn.

On December 21, 2000, Moody's Investors Service lowered Lucent's credit rating on senior unsecured long-term debt from A2 to A3 and Standard & Poor's lowered its rating from A to BBB+. Moody's lowered its commercial paper rating from Prime-1 to Prime-2 and Standard & Poor's lowered its commercial paper rating from A-1 to A-2. On January 24, 2001 Moody's lowered the senior unsecured long-term debt from A3 to Baa1. On February 12, 2001, Moody's lowered Lucent's credit rating on senior unsecured long-term debt from Baa1 to Baa3 and Standard & Poor's lowered its rating from BBB+ to BBB-. Also on that date, Moody's lowered its commercial paper rating from Prime-2 to Prime-3 and Standard & Poor's lowered its rating from A-2 to A-3. All of the ratings have negative outlooks. Lucent believes that it will have sufficient capital resources to fulfill its own operational and capital needs, as well as to extend credit to customers when appropriate, although there can be no assurance that this will occur.

Future financings will be arranged to meet Lucent's requirements with the timing, amount and form of issue depending on the prevailing market and general economic conditions. Lucent's lower credit ratings may make commercial paper and certain other short-term borrowings unavailable or of limited availability to Lucent. Based upon the timely completion of the new credit facilities currently being negotiated, Lucent anticipates that borrowings under its bank credit facilities, short- and long-term debt financings, receivable securitizations, and the proceeds from the planned IPO of Agere Systems will be adequate to satisfy its future cash requirements, although there can be no assurance that this will be the case.

Notes Receivable and Financial Guarantees

Lucent's customers worldwide are requiring their suppliers to arrange or provide long-term financing for them as a condition of obtaining or bidding on infrastructure projects. These projects may require financing in amounts ranging from modest sums to more than a billion dollars. Lucent has increasingly provided or arranged long-term financing for customers, and continually monitors and reviews the creditworthiness of such arrangements. As market conditions permit, Lucent's intention is to sell or transfer these long-term financing arrangements, which may include both commitments and drawn-down borrowings, to financial institutions and other investors. This enables Lucent to reduce the amount of its commitments and free up additional financing capacity.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

As of December 31, 2000, Lucent had made commitments or entered into agreements to extend credit to certain customers for an aggregate of approximately $5.7 billion. In addition, Lucent is finalizing an agreement with a customer to extend $1.6 billion of credit. Excluding amounts that are not available because the customer has not yet satisfied the conditions precedent for borrowing, at December 31, 2000, approximately $2.3 billion in loan commitments was undrawn and available for borrowing and approximately $1.8 billion had been advanced and was outstanding. As part of the revenue recognition process, Lucent determines whether the notes receivable under these contracts are reasonably assured of collection based on various factors, among which is the ability of Lucent to sell these notes.

In addition, Lucent had made commitments to guarantee customer debt of about $1.8 billion at December 31, 2000. Excluding amounts not available for guarantee because conditions precedent have not been satisfied, approximately $860 million of guarantees was undrawn and available and about $740 million was outstanding on December 31, 2000.

Lucent will continue to provide or commit to financing where appropriate for its business. The ability of Lucent to arrange or provide financing for its customers will depend on a number of factors, including Lucent's capital structure, credit rating and level of available credit, and its continued ability to sell or transfer commitments and drawn-down borrowings on acceptable terms. Lucent believes that it will be able to access the capital markets on terms and in amounts that will be satisfactory to Lucent and that it will be able to obtain bid and performance bonds, to arrange or provide customer financing as necessary, and to engage in hedging transactions on commercially acceptable terms, although there can be no assurance that this will be the case.

RISK MANAGEMENT

Lucent is exposed to market risk from changes in foreign currency exchange rates and, to a lesser extent, changes in interest rates that could impact its results of operations and financial condition. Lucent manages its exposure to these market risks through its regular operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. Lucent uses derivative financial instruments as risk management tools and not for trading purposes. In addition, derivative financial instruments are entered into with a diversified group of major financial institutions in order to manage Lucent's exposure to nonperformance on such instruments.

Certain securities held in Lucent's equity and investment portfolio are subject to equity price risk. Lucent generally does not hedge its equity price risk and as of December 31, 2000, Lucent had no outstanding hedge instruments associated with this risk.

Lucent uses derivative financial instruments, including foreign exchange forward and option contracts and interest rate swap agreements to manage changes in foreign exchange rates and interest rates that may affect the eventual cash flows in foreign currencies or underlying financial instruments. The Company believes that its hedge activities achieve hedge effectiveness by creating a relationship whereby the gains and losses on its derivative instruments counterbalance the changes in value of the designated assets, liabilities and forecasted transactions being hedged.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Effective October 1, 2000, Lucent adopted SFAS 133 - "Accounting for Derivative Instruments and Hedging Activities" and its corresponding amendments under SFAS No. 138. The adoption of SFAS 133 resulted in a cumulative after-tax reduction in net loss of $30 million (net of tax of $17 million) and an $11 million credit to other comprehensive income (OCI) in the first quarter of fiscal year 2001. The reduction in net loss is primarily attributable to derivatives not designated as hedging instruments, including foreign currency embedded derivatives, equity warrants and other derivatives(for further description see Note 4).

Lucent has not changed its policy regarding how exposures are managed since the year ended September 30, 2000. Lucent continuously monitors all of its foreign currency exposures. Lucent cannot predict whether it will incur foreign exchange losses in the future; however, if significant foreign exchange losses are experienced, they could have a material adverse effect on the results of operations, financial condition and cash flows of Lucent.

While Lucent hedges certain foreign currency transactions, the decline in value of non-U.S. dollar currencies may, if not reversed, adversely affect Lucent's ability to contract for product sales in U.S. dollars because Lucent's products may become more expensive to purchase in U.S. dollars for local customers doing business in the countries of the affected currencies.

Lucent manages its ratio of fixed to floating rate debt with the objective of achieving a mix that management believes is appropriate. To manage this mix in a cost-effective manner, Lucent, from time to time, enters into interest rate swap agreements in which it agrees to exchange various combinations of fixed and/or variable interest rates based on agreed-upon notional amounts. Lucent had no material interest rate swap agreements in effect at December 31, 2000 or September 30, 2000.

OTHER INFORMATION

On November 21, 2000, Lucent announced that it had identified an issue impacting revenue in the fourth fiscal quarter of 2000. The Company informed the SEC and initiated a review by its outside counsel and outside auditors. In late December, the Company announced the results of the review, which resulted in certain adjustments to fourth fiscal quarter results. Lucent also informed the SEC and is cooperating fully with the SEC's review of these matters.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this report contain forward-looking statements that are based on current expectations, estimates, forecasts and projections

about the industries in which Lucent operates, management's beliefs, and assumptions made by management. In addition, other written or oral statements that constitute forward-looking statements may be made by or on behalf of Lucent. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("Future Factors") that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecast in such forward-looking statements. Lucent undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Future Factors include increasing price, products and services competition by U.S. and non-U.S. competitors, including new entrants; rapid technological developments and changes and the Company's ability to continue to introduce competitive new products and services on a timely, cost-effective basis; the mix of products and services; the availability of manufacturing capacity, components and materials; the ability to recruit and retain talent; the achievement of lower costs and expenses; credit concerns in the emerging service provider market; customer demand for the Company's products and services; the ability to successfully integrate the operations and business of acquired companies; timely completion of the proposed IPO and distribution of Lucent's remaining shares of Agere; the timely completion of the new credit facilities being negotiated; the successful implementation of the strategic reorganization; U.S. and non-U.S. governmental and public policy changes that may affect the level of new investments and purchases made by customers; changes in environmental and other U.S. and non-U.S. governmental regulations; protection and validity of patent and other intellectual property rights; reliance on large customers and significant suppliers; the ability to supply customer financing; technological, implementation and cost/financial risks in the use of large, multiyear contracts; the Company's credit ratings; the outcome of pending and future litigation and governmental proceedings and continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support the Company's future business. These are representative of the Future Factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general U.S. and non-U.S. economic conditions, including interest rate and currency exchange rate fluctuations and other Future Factors.

For a further description of Future Factors that could cause actual results to differ materially from such forward-looking statements, see the discussion in Lucent's Form 10-K for the year ended September 30, 2000 - Item 1. section VIII.

OUTLOOK and Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition - Forward-Looking Statements.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

European Monetary Union--Euro

Several member countries of the European Union have established fixed conversion rates between their existing sovereign currencies and the Euro and have adopted the Euro as their new single legal currency. The legacy currencies will remain legal tender in the participating countries for a transition period until January 1, 2002. During the transition period, cashless payments can be made in the Euro. Between January 1, 2002 and July 1, 2002, the participating countries will introduce Euro notes and coins and withdraw all legacy currencies so that they will no longer be available.

Lucent has in place a joint European-United States team representing affected functions within the Company. This team is evaluating Euro-related issues affecting the Company that include its pricing/marketing strategy, conversion of information technology systems and existing contracts.

The Euro conversion may affect cross-border competition by creating cross-border price transparency.

Lucent will continue to evaluate issues involving introduction of the Euro as further accounting, tax and governmental legal and regulatory guidance is available. Based on current information and Lucent's current assessment, Lucent does not expect that the Euro conversion will have a material adverse effect on its business or financial condition.

Part II - Other Information

Item 1. Legal Proceedings

Since early January 2001, Lucent has been served with at least five derivative complaints in Chancery Court in the State of Delaware. The actions were filed by

individual Lucent shareholders against the current members of Lucent's Board of Directors, a former director and a current officer. The actions are substantially similar to each other and make claims for breach of the fiduciary duty of good faith and other fiduciary duties allegedly owed to the Company. The actions seek damages against the defendants and in favor of Lucent, as well as costs and expenses associated with litigation for the individual plaintiffs. Lucent expects all of these derivative complaints to be consolidated in a single action. These actions are in the early stages and the Company is unable to determine their potential impact on the Consolidated Financial Statements.

Lucent is aware of several purported shareholder class actions that have been filed against the Company and certain of its current and former officers for alleged violations of federal securities laws in addition to the purported shareholder class actions described in the Company's Annual Report on Form 10-K for fiscal year 2000. The claims and relief sought in these newly-filed actions are substantially similar to the claims and relief sought in the purported class actions previously described in the Annual Report and, as with those actions, Lucent is unable to determine their potential impact on the Consolidated Financial Statements. Lucent intends to defend these actions vigorously.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits:

Exhibit Number

(27) Financial Data Schedule.

(b) Reports on Form 8-K:

The following reports on Form 8-K were filed during the current quarter to furnish company press releases.

Current Report on Form 8-K dated and filed December 28, 2000 was filed pursuant to Item 9 (Regulation FD Disclosures).

Current Report on Form 8-K dated December 21, 2000 and filed December 22, 2000 was filed pursuant to Item 5 (Other Events).

Current Report on Form 8-K dated and filed November 21, 2000 was filed pursuant to Item 5 (Other Events) and Item 7 (Financial Statements, Pro Forma Financial Information and Exhibits).

Current Report on Form 8-K dated November 13, 2000 and filed November 15, 2000 was filed pursuant to Item 5 (Other Events) and Item 7 (Financial Statements, Pro Forma Financial Information and Exhibits).

Current Report on Form 8-K dated and filed November 15, 2000 was filed pursuant to Item 9 (Regulation FD Disclosures).

Current Report on Form 8-K dated October 23 and filed October 24, 2000 was filed pursuant to Item 9 (Regulation FD Disclosures).

Current Report on Form 8-K dated October 23 and filed October 24, 2000 was filed pursuant to Item 9 (Regulation FD Disclosures).

Current Report on Form 8-K dated October 10, 2000 and filed October 12, 2000 was filed pursuant to Item 5 (Other Events) and Item 7 (Financial Statements, Pro Forma Financial Information

and Exhibits).

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.

Lucent Technologies Inc.
Registrant

Date February 14, 2001

/s/ Mark R. White

Mark R. White
Senior Vice President and Controller
(Principal Accounting Officer)

Exhibit Index

Exhibit Number	
(27)	Financial Data Schedule

tyle="padding:0in 0in 0in 0in;width:2.5%;">

$	42,127	
Current portion of long-term debt	10,000	10,000
Accrued expenses	58,391	52,131
Deferred income on shipments to distributors	41,042	35,448

Income taxes	3,084	2,615
Total current liabilities	155,096	142,321
Long-term debt	65,000	67,500
Other non-current liabilities	28,739	40,528
Total liabilities	248,835	

250,349

Commitments and contingencies

Stockholders equity:

Preferred stock $0.0001 par value; 10,000 shares authorized; no shares issued and outstanding

Common stock $0.0001 par value; 250,000 shares authorized; 41,743 and 41,727 shares issued and outstanding at April 2, 2016 and January 2, 2016, respectively

4

4

Additional paid-in capital

		13,868
Retained earnings	750,256	747,749
Accumulated other comprehensive loss	(813)	(507)
Total stockholders equity	749,447	761,114
Total liabilities and stockholders equity	$ 998,282	$

1,011,463

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

Table of Contents

Silicon Laboratories Inc.

Condensed Consolidated Statements of Income

(In thousands, except per share data)

(Unaudited)

	Three Months Ended	
	April 2, 2016	April 4, 2015
Revenues	$ 162,025	$ 163,705
Cost of revenues	66,494	67,336
Gross margin	95,531	96,369
Operating expenses:		
Research and development	49,046	46,857
Selling, general and administrative	39,637	42,300
Operating expenses	88,683	89,157
Operating income	6,848	7,212
Other income (expense):		
Interest income	271	192
Interest expense	(655)	(745)
Other income (expense), net	(391)	408
Income before income taxes	6,073	7,067
Provision for income taxes	265	689
Net income	$ 5,808	$ 6,378
Earnings per share:		
Basic	$ 0.14	$ 0.15
Diluted	$ 0.14	$ 0.15
Weighted-average common shares outstanding:		
Basic	41,629	42,412
Diluted	42,199	43,149

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

Table of Contents

Silicon Laboratories Inc.

Condensed Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three Months Ended	
	April 2, 2016	April 4, 2015
Net income	$ 5,808	$ 6,378
Other comprehensive loss, before tax:		
Net changes to available-for-sale securities:		
Unrealized losses arising during the period	(251)	(20)
Reclassification for losses included in net income		10
Net changes to cash flow hedges:		
Unrealized losses arising during the period	(286)	(626)
Reclassification for losses included in net income	66	130
Other comprehensive loss, before tax	(471)	(506)
Benefit from income taxes	(165)	(177)
Other comprehensive loss	(306)	(329)
Comprehensive income	$ 5,502	$ 6,049

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

Table of Contents

Silicon Laboratories Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended	
	April 2, 2016	April 4, 2015
Operating Activities		
Net income	$ 5,808	$ 6,378
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation of property and equipment	3,310	2,987
Amortization of other intangible assets and other assets	7,980	6,521
Stock-based compensation expense	10,344	10,519
Income tax benefit (shortfall) from stock-based awards	(1,025)	1,773
Excess income tax benefit from stock-based awards	(6)	(1,785)
Deferred income taxes	(38)	6,844
Changes in operating assets and liabilities:		
Accounts receivable	(990)	6,564
Inventories	4,580	(6,424)
Prepaid expenses and other assets	9,159	8,584
Accounts payable	1,559	447
Accrued expenses	6,260	(5,046)
Deferred income on shipments to distributors	5,558	(1,049)
Income taxes	494	(8,409)
Other non-current liabilities	(10,584)	(3,816)
Net cash provided by operating activities	42,409	24,088
Investing Activities		
Purchases of available-for-sale investments	(44,547)	(13,037)
Proceeds from sales and maturities of available-for-sale investments	46,654	57,739
Purchases of property and equipment	(2,303)	(1,991)
Purchases of other assets	(1,107)	(935)
Acquisition of business, net of cash acquired		(76,899)
Net cash used in investing activities	(1,303)	(35,123)
Financing Activities		
Payment of taxes withheld for vested stock awards, net of proceeds from the issuance of common stock	(7,523)	(2,561)
Excess income tax benefit from stock-based awards	6	1,785
Repurchases of common stock	(18,484)	(10,138)
Payment of acquisition-related contingent consideration		(4,464)
Payments on debt	(2,500)	(2,583)
Net cash used in financing activities	(28,501)	(17,961)
Increase (decrease) in cash and cash equivalents	12,605	(28,996)
Cash and cash equivalents at beginning of period	114,085	141,706
Cash and cash equivalents at end of period	$ 126,690	$ 112,710

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The Condensed Consolidated Financial Statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the condensed consolidated financial position of Silicon Laboratories Inc. and its subsidiaries (collectively, the Company) at April 2, 2016 and January 2, 2016, the condensed consolidated results of its operations for the three months ended April 2, 2016 and April 4, 2015, the Condensed Consolidated Statements of Comprehensive Income for the three months ended April 2, 2016 and April 4, 2015, and the Condensed Consolidated Statements of Cash Flows for the three months ended April 2, 2016 and April 4, 2015. All intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated results of operations for the three months ended April 2, 2016 are not necessarily indicative of the results to be expected for the full year.

The accompanying unaudited Condensed Consolidated Financial Statements do not include certain footnotes and financial presentations normally required under U.S. generally accepted accounting principles (GAAP). Therefore, these Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto for the year ended January 2, 2016, included in the Company s Form 10-K filed with the Securities and Exchange Commission (SEC) on February 5, 2016.

The Company prepares financial statements on a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2016 will have 52 weeks and fiscal 2015 had 52 weeks. In a 52-week year, each fiscal quarter consists of 13 weeks.

Use of Estimates

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

Revenue Recognition

Revenues are generated predominately by sales of the Company s products. The Company recognizes revenue when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists, 2) delivery of goods has occurred, 3) the sales price is fixed or determinable, and 4) collectibility is reasonably assured. Generally, revenue from product sales to direct customers and contract manufacturers is recognized upon shipment.

A portion of the Company s sales are made to distributors under agreements allowing certain rights of return and price protection related to the final selling price to the end customers. Accordingly, the Company defers revenue and cost of revenue on such sales until the distributors sell the product to the end customers. The net balance of deferred revenue less deferred cost of revenue associated with inventory shipped to a distributor but not yet sold to an end customer is recorded in the deferred income on shipments to distributors liability on the Consolidated Balance Sheet. Such net deferred income balance reflects the Company s estimate of the impact of rights of return and price protection.

A small portion of the Company s revenues is derived from the sale of patents. The above revenue recognition criteria for patent sales are generally met upon the execution of the patent sale agreement.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Update (ASU) No. 2016-09, *Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.* The amendments in this update simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This ASU is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted in any interim or annual period. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

In February 2016, the FASB issued FASB ASU No. 2016-02, *Leases (Topic 842).* The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. For operating leases, a lessee is required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

In January 2016, the FASB issued FASB ASU No. 2016-01, *Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* The amendments in this update address certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This ASU requires equity investments to be measured at fair value with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity s other deferred tax assets. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Earlier application is permitted for financial statements of fiscal years or interim periods that have not yet been issued. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

In July 2015, the FASB issued FASB ASU No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. The amendments in this update require inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments in this update should be applied

prospectively with earlier application permitted. The Company does not expect that the adoption of this ASU will have a material impact on its financial statements.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

In May 2014, the FASB issued FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition*. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. In August 2015, the FASB issued FASB ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which deferred the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, using one of two retrospective application methods. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. In March 2016, the FASB issued FASB ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).* ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations. The Company is currently evaluating the effect that the adoption of ASU 2014-09, ASU 2015-14 and ASU 2016-08 will have on its financial statements.

2. Earnings Per Share

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

	Three Months Ended	
	April 2, 2016	**April 4, 2015**
Net income	$ 5,808	$ 6,378
Shares used in computing basic earnings per share	41,629	42,412
Effect of dilutive securities:		
Stock options and other stock-based awards	570	737
Shares used in computing diluted earnings per share	42,199	43,149
Earnings per share:		
Basic	$ 0.14	$ 0.15
Diluted	$ 0.14	$ 0.15

For the three months ended April 2, 2016 and April 4, 2015, approximately 0.8 million and 0.1 million shares, respectively, were not included in the diluted earnings per share calculation since the shares were anti-dilutive.

9

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Cash, Cash Equivalents and Investments

The Company s cash equivalents and short-term investments as of April 2, 2016 consisted of municipal bonds, money market funds, variable-rate demand notes, corporate bonds, U.S. government bonds, asset-back securities, commercial paper, certificates of deposit and international government bonds. The Company s long-term investments consisted of auction-rate securities. In fiscal 2008, auctions for many of the Company s auction-rate securities failed because sell orders exceeded buy orders. As of April 2, 2016, the Company held $8.0 million par value auction-rate securities, all of which have experienced failed auctions. The underlying assets of the securities consisted of student loans and municipal bonds, of which $6.0 million were guaranteed by the U.S. government and the remaining $2.0 million were privately insured. As of April 2, 2016, $6.0 million of the auction-rate securities had credit ratings of AA and $2.0 million had a credit rating of A. These securities have contractual maturity dates ranging from 2033 to 2046 at April 2, 2016. The Company is receiving the underlying cash flows on all of its auction-rate securities. The principal amounts associated with failed auctions are not expected to be accessible until a successful auction occurs, the issuer redeems the securities, a buyer is found outside of the auction process or the underlying securities mature. The Company is unable to predict if these funds will become available before their maturity dates.

The Company does not expect to need access to the capital represented by any of its auction-rate securities prior to their maturities. The Company does not intend to sell, and believes it is not more likely than not that it will be required to sell, its auction-rate securities before their anticipated recovery in market value or final settlement at the underlying par value. The Company believes that the credit ratings and credit support of the security issuers indicate that they have the ability to settle the securities at par value. As such, the Company has determined that no other-than-temporary impairment losses existed as of April 2, 2016.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Company s cash, cash equivalents and investments consisted of the following (in thousands):

	April 2, 2016			
	Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Cash and cash equivalents:				
Cash on hand	$ 76,197	$	$	$ 76,197
Available-for-sale securities:				
Money market funds	40,720			40,720
Municipal bonds	5,724			5,724
Certificates of deposit	2,849			2,849
Commercial paper	1,200			1,200
Total available-for-sale securities	50,493			50,493
Total cash and cash equivalents	$ 126,690	$	$	$ 126,690
Short-term investments:				
Available-for-sale securities:				
Municipal bonds	$ 85,668	$ (14)	$ 55	$ 85,709
Variable-rate demand notes	18,395			18,395
Corporate bonds	8,021	(18)		8,003
U.S. government bonds	6,004		5	6,009
Asset-backed securities	3,995		3	3,998
Commercial paper	2,489			2,489
International government bonds	2,220		1	2,221
Total short-term investments	$ 126,792	$ (32)	$ 64	$ 126,824
Long-term investments:				
Available-for-sale securities:				
Auction rate securities	$ 8,000	$ (1,155)	$	$ 6,845
Total long-term investments	$ 8,000	$ (1,155)	$	$ 6,845

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

	January 2, 2016			
	Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Cash and cash equivalents:				
Cash on hand	$ 59,071	$	$	$ 59,071
Available-for-sale securities:				
Money market funds	37,721			37,721
Commercial paper	11,272			11,272
Certificates of deposit	2,845			2,845
U.S. government agency	1,599			1,599
Municipal bonds	1,576		1	1,577
Total available-for-sale securities	55,013		1	55,014
Total cash and cash equivalents	$ 114,084	$	$ 1	$ 114,085
Short-term investments:				
Available-for-sale securities:				
Municipal bonds	$ 93,506	$ (32)	$ 42	$ 93,516
Commercial paper	11,176			11,176
Variable-rate demand notes	8,995			8,995
Certificates of deposit	8,000			8,000
U.S. government agency	3,997		1	3,998
International government bonds	2,227	(7)		2,220
Corporate bonds	999	(3)		996
Total short-term investments	$ 128,900	$ (42)	$ 43	$ 128,901
Long-term investments:				
Available-for-sale securities:				
Auction rate securities	$ 8,000	$ (874)	$	$ 7,126
Total long-term investments	$ 8,000	$ (874)	$	$ 7,126

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

	Less Than 12 Months		12 Months or Greater		Total	
As of April 2, 2016	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Municipal bonds	$ 27,767	$ (11)	$ 2,708	$ (3)	$ 30,475	$ (14)
Corporate bonds	8,003	(18)			8,003	(18)
Auction rate securities			6,845	(1,155)	6,845	(1,155)
	$ 35,770	$ (29)	$ 9,553	$ (1,158)	$ 45,323	$ (1,187)

12

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

As of January 2, 2016	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Municipal bonds	$ 29,271	$ (30)	$ 1,198	$ (2)	$ 30,469	$ (32)
Auction rate securities			7,126	(874)	7,126	(874)
International government bonds	2,220	(7)			2,220	(7)
Corporate bonds	996	(3)			996	(3)
	$ 32,487	$ (40)	$ 8,324	$ (876)	$ 40,811	$ (916)

The gross unrealized losses as of April 2, 2016 and January 2, 2016 were due primarily to the illiquidity of the Company s auction-rate securities and, to a lesser extent, to changes in market interest rates.

The following summarizes the contractual underlying maturities of the Company s available-for-sale investments at April 2, 2016 (in thousands):

	Cost	Fair Value
Due in one year or less	$ 114,458	$ 114,470
Due after one year through ten years	41,002	41,022
Due after ten years	29,825	28,670
	$ 185,285	$ 184,162

4. Derivative Financial Instruments

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

Interest Rate Swaps

The Company is exposed to interest rate fluctuations in the normal course of its business, including through its Credit Facilities. The interest payments on the facility are calculated using a variable-rate of interest. The Company has entered into an interest rate swap agreement with an original notional value of $100 million (equal to the full amount borrowed under the Credit Facilities) and, effectively, converted the Eurodollar portion of the variable-rate interest payments to fixed-rate interest payments through July 2017.

The Company s interest rate swap agreement is designated and qualifies as a cash flow hedge. The effective portion of the gain or loss on the interest rate swap is recorded in accumulated other comprehensive loss as a separate component of stockholders equity and is subsequently recognized as interest expense in the Consolidated Statement of Income when the hedged exposure affects earnings.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Company estimates the fair values of interest rate swaps based on quoted prices and market observable data of similar instruments. If the Credit Facilities or the interest rate swap agreement is terminated prior to maturity, the fair value of the interest rate swap recorded in accumulated other comprehensive loss may be recognized in the Consolidated Statement of Income based on an assessment of the agreements at the time of termination. The Company did not discontinue any cash flow hedges in any of the periods presented.

The Company measures the effectiveness of its cash flow hedge by comparing the change in fair value of the hedged variable interest payments with the change in fair value of the interest rate swap. The Company recognizes ineffective portions of the hedge, as well as amounts not included in the assessment of effectiveness, in the Consolidated Statement of Income. As of April 2, 2016, no portion of the gains or losses from the Company s hedging instrument was excluded from the assessment of effectiveness. Hedge ineffectiveness was not material for any of the periods presented.

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

		Fair Value	
	Balance Sheet Location	**April 2, 2016**	**January 2, 2016**
Interest rate swap	Other assets, net	$	$ 92
	Other non-current liabilities	129	

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

	Loss Recognized in OCI on Derivatives (Effective Portion) during the: Three Months Ended		Location of Loss Reclassified into Income	Loss Reclassified from Accumulated OCI into Income (Effective Portion) during the: Three Months Ended	
	April 2, 2016	**April 4, 2015**		**April 2, 2016**	**April 4, 2015**
Interest rate swaps	$ (286)	$ (626)	Interest expense	$ (66)	$ (130)

The Company expects to reclassify $0.1 million of its interest rate swap losses included in accumulated other comprehensive loss as of April 2, 2016 into earnings in the next 12 months, which would be offset by lower interest payments.

Foreign Currency Forward Contracts

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

As of April 2, 2016 and April 4, 2015, the Company held one foreign currency forward contract denominated in Norwegian Krone with a notional value of $4.8 million and $6.8 million, respectively. The fair value of the contracts was not material as of April 2, 2016 or April 4, 2015. The contract held as of April 2, 2016 has a maturity date of June 29, 2016 and it was not designated as a hedging instrument.

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

	Three Months Ended		
Gain (Loss) Recognized in Income	**April 2, 2016**	**April 4, 2015**	**Location**
Foreign currency forward contracts	$ (300)	$ 550	Other income (expense), net

5. Fair Value of Financial Instruments

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

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

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

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

	Fair Value Measurements at April 2, 2016 Using			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets:				
Cash equivalents:				
Money market funds	$ 40,720	$	$	$ 40,720
Municipal bonds		5,724		5,724
Certificates of deposit		2,849		2,849
Commercial paper		1,200		1,200
Total cash equivalents	$ 40,720	$ 9,773	$	$ 50,493
Short-term investments:				
Municipal bonds	$	$ 85,709	$	$ 85,709
Variable-rate demand notes		18,395		18,395
Corporate bonds		8,003		8,003
U.S. government bonds	6,009			6,009
Asset-backed securities		3,998		3,998
Commercial paper		2,489		2,489
International government bonds		2,221		2,221
Total short-term investments	$ 6,009	$ 120,815	$	$ 126,824
Long-term investments:				
Auction rate securities	$	$	$ 6,845	$ 6,845
Total long-term investments	$	$	$ 6,845	$ 6,845
Total	$ 46,729	$ 130,588	$ 6,845	$ 184,162
Liabilities:				
Other non-current liabilities:				
Derivative instruments	$	$ 129	$	$ 129
Total	$	$ 129	$	$ 129

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

	Fair Value Measurements at January 2, 2016 Using			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets:				
Cash equivalents:				
Money market funds	$ 37,721	$	$	$ 37,721
Commercial paper		11,272		11,272
Certificates of deposit		2,845		2,845
U.S. government agency		1,599		1,599
Municipal bonds		1,577		1,577
Total cash equivalents	$ 37,721	$ 17,293	$	$ 55,014
Short-term investments:				
Municipal bonds	$	$ 93,516	$	$ 93,516
Commercial paper		11,176		11,176
Variable-rate demand notes		8,995		8,995
Certificates of deposit		8,000		8,000
U.S. government agency		3,998		3,998
International government bonds		2,220		2,220
Corporate bonds		996		996
Total short-term investments	$	$ 128,901	$	$ 128,901
Long-term investments:				
Auction rate securities	$	$	$ 7,126	$ 7,126
Total long-term investments	$	$	$ 7,126	$ 7,126
Other assets, net:				
Derivative instruments	$	$ 92	$	$ 92
Total	$	$ 92	$	$ 92
Total	$ 37,721	$ 146,286	$ 7,126	$ 191,133
Liabilities:				
Accrued expenses:				
Contingent consideration	$	$	$ 4,749	$ 4,749
Other non-current liabilities:				
Contingent consideration	$	$	$ 9,324	$ 9,324
Total	$	$	$ 14,073	$ 14,073

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Company s cash equivalents and short-term investments that are classified as Level 1 are valued using quoted prices and other relevant information generated by market transactions involving identical assets. Cash equivalents and short-term investments classified as Level 2 are valued using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments in active markets; or pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data. Investments classified as Level 3 are valued using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, amount of cash flows, expected holding periods of the securities and a discount to reflect the Company s inability to liquidate the securities. The Company s derivative instruments are valued using discounted cash flow models. The assumptions used in preparing the valuation models include quoted interest swap rates, foreign exchange rates, forward and spot prices for currencies, and market observable data of similar instruments.

The Company s contingent consideration is valued using a Monte Carlo simulation model or a probability weighted discounted cash flow model. The assumptions used in preparing the Monte Carlo simulation model include estimates for revenue growth rates, revenue volatility, contractual terms and discount rates. The assumptions used in preparing the discounted cash flow model include estimates for outcomes if milestone goals are achieved, the probability of achieving each outcome and discount rates.

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

Auction rate securities

Fair Value at April 2, 2016 (000s)		Valuation Technique	Unobservable Input	Weighted Average
$	6,845	Discounted cash flow	Estimated yield	1.09%
			Expected holding period	10 years
			Estimated discount rate	3.27%

The Company has followed an established internal control procedure used in valuing auction rate securities. The procedure involves the analysis of valuation techniques and evaluation of unobservable inputs commonly used by market participants to price similar instruments, and which have been demonstrated to provide reasonable estimates of prices obtained in actual market transactions. Outputs from the valuation process are assessed against various market sources when they are available, including marketplace quotes, recent trades of similar illiquid securities, benchmark indices and independent pricing services. The technique and unobservable input parameters may be recalibrated periodically to achieve an appropriate estimation of the fair value of the securities.

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Contingent consideration

The Company has followed an established internal control procedure used in valuing contingent consideration. The valuation of contingent consideration for the Energy Micro acquisition was based on a Monte Carlo simulation model. The fair value of this valuation was estimated on a quarterly basis through a collaborative effort by the Company s sales, marketing and finance departments.

The following summarizes the activity in Level 3 financial instruments for the three months ended April 2, 2016 (in thousands):

Assets

Auction Rate Securities		**Three Months Ended**
Beginning balance	$	7,126
Loss included in other comprehensive loss		(281)
Balance at April 2, 2016	$	6,845

Liabilities

Contingent Consideration (1)		**Three Months Ended**
Beginning balance	$	14,073
Settlements (2)		(11,375)
Gain recognized in earnings (3)		(2,698)
Balance at April 2, 2016	$	

---

(1) In connection with the acquisition of Energy Micro, the Company recorded contingent consideration based upon the expected achievement of certain milestone goals. Changes to the fair value of contingent consideration due to changes in assumptions used in preparing the valuation model were recorded in selling, general and administrative expenses in the Consolidated Statement of Income.

(2) On March 11, 2016, the Company entered into an agreement which settled the total amount of contingent consideration related to the Energy Micro acquisition (including all amounts for fiscal 2015 through 2018). See Note 7, *Acquisitions*, for additional information.

(3) The gain recognized in earnings was due to the settlement of the Energy Micro contingent consideration. This gain was offset in part by a charge of approximately $2.7 million recorded in the three months ended April 2, 2016 for a portion of the contingent consideration accounted for as post-combination compensation expense.

Fair values of other financial instruments

The Company s debt under the Credit Facilities bears interest at the Eurodollar rate plus an applicable margin. The Credit Facilities are recorded at cost, but are measured at fair value for disclosure purposes. Fair value is estimated based on Level 2 inputs, using a discounted cash flow analysis of future principal payments and projected interest based on current market rates. As of April 2, 2016 and January 2, 2016, the fair value of the Company s debt under the Credit Facilities was approximately $75.0 million and $77.5 million, respectively.

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

6. Balance Sheet Details

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

Inventories

	April 2, 2016	January 2, 2016
Work in progress	$ 34,689	$ 36,774
Finished goods	14,234	17,121
	$ 48,923	$ 53,895

7. Acquisitions

Energy Micro

On July 1, 2013, the Company acquired Energy Micro. In the first quarter of 2015, the Company made the following payments in connection with the Energy Micro acquisition: (a) approximately $20.0 million was paid for the release of the holdback; and (b) approximately $6.3 million was paid for the first annual period of the earn-out. Approximately $1.8 million of the earn-out payment was recorded as compensation expense during fiscal 2014. The remaining approximately $4.5 million of the earn-out payment represented additional consideration.

On March 11, 2016, the Company entered into an agreement with Energy AS, the former parent of Energy Micro. The agreement settled the amount of the earn-out to be paid for fiscal 2015 through 2018. The total settlement amount was approximately $16.0 million (in lieu of potential payments of up to $26.7 million) and will be paid on or before May 11, 2016. The settlement amount represented approximately $11.4 million of additional consideration and approximately $4.6 million of compensation expense (of which approximately $2.7 million was recorded in the three months ended April 2, 2016 and approximately $1.9 million was recorded in fiscal 2015). The compensation expense recorded in fiscal 2016 was offset in part by a gain of approximately $2.7 million to adjust the consideration portion of the earn-out to fair value due to the settlement.

8. Debt

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

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

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Amended Credit Agreement contains various conditions, covenants and representations with which the Company must be in compliance in order to borrow funds and to avoid an event of default, including financial covenants that the Company must maintain a leverage ratio (funded debt/EBITDA) of no more than 3.00 to 1 and a minimum fixed charge coverage ratio (EBITDA/interest payments, income taxes and capital expenditures) of no less than 1.25 to 1. As of April 2, 2016, the Company was in compliance with all covenants of the Amended Credit Agreement. The Company s obligations under the Amended Credit Agreement are guaranteed by the Guarantors and are secured by a security interest in substantially all assets of the Company and the Guarantors.

Interest Rate Swap Agreement

In connection with the $100 million borrowed under the Credit Facilities, the Company entered into an interest rate swap agreement as a hedge against the Eurodollar portion of such variable interest payments. Under the terms of the swap agreement, the Company effectively converted the Eurodollar portion of the interest on the Credit Facilities to a fixed interest rate of 0.764% through July 2017. As of April 2, 2016, the combined interest rate of the Credit Facilities (which includes an applicable margin) and the interest rate swap was 2.264%. See Note 4, *Derivative Financial Instruments*, for additional information.

9. Stockholders Equity

Common Stock

The Company issued 0.4 million shares of common stock during the three months ended April 2, 2016.

Share Repurchase Programs

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

Program Authorization Date	Program Termination Date		Program Amount
August 2015	December 2016	$	100,000

October 2014	December 2015	$	100,000
January 2014	January 2015	$	100,000

These programs allow for repurchases to be made in the open market or in private transactions, including structured or accelerated transactions, subject to applicable legal requirements and market conditions. The Company repurchased 0.4 million shares of its common stock for $18.5 million during the three months ended April 2, 2016. The Company repurchased 0.2 million shares of its common stock for $10.1 million during the three months ended April 4, 2015. These shares were retired upon repurchase.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of taxes, were as follows (in thousands):

	Unrealized Gain (Loss) on Cash Flow Hedge	Net Unrealized Losses on Available-For-Sale Securities	Total
Balance at January 2, 2016	$ 60	$ (567)	$ (507)
Other comprehensive loss before reclassifications	(186)	(163)	(349)
Amount reclassified from accumulated other comprehensive loss	43		43
Net change for the period	(143)	(163)	(306)
Balance at April 2, 2016	$ (83)	$ (730)	$ (813)

Reclassifications From Accumulated Other Comprehensive Loss

	Three Months Ended	
Reclassification (in thousands)	**April 2, 2016**	**April 4, 2015**
Losses on cash flow hedges to:		
Interest expense	$ (66)	$ (130)
Losses on available-for-sales securities to:		
Interest income		(10)
	(66)	(140)
Income tax benefit	23	49
Total reclassifications	$ (43)	$ (91)

10. Stock-Based Compensation

In fiscal 2009, the stockholders of the Company approved the 2009 Stock Incentive Plan (the 2009 Plan) and the 2009 Employee Stock Purchase Plan (the 2009 Purchase Plan). In fiscal 2014, the stockholders of the Company approved amendments to both the 2009 Plan and the 2009 Purchase Plan. The amendments authorized additional shares of common stock for issuance, to comply with changes in applicable law, improve

the Company s corporate governance and to implement other best practices. The amended plans are currently effective.

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

	Three Months Ended	
	April 2, 2016	April 4, 2015
Cost of revenues	$ 266	$ 230
Research and development	4,910	4,795
Selling, general and administrative	5,168	5,494
	10,344	10,519
Income tax benefit	2,236	1,304
	$ 8,108	$ 9,215

The Company had approximately $77.3 million of total unrecognized compensation costs related to granted stock awards as of April 2, 2016 that are expected to be recognized over a weighted-average period of approximately 2.5 years. There were no significant stock-based compensation costs capitalized into assets in any of the periods presented.

11. Commitments and Contingencies

Patent Litigation

On January 21, 2014, Cresta Technology Corporation (Cresta Technology), a Delaware corporation, filed a lawsuit against the Company, Samsung Electronics Co., Ltd., Samsung Electronics America, Inc., LG Electronics Inc. and LG Electronics U.S.A., Inc. in the United States District Court in the District of Delaware, alleging infringement of three United States Patents (the Cresta Patents). The Delaware District Court action has been stayed.

On January 28, 2014, Cresta Technology also filed a complaint with the United States International Trade Commission (ITC) alleging infringement of the same patents. On September 29, 2015, the ITC issued its Final Determination, finding that all the patent claims asserted against the Company s products were either invalid or not infringed and that Cresta Technology failed to establish the ITC s domestic industry requirement. The ITC found no violation by the Company and terminated the investigation. On November 30, 2015, Cresta Technology filed an appeal of the ITC decision to the Federal Circuit. On March 8, 2016, pursuant to a stipulated dismissal, the Federal Circuit dismissed Cresta Technology s appeal in its entirety.

In a parallel process, the Company challenged the validity of the claims of the Cresta Patents asserted in the ITC investigation through a series of Inter-Partes Review (IPR) proceedings at the Patent Trial and Appeal Board (PTAB) of the United States Patent and Trademark Office (USPTO). On October 21, 2015, the USPTO issued final written decisions on a first set of reviewed claims finding all of the reviewed claims invalid. On December 18, 2015, Cresta Technology appealed those adverse decisions to the United States Court of Appeals for the Federal Circuit as to this first USPTO determination. The USPTO has instituted a second set of IPR proceedings against a second set of the remaining claims. On March 18, 2016, Cresta Technology filed for chapter 7 bankruptcy in the United States Bankruptcy Court for the Northern District of California. The second set of IPR proceedings are currently stayed due to Cresta Technology s bankruptcy petition.

On July 16, 2014, the Company filed a lawsuit against Cresta Technology in the United States District Court in the Northern District of California alleging infringement of six United States Patents. The Company is seeking a permanent injunction and an award of damages and attorney fees. As a result of the chapter 7 bankruptcy filing by Cresta Technology, these proceedings are currently stayed.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

As is customary in the semiconductor industry, the Company provides indemnification protection to its customers for intellectual property claims related to the Company s products. The Company has not accrued any material liability on its Condensed Consolidated Balance Sheet related to such indemnification obligations in connection with the Cresta Technology litigation.

The Company intends to continue to vigorously defend against Cresta Technology s allegations and to continue to pursue its claims against Cresta and their patents. At this time, the Company cannot predict the outcome of these matters or the resulting financial impact to it, if any.

Other

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

12. Related Party Transactions

On July 1, 2013, Geir Førre joined the Company as senior vice president. Mr. Førre was chief executive officer of Energy Micro, until it was acquired by the Company. Mr. Førre was the beneficial owner of approximately 30% of the Energy Micro equity and accordingly received approximately $35 million at closing. In the first quarter of 2015, Mr. Førre received approximately $6.1 million of the $20.0 million paid for the holdback related to potential indemnification claims and approximately $1.9 million of the $6.3 million paid for the fiscal 2014 earn-out. On March 11, 2016, the Company entered into an agreement which settled the amount of the earn-out to be paid for fiscal 2015 through 2018. Under this agreement, Mr. Førre will receive approximately $4.8 million of the $16.0 million that will be paid.

Alf-Egil Bogen served on the Company s board of directors from October 17, 2013 to April 21, 2016. Mr. Bogen was chief marketing officer of Energy Micro, until it was acquired by the Company. Mr. Bogen was the beneficial owner of approximately 2% of the Energy Micro equity and accordingly received approximately $0.9 million at closing. In the first quarter of 2015, Mr. Bogen received approximately $0.4 million of the $20.0 million paid for the holdback related to potential indemnification claims and approximately $0.1 million of the $6.3 million paid for the fiscal 2014 earn-out. Under the settlement agreement, Mr. Bogen will receive approximately $0.3 million of the $16.0 million that will be paid for fiscal 2015 through 2018 earn-out. Mr. Bogen had invested approximately $0.8 million in Energy Micro prior to the acquisition.

13. Income Taxes

Provision for income taxes includes both domestic and foreign income taxes at the applicable tax rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences. Income tax expense was $0.3 million and $0.7 million for the three months ended April 2, 2016 and April 4, 2015, resulting in effective tax rates of 4.4% and 9.7%, respectively. The effective tax rate for the three months ended April 2, 2016 decreased from the prior period primarily due to a revaluation of deferred tax liabilities to a lower enacted tax rate as well as an increase in the foreign tax rate benefit resulting from a net increase in earnings indefinitely reinvested in lower tax jurisdictions.

At April 2, 2016, the Company had gross unrecognized tax benefits of $4.2 million, of which $3.2 million would affect the effective tax rate if recognized. The Company recognizes interest and penalties related to unrecognized tax benefits in the provision for income taxes.

The Company believes it is reasonably possible that the gross unrecognized tax benefits will decrease by approximately $1.1 million in the next 12 months due to the lapse of the statute of limitations applicable to tax deductions and tax credits claimed on prior year tax returns.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

The tax years 2011 through 2015 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company is not currently under audit in any major taxing jurisdiction.

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related notes thereto included elsewhere in this report. This discussion contains forward-looking statements. Please see the Cautionary Statement above and Risk Factors below for discussions of the uncertainties, risks and assumptions associated with these statements. Our fiscal year-end financial reporting periods are a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2016 will have 52 weeks and fiscal 2015 had 52 weeks. Our first quarter of fiscal 2016 ended April 2, 2016. Our first quarter of fiscal 2015 ended April 4, 2015.

Overview

We are a provider of silicon, software and solutions for the Internet of Things (IoT), Internet infrastructure, industrial control, consumer and automotive markets. We solve some of the electronics industry s toughest problems, providing customers with significant advantages in performance, energy savings, connectivity and design simplicity. Mixed-signal integrated circuits (ICs) are electronic components that convert real-world analog signals, such as sound and radio waves, into digital signals that electronic products can process. Therefore, mixed-signal ICs are critical components in products addressing a variety of markets, including industrial, communications, consumer and automotive. Our major customers include Chamberlain, Cisco, Fitbit, Harman Becker, Huawei, LG Electronics, Samsung, Technicolor, Technisat and Varian Medical Systems.

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

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

- Internet of Things (IoT) products, which include our microcontroller (MCU), wireless, sensor and analog products;
- Broadcast products, which include our broadcast consumer and automotive products;
- Infrastructure products, which include our timing products (clocks and oscillators), and isolation devices; and

Table of Contents

- Access products, which include our Voice over IP (VoIP) products, embedded modems and our Power over Ethernet (PoE) devices.

Through acquisitions and internal development efforts, we have continued to diversify our product portfolio and introduce new products and solutions with added functionality and further integration. In the first three months of fiscal 2016, we introduced a fully integrated, pre-certified Bluetooth® module for low-energy applications; a family of isolated gate drivers for high-speed power supply designs; a plug-and-play Wi-Fi® module solution for IoT applications; the scalable Blue Gecko wireless system-on-chip (SoC) family for the Bluetooth low-energy market; the Wireless Gecko portfolio of multiprotocol SoC devices for IoT applications; next-generation optical sensors that enable enhanced measurement of ultraviolet (UV) radiation and gesture recognition; and an optical heart rate sensing solution for wrist-based heart rate monitoring (HRM) applications. We plan to continue to introduce products that increase the content we provide for existing applications, thereby enabling us to serve markets we do not currently address and expand our total available market opportunity.

During the three months ended April 2, 2016, we had no customer that represented more than 10% of our revenues. In addition to direct sales to customers, some of our end customers purchase products indirectly from us through distributors and contract manufacturers. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer. Three of our distributors, Edom Technology, Avnet and Arrow Electronics, represented more than 10% of our revenues during the three months ended April 2, 2016. There were no other distributors or contract manufacturers that accounted for more than 10% of our revenues during the three months ended April 2, 2016.

The percentage of our revenues derived from outside of the United States was 87% during the three months ended April 2, 2016. All of our revenues to date have been denominated in U.S. dollars. We believe that a majority of our revenues will continue to be derived from customers outside of the United States.

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

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

Results of Operations

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

Revenues. Revenues are generated predominately by sales of our products. We recognize revenue on sales when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists, 2) delivery of goods has occurred, 3) the sales price is fixed or determinable, and 4) collectibility is reasonably assured. Generally, we recognize revenue from product sales to direct customers and contract manufacturers upon shipment. Certain of our sales are made to distributors under agreements allowing certain rights of return and price protection on products unsold by distributors. Accordingly, we defer the revenue and cost of revenue on such sales until the distributors sell the product to the end customer. A small portion of our revenues is derived from the sale of patents. The above revenue recognition criteria for patent sales are generally met upon the execution of the patent sale agreement. Our products typically carry a one-year replacement warranty. Replacements have been insignificant to date.

Table of Contents

Our revenues are subject to variation from period to period due to the volume of shipments made within a period, the mix of products we sell and the prices we charge for our products. The vast majority of our revenues were negotiated at prices that reflect a discount from the list prices for our products. These discounts are made for a variety of reasons, including: 1) to establish a relationship with a new customer, 2) as an incentive for customers to purchase products in larger volumes, 3) to provide profit margin to our distributors who resell our products or 4) in response to competition. In addition, as a product matures, we expect that the average selling price for such product will decline due to the greater availability of competing products. Our ability to increase revenues in the future is dependent on increased demand for our established products and our ability to ship larger volumes of those products in response to such demand, as well as our ability to develop or acquire new products and subsequently achieve customer acceptance of newly introduced products.

Cost of Revenues. Cost of revenues includes the cost of purchasing finished silicon wafers processed by independent foundries; costs associated with assembly, test and shipping of those products; costs of personnel and equipment associated with manufacturing support, logistics and quality assurance; costs of software royalties, other intellectual property license costs and certain acquired intangible assets; and an allocated portion of our occupancy costs.

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

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

Interest Income. Interest income reflects interest earned on our cash, cash equivalents and investment balances.

Interest Expense. Interest expense consists of interest on our short and long-term obligations, including our credit facilities.

Other Income (Expense), Net. Other income (expense), net consists primarily of foreign currency remeasurement adjustments as well as other non-operating income and expenses.

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

differences.

Table of Contents

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

	Three Months Ended	
	April 2, 2016	**April 4, 2015**
Revenues	100.0%	100.0%
Cost of revenues	41.0	41.1
Gross margin	59.0	58.9
Operating expenses:		
Research and development	30.3	28.6
Selling, general and administrative	24.5	25.9
Operating expenses	54.8	54.5
Operating income	4.2	4.4
Other income (expense):		
Interest income	0.2	0.1
Interest expense	(0.4)	(0.5)
Other income (expense), net	(0.2)	0.3
Income before income taxes	3.8	4.3
Provision for income taxes	0.2	0.4
Net income	3.6%	3.9%

Revenues

	Three Months Ended			
(in millions)	**April 2, 2016**	**April 4, 2015**	**Change**	**% Change**
Internet of Things	$ 70.9	$ 60.9	$ 10.0	16.3%
Broadcast	38.4	46.1	(7.7)	(16.6)%
Infrastructure	31.6	30.2	1.4	4.8%
Access	21.1	26.5	(5.4)	(20.4)%
Revenues	$ 162.0	$ 163.7	$ (1.7)	(1.0)%

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

- Increased revenues of $10.0 million for our Internet of Things products, due primarily to market share gains for our products, increases in the market and the addition of revenues from acquisitions.

- Decreased revenues of $7.7 million for Broadcast products, due primarily to decreases in our market share and the market for our consumer products.

- Increased revenues of $1.4 million for our Infrastructure products, due primarily to market share gains.

- Decreased revenues of $5.4 million for our Access products, due primarily to decreases in our market share and the market for such products.

Unit volumes of our products increased by 4.5% and average selling prices decreased by 5.3% compared to the three months ended April 4, 2015. The average selling prices of our products may fluctuate significantly from period to period. In general, as our products become more mature, we expect to experience decreases in average selling prices. We anticipate that newly announced, higher priced, next generation products and product derivatives will offset some of these decreases.

Table of Contents

Gross Margin

(in millions)	Three Months Ended April 2, 2016	April 4, 2015	Change
Gross margin	$ 95.5	$ 96.4	$ (0.9)
Percent of revenue	59.0%	58.9%	0.1%

The decreased dollar amount of gross margin in the recent three month period was due to decreases in gross margin of $3.8 million for our Broadcast products and $1.7 million for our Access products, offset by increases in gross margin of $3.5 million for our Internet of Things products and $1.1 million for our Infrastructure products.

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

Research and Development

(in millions)	Three Months Ended April 2, 2016	April 4, 2015	Change	% Change
Research and development	$ 49.0	$ 46.9	$ 2.1	4.7%
Percent of revenue	30.3%	28.6%		

The increase in research and development expense in the recent three month period was principally due to increases of (a) $1.7 million for the amortization of intangible assets, and (b) $0.9 million for personnel-related expenses, including costs associated with increased headcount. We expect that research and development expense will increase in absolute dollars in the second quarter of 2016.

Recent development projects include a fully integrated, pre-certified Bluetooth module for low-energy applications; a family of isolated gate drivers for high-speed power supply designs; a plug-and-play Wi-Fi module solution for IoT applications; the scalable Blue Gecko wireless SoC family for the Bluetooth low-energy market; the Wireless Gecko portfolio of multiprotocol SoC devices for IoT applications; next-generation optical sensors that enable enhanced measurement of UV radiation and gesture recognition; an optical heart rate sensing solution for wrist-based HRM applications; two new EFM32 Gecko MCU families that provide advancements in security and energy management technologies; the TouchXpress family of fixed-function controllers, which speeds development of capacitive sensing applications; a new EFM8 MCU family that delivers high analog performance and peripheral integration in the 8-bit market; comprehensive reference designs that reduce time to market and simplify the development of ZigBee®-based home automation,

connected lighting and smart gateway products; a new family of multi-channel digital isolators featuring a high-voltage isolation barrier designed to withstand 10 kV surge hits; a new family of subscriber line interface circuits (SLICs) offering low power consumption, small footprint, and high levels of integration and programmability for the VoIP gateway market; a comprehensive reference design solution that streamlines the development of voice-enabled ZigBee remote controls; a sixth-generation version of the iWRAP Bluetooth software stack for the Bluetooth 3.0 wireless audio accessory market; an isolated current sense amplifier delivering high bandwidth and low signal delay; a fully integrated, pre-certified Blue Gecko wireless module providing a plug-and-play solution for Bluetooth Smart connectivity; a low-jitter, small-footprint and low-power network synchronizer clock; a new release of the Simplicity Studio development platform featuring an enhanced real-time Energy Profiler tool; the release of the Thread protocol stack providing IP-based mesh networking technology for the Connected Home market; a highly integrated clock IC for wireless infrastructure applications including base stations; a dual-mode Bluetooth module solution that supports both Bluetooth Smart and Bluetooth Classic wireless technologies; energy-friendly USB-enabled MCUs for power-sensitive IoT applications; a complete Wireless M-Bus platform solution for wirelessly connected smart meters in the European market; and high-speed, multi-channel digital isolators targeting industrial applications.

Table of Contents

Selling, General and Administrative

	Three Months Ended			
(in millions)	April 2, 2016	April 4, 2015	Change	% Change
Selling, general and administrative	$ 39.7	$ 42.3	$ (2.6)	(6.3)%
Percent of revenue	24.5%	25.9%		

The decrease in selling, general and administrative expense in the recent three month period was principally due to decreases of (a) $1.4 million for adjustments to the fair value of acquisition-related contingent consideration, and (b) $1.2 million for acquisition-related costs. We expect that selling, general and administrative expense will decrease in absolute dollars in the second quarter of 2016.

Interest Income

Interest income for the three months ended April 2, 2016 was $0.3 million compared to $0.2 million for the three months ended April 4, 2015.

Interest Expense

Interest expense was $0.7 million for the three months ended April 2, 2016 and April 4, 2015.

Other Income (Expense), Net

Other income (expense), net for the three months ended April 2, 2016 was $(0.4) million compared to $0.4 million for the three months ended April 4, 2015.

Provision for Income Taxes

	Three Months Ended		
(in millions)	April 2, 2016	April 4, 2015	Change
Provision for income taxes	$ 0.3	$ 0.7	$ (0.4)
Effective tax rate	4.4%	9.7%	

The effective tax rate for the three months ended April 2, 2016 decreased from the prior period primarily due to a revaluation of deferred tax liabilities to a lower enacted tax rate as well as an increase in the foreign tax rate benefit resulting from a net increase in earnings indefinitely reinvested in lower tax jurisdictions. See Note 13, *Income Taxes*, to the Condensed Consolidated Financial Statements for additional information.

The effective tax rates for each of the periods presented differ from the federal statutory rate of 35% due to the amount of indefinitely reinvested earnings in foreign jurisdictions where the tax rate may be lower than the federal statutory rate and other permanent items including nondeductible compensation expenses and research and development tax credits.

Business Outlook

We expect revenues in the second quarter of fiscal 2016 to be in the range of $168 to $173 million. Furthermore, we expect our diluted earnings (loss) per share to be in the range of $0.23 to $0.29.

Liquidity and Capital Resources

Our principal sources of liquidity as of April 2, 2016 consisted of $253.5 million in cash, cash equivalents and short-term investments, of which approximately $178.6 million was held by our U.S. entities. The remaining balance was held by our foreign subsidiaries. Our cash equivalents and short-term investments consisted of municipal bonds, money market funds, variable-rate demand notes, corporate bonds, U.S. government bonds, asset-back securities, commercial paper, certificates of deposit and international government bonds.

Table of Contents

Our long-term investments consisted of auction-rate securities. In fiscal 2008, auctions for many of our auction-rate securities failed because sell orders exceeded buy orders. As of April 2, 2016, we held $8.0 million par value auction-rate securities, all of which have experienced failed auctions. These securities have contractual maturity dates ranging from 2033 to 2046. We are receiving the underlying cash flows on all of our auction-rate securities. The principal amounts associated with failed auctions are not expected to be accessible until a successful auction occurs, the issuer redeems the security, a buyer is found outside of the auction process or the underlying securities mature. We are unable to predict if these funds will become available before their maturity dates. We do not expect to need access to the capital represented by any of our auction-rate securities prior to their maturities.

Operating Activities

Net cash provided by operating activities was $42.4 million during the three months ended April 2, 2016, compared to net cash provided of $24.1 million during the three months ended April 4, 2015. Operating cash flows during the three months ended April 2, 2016 reflect our net income of $5.8 million, adjustments of $20.6 million for depreciation, amortization, stock-based compensation and deferred income taxes, and a net cash inflow of $16.0 million due to changes in our operating assets and liabilities.

Accounts receivable increased to $74.6 million at April 2, 2016 from $73.6 million at January 2, 2016. The increase in accounts receivable resulted primarily from normal variations in the timing of collections and billings. Our average days sales outstanding (DSO) was 41 days at April 2, 2016 and January 2, 2016.

Inventory decreased to $48.9 million at April 2, 2016 from $53.9 million at January 2, 2016. Our inventory level is primarily impacted by our need to make purchase commitments to support forecasted demand and variations between forecasted and actual demand. Our average days of inventory (DOI) was 66 days at April 2, 2016 and 73 days at January 2, 2016.

Investing Activities

Net cash used in investing activities was $1.3 million during the three months ended April 2, 2016, compared to net cash used of $35.1 million during the three months ended April 4, 2015. The decrease in cash outflows was principally due to $76.9 million in net payments for the acquisition of businesses during the three months ended April 4, 2015, including $56.9 million for the purchase of Bluegiga and $20.0 million for consideration previously withheld in connection with our purchase of Energy Micro, offset by a decrease of $42.6 million from net proceeds from the sales and maturities of marketable securities.

We anticipate capital expenditures of approximately $14 to $16 million for fiscal 2016. Additionally, as part of our growth strategy, we expect to evaluate opportunities to invest in or acquire other businesses, intellectual property or technologies that would complement or expand our current offerings, expand the breadth of our markets or enhance our technical capabilities.

Financing Activities

Net cash used in financing activities was $28.5 million during the three months ended April 2, 2016, compared to net cash used of $18.0 million during the three months ended April 4, 2015. The increase in cash outflows was principally due to an increase of $8.3 million for repurchases of our common stock and an increase of $5.0 million for payment of taxes withheld for vested stock awards, net of proceeds from the issuance of common stock. In August 2015, the Board of Directors authorized a program to repurchase up to $100 million of our common stock through December 2016.

Debt

On July 31, 2012, we entered into a $230 million five-year Credit Agreement (the Credit Agreement), which consisted of a $100 million Term Loan Facility and a $130 million Revolving Credit Facility (collectively, the Credit Facilities). On July 24, 2015, we amended the Credit Agreement (the Amended Credit Agreement) in order to, among other things, increase the borrowing capacity under the Revolving Credit Facility to $300 million, eliminate the Term Loan Facility and extend the maturity date to five years from the closing date. On July 24, 2015, we borrowed $82.5 million under the Amended Credit Agreement and paid off the remaining balance of our Term Loan Facility.

Table of Contents

The Amended Credit Agreement includes a $25 million letter of credit sublimit and a $10 million swingline loan sublimit. We also have an option to increase the size of the borrowing capacity by up to an aggregate of $200 million in additional commitments, subject to certain conditions.

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

The Amended Credit Agreement contains various conditions, covenants and representations with which we must be in compliance in order to borrow funds and to avoid an event of default, including financial covenants that we must maintain a leverage ratio (funded debt/EBITDA) of no more than 3.00 to 1 and a minimum fixed charge coverage ratio (EBITDA/interest payments, income taxes and capital expenditures) of no less than 1.25 to 1. As of April 2, 2016, we were in compliance with all covenants of the Amended Credit Agreement. Our obligations under the Amended Credit Agreement are secured by a security interest in substantially all of our assets.

We have entered into an interest rate swap agreement as a hedge against the Eurodollar portion of the variable interest payments under the Credit Facilities and effectively converted the Eurodollar portion of the interest on the Credit Facilities to a fixed interest rate through July 2017. See Note 4, *Derivative Financial Instruments*, to the Condensed Consolidated Financial Statements for additional information.

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

Critical Accounting Policies and Estimates

The preparation of financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles requires that we make estimates and assumptions that affect the amounts reported. Changes in facts and circumstances could have a significant impact on the resulting estimated amounts included in the financial statements. We believe the following critical accounting policies affect our more complex judgments and estimates. We also have other policies that we consider to be key accounting policies, such as our policies for revenue recognition, including the deferral of revenues and cost of revenues on sales to distributors; however, these policies do not meet the definition of critical accounting estimates because they do not generally require us to make estimates or judgments that are difficult or subjective.

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

Table of Contents

Stock-based compensation We recognize the fair-value of stock-based compensation transactions in the Consolidated Statements of Income. The fair value of our full-value stock awards (with the exception of market-based performance awards) equals the fair market value of our stock on the date of grant. The fair value of our market-based performance awards is estimated at the date of grant using a Monte-Carlo simulation. The fair value of our stock option and employee stock purchase plan grants is estimated at the date of grant using the Black-Scholes option pricing model. In addition, we are required to estimate the expected forfeiture rate of our stock grants and only recognize the expense for those shares expected to vest. If our actual experience differs significantly from the assumptions used to compute our stock-based compensation cost, or if different assumptions had been used, we may have recorded too much or too little stock-based compensation cost. See Note 10, *Stock-Based Compensation*, to the Condensed Consolidated Financial Statements for additional information.

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

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

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

equal to the amount by which the carrying value of the asset exceeds its fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique.

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

Table of Contents

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

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

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

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Update (ASU) No. 2016-09, *Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.* The amendments in this update simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This ASU is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted in any interim or annual period. We are currently evaluating the effect that the adoption of this ASU will have on our financial statements.

In February 2016, the FASB issued FASB ASU No. 2016-02, *Leases (Topic 842).* The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. For operating leases, a lessee is required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.

We are currently evaluating the effect that the adoption of this ASU will have on our financial statements.

Table of Contents

In January 2016, the FASB issued FASB ASU No. 2016-01, *Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* The amendments in this update address certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This ASU requires equity investments to be measured at fair value with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity s other deferred tax assets. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Earlier application is permitted for financial statements of fiscal years or interim periods that have not yet been issued. We are currently evaluating the effect that the adoption of this ASU will have on our financial statements.

In July 2015, the FASB issued FASB ASU No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. The amendments in this update require inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments in this update should be applied prospectively with earlier application permitted. We do not expect that the adoption of this ASU will have a material impact on our financial statements.

In May 2014, the FASB issued FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* which supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition*. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. In August 2015, the FASB issued FASB ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which deferred the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, using one of two retrospective application methods. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. In March 2016, the FASB issued FASB ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).* ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations. We are currently evaluating the effect that the adoption of ASU 2014-09, ASU 2015-14 and ASU 2016-08 will have on our financial statements.

Quantitative and Qualitative Disclosures about Market Risk

Interest Income

Our investment portfolio includes cash, cash equivalents, short-term investments and long-term investments. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Our interest income is sensitive to

changes in the general level of U.S. interest rates. Our investment portfolio holdings as of April 2, 2016 yielded less than 100 basis points. A decline in yield to zero basis points on our investment portfolio holdings as of April 2, 2016 would decrease our annual interest income by approximately $1.1 million. We believe that our investment policy, which defines the duration, concentration, and minimum credit quality of the allowable investments, meets our investment objectives.

Table of Contents

Interest Expense

We are exposed to interest rate fluctuations in the normal course of our business, including through our Credit Facilities. The interest payments on the Credit Facilities consist of a variable-rate of interest and an applicable margin. We have entered into an interest rate swap agreement with an original notional value of $100 million that, effectively, converted the variable-rate interest payments to fixed-rate interest payments through July 2017.

Foreign currency exchange rate risk

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

Investments in Auction-rate Securities

In fiscal 2008, auctions for many of our auction-rate securities failed because sell orders exceeded buy orders. As of April 2, 2016, we held $8.0 million par value auction-rate securities, all of which have experienced failed auctions. The principal amounts associated with failed auctions are not expected to be accessible until a successful auction occurs, the issuer redeems the securities, a buyer is found outside of the auction process or the underlying securities mature. We are unable to predict if these funds will become available before their maturity dates. Additionally, if we determine that an other-than-temporary decline in the fair value of any of our available-for-sale auction-rate securities has occurred, we may be required to adjust the carrying value of the investments through an impairment charge.

Available Information

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Table of Contents

Item 4. Controls and Procedures

We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of April 2, 2016 to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Such disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosures. There was no change in our internal controls during the fiscal quarter ended April 2, 2016 that materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

Patent Litigation

On January 21, 2014, Cresta Technology Corporation (Cresta Technology), a Delaware corporation, filed a lawsuit against us, Samsung Electronics Co., Ltd., Samsung Electronics America, Inc., LG Electronics Inc. and LG Electronics U.S.A., Inc. in the United States District Court in the District of Delaware, alleging infringement of three United States Patents (the Cresta Patents). The Delaware District Court action has been stayed.

On January 28, 2014, Cresta Technology also filed a complaint with the United States International Trade Commission (ITC) alleging infringement of the same patents. On September 29, 2015, the ITC issued its Final Determination, finding that all the patent claims asserted against our products were either invalid or not infringed and that Cresta Technology failed to establish the ITC s domestic industry requirement. The ITC found no violation by us and terminated the investigation. On November 30, 2015, Cresta Technology filed an appeal of the ITC decision to the Federal Circuit. On March 8, 2016, pursuant to a stipulated dismissal, the Federal Circuit dismissed Cresta Technology s appeal in its entirety.

In a parallel process, we challenged the validity of the claims of the Cresta Patents asserted in the ITC investigation through a series of Inter-Partes Review (IPR) proceedings at the Patent Trial and Appeal Board (PTAB) of the United States Patent and Trademark Office (USPTO). On October 21, 2015, the USPTO issued final written decisions on a first set of reviewed claims finding all of the reviewed claims invalid. On December 18, 2015, Cresta Technology appealed those adverse decisions to the United States Court of Appeals for the Federal Circuit as to this first USPTO determination. The USPTO has instituted a second set of IPR proceedings against a second set of the remaining claims. On March 18, 2016, Cresta Technology filed for chapter 7 bankruptcy in the United States Bankruptcy Court for the Northern District of California. The second set of IPR proceedings are currently stayed due to Cresta Technology s bankruptcy petition.

On July 16, 2014, we filed a lawsuit against Cresta Technology in the United States District Court in the Northern District of California alleging infringement of six United States Patents. We are seeking a permanent injunction and an award of damages and attorney fees. As a result of the chapter 7 bankruptcy filing by Cresta Technology, these proceedings are currently stayed.

As is customary in the semiconductor industry, we provide indemnification protection to our customers for intellectual property claims related to our products. We have not accrued any material liability on our Condensed Consolidated Balance Sheet related to such indemnification obligations in connection with the Cresta Technology litigation.

We intend to continue to vigorously defend against Cresta Technology s allegations and to continue to pursue our claims against Cresta and their patents. At this time, we cannot predict the outcome of these matters or the resulting financial impact to us, if any.

Table of Contents

Other

We are involved in various other legal proceedings that have arisen in the normal course of business. While the ultimate results of these matters cannot be predicted with certainty, we do not expect them to have a material adverse effect on our Consolidated Financial Statements.

Item 1A. Risk Factors

Risks Related to our Business

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

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

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

- The timing and volume of orders received from our customers;
- The timeliness of our new product introductions and the rate at which our new products may cannibalize our older products;
- The rate of acceptance of our products by our customers, including the acceptance of new products we may develop for integration in the products manufactured by such customers, which we refer to as design wins ;
- The time lag and realization rate between design wins and production orders;

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

- The rate of adoption of mixed-signal products in the markets we target;

- Deferrals or reductions of customer orders in anticipation of new products or product enhancements from us or our competitors or other providers of mixed-signal ICs;

- Changes in product mix;

- The average selling prices for our products could drop suddenly due to competitive offerings or competitive predatory pricing;

- The average selling prices for our products generally decline over time;

- Changes in market standards;

- Impairment charges related to inventory, equipment or other long-lived assets;

- The software used in our products, including software provided by third parties, may not meet the needs of our customers;

- Significant legal costs to defend our intellectual property rights or respond to claims against us; and

Table of Contents

- The rate at which new markets emerge for products we are currently developing or for which our design expertise can be utilized to develop products for these new markets.

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

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

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

- Requirements of customers;

- Accurate prediction of market and technical requirements;

- Timely completion and introduction of new designs;

- Timely qualification and certification of our products for use in our customers products;

- Commercial acceptance and volume production of the products into which our ICs will be incorporated;

- Availability of foundry, assembly and test capacity;

- Achievement of high manufacturing yields;
- Quality, price, performance, power use and size of our products;
- Availability, quality, price and performance of competing products and technologies;
- Our customer service, application support capabilities and responsiveness;
- Successful development of our relationships with existing and potential customers;
- Technology, industry standards or end-user preferences; and
- Cooperation of third-party software providers and our semiconductor vendors to support our chips within a system.

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

Table of Contents

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

Our products serve as components and solutions in electronic devices in various markets. As a result, we have devoted and expect to continue to devote a large amount of resources to develop products based on new and emerging technologies and standards that will be commercially introduced in the future. Research and development expense during the three months ended April 2, 2016 was $49.0 million, or 30.3% of revenues. A number of companies are actively involved in the development of these new technologies and standards. Should any of these companies delay or abandon their efforts to develop commercially available products based on new technologies and standards, our research and development efforts with respect to these technologies and standards likely would have no appreciable value. In addition, if we do not correctly anticipate new technologies and standards, or if the products that we develop based on these new technologies and standards fail to achieve market acceptance, our competitors may be better able to address market demand than we would. Furthermore, if markets for these new technologies and standards develop later than we anticipate, or do not develop at all, demand for our products that are currently in development would suffer, resulting in lower sales of these products than we currently anticipate.

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

The loss of any of our key customers, or a significant reduction in sales to any one of them, would significantly reduce our revenues and adversely affect our business. During the three months ended April 2, 2016, our ten largest customers accounted for 28% of our revenues. Some of the markets for our products are dominated by a small number of potential customers. Therefore, our operating results in the foreseeable future will continue to depend on our ability to sell to these dominant customers, as well as the ability of these customers to sell products that incorporate our IC products. In the future, these customers may decide not to purchase our products at all, purchase fewer products than they did in the past or alter their purchasing patterns, particularly because:

- We do not have material long-term purchase contracts with our customers;

- Substantially all of our sales to date have been made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty;

- Some of our customers may have efforts underway to actively diversify their vendor base which could reduce purchases of our products; and

- Some of our customers have developed or acquired products that compete directly with products these customers purchase from us, which could affect our customers purchasing decisions in the future.

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

Table of Contents

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

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

- Cease selling or manufacturing products that use the challenged intellectual property;

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

- Redesign those products that use infringing intellectual property; or

- Pursue legal remedies with third parties to enforce our indemnification rights, which may not adequately protect our interests.

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

As part of our growth and product diversification strategy, we continue to evaluate opportunities to acquire other businesses, intellectual property or technologies that would complement our current offerings, expand the breadth of our markets or enhance our technical capabilities. The acquisitions that we have made and may make in the future entail a number of risks that could materially and adversely affect our business and operating results, including:

- Problems integrating the acquired operations, technologies or products with our existing business and products;

- Diversion of management s time and attention from our core business;
- Need for financial resources above our planned investment levels;
- Difficulties in retaining business relationships with suppliers and customers of the acquired company;
- Risks associated with entering markets in which we lack prior experience;
- Risks associated with the transfer of licenses of intellectual property;
- Increased operating costs due to acquired overhead;
- Tax issues associated with acquisitions;
- Acquisition-related disputes, including disputes over earn-outs and escrows;
- Potential loss of key employees of the acquired company; and

Table of Contents

- Potential impairment of related goodwill and intangible assets.

In contrast to the ICs that we have historically developed, our acquisition of Bluegiga and Telegesis will entail additional efforts to develop modules, which are products that incorporate ICs as well as additional software. We have limited experience with developing modules. Modules tend to have higher average selling prices but lower overall gross margins than ICs. Bluegiga s modules currently incorporate products from some of our competitors. Any disruption in supply of those products would adversely affect our business.

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

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

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

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

The future growth of our business will depend in large part on our ability to manage our relationships with current and future distributors and sales representatives, develop additional channels for the distribution and sale of our products and manage these relationships. During the three months ended April 2, 2016, 66% of our revenue was derived from distributors. As we execute our indirect sales strategy, we must manage the potential conflicts that may arise with our direct sales efforts. For example, conflicts with a distributor may arise when a customer begins purchasing directly from us rather than through the distributor. The inability to successfully execute or manage a multi-channel sales strategy could impede our future growth. In addition, relationships with our distributors often involve the use of price protection and inventory return rights. This often requires a significant amount of sales management s time and system resources to manage properly.

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

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

Table of Contents

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

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

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

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

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

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

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

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

- Failure by us, our customers or their end customers to qualify a selected supplier;

- Potential insolvency of the third-party subcontractors;
- Reduced control over delivery schedules and quality;
- Limited warranties on wafers or products supplied to us;
- Potential increases in prices or payments in advance for capacity;
- Increased need for international-based supply, logistics and financial management;
- Their inability to supply or support new or changing packaging technologies; and
- Low test yields.

Table of Contents

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

Most of the silicon wafers for the products that we sold during fiscal 2015 were manufactured either by Taiwan Semiconductor Manufacturing Co. (TSMC) or TSMC s affiliates or by Semiconductor Manufacturing International Corporation (SMIC). Our customers typically complete their own qualification process. If we fail to properly balance customer demand across the existing semiconductor fabrication facilities that we utilize or are required by our foundry partners to increase, or otherwise change the number of fab lines that we utilize for our production, we might not be able to fulfill demand for our products and may need to divert our engineering resources away from new product development initiatives to support the fab line transition, which would adversely affect our operating results.

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

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

We have substantial international activities, which subjects us to additional business risks including logistical and financial complexity, political instability and currency fluctuations

We have established international subsidiaries and have opened offices in international markets to support our activities in Europe and Asia. This has included the establishment of a headquarters in Singapore for non-U.S. operations. The percentage of our revenues derived from outside of the United States was 87% during the three months ended April 2, 2016. We may not be able to maintain or increase international market demand for our products. Our international operations are subject to a number of risks, including:

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

- Protectionist laws and business practices that favor local competition in some countries;

- Difficulties related to the protection of our intellectual property rights in some countries;

- Multiple, conflicting and changing tax and other laws and regulations that may impact both our international and domestic tax and other liabilities and result in increased complexity and costs;

- Longer sales cycles;

- Greater difficulty in accounts receivable collection and longer collection periods;

- High levels of distributor inventory subject to price protection and rights of return to us;

- Political and economic instability;

- Greater difficulty in hiring and retaining qualified technical sales and applications engineers and administrative personnel; and

- The need to have business and operations systems that can meet the needs of our international business and operating structure.

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

Our products incorporate technology licensed from third parties

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

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

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

We are subject to risks relating to product concentration

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

- A decline in demand for any of our more significant products;

- Failure of our products to achieve continued market acceptance;

- Competitive products;

- New technological standards or changes to existing standards that we are unable to address with our products;

Table of Contents

- A failure to release new products or enhanced versions of our existing products on a timely basis; and
- The failure of our new products to achieve market acceptance.

We are subject to credit risks related to our accounts receivable

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

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

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

Any dispositions could harm our financial condition

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

- Diversion of management s time and attention from our core business;
- Difficulties separating the divested business;

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

Table of Contents

Our stock price may be volatile

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

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

- The required expensing of stock awards.

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

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

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

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

Table of Contents

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

The manufacturing of our products is a highly complex and technologically demanding process. Although we work closely with our foundries and assemblers to minimize the likelihood of reduced manufacturing yields, we have from time to time experienced lower than anticipated manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials could result in lower than anticipated manufacturing yields or unacceptable performance deficiencies, which could lower our gross margins. If our foundries fail to deliver fabricated silicon wafers of satisfactory quality in a timely manner, we will be unable to meet our customers demand for our products in a timely manner, which would adversely affect our operating results and damage our customer relationships. Additionally, we have utilized microelectromechanical systems (MEMS) in certain of our timing products rather than the pure complementary metal oxide semiconductor (CMOS) manufacturing process that we have traditionally utilized. We have less operating history with MEMS IC design and MEMS IC manufacturing processes and have encountered lower yields and reduced manufacturing capacity.

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

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

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

Our debt could adversely affect our operations and financial condition

We believe we have the ability to service our debt under our credit facilities, but our ability to make the required payments thereunder when due depends upon our future performance, which will be subject to general economic conditions, industry cycles and other factors affecting our operations, including risk factors described under this Item 1A, many of which are beyond our control. Our credit facilities also contain covenants, including financial covenants. If we breach any of the covenants under our credit facilities and do not obtain appropriate waivers, then, subject to any applicable cure periods, our outstanding indebtedness thereunder could be declared immediately due and payable.

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

We believe that our existing cash, cash equivalents, investments and credit under our credit facilities will be sufficient to meet our working capital needs, capital expenditures, investment requirements and commitments for at least the next 12 months. However, our ability to

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

Table of Contents

We are a relatively small company with limited resources compared to some of our current and potential competitors and we may not be able to compete effectively and increase market share

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

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

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

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

- The ability of our Board of Directors to issue shares of our preferred stock in one or more series without further authorization of our stockholders;

- A prohibition on stockholder action by written consent;

- Elimination of the right of stockholders to call a special meeting of stockholders;

- A requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders; and

- A requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation.

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

Table of Contents

Risks related to our industry

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

The following table summarizes repurchases of our common stock during the three months ended April 2, 2016 (in thousands, except per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
January 3, 2016 January 30, 2016	268	$ 43.81	268	$ 88,271
January 31, 2016 February 27, 2016	163	$ 41.24	163	$ 81,525
February 28, 2016 April 2, 2016		$		$ 81,525
Total	431	$ 42.84	431	

In August 2015, the Board of Directors authorized a program to repurchase up to $100 million of our common stock through December 2016. The program allows for repurchases to be made in the open market or in private transactions, including structured or accelerated transactions, subject to applicable legal requirements and market conditions.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

Not applicable

Table of Contents

Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit Number	
2.1*	Share Purchase Agreement, dated June 6, 2013, by and between Silicon Laboratories International Pte. Ltd. and Energy AS and Silicon Laboratories Inc. (filed as Exhibit 2.1 to the Form 8-K filed on June 7, 2013).
3.1*	Form of Fourth Amended and Restated Certificate of Incorporation of Silicon Laboratories Inc. (filed as Exhibit 3.1 to the Registrant s Registration Statement on Form S-1 (Securities and Exchange Commission File No. 333-94853) (the IPO Registration Statement)).
3.2*	Third Amended and Restated Bylaws of Silicon Laboratories Inc. (filed as Exhibit 3.2 to the Registrant s Current Report on Form 8-K filed on July 29, 2015).
4.1*	Specimen certificate for shares of common stock (filed as Exhibit 4.1 to the IPO Registration Statement).
31.1	Certification of the Principal Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification as required by Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

---

* Incorporated herein by reference to the indicated filing.

Table of Contents

SIGNATURES

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

SILICON LABORATORIES INC.

April 27, 2016 Date	/s/ G. Tyson Tuttle G. Tyson Tuttle *President and* *Chief Executive Officer* *(Principal Executive Officer)*
April 27, 2016 Date	/s/ John C. Hollister John C. Hollister *Senior Vice President and* *Chief Financial Officer* *(Principal Financial and Accounting Officer)*