InvenSense Inc
Form 10-Q
February 08, 2013
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, DC 20549**

# FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the quarterly period ended December 30, 2012**

**or**

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

**Commission File Number 001-35269**

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

# INVENSENSE, INC.

| | |
|---|---|
| **Delaware** | **01-0789977** |
| **(State or other jurisdiction of** | **(I.R.S. Employer** |
| **Incorporation or organization)** | **Identification No.)** |

**1197 Borregas Avenue Sunnyvale, CA 94089**

**(Address of principal executive offices and zip code)**

**(408) 988-7339**

**(Registrant s telephone number, including area code)**

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 ¨

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | x |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |

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

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

| **Class** | **Shares Outstanding at January 25, 2013** |
|---|---|
| Common Stock, $0.001 par value | 84,187,528 |

Table of Contents

**INVENSENSE, INC.**

TABLE OF CONTENTS

**Table of Contents**

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)

**INVENSENSE, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Unaudited)**

**(In thousands, except par value)**

| | December 30, 2012 | April 1, 2012 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 94,039 | $ 153,643 |
| Short-term investments | 65,227 | 4,129 |
| Accounts receivable | 24,524 | 11,931 |
| Inventories | 18,800 | 12,240 |
| Prepaid expenses and other current assets | 8,027 | 4,188 |
| Total current assets | 210,617 | 186,131 |
| Property and equipment, net | 6,705 | 4,011 |
| Long-term investments | 33,308 | |
| Other assets | 1,226 | 3,176 |
| Total assets | $ 251,856 | $ 193,318 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 8,392 | $ 5,446 |
| Accrued liabilities | 8,279 | 7,754 |
| Total current liabilities | 16,671 | 13,200 |
| Long-term liabilities | 5,678 | 3,241 |
| Total liabilities | 22,349 | 16,441 |
| Commitments and contingencies (note 4) | | |
| Stockholders equity: | | |
| Preferred stock: | | |
| Preferred stock, $0.001 par value 20,000 shares authorized, no shares issued and outstanding at December 30, 2012 and April 1, 2012 | | |
| Common stock: | | |
| Common stock, $0.001 par value 750,000 shares authorized, 83,858 shares issued and outstanding at December 30, 2012, 80,890 shares issued and outstanding at April 1, 2012 | 151,227 | 136,792 |
| Accumulated other comprehensive income | 63 | 1 |
| Retained earnings | 78,217 | 40,084 |
| Total stockholders equity | 229,507 | 176,877 |
| Total liabilities and stockholders equity | $ 251,856 | $ 193,318 |

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

Table of Contents

**INVENSENSE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

**(Unaudited)**

**(In thousands, except per share amounts)**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Net revenue | $ 58,929 | $ 41,229 | $ 153,424 | $ 119,890 |
| Cost of revenue | 27,723 | 18,538 | 70,284 | 52,919 |
| Gross profit | 31,206 | 22,691 | 83,140 | 66,971 |
| Operating expenses: | | | | |
| Research and development | 6,712 | 4,758 | 18,285 | 14,099 |
| Selling, general and administrative | 8,428 | 4,427 | 21,887 | 12,836 |
| Total operating expenses | 15,140 | 9,185 | 40,172 | 26,935 |
| Income from operations | 16,066 | 13,506 | 42,968 | 40,036 |
| Other income (expense) net | 98 | (43) | 188 | 166 |
| Income before income taxes | 16,164 | 13,463 | 43,156 | 40,202 |
| Income tax (benefit) provision | (654) | 2,887 | 5,023 | 9,147 |
| Net income | 16,818 | 10,576 | 38,133 | 31,055 |
| Net income allocable to convertible preferred stockholders | | 5,157 | | 20,618 |
| Net income allocable to common stockholders | $ 16,818 | $ 5,419 | $ 38,133 | $ 10,437 |
| Basic | $ 0.20 | $ 0.11 | $ 0.46 | $ 0.36 |
| Diluted | $ 0.19 | $ 0.10 | $ 0.44 | $ 0.34 |
| Weighted average shares outstanding in computing net income per share allocable to common stockholders: | | | | |
| Basic | 83,218 | 49,890 | 82,280 | 28,770 |
| Diluted | 87,350 | 55,294 | 87,232 | 33,591 |

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

Table of Contents

**INVENSENSE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

**(In thousands)**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Net income | $ 16,818 | $ 10,576 | $ 38,133 | $ 31,055 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized (losses) gains on available-for-sale securities | (22) | 1 | 62 | 5 |
| Total comprehensive income | $ 16,796 | $ 10,577 | $ 38,195 | $ 31,060 |

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

5

Table of Contents

**INVENSENSE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**(In thousands)**

| | Nine Months Ended | |
|---|---|---|
| | **December 30, 2012** | **January 1, 2012** |
| **Cash flows from operating activities:** | | |
| Net income | $ 38,133 | $ 31,055 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,480 | 1,465 |
| Gain on disposal of property and equipment | | (160) |
| Stock-based compensation expense | 6,449 | 2,507 |
| Deferred income tax assets | 114 | 175 |
| Tax effect of employee benefit plans | 3,818 | |
| Excess tax benefit from stock-based compensation | (3,818) | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (12,593) | (536) |
| Inventories | (6,560) | (851) |
| Prepaid expenses and other current assets | (3,911) | (585) |
| Other assets | 1,871 | (1,603) |
| Accounts payable | 2,933 | (2,297) |
| Accrued liabilities | 3,391 | 4,393 |
| Net cash provided by operating activities | 31,307 | 33,563 |
| **Cash flows from investing activities:** | | |
| Purchase of property and equipment | (4,071) | (1,669) |
| Proceeds from the sale of property and equipment | | 188 |
| Sales and maturities of available-for-sale investments | 10,509 | 7,793 |
| Purchase of available-for-sale investments | (104,820) | (8,025) |
| Net cash used in investing activities | (98,382) | (1,713) |
| **Cash flows from financing activities:** | | |
| Proceeds from initial public offering, net of underwriting commissions | | 69,750 |
| Net proceeds from exercise of warrants and preferred stock | 81 | 499 |
| Proceeds from issuance of common stock | 4,064 | 969 |
| Offering costs | (471) | (1,717) |
| Payments of long-term debt and capital lease obligations | (21) | (19) |
| Excess tax benefit from stock-based compensation | 3,818 | |
| Net cash provided by financing activities | 7,471 | 69,482 |
| Net (decrease) increase in cash and cash equivalents | (59,604) | 101,332 |
| Cash and cash equivalents: | | |
| Beginning of period | $ 153,643 | $ 28,795 |
| End of period | $ 94,039 | $ 130,127 |

| | | | | |
|---|---|---|---|---|
| Supplemental disclosures of cash flow information: | | | | |
| Cash paid for interest | $ | 2 | $ | 22 |
| Cash paid for income taxes | $ | 31 | $ | 6,586 |
| Noncash investing and financing activities: | | | | |
| Unpaid accounts payable for property and equipment purchased | $ | 371 | $ | 204 |
| Unrealized gains from available-for-sale investments | $ | 62 | $ | 5 |
| Net exercise of warrants | $ | 70 | $ | |
| Fixed assets acquired under capital leases | $ | | $ | 40 |
| Unpaid accrued liabilities for offering costs incurred | $ | | $ | 357 |

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

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

## 1. Organization and Summary of Significant Accounting Policies

### Business

InvenSense, Inc. ( the Company ) was incorporated in California in June 2003 and reincorporated in Delaware in January 2004. The Company designs, develops, markets and sells micro-electro-mechanical system (MEMS) gyroscopes for MotionTracking devices in consumer electronics and is dedicated to bringing the best-in-class size, performance and cost solutions to market. Targeting applications in smartphones and tablets, console and portable video gaming devices, digital still and video cameras, smart TVs (including digital set-top boxes, televisions and multi-media HDDs), 3D mice, navigation devices, toys, and health and fitness accessories, the Company delivers leading generation of motion interface solutions based on its advanced multi-axis gyroscope technology.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the fiscal year ended April 1, 2012 included in the Company s Annual Report on Form 10-K filed on June 19, 2012 with the Securities and Exchange Commission ( SEC ).

### Fiscal Year

The Company s fiscal year is a 52 or 53 week period ending on the Sunday closest to March 31. The Company s most recent fiscal year ( Fiscal 2012 ) ended on April 1, 2012 ( April 2012 ). The third fiscal quarter in each of the two most recent fiscal years ended on December 30, 2012 ( three months ended December 30, 2012 or December 2012 ) and January 1, 2012 ( three months ended January 1, 2012 or January 2012 ), respectively, each quarter period included 13 weeks and the nine-month periods ended December 30, 2012 and January 1, 2012 both included 39 weeks.

### Basis of Presentation

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

The condensed consolidated balance sheet as of April 1, 2012, included herein was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP. The unaudited interim condensed consolidated financial statements, in the opinion of management, reflect all normal recurring adjustments necessary to present fairly the Company s financial position, results of operations, comprehensive income and cash flows for the interim periods. The results of operations for the period ended December 30, 2012 is not necessarily indicative of the results to be expected for the fiscal year ending March 31, 2013 or for any future year or interim period. Certain prior period amounts in the unaudited condensed consolidated financial statements and notes thereto have been reclassified to conform to the current period s presentation.

### Basis of Consolidation

All intercompany transactions and balances have been eliminated upon consolidation. The functional currency of each of the Company s subsidiaries is the U.S. dollar. Foreign currency gains or losses are recorded as other income (expense), net in the condensed consolidated statements of income.

### Use of Estimates

The preparation of the Company s condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Significant estimates included in the condensed consolidated financial statements include inventory valuation, valuation allowance for deferred tax assets, recognition and measurement of uncertain tax positions, stock-based compensation and valuation of common and convertible preferred stock for periods prior to the completion of the Company s initial public offering. These estimates are based upon information available as of the date of the condensed consolidated financial statements, and actual results could differ from those estimates.

Table of Contents

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Concentration of Credit Risk**

At December 2012, four customers each accounted for 17%, 16%, 14% and 14% of total accounts receivable. At April 2012, five each customers accounted for 18%, 17%, 13%, 12% and 10% of total accounts receivable. No other customers accounted for more than 10% of total accounts receivable at December 2012 or April 2012.

For the three months ended December 30, 2012, three customers each accounted for 24%, 22% and 10% of total net revenue. For the nine months ended December 30, 2012, three customers each accounted for 23%, 20% and 13% of total net revenue. For the three months ended January 1, 2012, three customers each accounted for 41%, 17% and 13% of total net revenue. For the nine months ended January 1, 2012, three customers each accounted for 34%, 17% and 10% of total net revenue. No other customers accounted for more than 10% of total net revenue for the three and nine months ended December 30, 2012 or the three and nine months ended January 1, 2012.

**Warranty**

The Company s warranty agreements are contract and component specific and can be up to three years for selected components. The Company accrues for anticipated warranty costs upon shipment based on the number of shipped units, historical analysis of the volume of product returned under the warranty program and management s judgment regarding anticipated rates of warranty claims and associated repair costs. The following table summarizes the activity related to the product warranty liability during the nine months ended December 30, 2012 and January 1, 2012:

| | Nine Months Ended December 30, 2012 | Nine Months Ended January 1, 2012 |
|---|---|---|
| | (in thousands) | |
| Beginning balance | $ 361 | $ 697 |
| Increase (decrease) in provision for warranty | (199) | 300 |
| Less: actual warranty costs | (32) | (85) |
| Ending balance | $ 130 | $ 912 |

**Net Income Per Share**

Basic and diluted net income per common share are presented in conformity with the two-class method required for participating securities for the period prior to their conversion upon the Company s initial public offering ( IPO ) in November 2011, when all preferred shares were converted to common stock.

Prior to the IPO, holders of the Company s preferred stock were entitled to receive noncumulative dividends prior to the payment of dividends on shares of the Company s common stock. In the event a dividend were paid on common stock, the preferred stockholders would have also been entitled to a proportionate share of any such dividend as if they were holders of common stock (on an as-if converted basis).

Under the two-class method, net income allocable to common stockholders is determined by allocating undistributed earnings, calculated as net income less current period non-cumulative dividends allocable to the preferred stockholders for the period prior to their conversion upon the Company s initial public offering. In computing diluted net income attributed to common stockholders, undistributed earnings are reallocated to reflect the potential impact of dilutive securities. Basic net income per common share is computed by dividing the net income allocable to common stockholders by the weighted average number of common shares outstanding during the period, which excludes dilutive unvested restricted stock.

Diluted net income per share allocable to common stockholders is computed by dividing the net income allocable to common stockholders by the weighted average number of common shares outstanding, including unvested restricted stock, certain preferred stock warrants, (which were converted into common stock warrants at the completion of the Company s IPO), and potential dilutive common shares assuming the dilutive effect of outstanding stock options and restricted stock units using the treasury stock method.

Table of Contents

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| | (in thousands, except per share data) | | | |
| Net income allocable to common stockholders: | | | | |
| Numerator: | | | | |
| Basic: | | | | |
| Net income | $ 16,818 | $ 10,576 | $ 38,133 | $ 31,055 |
| Non-cumulative dividends on convertible preferred stock | | (385) | | (1,914) |
| Undistributed earnings allocable to convertible preferred stockholders | | (4,772) | | (18,704) |
| Net income allocable to common stockholders basic | $ 16,818 | $ 5,419 | $ 38,133 | $ 10,437 |
| Diluted: | | | | |
| Net income | $ 16,818 | $ 10,576 | $ 38,133 | $ 31,055 |
| Non-cumulative dividends on convertible preferred stock | | (393) | | (1,967) |
| Undistributed earnings allocable to convertible preferred stockholders | | (4,464) | | (17,600) |
| Net income allocable to common stockholders diluted | $ 16,818 | $ 5,719 | $ 38,133 | $ 11,488 |
| Denominator: | | | | |
| Basic shares: | | | | |
| Weighted average shares used in computing basic net income per common share | 83,218 | 49,890 | 82,280 | 28,770 |
| Diluted shares: | | | | |
| Weighted average shares used in computing basic net income per common share | 83,218 | 49,890 | 82,280 | 28,770 |
| Effect of potentially dilutive securities: | | | | |
| Stock options and unvested restricted stock | 3,964 | 4,962 | 4,765 | 4,644 |
| Common stock warrants | 168 | 442 | 187 | 177 |
| Weighted average shares used in computing diluted net income per common share | 87,350 | 55,294 | 87,232 | 33,591 |
| Net income per common share: | | | | |
| Basic | $ 0.20 | $ 0.11 | $ 0.46 | $ 0.36 |
| Diluted | $ 0.19 | $ 0.10 | $ 0.44 | $ 0.34 |

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| | | (in thousands) | | |
| Employee stock options | 3,423 | 648 | 4,004 | 923 |
| Unvested restricted stock units | 590 | | 152 | |
| Total antidilutive securities | 4,013 | 648 | 4,156 | 923 |

Table of Contents

INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Recent Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standard Update ( ASU ) No. 2011-05, Presentation of Comprehensive Income which requires that all non-owner changes in stockholders equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholder s equity. ASU No. 2011-05 became effective for fiscal years, and interim periods within those years, beginning after December 15, 2012, which is the Company s fiscal interim period ended July 1, 2012 of fiscal year ending March 31, 2013. Upon adoption of ASU No. 2011-05, the Company has separately reported Condensed Consolidated Statements of Comprehensive Income and the adoption did not impact the Company s financial condition or results of operations.

**2. Cash Equivalents and Available-for-sale Investments**

Short-term available-for-sale investments consist of securities with remaining maturities at the time of purchase of less than three months and remaining maturities of less than twelve months from the balance sheet date. Long-term available-for-sale investments which have maturities exceeding twelve months beyond the balance sheet date are classified as long-term investments in the Company s condensed consolidated balance sheets. The Company s investments are classified as available-for-sale since the sale of these investments may be required prior to their stated maturity to implement management s liquidity-related strategies. Available-for-sale securities are carried at fair value with temporary unrealized gains and losses, net of taxes, reported within accumulated other comprehensive income in the Company s condensed consolidated balance sheets and included in other comprehensive income in the Company s condensed consolidated statements of comprehensive income.

At December 30, 2012, of the $94.0 million of the Company s cash and cash equivalents, $70.1 million was cash and $23.9 million was cash equivalents invested in money market funds. As of December 30, 2012, $50.7 million of the $94.0 million of cash and cash equivalents were held by our foreign subsidiaries. If these funds are needed for our operations in the United States, the Company would be required to accrue and pay U.S. taxes to repatriate these funds. However, the Company s intent is to indefinitely reinvest these funds outside of the United States, and the Company s current plans for the foreseeable future do not demonstrate a need to repatriate them to fund U.S. operations. Additionally, as of December 30, 2012, the Company had short-term available-for-sale investments of $65.2 million and long-term available-for-sale investments of $33.3 million totaling $98.5 million.

At April 1, 2012, of the $153.6 million of the Company s cash and cash equivalents, $135.0 million was cash and $18.6 million was cash equivalents invested primarily in money market funds. As of April 1, 2012, $29.3 million of the $153.6 million of cash and cash equivalents were held by our foreign subsidiaries. Additionally, the Company had available-for-sale investments totaling $4.1 million.

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

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

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

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

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

Table of Contents

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

**December 2012:**

Assets measured at fair value on a recurring basis were presented in the Company s condensed consolidated balance sheet as of December 30, 2012.

| | December 2012 Balance | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Other Unobservable Inputs Level 3 |
|---|---|---|---|---|
| | | (in thousands) | | |
| Money Market Funds | $ 23,896 | $ 23,896 | $ | $ |
| Corporate Notes and Bonds | 90,541 | | 90,541 | |
| Commercial Paper | 4,993 | | 4,993 | |
| U.S. Agency Securities | 3,001 | | 3,001 | |
| Total | $ 122,431 | $ 23,896 | $ 98,535 | $ |
| Cash equivalents | $ 23,896 | $ 23,896 | $ | $ |
| Short-term investments | 65,227 | | 65,227 | |
| Long-term investments | 33,308 | | 33,308 | |
| Total | $ 122,431 | $ 23,896 | $ 98,535 | $ |

| | December 2012 Amortized Cost | Unrealized Loss | December 2012 Estimated FMV |
|---|---|---|---|
| Corporate Notes and Bonds | $ 90,550 | $ (9) | $ 90,541 |
| Commercial Paper | 4,996 | (3) | 4,993 |
| U.S. Agency Securities | 3,002 | (1) | 3,001 |
| Total Available-for-sale investments | $ 98,548 | $ (13) | $ 98,535 |
| Cash | | | 70,143 |
| Cash equivalents | | | 23,896 |
| Total Aggregate Fair Value | | | $ 192,574 |

There were no transfers of assets measured at fair value between Level 1 and Level 2 during the nine months ended December 30, 2012.

**April 2012:**

Assets measured at fair value on a recurring basis were presented in the Company s condensed consolidated balance sheet as of April 1, 2012.

| | April 2012 Balance | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Other Unobservable Inputs Level 3 |
|---|---|---|---|---|
| | | (in thousands) | | |
| Money Market Funds | $ 17,712 | $ 17,712 | $ | $ |
| U.S. Treasury | 1,000 | 1,000 | | |
| U.S. Agency Securities | 3,979 | | 3,979 | |
| Total | $ 22,691 | $ 18,712 | $ 3,979 | $ |
| Cash equivalents | $ 18,562 | $ 17,712 | $ 850 | $ |
| Short-term investments | 4,129 | 1,000 | 3,129 | |
| Total | $ 22,691 | $ 18,712 | $ 3,979 | $ |

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

| | April 2012 Amortized Cost | Unrealized Gain (in thousands) | April 2012 Estimated FMV |
|---|---|---|---|
| U.S. Treasury | $ 1,000 | $ | $ 1,000 |
| U.S. Agency Securities | 3,129 | | 3,129 |
| Total Available-for-sale Investments | $ 4,129 | $ | $ 4,129 |
| Cash | | | 135,081 |
| Cash equivalents | | | 18,562 |
| Total Aggregate Fair Value | | | $ 157,772 |

There were no transfers of assets measured at fair value between Level 1 and Level 2 during Fiscal 2012.

**3. Balance Sheet Details**

**Inventories**

Inventories at December 2012 and April 2012 consisted of the following:

| | December 2012 | April 2012 |
|---|---|---|
| | (in thousands) | |
| Work in progress | $ 15,310 | $ 9,021 |
| Finished goods | 3,490 | 3,219 |
| Total Inventories | $ 18,800 | $ 12,240 |

**Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets at December 2012 and April 2012 consisted of the following:

| | December 2012 | April 2012 |
|---|---|---|
| | (in thousands) | |
| Prepaid expenses | $ 1,648 | $ 1,040 |
| Advance to vendors | 1,752 | 548 |
| Prepaid income taxes | 2,513 | 1,106 |
| Deferred tax assets | 1,351 | 1,418 |
| Other current assets | 763 | 76 |
| Total prepaid expenses and other current assets | $ 8,027 | $ 4,188 |

The Company has signed agreements with foundry vendors to facilitate and expand capacity for the Company s products. Certain of these agreements require advance payments to these foundry vendors, which are partially offset by the purchases from these vendors. The agreements allow the Company to offset these advances against wafer purchases from the foundries at various agreed upon rates. The Company classifies advances expected to be offset by purchases within 12 months as prepaid and other current assets and the remaining balances as other assets on the Company s Condensed Consolidated Balance Sheets. The Company believes that the advances to these vendors will be fully offset by future purchases from these vendors.

The Company regularly reviews the carrying amount of its assets, to determine whether indicators of impairment may exist which warrant adjustments to carrying values or estimated useful lives. An impairment loss is recognized when the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset. Should impairment exist, the impairment loss is measured based on the excess of the carrying amount of the asset over the asset s fair value. In the quarter ended July 1, 2012, the Company recognized an impairment loss of $0.4 million related to one of its vendor advances.

Table of Contents

INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Property and Equipment**

Property and equipment at December 2012 and April 2012 consisted of the following:

| | December 2012 | April 2012 |
|---|---|---|
| | (in thousands) | |
| Production and lab equipment | $ 8,674 | $ 6,866 |
| Computer equipment and software | 1,021 | 861 |
| Equipment under construction | 2,551 | 435 |
| Leasehold improvements and furniture and fixtures | 887 | 819 |
| Subtotal | $ 13,133 | $ 8,981 |
| Accumulated depreciation and amortization | (6,428) | (4,970) |
| Property and equipment net | $ 6,705 | $ 4,011 |

Depreciation and amortization expense for the three and nine months ended December 30, 2012 was $0.3 million and $1.5 million, respectively. Depreciation and amortization expense for the three and nine months ended January 1, 2012 was $0.5 million and $1.5 million, respectively. Equipment under construction consists primarily of production and lab equipment. Equipment under construction is not subject to depreciation until it is available for its intended use. Capitalized leases consist of office equipment. For the three and nine months ended December 30, 2012 there were no new capitalized leases. For both the three and nine months ended January 1, 2012, new capitalized leases totaled $40,000.

**Accrued Liabilities**

Accrued liabilities at December 2012 and April 2012 consisted of the following:

| | December 2012 | April 2012 |
|---|---|---|
| | (in thousands) | |
| Engineering services | $ 382 | $ 104 |
| Payroll-related expenses | 2,605 | 2,274 |
| Bonus | 2,965 | 3,571 |
| Legal fees | 762 | 968 |
| Warranty reserves | 130 | 361 |
| Deferred revenue | | 284 |
| Former CEO separation costs | 828 | |
| Income tax payable | 65 | 27 |
| Other | 542 | 165 |
| Total accrued liabilities | $ 8,279 | $ 7,754 |

**4. Commitments and Contingencies**

**Operating Lease Obligations**

The Company has non-cancelable operating leases for its facilities through fiscal year 2018.

Table of Contents

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

Future minimum lease payments under operating leases as of December 30, 2012 are as follows:

| Fiscal Years Ending March or April | Amount (in thousands) |
|---|---|
| 2013 (remaining three months) | $ 481 |
| 2014 | 977 |
| 2015 | 234 |
| 2016 | 139 |
| 2017 and future fiscal years | 201 |
| Total | $ 2,032 |

The Company s lease agreements provide for rental payments which have certain lease incentives and graduated rental payments. As a result, the rent expense is recognized on a straight-line basis over the term of the lease. The Company s rental expense under operating leases was approximately $0.5 million and $1.5 million for the three and nine months ended December 30, 2012, respectively, and was approximately $0.4 million and $1.2 million for the three and nine months ended January 1, 2012, respectively.

**Purchase Commitments**

The Company has non-cancelable purchase commitments with its foundry vendors through fiscal year 2014. Future minimum payments under the purchase commitments as of December 30, 2012 are as follows:

| Fiscal Years Ending March or April | Amount (in thousands) |
|---|---|
| 2013 (remaining three months) | $ 31,512 |
| Beyond 2013 | |
| Total | $ 31,512 |

**401(k) Savings Plan**

In November 2004, the Company established a defined contribution savings plan under Section 401(k) of the Internal Revenue Code. This plan covers substantially all employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pretax basis. The Company contributions to the plan may be made at the discretion of the Board of Directors. To date, no contributions have been made to the plan by the Company.

**Legal Proceedings**

The Company is subject to various legal proceedings and claims arising in the ordinary course of business. Although occasional adverse decisions or settlements may occur, management believes that the final disposition of such matters will not have a material effect on the Company s business, financial position, results of operations or cash flows.

On May 16, 2012, STMicroelectronics, Inc. ( STI ) filed a patent infringement complaint in the Northern District of California against the Company, alleging infringement of certain of their patents (collectively, the Asserted Patents ). STI alleges that certain lnvenSense Micro-Electro-Mechanical Systems products and services, including but not limited to InvenSense s ISZ, IXZ, IDG, IMU, ITG, and MPU product lines, infringe one or more claims of the Asserted Patents. The Company intends to contest the case vigorously. On July 9, 2012, the Company filed counterclaims against STI for alleged infringement of certain of the Company s patents. A Markman hearing has been set for May 29, 2013, and no trial date has been set. Of the nine Asserted Patents, seven are now being reexamined by the U.S. Patent & Trademark Office ( PTO ) at the Company s request. At the conclusion of the reexamination proceedings, the PTO may decide to invalidate some or all of these patents. The parties have also exchanged their infringement and invalidity contentions, and are in the midst of the claim construction process leading up to the May 29, 2013 Markman hearing. On January 31, 2013, the Company filed a motion requesting that the court stay the case in its entirety pending resolution of the reexamination proceedings. As this litigation is still in its early stages, the Company believes it is not yet possible to assess the merits of the plaintiff s claim and or the amount of damages, if any, that could be awarded in the event of an unfavorable outcome.

On July 20, 2010, plaintiff Wacoh Company filed a complaint in the District of Delaware against the Company and four other companies in the business of making gyroscopes for various applications, alleging infringement of certain of their patents. The complaint sought unspecified monetary damages, costs, attorneys fees and other appropriate relief. In January 2012, the Company prevailed on a motion to sever the case against it from the cases against other companies and to transfer the case to the Northern District of California. The Company and Wacoh subsequently settled the matter on a basis that is not material to the Company.

Table of Contents

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

The Company indemnifies certain customers, distributors, suppliers and subcontractors for attorney fees and damages and costs awarded against such parties in certain circumstances in which the Company s products are alleged to infringe third-party intellectual property rights, including patents, registered trademarks or copyrights. There were no indemnification costs for the three and nine months ended December 30, 2012 and January 1, 2012. Indemnification costs are charged to operations as incurred.

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

**5. Stockholders Equity**

**Stock Plans**

In July 2011, the Company s Board of Directors and its stockholders approved the establishment of the 2011 Stock Incentive Plan (the 2011 Plan ). The 2011 Plan provides for annual increases in the number of shares available for issuance there under on the first business day of each fiscal year, beginning with the Company s fiscal year following the year of this offering, equal to four percent (4%) of the number of shares of the Company s common stock outstanding as of such date, which resulted in an annual increase of 3.2 million shares for fiscal year 2013.

Under the Company s 2004 Stock Incentive Plan and 2011 Stock Incentive Plan (the Plans ), the Board of Directors may grant either incentive stock options, nonqualified stock options, or stock awards to eligible persons, including employees, nonemployees, members of the Board of Directors, consultants and other independent advisors who provide services to the Company. As of December 30, 2012 the Company has reserved for issuance under the Plans a total of 30.9 million shares (plus additional shares subject to automatic increase provisions under the 2011 Plan).

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

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

| | Options Available for Grant | Options Issued and Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (In Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|---|
| Balance April 1, 2012 | 9,710 | 11,116 | $ 4.31 | | |
| Increase in stock option pool | 3,236 | | | | |
| Options granted (weighted-average fair value of $5.09 per share) | (3,536) | 3,536 | 11.94 | | |
| Options exercised | | (2,357) | 1.72 | | |
| Options canceled | 880 | (880) | 8.83 | | |

| | | | | | |
|---|---|---|---|---|---|
| Balance December 30, 2012 | 10,290 | 11,415 | $ 6.87 | 7.42 | $ 51,060 |
| December 30, 2012 | | | | | |
| Vested and expected to vest | | 10,305 | $ 6.57 | 7.24 | $ 48,967 |
| Exercisable December 30, 2012 | | 4,337 | $ 2.68 | 4.85 | $ 35,916 |
| April 1, 2012 | | | | | |
| Vested and expected to vest | | 10,064 | $ 4.02 | 7.60 | $ 141,827 |
| Exercisable April 1, 2012 | | 5,202 | $ 1.46 | 6.31 | $ 86,557 |

15

Table of Contents

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

Additional information regarding options outstanding as of December 2012 is as follows (in thousands except per share amounts):

| Exercise Price | Options Outstanding December 2012 Number Outstanding | Weighted-Average Remaining Contractual Life (In Years) | Weighted-Average Exercise Price of Options Outstanding | Number Exercisable | Weighted-Average Exercise Price of Options Exercisable |
|---|---|---|---|---|---|
| $0.04 - $0.08 | 15 | 3.02 | $ 0.07 | 15 | $ 0.07 |
| $0.11 - $0.172 | 95 | 3.95 | 0.15 | 95 | 0.15 |
| $0.32 - $0.70 | 1,845 | 1.65 | 0.66 | 1,843 | 0.66 |
| $1.02 - $2.97 | 1,639 | 6.65 | 2.50 | 1,283 | 2.42 |
| $5.07 - $10.00 | 3,827 | 8.38 | 6.68 | 1,082 | 6.51 |
| $10.07 - $15.24 | 3,740 | 9.59 | 11.54 | 14 | 12.67 |
| $15.58 - $20.89 | 254 | 9.23 | 17.36 | 5 | 16.69 |
| | 11,415 | 7.42 | $ 6.87 | 4,337 | $ 2.68 |

**Valuation of Stock-Based Awards**

The Company applies the provisions of ASC 718-10 Compensation Stock Compensation which establishes the accounting for stock-based awards based on the fair value of the award measured at grant date. Accordingly, stock-based compensation cost is recognized in the consolidated statements of income as a component of both cost of revenues and operating expenses over the requisite service period. ASC 718-10 requires tax benefits in excess of compensation cost to be reported as a financing cash flow rather than as a reduction of taxes paid. The determination of the fair value of stock-based payment awards on the date of grant using the Black-Scholes option pricing model is affected by the volatilities of a peer group of companies based on industry, stage of life cycle, size and financial leverage, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. Variables to be determined include expected volatility, estimated term and risk-free interest rate.

The aggregate intrinsic value of the stock options exercised during the three and nine months ended December 30, 2012 was $4.7 million and $24.4 million, respectively. The aggregate intrinsic value of the stock options exercised during the three and nine months ended January 1, 2012 was $0.7 million and $2.2 million, respectively. The aggregate intrinsic value was calculated as the difference between the exercise price of the stock options and the estimated fair market value of the underlying common stock at the date of exercise.

The number of options expected to vest takes into account an estimate of expected forfeitures. The remaining unamortized stock-based compensation expense, reduced for estimated forfeitures and related to non-vested options, was $22.9 million, and $13.9 million at December 2012 and April 2012 respectively, and, for both periods will be amortized over a weighted-average remaining period of approximately 3.4 years and 3.0 years respectively. Total unrecognized expense will be adjusted for future changes in estimated forfeitures.

Table of Contents

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Weighted-Average Assumptions**

The Company used the following weighted-average assumptions in determining stock-based compensation expense for the three and nine months ended December 30, 2012 and January 1, 2012.

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Expected term | 4.3 years | 5.6 years | 6.0 years | 5.8 years |
| Volatility | 46.5% | 48.2% | 47.7% | 48.7% |
| Risk-free interest rate | 0.6% | 1.1% | 0.9% | 1.5% |
| Dividend yield | 0% | 0% | 0% | 0% |

**Market-based Awards**

During the three months ended December 30, 2012, the Company s CEO was granted options to purchase up to 622,115 shares at $11.57 per share whose vesting is contingent upon meeting various price target thresholds that begin a four year ratable vesting period if the minimum twenty day closing stock prices cross thresholds of $15.00, $17.50 and $20.00 respectively. The options were granted at-the-money and have an estimated term of 5.0 to 6.2 years, and have a legal term of 10 years. The fair value of each option granted was estimated on the date of grant using a Monte Carlo Simulation analysis valuation model and assumes that price target thresholds will be achieved. If such price target thresholds are not met, compensation cost is not reversed. The Company used the following assumptions in estimating the fair value of the shares; expected volatility 46.5%, expected dividends 0%, and risk-free rate of 0.8%. The weighted-average grant-date fair value of options granted during the period was $4.87. During the three months ended December 30, 2012, none of the market-based options were exercised. At December 30, 2012, there was $3.0 million of total unrecognized compensation cost related to non-vested shares; that cost is expected to be recognized over a period of 7 years.

**Restricted Stock Units (RSUs)**

Restricted stock unit activities of the Company under the Plans are as follows (in thousands, except per share amounts):

| Restricted stock unit activity | Shares | Weighted average grant date fair value |
|---|---|---|
| | (in thousands) | |
| Nonvested at April 1, 2012 | 118 | $ 12.47 |
| Granted | 683 | 12.01 |
| Vested | | |
| Forfeited | 27 | 12.46 |
| Total nonvested at December 30, 2012 | 774 | $ 12.06 |

RSUs granted to employees are subject to the employee s continued service to the Company over that period. The fair value of RSUs is determined using the fair value of the Company s common stock on the date of the grant. Compensation expense is recognized on a straight-line basis over the requisite service period of each grant adjusted for estimated forfeitures. At December 30, 2012, there was approximately $8.5 million of total unrecognized compensation cost related to restricted stock units, which the Company expects to recognize over a weighted-average period of 3.4 years.

**Stock-Based Compensation Expense**

Total employee stock-based compensation cost for the Plans for the three and nine months ended December 30, 2012 and January 1, 2012 is as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| | (in thousands) | | | |
| Cost of revenue | $ 191 | $ 78 | $ 522 | $ 237 |
| Research and development | 752 | 349 | 2,075 | 995 |
| Selling, general and administrative | 1,814 | 474 | 3,852 | 1,261 |
| Total employee stock-based compensation expense | $ 2,757 | $ 901 | $ 6,449 | $ 2,493 |

17

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

Selling, general and administrative stock-based compensation expense for the three and nine months ended December 2012, included executive separation costs of $0.6 million, related to the acceleration of approximately 150,000 shares related to our former CEO.

**Common Stock**

As of December 2012 and April 2012, common stock reserved for future issuance was as follows (in thousands):

| | Number of Shares | |
|---|---|---|
| **Common stock reserved for issuance** | **December 2012** | **April 2012** |
| Stock Plans: | | |
| Outstanding stock options | 11,415 | 11,116 |
| Outstanding restricted stock units | 774 | 118 |
| Reserved for future equity incentive grants | 9,516 | 9,592 |
| | 21,705 | 20,826 |
| Warrants to purchase common stock | 202 | 405 |
| Total common stock reserved for future issuances | 21,907 | 21,231 |

**6. Income Taxes**

For the three months ended December 30, 2012, the Company recorded an income tax benefit of $0.7 million. For the nine months ended December 30, 2012, the Company recorded an income tax provision of $5.0 million. During the three months ended December 30, 2012, the Company changed its estimate of earnings attributable to its domestic versus foreign operations expected to be earned for the fiscal year. As a result of an increase in the amount of earnings attributable to foreign jurisdictions with lower tax rates, the Company adjusted its tax provision for the nine months ended December 30, 2012 to $5.0 million to reflect these new estimates; to the extent that the adjustments related to prior periods, the income tax impact is recorded in this quarter and not as a component of the annual effective tax rate. The impact of recording this change in estimate, along with the results of operations for the quarter, gave rise to an income tax benefit of $0.7 million for the three months ended December 30, 2012. For the three months and nine months ended January 1, 2012, the Company recorded an income tax provision of $2.9 million and $9.1 million, respectively. The Company s estimated 2013 effective tax rate differs from the U.S. statutory rate primarily due to profits earned in jurisdictions where the tax rate is lower than the U.S. tax rate partially offset by the unfavorable effects of non-deductible stock-based compensation expense.

The Company files U.S. federal income tax returns as well as income tax returns in California and various foreign jurisdictions. The Company has not provided for U.S. federal income and foreign withholding taxes on undistributed earnings from non-U.S. operations as of December 2012 because such earnings are to be reinvested indefinitely.

The Company s tax years from 2003 and onwards could be subject to examinations by tax authorities in one or more tax jurisdictions. The Company has recorded $5.6 million of uncertain tax positions within other long-term liabilities on the condensed consolidated balance sheet at December 2012. The Company does not expect any significant increases or decreases to its existing unrecognized tax benefits within the next twelve months. While management believes that the Company has adequately provided for all tax positions, amounts asserted by tax authorities could be greater or less than the recorded position. Accordingly, the Company s provisions on federal, state and foreign tax-related matters to be recorded in the future may change as revised estimates are made or the underlying matters are settled or otherwise resolved.

Table of Contents

**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the notes to those statements included elsewhere in this Quarterly Report on Form 10-Q, the Consolidated Financial Statements and Notes thereto for the year ended April 1, 2012, and with management s discussion and analysis of our financial condition and results of operations included in our Annual Report on Form 10-K filed with the SEC on June 19, 2012.*

*This Quarterly Report on Form 10-Q, including this Management s Discussion and Analysis of Financial Condition and Results of Operations, includes a number of forward-looking statements that involve many risks and uncertainties. Forward-looking statements are identified by the use of the words would , could , will , may , expect , believe , should , anticipate , outlook , if , future , intend , plan , estimate , predict , potential , targets , seek or continue and similar words and phrases, including the negatives of these terms, or other variations of these terms, that denote future events. These forward-looking statements include our expectations as to future sales of consumer electronics devices that could potentially integrate motion processors, our expectation that our products will remain a component of customers products throughout any such product s life cycle, our belief that users of our products are likely to introduce these products into other devices as well as to adopt our more advanced devices, our belief that certain end-markets pose large growth opportunities for motion processing functionality, our ability to protect our intellectual property in the United States and abroad, our freedom to manufacture and sell our product without infringing the intellectual property of third parties, our belief in the sufficiency of our cash flows to meet our needs and our future financial and operating results. These statements reflect our current views with respect to future events and our potential financial performance and are subject to risks and uncertainties that could cause our actual results and financial position to differ materially and adversely from what is projected or implied in any forward-looking statements included in this Form 10-Q. These factors include, but are not limited to, the risks described under Item 1A of Part II Risk Factors, elsewhere in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the SEC. We make these forward-looking statements based upon information available on the date of this Form 10-Q, and we have no obligation (and expressly disclaim any such obligation) to update or alter any forward-looking statements, whether as a result of new information or otherwise except as otherwise required by securities regulations.*

**Overview**

We are the pioneer and a global market leader of devices for the motion interface market that detect and track an object s motion in three-dimensional space. Our MotionTracking devices combine micro-electro-mechanical system, or (MEMS) motion sensors, such as accelerometers, gyroscopes and compasses, with mixed-signal integrated circuits (ICs) and proprietary algorithms and firmware that intelligently process, synthesize and calibrate the output of sensors for use by software applications via an application programming interface (API). Our MotionTracking devices are differentiated by small form factor, high level of integration, performance, reliability and cost effectiveness. While our solutions have broad applicability, we currently target consumer electronics applications such as smartphones and tablets, console and portable video gaming devices, digital still and video cameras, smart TVs (including digital set-top boxes, televisions and multi-media HDDs), 3D mice, navigation devices, toys, and health and fitness accessories. We utilize a fabless model, leveraging current CMOS and MEMS foundries and semiconductor packaging supply chains.

Our current strategy is to continue targeting the consumer electronics market with integrated MotionTracking devices that meet or exceed the performance and cost requirements of consumer electronics manufacturers, are easy to integrate and set industry performance benchmarks. Our ability to secure new customers depends on winning competitive processes, known as design wins. These selection processes are typically lengthy, and, as a result, our sales cycles will vary based on the market served, whether the design win is with an existing or a new customer and whether our product being designed into our customer s device is a first generation or subsequent generation product. Because the sales cycle for our products is long, we can incur design and development support expenditures in circumstances where we do not ultimately recognize any net revenue. We do not receive long-term purchase commitments from any of our customers, all of whom purchase our products on a purchase order basis. While product life cycles in our target market vary by application, once one of our solutions is incorporated into a customer s design, we believe that it will likely remain a component of the customer s product for its life cycle because of the time and expense associated with redesigning the product or substituting an alternative solution. The trend is also supported by the increased likelihood that once a customer introduces one of our products into one of their devices, we believe they are likely to introduce it into others. Additionally, once a customer introduces one of our lower functionality sensors into their platforms, we believe they are more likely to adopt our more advanced integrated MotionTracking devices.

**Table of Contents**

The history of our product development and sales and marketing efforts is, on a calendar year basis, as follows:

From our inception in 2003 through 2005, we were primarily engaged in the design and development of our analog gyroscopes. In this period, we also developed and refined our fabrication process, which we refer to as the Nasiri-Fabrication platform.

In 2006, we began volume shipments of our IDG family of integrated X-Y dual-axis analog gyroscopes for the compact digital camera market, the first commercially available sensors of that type. Subsequently, through 2008, we developed and shipped successive generations of these gyroscopes with enhanced performance and reduced die sizes. We began high-volume shipments of our IDG-600 to Nintendo beginning in May 2008.

In 2009, we began shipping enhanced and alternative versions of our single and dual-axis analog gyroscopes as well as our ITG family of X-Y-Z three-axis digital output gyroscopes. We also significantly accelerated shipments of our products due to the broad market adoption of the Nintendo Wii MotionPlus accessory. In addition, we migrated our manufacturing processes to larger wafer sizes enabling significant cost efficiencies.

In 2010, we began volume shipments of our MPU-3000 family of Motion-Processors consisting of three-axis gyroscopes digital outputs and software development kits, designed to enable faster motion interface application development. In addition, we started shipping our ITG and IMU-3000 family of products, which address a broader array of consumer applications than our analog products. We also started sampling our MPU-6000 family of integrated six-axis Motion-Processors that integrate a three-axis gyroscope and three-axis accelerometer on one chip used with our MotionApps software platform.

In 2012, we began high-volume shipments of our ITG/IMU/MPU-3000 family of Motion-Processors for the portable gaming, smart TV, smartphone and tablet markets. In addition, we began volume shipments of our MPU-6000 family of six-axis motion processors for the smartphone and tablet markets. We also introduced our IDG-2020 and IXZ-2020 families of dual-axis gyroscopes, which address the need for optical image stabilization (OIS) technology in camera phones and digital still cameras.

In January 2012, we introduced our nine-axis MPU-9150 Motion-Processor, which is available for sampling to selected customers and is targeted for the smartphone, tablet, gaming controller and wearable sensor markets.

In June 2012, we introduced our MPU-3300, a single-chip, high performance integrated 3-axis gyroscope for industrial applications.

In July 2012, we introduced the MPU 6500, the Company s next-generation 6-axis MotionTracking device for smartphones, tablets, wearable sensors, and other consumer markets.

In January 2013, we introduced the MPU-9250, an integrated accelerometer/gyroscope/compass in 3x3x1mm package with 9.2mW power consumption, ideal for mobile devices, wearable sensors for sports and remote health monitoring, and emerging applications.

Our fiscal year is a 52 or 53 week period ending on the Sunday closest to March 31. Our most recent fiscal year ( Fiscal 2012 ) ended on April 1, 2012 ( April 2012 ). The third fiscal quarters in each of the two most recent fiscal years ended on December 30, 2012 ( three months ended December 30, 2012 or December 2012 ) and January 1, 2012 ( three months ended January 1, 2012 or January 2012 ), respectively, and each quarter period included 13 weeks.

**Critical Accounting Policies and Estimates**

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

We believe that the assumptions and estimates associated with income taxes, inventory valuation, valuation allowance for deferred tax assets, recognition and measurement of uncertain tax positions and stock-based compensation have the greatest potential impact on our condensed consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

There have been no material changes to the our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K filed with the SEC on June 19, 2012.

Table of Contents

**Basis of Presentation**

**Net Revenue**

We derive our net revenue from sales of our MotionTracking devices. We primarily sell our products through our worldwide sales organization directly to manufacturers of consumer electronics devices. To date, a significant majority of our net revenue has been derived from these direct sales, and we expect this trend to continue for the foreseeable future. We also sell our products through an indirect channel of distributors that fulfill orders for our products from manufacturers of consumer electronics devices, original design manufacturers and contract manufacturers.

We believe that a substantial majority of our net revenue will continue to come from sales to customers located in Asia, where most of the manufacturers of consumer electronics devices that use and may in the future use our products are located. As a result of this regional customer concentration, we may be subject to economic and political events and other developments that impact our customers in Asia. For more information, see the section in this Quarterly Report on Form 10-Q titled Risk Factors Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business and other factors related to our international operations .

**Gross Profit**

Gross profit is the difference between net revenue and the cost of revenue. Cost of revenue primarily consists of manufacturing, packaging, assembly and testing costs for our products, shipping costs, costs of personnel, including stock-based compensation, warranty costs and write-downs for excess and obsolete inventory.

We price our products based on market and competitive conditions and periodically reduce the price of our products as market and competitive conditions change. Typically we experience price decreases over the life cycle of our products, which may vary by market and customer. As a result, if we are not able to decrease the cost of our products in line with the price decreases of our products, we may experience a reduction in our gross profit and gross margin. Gross margin has been and will continue to be affected by a variety of factors, including:

- demand for our products and services;
- product manufacturing yields;
- write-downs of inventory for excess quantity and technological obsolescence;
- a reduction in inventory reserves due to the sale of inventories previously reserved;
- product mix;
- erosion of average selling prices, as required by agreements entered into with our customers and in anticipation of competitive pricing pressures, new product introductions by us and our competitors, product end of life programs, and for other reasons;
- the proportion of our products that are sold through direct versus indirect channels;
- our ability to attain volume manufacturing pricing from our foundry partners and suppliers; and

growth in our headcount and other related costs incurred in our organization.

**Research and Development**

Research and development expense primarily consists of personnel related expenses (including stock-based compensation), intellectual property license costs, reference design development costs, development testing and evaluation costs, depreciation expense and allocated occupancy costs. Research and development activities include the design of new products, refinement of existing products and processes and design of test methodologies, including hardware and software to ensure compliance with required specifications. All research and development costs are expensed as incurred. We expect our research and development expenses to increase on an absolute basis as we continue to expand our product offerings and enhance existing products.

**Selling, General and Administrative**

Selling, general and administrative expense primarily consists of personnel related expenses (including stock-based compensation), sales commissions, field application engineering support, travel costs, professional and consulting fees, legal fees, depreciation expense and allocated occupancy costs. We expect selling, general and administrative expenses to increase on an absolute basis in the future as we expand our sales, marketing, finance and administrative personnel, and we incur additional expenses associated with operating as a public company.

Table of Contents

**Income Tax Provision**

The provision for income taxes consists of our estimated federal, state and foreign income taxes based on our pre-tax income. Our provision differs from the federal statutory rate primarily due to expenses that are not deductible for income taxes such as certain stock-based compensation and due to foreign tax rate differentials.

**Results of Operations**

The following table sets forth certain condensed consolidated statement of income data as a percentage of net revenue for the periods indicated.

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Net revenue | 100% | 100% | 100% | 100% |
| Cost of revenue | 47 | 45 | 46 | 44 |
| Gross profit | 53 | 55 | 54 | 56 |
| Operating expenses: | | | | |
| Research and development | 11 | 12 | 12 | 12 |
| Selling, general and administrative | 14 | 11 | 14 | 11 |
| Total operating expenses | 25 | 23 | 26 | 23 |
| Income from operations | 28 | 32 | 28 | 33 |
| Other income (expense), net | | | | |
| Income before income taxes | 28 | 32 | 28 | 33 |
| Income tax (benefit) provision | (1) | 7 | 3 | 8 |
| Net income | 29% | 25% | 25% | 25% |

**Net Revenue**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| **(in thousands)** | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Net revenue | $ 58,929 | $ 41,229 | $ 153,424 | $ 119,890 |

Net revenue for the third quarter and first nine months of fiscal year 2013 increased by $17.7 million and $33.5 million, or 43% and 28%, respectively, compared to the same periods of the prior fiscal year, primarily due to higher volume shipments to an expanded customer base, including manufacturers of smartphones, tablet devices and digital television and set-top box remote controls. Total unit shipments for the three and nine months ended December 30, 2012 increased by 67% and 57%, respectively, compared to the same periods of the prior fiscal year. Our overall average unit selling price declined for the third quarter and nine months ended December 30, 2012, compared to the same periods of the prior fiscal year, as a result of the change in our product mix and declines in average selling prices associated with products primarily introduced in prior years.

**Cost of Revenue and Gross Profit**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (in thousands) | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Cost of revenue | $ 27,723 | $ 18,538 | $ 70,284 | $ 52,919 |
| % of net revenue | 47% | 45% | 46% | 44% |
| Gross profit | $ 31,206 | $ 22,691 | $ 83,140 | $ 66,971 |
| % of net revenue | 53% | 55% | 54% | 56% |

Gross profit for the third quarter and first nine months of fiscal year 2013 increased by $8.5 million and $16.2 million, or 38% and 24%, respectively, compared to the same periods of the prior fiscal year, due to an increase in unit sales of our products, changes in product mix sold, the effect of decreases in average selling price per unit sold for comparable products, decreases in manufacturing costs, improvements in manufacturing related product yields for comparable products and the favorable effect of a reduction of inventory reserves due to the sale of inventory previously reserved. We expect gross margins to fluctuate during the remainder of fiscal year 2013 due to changes in product mix, average unit selling prices, manufacturing costs, manufacturing yields and levels of product demand.

Table of Contents

**Research and Development**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (in thousands) | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Research and development | $ 6,712 | $ 4,758 | $ 18,285 | $ 14,099 |
| % of net revenue | 11% | 12% | 12% | 12% |

Research and development expense for the third quarter and first nine months of fiscal year 2013 increased by $2.0 million and $4.2 million, or 41% and 30%, respectively, compared to the same periods of the prior fiscal year. The increase for the third quarter of fiscal year 2013 were primarily attributable to increased payroll and fringe costs of $0.6 million, resulting from increased headcount, increased stock compensation cost of $0.4 million and an increase in mask and foundry costs of $0.6 million. The increase for the first nine months of fiscal year 2013 were primarily attributable to increased payroll and fringe costs of $2.3 million, resulting from increased headcount, increased stock compensation cost of $1.1 million and an increase in mask and foundry costs of $0.7 million. Research and development headcount was 109 at the end of the third quarter of fiscal year 2013 and 99 at the end of the third quarter of fiscal year 2012.

**Selling, General and Administrative**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (in thousands) | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Selling, general and administrative | $ 8,428 | $ 4,427 | $ 21,887 | $ 12,836 |
| % of net revenue | 14% | 11% | 14% | 11% |

Selling, general and administrative expense for the third quarter and first nine months of fiscal year 2013 increased by $4.0 million and $9.1 million, or 90% and 71%, respectively, compared to the same periods of the prior fiscal year. The increase for the third quarter of fiscal year 2013 were primarily attributable to increased payroll and fringe costs of $1.4 million, resulting from increased headcount, increased stock compensation costs of $1.3 million and increased outside service cost of $1.1 million. The increase for the first nine months of fiscal year 2013 were primarily attributable to increased payroll and fringe costs of $3.6 million, resulting from increased headcount, increased stock compensation costs of $2.6 million and increased outside service cost of $2.6 million. The three and nine months of fiscal year 2013 included executive separation costs of $0.8 million, included in payroll and fringe costs and $0.6 million, included in stock compensation costs. Selling, general and administrative headcount was 104 at the end of the third quarter of fiscal year 2013 and 88 at the end of the third quarter of fiscal year 2012.

**Income from Operations**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (in thousands) | December 30, 2012 | January 1, 2012 | December 30, 2012 | January 1, 2012 |
| Income from operations | $ 16,066 | $ 13,506 | $ 42,968 | $ 40,036 |
| % of net revenue | 28% | 32% | 28% | 33% |

Income from operations for the third quarter of fiscal year 2013 increased by $2.6 million, or 19%, compared to the same period of the prior year primarily due to an increase in gross profit of $8.5 million, offset by an increase in research and development expenses of $2.0 million and an increase in selling, general and administrative expenses of $4.0 million. Income from operations for the first nine months of fiscal year 2013 increased by $2.9 million, or 7%, compared to the same period of the prior year primarily due to an increase in gross profit of $16.2 million, offset by an increase in research and development expenses of $4.2 million and an increase in selling, general and administrative expenses of $9.1 million.

Table of Contents

**Other Income, (Expense) Net**

| (in thousands) | Three Months Ended December 30, 2012 | Three Months Ended January 1, 2012 | Nine Months Ended December 30, 2012 | Nine Months Ended January 1, 2012 |
|---|---|---|---|---|
| Other income, (expense) net | $ 98 | $ (43) | $ 188 | $ 166 |
| % of net revenue | % | % | % | % |

Other income (expense), net for the third quarter and first nine months were comparable to the same periods of the prior year and the changes were primarily attributable to foreign exchange gains (losses) and interest income (loss) for all periods.

**Income Tax (Benefit) Provision**

| (in thousands) | Three Months Ended December 30, 2012 | Three Months Ended January 1, 2012 | Nine Months Ended December 30, 2012 | Nine Months Ended January 1, 2012 |
|---|---|---|---|---|
| Income tax (benefit) provision | $ (654) | $ 2,887 | $ 5,023 | $ 9,147 |
| % of income before income taxes | (4)% | 21% | 12% | 23% |

For the third quarter and nine months ended December 30, 2012, we recorded an income tax (benefit) provision of $(0.7) million and $5.0 million respectively. During the three months ended December 30, 2012, the Company changed its estimate of earnings attributable to its domestic versus foreign operations expected to be earned for the fiscal year. As a result of an increase in the amount of earnings attributable to foreign jurisdictions with lower tax rates, the Company adjusted its tax provision for the nine months ended December 30, 2012 to $5.0 million to reflect these new estimates; to the extent that the adjustments related to prior periods, the income tax impact is recorded in this quarter and not as a component of the annual effective tax rate. The impact of recording this change in estimate, along with the results of operations for the quarter, gave rise to an income tax benefit of $0.7 million for the three months ended December 30, 2012. For the three months and nine months ended January 1, 2012, we recorded an income tax provision of $2.9 million and $9.1 million respectively. The estimated 2013 effective tax rate differs from the U.S. statutory rate primarily due to profits earned in jurisdictions where the tax rate is lower than the U.S. tax rate partially offset by the unfavorable effects of non-deductible stock-based compensation expense.

**Net Income**

| (in thousands) | Three Months Ended December 30, 2012 | Three Months Ended January 1, 2012 | Nine Months Ended December 30, 2012 | Nine Months Ended January 1, 2012 |
|---|---|---|---|---|
| Net income | $ 16,818 | $ 10,576 | $ 38,133 | $ 31,055 |
| % of net revenue | 29% | 25% | 25% | 25% |

Net income for the third quarter of fiscal year 2013 increased by $6.2 million, or 59%, compared to the same period of the prior year primarily due to an increase in gross profit of $8.5 million and a decrease in income tax (benefit) provision of $3.5 million, offset by an increase in research and development expenses of $2.0 million and an increase in selling, general and administrative expenses of $4.0 million. Net income for the first nine months of fiscal year 2013 increased by $7.1 million, or 23%, compared to the same period of the prior year primarily due to an increase in gross profit of $16.2 million and a decrease in income tax (benefit) provision of $4.1 million, offset by an increase in research and development expenses of $4.2 million, and an increase in selling, general and administrative expenses of $9.1 million.

**Liquidity and Capital Resources**

Since our inception, our operations have been financed primarily by net proceeds of $50.2 million from the issuance of shares of our preferred stock, net proceeds of $75.2 million from the issuance of shares in public offerings and $44.4 million, and $7.9 million in cash generated from operations in fiscal years 2012 and 2011, respectively. As of December 30, 2012, we had $192.6 million of cash, cash equivalents and investments. Although the majority of our sales are generated from a limited number of customers, we increased the number of total customers and the volume of sales to those customers in recent years. We expect that trend to continue as the markets for our products develop.

We believe our current cash, along with net cash provided by operating activities, will be sufficient to satisfy our liquidity requirements for the next 12 months. We also believe our current cash, along with net cash provided by operating activities position us to pursue value-creating acquisitions if opportunities arise. Our liquidity may be negatively impacted as a result of a decline in sales of our products due to a decline in our end markets, decrease in sales of our customers products in the market, or adoption of competitors products. As of December 30, 2012, $50.7 million of the $94.0 million of cash and cash equivalents were held by our foreign subsidiaries. If these funds are needed for our operations in the United States, the Company would be required to accrue and pay U.S. taxes to repatriate these funds. However, the Company s intent is to indefinitely reinvest these funds outside of the United States, and the Company s current plans for the foreseeable future do not demonstrate a need to repatriate them to fund U.S. operations.

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

Table of Contents

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

Below is a summary of our cash flows (used in) provided by operating activities, investing activities and financing activities for the periods indicated:

| | Nine Months Ended | |
|---|---|---|
| (in thousands) | December 30, 2012 | January 1, 2012 |
| Net cash provided by operating activities | $ 31,307 | $ 33,563 |
| Net cash used in investing activities | (98,382) | (1,713) |
| Net cash provided by financing activities | 7,471 | 69,482 |
| Net (decrease) increase in cash and cash equivalents | $ (59,604) | $ 101,332 |

**Net Cash Provided by Operating Activities**

Net cash provided by operating activities in the first nine months of fiscal year 2013 of $31.3 million, primarily reflected net income of $38.1 million, non-cash expenses of $8.0 million and a net increase in operating assets and liabilities of $14.9 million. This net increase of $14.9 million consisted primarily of an increase in accounts receivable of $12.6 million, and an increase in inventories of $6.6 million, partially offset by an increase in accounts payable and accrued liabilities of $2.9 million and $3.4 million, respectively. The increases in our operating assets and liabilities resulted primarily from our increase in sales volume weighted towards the end of the third quarter of fiscal year 2013, and additionally, the increase in inventory to support future sales. Non-cash expenses of $8.0 million consisted primarily of depreciation and amortization of $1.5 million and stock-based compensation of $6.4 million.

Net cash provided by operating activities in the first nine months of fiscal year 2012 of $33.6 million primarily reflected net income of $31.1 million, non-cash expenses of $4.0 million, partially offset by a net decrease in operating assets and liabilities of $1.5 million. This net decrease of $1.5 million consisted primarily of a decrease in other assets of $1.6 million, a decrease in accounts payable of $2.3 million, and an increase in inventories of $0.9 million, partially offset by an increase in accrued liabilities of $4.4 million. Non-cash expenses of $4.0 million consisted primarily of depreciation and amortization of $1.5 million and stock-based compensation of $2.5 million.

**Net Cash Provided Used in Investing Activities**

Net cash used in investing activities in the first nine months of fiscal year 2013 of $98.4 million primarily reflected the purchase of property and equipment of $4.1 million, the purchase of available-for-sale investments of $104.8 million, partially offset by the sale of available-for-sale investments of $10.5 million.

Net cash used in investing activities in the first nine months of fiscal year 2012 of $1.7 million primarily included the purchase of property and equipment of $1.7 million and the purchase of available-for-sale investments of $8.0 million partially offset by the sale of available-for-sale investments of $7.8 million,

**Net Cash Provided by Financing Activities**

Net cash provided by financing activities in the first nine months of fiscal year 2013 of $7.5 million resulted primarily from proceeds from the issuance of common stock of $4.1 million and excess tax benefit from stock-based compensation of $3.8 million.

Net cash provided by financing activities in the first nine months of fiscal year 2012 of $69.5 million resulted primarily from $69.8 million of net proceeds from the Company s initial public offering, partially offset by payment of $1.7 million related to the Company s offering.

**Off Balance Sheet Arrangements**

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 30, 2012, we were not involved in any unconsolidated SPE transactions.

Table of Contents

**Warranties and Indemnification**

In connection with the sale of products in the ordinary course of business, we often make representations affirming, among other things, that our products do not infringe on the intellectual property rights of others, and agree to indemnify customers against third-party claims for such infringement. Further, our bylaws require us to indemnify our officers and directors against any action that may arise out of their services in that capacity. We have not been subject to any material liabilities under such provisions and therefore believe that our exposure for these indemnification obligations is minimal. Accordingly, we have no liabilities recorded for these indemnity agreements as of December 30, 2012.

**Contractual Obligations**

The following table summarizes our outstanding contractual obligations as of December 30, 2012:

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More Than 5 Years |
| | | | (in thousands) | | |
| Operating lease obligations | $ 2,032 | $ 481 | $ 1,350 | $ 201 | $ |
| Capital lease obligations | 28 | 16 | 12 | | |
| Purchase obligations | 31,512 | 31,512 | | | |
| Total contractual obligations | $ 33,572 | $ 32,009 | $ 1,362 | $ 201 | $ |

Operating leases consist of contractual obligations from agreements for non-cancelable office space. Capital lease obligations consist of leases used to finance the acquisition of equipment. Purchase obligations consist of the minimum purchase commitments made to contract manufacturers.

As of December 30, 2012, our unrecognized tax benefits were $5.6 million. Due to the high degree of uncertainty regarding the settlement of these liabilities, we are unable to estimate the year in which the future cash flows may occur. As a result, these amounts are not included in the table above.

**Recent Accounting Pronouncements**

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income which requires that all non-owner changes in stockholders equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholder s equity. ASU No. 2011-05 became effective for fiscal years, and interim periods within those years, beginning after December 15, 2012, which is the Company s fiscal interim period ended July 1, 2012 of fiscal year ending March 31, 2013. Upon adoption of ASU No. 2011-05, the Company has separately reported Condensed Consolidated Statements of Comprehensive Income and the adoption did not impact the Company s financial condition or results of operations.

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

**Interest Rate Risk**

We had cash, cash equivalents and investments of $192.6 million at December 30, 2012 that could be used for working capital purposes. We do not enter into investments for trading or speculative purposes. As of December 30, 2012, our cash, cash equivalents and investments were in money market funds, U.S. Agency securities, corporate notes and bonds and commercial paper. To provide an assessment of the interest rate risk associated with the Company s investments, the Company performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of the investments assuming a 10% parallel shift in the yield curve. Based on investment positions as of December 30, 2012, a hypothetical 10% increase in interest rates across all maturities would result in an insignificant incremental decline in the fair market value of the investments. Such losses would only be realized if the Company sold the investments prior to maturity.

**Foreign Currency Risk**

Our sales contracts are primarily denominated in U.S. dollars and therefore substantially all of our net revenue is not subject to foreign currency risk. However, a portion of our operating expenses are incurred outside the United States are denominated in foreign currencies and are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the New Taiwan Dollar, Japanese Yen. Korean Won and Chinese Yuan. Additionally, fluctuations in foreign currency exchange rates may cause us to recognize transaction gains and losses in our statement of income. Based on our estimated future level of foreign currency denominated expenditures, a 10% change in foreign currency rates would not result in a material gain or loss to our results of operations.

Table of Contents

**ITEM 4. CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures*

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a 15(e) and 15d 15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were effective. The purpose of these controls and procedures is to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules, and that such information is accumulated and communicated to our management, including our CEO and our CFO, to allow timely decisions regarding required disclosures.

*Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

*Inherent Limitations of Internal Controls*

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

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The Company is subject to various legal proceedings and claims arising in the ordinary course of business. Although occasional adverse decisions or settlements may occur, management believes that the final disposition of such matters will not have a material effect on the Company s business, financial position, results of operations or cash flows.

On May 16, 2012, STMicroelectronics, Inc. ( STI ) filed a patent infringement complaint in the Northern District of California against the Company, alleging infringement of certain of their patents (collectively, the Asserted Patents ). STI alleges that certain lnvenSense Micro-Electro-Mechanical Systems products and services, including but not limited to InvenSense s ISZ, IXZ, IDG, IMU, ITG, and MPU product lines, infringe one or more claims of the Asserted Patents. The Company intends to contest the case vigorously. On July 9, 2012, the Company filed counterclaims against STI for alleged infringement of certain of the Company s patents. A Markman hearing has been set for May 29, 2013, and no trial date has been set. Of the nine Asserted Patents, seven are now being reexamined by the U.S. Patent & Trademark Office ( PTO ) at the Company s request. At the conclusion of the reexamination proceedings, the PTO may decide to invalidate some or all of these patents. The parties have also exchanged their infringement and invalidity contentions, and are in the midst of the claim construction process leading up to the May 29, 2013 Markman hearing. On January 31, 2013, the Company filed a motion requesting that the court stay the case in its entirety pending resolution of the reexamination proceedings. As this litigation is still in its early stages, the Company believes it is not yet possible to assess the merits of the plaintiff s claim and or the amount of damages, if any, that could be awarded in the event of an unfavorable outcome.

On July 20, 2010, plaintiff Wacoh Company filed a complaint in the District of Delaware against the Company and four other companies in the business of making gyroscopes for various applications, alleging infringement of U.S. Patent Nos. 6,282,956 and 6,865,943. The complaint sought unspecified monetary damages, costs, attorneys fees and other appropriate relief. In January 2012, the Company prevailed on a motion to sever the case against it from the cases against other companies and to transfer the case to the Northern District of California. The Company and

Wacoh subsequently settled the matter on a basis that is not material to the Company.

The Company indemnifies certain customers, distributors, suppliers and subcontractors for attorney fees and damages and costs awarded against such parties in certain circumstances in which the Company s products are alleged to infringe third-party intellectual property rights, including patents, registered trademarks or copyrights. There were no indemnification costs for the three and nine months ended December 30, 2012 and January 1, 2012. Indemnification costs are charged to operations as incurred.

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

Table of Contents

**ITEM 1A. RISK FACTORS**

Our operations and financial results are subject to various risks and uncertainties, including those described below, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

***We face intense competition based on a number of factors, including price, and we expect competition to increase in the future, which could have an adverse effect on our net revenue, potential net revenue growth rate and market share.***

The market for motion interface products is highly competitive, particularly in the market for consumer electronics, which is highly sensitive to price. In the market for consumer electronics, we compete to various degrees on the basis of our products size, price, integration, performance, product roadmap, and reliability. Competition may increase and intensify if more and larger semiconductor companies, or the internal resources of large, integrated original equipment manufacturers, or OEMs, enter our markets. Increased competition could result in price pressure, reduced profitability and loss of market share, any of which could materially and adversely affect our business, net revenue and operating results.

Our primary competitor in most of our target markets is STMicroelectronics N.V. We also face competition from integrated semiconductor manufacturers, from in-house development organizations within some of our potential customers and from smaller companies specializing in MEMS and motion-sensing products, including those that provide motion-sensing products offering less functionality at a lower cost, such as accelerometers. We also compete with large, sophisticated platform developers that may prefer to integrate less sophisticated motion sensors and to develop their own motion interface application for developers, marginalizing the total solution we offer. Additionally, competitors that have traditionally focused on industrial or automotive applications for MEMS motion sensors may pursue the consumer electronics market, thus intensifying competition for our products. We expect competition in the markets in which we participate to increase in the future as existing competitors improve or expand their product offerings.

Most of our current competitors have longer operating histories, significantly greater resources, greater brand recognition and a larger base of customers than we do. Some of our competitors also have in-house vertically integrated manufacturing capabilities. In addition, these competitors may have greater credibility with our existing or prospective customers and in some cases are already providing components for products to such existing and prospective customers that may in the future include MotionTracking devices. Moreover, many of our competitors have been doing business with our customers or potential customers for a long period of time and have established relationships that may provide them with information regarding future market trends and requirements that may not be available to us. Additionally, some of our larger competitors may be able to provide greater incentives to customers through rebates and similar programs. Finally, some of our competitors with multiple product lines may bundle their products to offer customers a broader product portfolio at a more competitive price point. These factors may make it difficult for us to gain or maintain market share.

***The average selling prices of our products continues to decrease, which could have a material adverse effect on our net revenue and gross margins if we cannot reduce our costs.***

Our primary customers expect the average selling prices of our products to continue to decrease over time as a result of agreements we enter into with our customers from time to time, competitive pricing pressures, new product introductions by us or our competitors, product end-of-life programs and for other reasons. We have experienced and may continue to experience substantial period-to-period fluctuations in future operating results due to the erosion of the average selling prices of our products. If we are unable to offset any reductions in our average selling prices by implementing internal cost reduction programs, increasing our sales volumes or introducing new products with higher gross margins, our net revenue and gross margins will decline, which could have a material adverse effect on our results of operations.

***Our intellectual property is integral to our business. If we are unable to protect our intellectual property, our business could be adversely affected.***

Our success depends in part upon our ability to protect our intellectual property. To accomplish this, we rely on a combination of intellectual property rights, including patents, copyrights, trademarks and trade secrets in the United States and in selected foreign countries where we believe filing for such protection is appropriate. Our ability to use and prevent others from using our Nasiri-Fabrication platform, which is the subject of several patents and patent applications, is crucial to our success. Effective patent, copyright, trademark and trade secret protection may be unavailable, limited or not applied for in some countries. Some of our products and technologies are not covered by any patent or patent application. We cannot guarantee that:

- any of our present or future patents or patent claims will not lapse or be invalidated, circumvented, challenged or abandoned;

our intellectual property rights will provide competitive advantages to us;

our ability to assert our intellectual property rights against potential competitors or to settle current or future disputes will not be limited by our agreements with third parties;

any of our pending or future patent applications will be issued or have the coverage originally sought;

our intellectual property rights will be enforced in jurisdictions where legal protection may be weak;

third parties will not infringe our key intellectual property, and specifically, the Nasiri-Fabrication platform;

any of the trademarks, copyrights, trade secrets or other intellectual property rights that we presently employ in our business will not lapse or be invalidated, circumvented, challenged or abandoned; or

we will not lose the ability to assert our intellectual property rights against others.

In addition, our competitors or others may design around our protected patents or technologies. Effective intellectual property protection may be unavailable or more limited in one or more relevant jurisdictions relative to the protections available in the United States, or may not be applied for in one or more relevant jurisdictions. If we pursue litigation to assert our intellectual property rights, an adverse judicial decision in any of these legal actions could limit our ability to assert our intellectual property rights, limit the value of our technology or otherwise negatively impact our business, financial condition and results of operations.

Monitoring unauthorized use of our intellectual property is difficult and costly. Unauthorized use of our intellectual property may have occurred or may occur in the future. Although we have taken steps to try to minimize the risk of this occurring, any such failure to identify unauthorized use and otherwise adequately protect our intellectual property would adversely affect our business.

We also rely on customary contractual protections with our customers, suppliers, distributors, employees and consultants, and we implement security measures to protect our trade secrets. We cannot ensure that these contractual protections and security measures will not be breached, that we will have adequate remedies for any such breach or that our suppliers, employees or consultants will not assert rights to intellectual property arising out of such contracts.

***We face claims of intellectual property infringement and may face additional such claims in the future, which could be time-consuming and costly to defend or settle and, if adversely adjudicated, could result in the loss of significant rights.***

The semiconductor and MEMS industries are characterized by companies that hold large numbers of patents and other intellectual property rights and that vigorously pursue, protect and enforce intellectual property rights. STMicroelectonics, Inc., our most significant competitor, has filed a lawsuit asserting that several of our products infringe its patents, which is ongoing. A third party asserted in litigation that our z axis gyroscope infringes a patent held by it. This matter was resolved. Another competitor has made generalized assertions of potential infringement and we have met with it to discuss the matter. In the future other third parties may assert against us and our customers and distributors their patent and other intellectual property rights to technologies that are important to our business.

Claims that our products, processes or technology infringe third-party intellectual property rights, regardless of their merit or resolution, could be costly to defend or settle and could divert the efforts and attention of our management and technical personnel. In addition, many of our customer and distributor agreements, including our agreement with our largest customer, require us to indemnify and defend our customers or distributors, as applicable, from third-party infringement claims and pay damages in the case of adverse rulings. Claims of this sort also could harm our relationships with our customers or distributors and might deter future customers from doing business with us. We do not know whether we will prevail in the current proceeding to which we are a party or in any future proceedings given the complex technical issues involved and the inherent uncertainties in intellectual property litigation. If any such proceedings result in an adverse outcome, we could be required to:

- cease the manufacture, use or sale of the infringing products, processes or technology;
- pay substantial damages for infringement;
- expend significant resources to develop non-infringing products, processes or technology;
- license technology from the third party claiming infringement, which license may not be available on commercially reasonable terms, or at all;
- cross-license our technology to a competitor to resolve an infringement claim, which could weaken our ability to compete with that competitor; or
- pay substantial damages to our customers or end users to discontinue their use of or to replace infringing technology sold to them with non-infringing technology.

Any of the foregoing results could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

***We rely on a limited number of third parties to supply, manufacture and assemble our products, and the failure to manage our relationships with our third-party contractors could adversely affect our ability to produce, market and sell our products.***

We do not have our own manufacturing facilities. We operate based on an outsourced manufacturing business model that utilizes third-party foundry and packaging capabilities. Relying on third-party manufacturing, assembly and packaging presents significant risks to us, including the following:

- reduced control over delivery schedules, yields and product reliability;
- price increases;
- the failure of a key supplier to perform its obligations to us for technical, market or other reasons;
- challenges presented by introducing our fabrication processes to new suppliers or deploying them in new foundries;
- difficulties in establishing additional manufacturing suppliers if we are presented with the need to transfer our manufacturing process technologies to them;
- shortages of materials;
- misappropriation of our intellectual property; and
- limited warranties on wafers or products supplied to us.

The performance of our third-party manufacturers is outside of our control. At present, we depend primarily upon Taiwan Semiconductor Manufacturing Company (TSMC) to manufacture most of our products. Although we are not obligated to purchase a specific volume of products from, or to contract with TSMC on an exclusive basis, we anticipate that we will be dependent on TSMC to supply a substantial portion of our products for the next several fiscal quarters. In the fourth quarter of fiscal year 2012 we announced qualification of a second high volume foundry, Global Foundries. We expect that it would take approximately nine to 16 months to transition our manufacturing to new third-party manufacturers that have not already begun installing our manufacturing processes. Such a transition would likely require certain customers to qualify our new manufacturers. If one or more of our third-party contractors or other outsourcers fail to perform their obligations in a timely manner or at satisfactory quality levels, our ability to bring products to market, the reliability of our products and our reputation could suffer.

In the future, if our third-party manufacturers fail to deliver quality products and components on time and at reasonable prices, we could have difficulties fulfilling our customer orders, our net revenue could decline and our business, financial condition and results of operations would be adversely affected. In addition, if our foundry partners materially increase their prices for the fabrication of our products, our business would be materially harmed.

***Our third-party manufacturers may not allocate sufficient capacity for us to have our products produced and shipped to our customers on a timely basis, which may materially adversely affect our growth and our results of operations.***

We rely on third-party foundries for our CMOS-MEMS wafer fabrication, assembly and packaging services. We make substantially all of our purchases through purchase orders based on our own rolling forecasts, and our third-party manufacturers are not required to supply us products beyond these forecasted quantities. Beyond minimal capacity guarantees, most of our third-party manufacturers do not have any obligations to provide us with additional capacity on a timely basis.

***To date, a significant amount of our net revenue has been attributable to demand for our products used in video gaming and handheld devices, including smartphones and tablet devices. The markets for these products may decline or remain flat. Even if these markets grow, such growth may not benefit the products that incorporate our products. Any of these potential developments could have a material adverse effect on our business, net revenue and operating results.***

We derive a significant amount of our net revenue from our products used in video gaming and handheld devices, including smartphones and tablet devices. Future generations of these products may not adopt motion interface at all or, if they do, may use our competitors products, internally developed solutions or alternative technologies not based on MEMS sensors. If we are not successful in obtaining design wins in new generations of these products or, if these products that incorporate our products are not successful, our net revenue and operating results will decline. If we achieve design wins, these markets or the markets for specific products incorporating our solutions may not continue to grow or may decline for a number of reasons outside of our control, including competition among companies and market saturation.

Additionally, these markets are subject to volatility from changes in the macroeconomic environment as well as industry specific trends, such as trends resulting from announcements by one of the major companies in these markets. Any decline or volatility in these overall markets could cause our net revenue and operating results to fall short of expectations or decline.

Table of Contents

***We currently depend on a limited number of customers for a material portion of our net revenue, and the loss of, or a substantial reduction in orders from these customers would significantly reduce our net revenue and adversely impact our operating results***

We expect that sales to these customers will continue to account for a substantial portion of our net revenue for the foreseeable future. The loss of, or a substantial reduction in orders from, any of these customers would have a significant negative impact on our business and our operating results. For the three months ended December 30, 2012, three customers each accounted for 24%, 22% and 10% of total net revenue. For the nine months ended December 30, 2012, three customers each accounted for 23%, 20% and 13% of total net revenue.

***We are dependent upon the continued market acceptance and adoption of motion interface and, in particular, the adoption of our MotionTracking devices in consumer electronics products.***

Our products are currently used to provide motion sensing and processing functionality, primarily in consumer electronics products for video gaming and mobile and handheld devices, including smartphones and tablet devices. Motion sensing utilizes gyroscopes, accelerometers and other sensors (increasingly integrated together to reduce the number of discrete sensors) to measure the motion of the device when manipulated by the user, and enables applications such as re-orienting a screen on a smartphone from portrait mode to landscape mode and providing an interface for motion-based commands for video gaming. A motion interface platform, on the other hand, is a complete system-level solution that delivers improved functionality and performance because it integrates various motion sensors with digital control and processing, and provides high-level programming interfaces. Motion interface is a relatively new technology for many consumer electronics products that can be utilized in a number of applications, including motion-based video games or user interfaces for smartphones. We have developed a MotionApp platform that we consider to be proprietary.

Market adoption and acceptance of motion interface technology, including our MotionTracking devices, in consumer electronics products is dependent on a number of factors that are outside of our control. For example, device manufacturers must decide whether incorporating the improved functionality and performance that comes with motion interface will result in improved sales and market acceptance of their products. In addition, device manufacturers may not be able to integrate motion interface or processing technologies into their products in a manner that they, or their customers, consider to deliver cost-effective, compelling functionality, and developers may not introduce applications that employ motion interface in a compelling way. In addition, there are a number of companies that claim intellectual property ownership over motion as a user interface, and these claims could discourage manufacturers from integrating motion interface technology into their products.

We are particularly dependent upon the continued adoption of motion interface technology, including our MotionTracking devices, in mobile handheld devices, including smartphones and tablet devices. While smartphone manufacturers are incorporating advanced motion sensing functionality, including three-axis gyroscopes, into their devices, if applications that utilize this functionality are not further developed or if consumers do not find the applications provided by motion interface technology compelling, mobile device manufacturers may curtail their adoption of this technology. Consequently, our net revenue may fall short of our expectations and operating results could be adversely affected. Any unanticipated delay in the launch or decline in the volume of our customers smartphone and tablet device platforms into which we have been designed may negatively impact our net revenue.

***If we fail to develop and introduce new or enhanced products on a timely basis, our ability to attract and retain customers could be impaired, and our competitive position could be harmed.***

We operate in a dynamic environment characterized by rapidly changing technologies and industry standards, and rapid technological obsolescence. To compete successfully, we must design, develop, market and sell new or enhanced products that provide increasingly higher levels of performance, integration and reliability and meet the cost expectations of our customers. A key element of our product strategy is to integrate additional sensors and motion interface functionality into our products, and to reduce the size and power consumption of products providing a given level of functionality. For instance, the nine-axis MPU-9250 combines our three-axis MEMS gyroscope, three-axis MEMS accelerometer, with a third-party three-axis e-compass, MotionFusion technology and MotionApps platform, in a 3x3mm package, which is 45% smaller than the package of our previous nine-axis product, and consumes substantially less power. The introduction of new products by our competitors, the market acceptance of products based on new or alternative technologies, or the emergence of new industry standards could render our existing or future products obsolete.

***Revenue delays could result from shortages of key third party components to our customers and injunctions of our customer products from intellectual property claims by their competitors.***

We are dependent on our customers for our net revenue and our net revenues could be negatively impacted by shortages of key third party components to our customers. In 2012, a third party chip supplier s supply shortages limited the ability of handset makers to utilize our motion sensing technology.

In addition, our net revenues could be negatively impacted by court injunctions on our customer products from intellectual property claims by their competitors.

Table of Contents

***If we fail to successfully manage the transition to products using our next generation products or more highly integrated products, we will lose net revenue and our operations could be materially and adversely affected.***

The majority of our production volume today derives from our integrated three-axis and six-axis product families. We have introduced, and intend to continue to introduce, more highly integrated products that include greater motion sensing functionality and further enhancements to on-board motion interface capabilities. We may not be successful in achieving market acceptance of our more highly integrated single-chip products on the financial or other terms that we expect to obtain, and existing or potential new customers may instead rely on multi-chip, discrete motion sensor solutions. This could result in the loss of net revenue and earnings and potential inventory write-downs or obsolescence.

***If we fail to expand sales in our current markets, develop new customers and penetrate new markets, our net revenue and potential net revenue growth rate could be materially and adversely affected.***

Other than applications in the video gaming market and smartphones and tablet devices, where we have historically derived the significant majority of our net revenue, to date, our MotionTracking devices have been employed in a limited number of other applications, such as digital still and video cameras, digital television and set-top box remote controls, 3D mice and remote-controlled toys. Our future net revenue growth, if any, will depend on our ability to expand sales in our current markets, develop new customers and penetrate new markets. If new markets do not develop as we currently anticipate, or if we are unable to penetrate new markets successfully, our net revenue and net revenue growth rate could be materially and adversely affected.

While the general market for handheld devices is very fragmented, a limited number of manufacturers command a relatively large share of the market for smartphones with enhanced functionality running the Android operating system. All of these customers are large, multinational companies with substantial negotiating power relative to us over price and terms of supply. Securing design wins with any of these companies or other smartphone manufacturers require a substantial investment of our time and resources. Some of these companies produce products that already include motion sensors, and they may decide not to adopt our MotionTracking devices. Additionally, the smartphone market is subject to a unique set of industry dynamics, such as shorter design cycles and multiple devices and manufacturers. The smartphone market is highly competitive, and if we are unable to continue to successfully navigate the unique dynamics of such market, if we are unable to adapt our products in response to any future changes in the requirements of the Android operating system, or if the products of manufacturers that choose to incorporate our solutions are not commercially successful, our net revenue may not grow and our operating results may be adversely affected.

***Our sales are subject to a competitive selection process conducted by our prospective customers that can be lengthy and require us to expend significant resources, even though we ultimately may not be selected; revenues from being selected may be lower than anticipated due to customers desires to have multiple sources for components.***

The process of identifying potential new customers, developing their interest in our products, moving through their design cycle, obtaining a design win, obtaining purchase orders and entering into volume production is extremely time consuming. We compete during our customers product design and planning processes to achieve design wins, which refers to a customer s decision to include one of our solutions in its products under development. These selection processes can be lengthy and can require us to invest significant time and effort. Our products may not be selected during a customer s design process, and we may not generate net revenue despite incurring expenses and devoting significant resources to achieving a design win. Because the life cycles for our customers products can last several years and changing suppliers involves significant cost, time, effort and risk, our failure to be selected in a competitive design process can result in our foregoing net revenue from a given customer s product line for the life of that product.

Although we have a number of customers that have purchased our products in production volumes, such customers are smaller than our largest customer. Typically, many customers, including most of our current customers, initially include our products in only one or a few product lines. It generally takes time for sales volumes of a new product line to grow and for customers to incorporate one of our solutions into additional product lines, if any. Even after we achieve a design win, a customer may decide to cancel or change its product plans, may fail to commercialize its products, or those products may fail to achieve market acceptance, any of which could cause us to fail to generate sales from a particular design win and adversely affect our results of operations. In addition, large consumer electronics companies often elect to establish more than one source for components to promote competition and control risks of supply interruption. Such dual source strategies can result in lower sales from a design win than anticipated. Further, failure to achieve design wins could result in lost sales and hurt our prospects in future competitive selection processes because we may not be perceived as a preferred or competitive vendor.

We generally place orders for products with some of our suppliers approximately three to four months prior to the anticipated delivery date, with order volumes based on our forecasts of demand from our customers. Accordingly, if we inaccurately forecast demand for our products, we may be unable to obtain adequate and cost-effective foundry or assembly capacity from our third-party manufacturers to meet our customers delivery requirements, or we may accumulate excess inventories. On occasion, we have been unable to adequately respond to unexpected increases in customer purchase orders and therefore were unable to benefit from this

incremental demand. In addition, our third-party manufacturers may prioritize orders placed by other companies that order higher volumes of products, many of whom are larger and more established than us. In the event that manufacturing capacity is reduced or eliminated at one or more of our third-party manufacturers facilities, we could have difficulties fulfilling our customer orders, and our net revenue and results of operations could decline.

***Failure to achieve expected manufacturing yields for our products could negatively impact our operating results.***

Manufacturing yields for our products are a function of product design, which is developed largely by us, and process technology, some of which is proprietary to our foundries. Low yields may result from either product design or process technology failures. We do not know whether a yield problem exists until our products are manufactured based on our design. When a yield issue is identified, the product is analyzed and tested to determine the cause. As a result, yield deficiencies may not be identified until well into the production process. In the fourth quarter of fiscal year 2012 we announced qualification of GLOBALFOUNDRIES Inc., and we may experience delays or product yield issues as this facility increases production volumes in the future. Resolution of yield problems requires cooperation among, and communication between, us and our foundries. Because of our potentially limited access to wafer foundry capacity, decreases in manufacturing yields could result in an increase in our costs, cause us to fail to meet product delivery commitments and force us to allocate our available product supply among end customers. Lower than expected yields could potentially harm our operating results, our customer relationships and our reputation.

Our failure to anticipate or timely develop new or enhanced products or technologies in response to technological change could result in decreased net revenue and our competitors achieving more design wins. In particular, we may experience difficulties with product design, manufacturing or marketing that could delay or prevent our development, introduction or marketing of new or enhanced products, including products with higher levels of sensor integration such as our nine-axis device, which has not yet commenced production in commercial quantities. If we fail to introduce new or enhanced products with potentially greater integration that meet the needs of our customers or penetrate new markets in a timely fashion, we will lose market share and our operating results will be adversely affected.

***We are subject to order and shipment uncertainties, and differences between our estimates of customer demand and actual results could negatively affect our inventory levels, sales and operating results.***

Our net revenue is generated on the basis of purchase orders with our customers rather than long-term purchase commitments. In addition, our customers can cancel purchase orders or defer the shipments of our products under certain circumstances. For example, in September 2009, our major customer requested that we delay shipment of products that we had expected to ship pursuant to firm purchase orders to that customer during the third quarter of fiscal year 2010. Our products are manufactured by third-party manufacturers according to our estimates of customer demand, which requires us to make separate demand forecast assumptions for every customer, each of which may introduce significant variability into our aggregate estimates. We have limited visibility into future customer demand and the product mix that our customers will require, which could adversely affect our net revenue forecasts and operating margins. Moreover, because products with motion interface platforms have only recently been introduced into many of our target markets, many of our customers could have difficulty accurately forecasting demand for their products and the timing of their new product introductions, which ultimately affects their demand for our MotionTracking devices.

Historically, because of this limited visibility, at times our actual results have been different from our forecasts of customer demand. Some of these differences have been material, leading to net revenue and margin forecasts different from the results we were actually able to achieve. For example, our major customer reduced its orders for our products below levels we had anticipated during fiscal year 2011. These differences may occur in the future. Conversely, if we were to underestimate customer demand or if sufficient manufacturing capacity were unavailable, we could be unable to take advantage of net revenue opportunities, potentially lose market share and damage our customer relationships and market reputation. In addition, any significant future cancellations or deferrals of product orders could materially and adversely impact our profit margins, increase our inventory write-downs due to product obsolescence and restrict our ability to fund our operations.

***The complexity of our products could result in unforeseen delays or expenses caused by defects or bugs, which could delay the introduction or acceptance of our new products, damage our reputation with current or prospective customers and adversely affect our operating costs and revenue.***

Our highly complex motion sensing and processing products may contain defects and bugs when they are first introduced or as new versions are released. We have in the past experienced, and may in the future experience, defects and bugs. There may be additional defects and bugs contained in our products that, due to our limited operating history, may not have manifested. If any of our products contains defects or bugs, or has reliability, quality or other problems, we may not be able to successfully correct such problems in a timely manner. Consequently, our reputation may be damaged and customers may be reluctant to buy our products, which could materially and adversely affect our ability to retain existing customers and attract new customers. In addition, these defects or bugs could interrupt or delay sales to our customers. If any of our products contains defects or bugs, or has reliability, quality or other problems, we may not be able to successfully correct such problems. Defects or bugs could materially and adversely affect our ability to achieve design wins from existing customers and to attract new customers, which could adversely affect our market share and operating results. In addition, defects or bugs could interrupt or delay shipments to existing customers. If a significant defect or bug is not found until after we have commenced commercial production of a new product, we may be required to incur additional development costs and product recall, repair or replacement costs. These problems may also result in claims against us by our customers or others. As a result, our operating costs could be adversely affected.

Table of Contents

***If we do not achieve increased tax benefits as a result of our recently implemented corporate restructuring, our financial condition and operating results could be adversely affected.***

We completed a restructuring of our corporate organization during fiscal year 2011 to more closely align our corporate structure with the international nature of our business activities. This corporate restructuring activity has allowed us to reduce our overall effective tax rate through changes in how we develop and use our intellectual property and the structure of our international procurement and sales operations, including by entering into transfer-pricing arrangements that establish transfer prices for our intercompany transactions. We anticipate achieving a reduction in our overall effective tax rate in future periods as well. There can be no assurance that the taxing authorities of the jurisdictions in which we operate or to which we are otherwise deemed to have sufficient tax nexus will not challenge the tax benefits that we expect to realize as a result of the restructuring. In addition, future changes to U.S. or non-U.S. tax laws, including proposed legislation to reform U.S. taxation of international business activities as described above, would negatively impact the anticipated tax benefits of the proposed restructuring. Any benefits to our tax rate will also depend on our ability to operate our business in a manner consistent with the restructuring of our corporate organization and applicable taxing provisions, including by eliminating the amount of cash distributed to us by our subsidiaries. If the intended tax treatment is not accepted by the applicable taxing authorities, changes in tax law negatively impact the proposed structure or we do not operate our business consistent with the restructuring and applicable tax provisions, we may fail to achieve the financial efficiencies that we anticipate as a result of the restructuring and our future operating results and financial condition may be negatively impacted.

***The enactment of legislation implementing changes in U.S. taxation of international business activities or the adoption of other tax reform policies could materially impact our financial position and results of operations.***

Tax bills are introduced from time to time to reform U.S. taxation of international business activities. Depending on the final form of legislation enacted, if any, the consequences may be significant for us due to the large scale of our international business activities. If any of these proposals are enacted into legislation, they could have material adverse consequences on the amount of tax we pay and thereby on our financial position and results of operations.

***We recently appointed a new President and Chief Executive Officer and any failure or delay in successfully transitioning duties and responsibilities could have a negative impact on our business.***

On October 24, 2012, Behrooz Abdi, a member of our Board of Directors, was appointed as our President and Chief Executive Officer, replacing our founder, Steven Nasiri, who remains a member of the Board. Transitioning leadership of our company from the founder to our new chief executive officer may cause strategic or operational challenges for our organization, the impact of which could adversely affect our business, financial condition, results of operations and cash flows.

***Our future success depends on the continuing efforts of our key personnel, and on our ability to successfully attract, train and retain additional key personnel.***

Our future success depends heavily upon the continuing services of the members of our senior management team and various engineering and other technical personnel. If one or more of our senior executives or other key personnel are unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all, our business may be disrupted, and our financial condition and results of operations may be materially and adversely affected. In addition, if any member of our senior management team or any of our other key personnel joins a competitor or forms a competing company, we may experience material disruption of our operations and development plans and lose customers, distributors, know-how and key professionals and staff members, and we may incur increased operating expenses as the attention of other senior executives is diverted to recruit replacements for key personnel. Our industry is characterized by high demand and intense competition for talent, and the pool of qualified candidates is very limited. We cannot ensure that we will be able to retain existing, or attract and retain new, qualified personnel, including senior executives and skilled engineers, whom we will need to achieve our strategic objectives. In addition, our ability to train and integrate new employees into our operations may not meet the growing demands of our business. The loss of any of our key personnel or our inability to attract or retain qualified personnel, including engineers and others, could delay the development and introduction of, and would have an adverse effect on our ability to sell, our products, which could harm our overall business and growth prospects.

***The concentration of our capital stock ownership with our executive officers and directors, and their respective affiliates, will limit shareholder ability to influence corporate matters.***

Based on share ownership as of December 30, 2012, our executive officers and directors and their affiliates beneficially own or control, directly or indirectly, an aggregate of 36,095,023 shares, or 43.1%, of our common stock (including 2,039,727 shares of common stock subject to outstanding options and warrants exercisable within 60 days of December 30, 2012). In particular, our founder and board member

Mr. Nasiri beneficially owns or controls, directly or indirectly, an aggregate of 6,520,504 shares, or 7.8%, of our outstanding common stock (including 2,039,727 shares of common stock subject to outstanding options exercisable within 60 days of December 30, 2012). Mr. Nasiri therefore has significant influence over all matters requiring stockholder approval, including any change-of-control transaction, such as a merger or other sale of our company or all or substantially all of our assets, for the foreseeable future. This concentrated control limits shareholder ability to influence some corporate matters and could result in some corporate actions that our other stockholders do not view as beneficial, such as failure to approve change of control transactions that could offer holders of our common stock a premium over the market value of our company. As a result, the market price of our common stock could be adversely affected.

***Due to our limited operating history, we may have difficulty in accurately predicting our future net revenue and appropriately budgeting our expenses.***

We began doing business in 2003 and did not begin to generate net revenue until the first quarter of fiscal year 2007. We generated approximately 73% and 31% of our net revenue for fiscal years 2011 and 2012, respectively, from a single customer. As a result, we have only a limited operating history from which to predict future net revenue from multiple new customers and new markets. This limited operating experience, combined with the rapidly evolving nature of the markets in which we sell our products, substantial uncertainty concerning how these markets may develop, the rate of adoption of our products in these new markets and other factors beyond our control, reduces our ability to accurately forecast quarterly or annual net revenue. We are currently expanding our staffing, implementing new internal systems, and increasing our expense levels in anticipation of future growth. If our net revenue does not increase as we expect relative to the growth of our operating expenses, our operating margins could be negatively affected or we could incur significant losses.

***We may not sustain our growth rate, and we may not be able to manage any future growth effectively.***

We have experienced significant growth in a short period of time. We may not achieve similar growth rates in future periods. Our operating results for any prior quarterly or annual period should not be relied on as an indication of our future operating performance. If we are unable to maintain adequate net revenue growth, our financial results could suffer and our stock price could decline.

To manage our growth successfully and handle the responsibilities of being a public company, we believe we must effectively, among other things:

- recruit, hire, train and manage additional qualified engineers for our research and development activities, especially in the positions of design engineering, product and test engineering and applications engineering, as well as adding additional sales personnel;

- implement improvements in our financial, administrative, and operational systems, procedures and controls necessary to support larger manufacturing and sales volumes, a greater number of customers and an increased range of products; and

- enhance our information technology support for enterprise resource planning and design engineering by adapting and expanding our systems and tool capabilities, and properly training new hires as to their use.

Changes to the leadership or other senior members of our finance organization could result in delays in making improvements to our financial and control systems. If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities or develop new products, and we may fail to satisfy customer requirements, maintain product quality, execute our business plan or respond to competitive pressures.

***We are exposed to fluctuations in interest rates and changes in credit rating and in the market values of our portfolio investments which could have a material adverse impact on our financial condition and results of operations.***

Our cash, short-term and long-term investments represent significant assets that may be subject to fluctuating or even negative returns depending upon interest rate movements, changes in credit rating and financial market conditions. Since September 2007, the global credit markets have experienced adverse conditions that have negatively impacted the values of various types of investment and non-investment grade securities. During this time, the global credit and capital markets have experienced significant volatility and disruption due to instability in the global financial system, uncertainty related to global economic conditions and concerns regarding sovereign financial stability.

Therefore, there is a risk that we may incur other-than-temporary impairment charges for certain types of investments should credit market conditions deteriorate or the underlying assets fail to perform as anticipated. Our future investment income may fall short of expectations due to changes in interest rates or if the decline in fair values of our debt securities is judged to be other than temporary. Furthermore, we may suffer losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates or financial market conditions.

***If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors views of us.***

Maintaining adequate internal financial and accounting controls and procedures to help ensure that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. We will be subject to the rules adopted by the Securities and Exchange Commission, or SEC, pursuant to Section 404 of the Sarbanes-Oxley Act, or Section 404, which requires us to include, beginning with our Annual Report on Form 10-K for our fiscal year ending March 31, 2013, our management s report on and assessment of the effectiveness of our internal controls over financial reporting. In addition, beginning with our fiscal year ending March 31, 2013, our independent registered public accounting firm will be required to attest to and report on the effectiveness of our internal controls over financial reporting. Both we and our independent registered public accounting firm will be testing our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify areas for further attention or improvement. In the past, we have experienced material weaknesses in our internal control over financial reporting. While we have remediated these material weaknesses, there are no assurances that similar or new material weaknesses will not occur.

Implementing any appropriate changes to our internal controls may require specific compliance training of our directors, officers and employees, entail substantial costs in order to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate Consolidated Financial Statements and related Notes on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, investors perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements may adversely affect our stock price.

As part of our ongoing efforts to improve our financial accounting organization and processes, we have hired several senior accounting personnel in the United States. Accordingly, we may be unable to effectively manage our public company reporting obligations, which could adversely impact our business and results of operations.

***We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial condition and results of operations.***

Our sales contracts are primarily denominated in U.S. dollars and therefore substantially all of our net revenue is not subject to foreign currency risk. However, the recent strengthening of the U.S. dollar has increased the real cost of our products to our customers outside of the United States, which could adversely affect our financial condition and results of operations. Some of our operating expenses are incurred outside the United States, are denominated in foreign currency and are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the New Taiwan Dollar. We do not currently hedge currency exposures relating to operating expenses incurred outside of the United States, but we may do so in the future. If we do not hedge against these risks, or our attempts to hedge against these risks are not successful, our financial condition and results of operations could be adversely affected.

***We will continue to incur increased costs as a result of being a public company.***

As a newly public company, we continue to incur significant legal, accounting and other expenses that we did not incur as a private company, including costs related to compliance with SEC and the rules of the New York Stock Exchange, the Sarbanes-Oxley Act and other corporate governance requirements. We expect continued compliance with these requirements to increase our legal and financial costs and make some activities more time-consuming and costly. We also expect that these new rules and regulations may make it more difficult and expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as executive officers. We are currently evaluating and monitoring developments with respect to these rules, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs.

***Our primary customers, our sales and support facilities, our testing facilities and our third-party manufacturers are located in regions that are subject to natural disasters, as well as in some cases geopolitical risks and social upheaval.***

Currently, our wafer sort, final test and shipping operations, as well as the facilities of our third-party wafer manufacturing and assembly suppliers, are located in Singapore, Taiwan and Thailand. One of our largest customers is based in Japan. We have sales and support centers in China, Japan, the Republic of Korea, United Arab Emirates and Taiwan. In addition, our headquarters are located in Northern California. Thailand, Taiwan, the Republic of Korea and Japan are susceptible to earthquakes, tsunamis, typhoons, floods and other natural disasters, and have experienced severe earthquakes, typhoons and floods in recent years that caused significant property damage and loss of life. The Northern California area is also subject to significant risk of earthquakes.

Table of Contents

In addition, facilities located in the Republic of Korea, Taiwan, Thailand and China are subject to risks associated with uncertain political, economic and other conditions in Asia, including the outbreak of contagious diseases, such as the H1N1 virus, natural disasters, such as severe flooding in Thailand during the 2011 monsoon season, and political turmoil in the region. Although these risks have not materially adversely affected our business, financial condition or results of operations to date, there can be no assurance that such risks will not do so in the future. There also can be no assurance that another earthquake, tsunami or other natural disaster will not occur in the Pacific Rim region, where the risk of such an event is significant due to, among other things, the proximity of major earthquake fault lines in the area. Any such future event could include power outages, fires, flooding or other adverse conditions, as well as disruption or impairment of production capacity and the operations of our manufacturers and customers, which could have a material adverse effect on us. Any disruption resulting from these events could cause significant delays in shipments of our products until we are able to shift our manufacturing, assembly or testing from the affected facilities or contract to another location or third-party vendor. Under such circumstances, there can be no assurance that alternative capacity could be obtained on favorable terms, if at all. Any catastrophic loss to any of our facilities would likely disrupt our operations, delay production, shipments and net revenue and result in significant expenses to repair or replace the facility. In particular, any catastrophic loss at the Sunnyvale, California or Taiwan facilities would materially and adversely affect our business.

***Our operating results are subject to substantial quarterly and annual fluctuations due to a number of factors that could adversely affect our business and our stock price.***

Our net revenue and operating results have fluctuated in the past and are likely to fluctuate in the future. These fluctuations may occur on a quarterly and on an annual basis and are due to a number of factors, many of which are beyond our control. These factors include, among others:

- changes in end-user demand for the products manufactured and sold by our customers;
- the receipt, reduction, cancellation or delay of significant orders by customers;
- the gain or loss of significant customers;
- market acceptance of our products and our customers products;
- our ability to develop, introduce and market new products and technologies on a timely basis;
- Delays in our customers ability to manufacture and ship products which incorporate our products caused by internal and external factors unrelated to our business and beyond our control;
- new product announcements and introductions by us or our competitors;
- incurrence of research and development and related new product expenditures;
- seasonality or cyclical fluctuations in our markets;
- fluctuations in manufacturing yields;

- significant warranty claims, including those not covered by our suppliers;
- write-downs of inventory for excess quantity and technological obsolescence;
- changes in our product mix or customer mix;
- intellectual property disputes;
- loss of key personnel or the shortage of available skilled workers;
- the effects of competitive pricing pressures, including decreases in average selling prices of our products; and
- in cases where our products are designed into a customers product along with components provided by third-party suppliers, disruptions in the supply chains of such third-party suppliers.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly or annual operating results. In addition, a significant amount of our operating expenses are relatively fixed in nature due to our significant sales, research and development costs. Any failure to adjust spending quickly enough to compensate for a net revenue shortfall could magnify its adverse impact on our results of operations.

***Our product development efforts are time-consuming and expensive and may not generate an acceptable return, if any.***

Our product development efforts require us to incur substantial research and development expense. Our research and development expense was $15.8 million for fiscal year 2011 and $19.7 million for fiscal year 2012, and we anticipate that research and development expense will increase in the future. We may not be able to achieve an acceptable return, if any, on our research and development efforts.

Table of Contents

The development of our products is highly complex. We occasionally have experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. Unanticipated problems in developing products could also divert substantial engineering resources, which may impair our ability to develop new products and enhancements and could substantially increase our costs. Furthermore, we may expend significant amounts on research and development programs that may not ultimately result in commercially successful products. As a result of these and other factors, we may be unable to develop and introduce new products successfully and in a cost-effective and timely manner, and any new products we develop and offer may never achieve market acceptance. Any failure to successfully develop future products would have a material adverse effect on our business, financial condition and results of operations.

***We are subject to warranty and product liability claims and product recalls that may require us to make significant expenditures to defend against these claims or pay damage awards.***

From time to time, we may be subject to warranty or product liability claims that may require us to make significant expenditures to defend against these claims or pay damage awards. In the event of a warranty claim, we may also incur costs if we compensate the affected customer. For example, under the terms of our contracts with our larger customers, we are obligated to replace, repair or refund payment for defective products discovered by the customer generally for a period of up to three years after such products are delivered, and we remain responsible and liable for any latent defects caused by reasons attributable to us even after the contractual warranty period has elapsed. We maintain product liability insurance, but this insurance is limited in amount and subject to significant deductibles. There is no guarantee that our insurance will be available or adequate to protect against all such claims. We also may incur costs and expenses if defects in a device we supply make it necessary to recall a customer s product. The process of identifying a recalled device in products that have been widely distributed may be lengthy and require significant resources, and we may incur significant replacement costs, contract damage claims from our customers and reputational harm. Costs or payments made in connection with warranty and product liability claims and product recalls could have a material adverse effect on our financial condition and results of operations.

***Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business and other factors related to our international operations.***

Sales to end customers in Asia accounted for 92% of our net revenue in fiscal year 2012 and 98% of our net revenue for fiscal year 2011. In addition, approximately 40% of our employees are located in Asia, and substantially all of our products are manufactured, assembled or tested in Asia. Multiple factors relating to our international operations and to the particular countries in which we operate could have a material adverse effect on our business, financial condition and results of operations. These factors include:

- changes in political, regulatory, legal or economic conditions;
- restrictive governmental actions, such as restrictions on the transfer or repatriation of funds and foreign investments and trade protection measures, including export duties, quotas, customs duties and tariffs;
- disruptions of capital and trading markets;
- changes in import or export licensing requirements;
- transportation delays;
- civil disturbances or political instability;
- geopolitical turmoil, including terrorism, war or political or military coups;

- public health emergencies;
- currency fluctuations relating to our international operating activities;
- differing employment practices and labor standards;
- limitations on our ability under local laws to protect our intellectual property;
- local business and cultural factors that differ from our customary standards and practices;
- nationalization and expropriation;
- changes in tax laws; and
- difficulties in obtaining distribution and support services.

Substantially all of our products and our end customers products are manufactured in Taiwan and China. Any conflict or uncertainty in these countries, including due to public health or safety concerns, could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

***We are subject to the cyclical nature of the semiconductor and consumer electronics industries.***

The semiconductor and consumer electronics industries are highly cyclical and are 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. These industries experienced a significant downturn as part of the broader global recession in 2008 and 2009. Industry downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. The recent downturn and any future downturns could have a material adverse effect on our business and operating results. Furthermore, any upturn in the semiconductor or consumer electronics industries could result in increased competition for access to the third-party foundry and assembly capacity on which we are dependent to manufacture and assemble our products. None of our third-party foundry or assembly contractors has provided assurances that adequate capacity will be available to us in the future.

***Our business is subject to seasonality, which causes our net revenue to fluctuate.***

In addition to the general cyclicality of the semiconductor and consumer electronics industries, our business is subject to seasonality because of the nature of our target markets. At present, virtually all of our motion interface products are sold in the consumer electronics market. Sales of consumer electronics tend to be weighted towards holiday periods, and many consumer electronics manufacturers typically experience seasonality in sales of their products. Seasonality affects the timing and volume of orders for our products as our customers tend to increase production of their products that incorporate our solutions in the first three quarters of our fiscal year in order to build inventories for the holiday season. Sales of our products tend to correspondingly increase during these quarters and to significantly decrease in the fourth quarter of our fiscal year. For example, our net revenue was $41.2 million for the third quarter of fiscal year 2012 and declined to $33.1 million for the fourth quarter of fiscal year 2012. We expect this seasonality to continue in future periods and, as a result, our operating results are likely to vary significantly from quarter to quarter.

***Our business is subject to various governmental regulations, and compliance with these regulations may cause us to incur significant expenses. If we fail to maintain compliance with applicable regulations, we may be forced to recall products and cease their manufacture and distribution, which could subject us to civil or criminal penalties.***

The complex legal and regulatory environment exposes us to compliance and litigation costs and risks that could materially affect our operations and financial results. These laws and regulations may change, sometimes significantly, as a result of political or economic events. They include tax laws and regulations, import and export laws and regulations, government contracting laws and regulations, labor and employment laws and regulations, securities and exchange laws and regulations (and other laws applicable to publicly-traded companies such as the Foreign Corrupt Practices Act), and environmental laws and regulations. In addition, proposed laws and regulations in these and other areas, such as healthcare, could affect the cost of our business operations. Our international operations face political, legal, operational, exchange rate and other risks that we do not face in our domestic operations. We face the risk of discriminatory regulation, nationalization or expropriation of assets, changes in both domestic and foreign laws regarding trade and investment abroad, potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights. Violations of any of these laws and regulations could subject us to criminal or civil enforcement actions, any of which could have a material adverse effect on our business, financial condition or results of operations.

***Potential future acquisitions may not generate the results expected and could be difficult to integrate, divert the attention of key personnel, disrupt our business, dilute stockholder value and impair our financial results.***

As part of our business strategy, we may pursue acquisitions of companies, technologies and products that we believe could accelerate our ability to compete in our core markets or allow us to enter new markets. If we fail to manage the pursuit, consummation and integration of acquisitions effectively, our business could suffer. In addition, if we fail to properly evaluate acquisitions, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate. Acquisitions involve numerous risks, any of which could harm our business, including:

- difficulties in integrating the manufacturing, operations, technologies, products, existing contracts, accounting and personnel of the target company and realizing the anticipated synergies of the combined businesses;

- difficulties in supporting and transitioning customers, if any, of the acquired company;

diversion of financial and management resources from existing operations;

the price we pay or other resources that we devote may exceed the value we actually realize, or the value we could have realized if we had allocated the purchase price or other resources to another opportunity or for our existing operations;

risks associated with entering new markets in which we have limited or no experience;

potential loss of key employees, customers and strategic alliances from either our current business or the acquired company s business;

Table of Contents

- assumption of unanticipated problems or latent liabilities, such as problems with the quality of the acquired company s products;
- inability to generate sufficient revenue and profitability to offset acquisition costs;
- equity-based acquisitions may have a dilutive effect on our stock; and
- inability to successfully consummate transactions with identified acquisition candidates.

There can be no assurance that any acquisition we might consummate will generate the results we anticipate. Acquisitions also frequently result in the recording of goodwill and other intangible assets that are subject to potential impairments in the future that could harm our financial results.

***Our stock price has been and will likely continue to be volatile, and shareholders may not be able to resell shares of our common stock at or above the price they originally paid.***

The trading price of our common stock has been and will likely continue to be highly volatile and could be subject to wide fluctuations in price in response to various factors, some of which are beyond our control. In addition to the factors discussed in this Risk Factors section and elsewhere in this Quarterly Report on Form 10-Q, factors that may cause volatility in our share price include:

- our small public float relative to the total number of shares of common stock that are issued and outstanding;
- sales of common stock by us or our stockholders;
- share price and volume fluctuations attributable to inconsistent trading volume levels of our shares;
- the expiration of the contractual lock-up and market stand-off agreements;
- quarterly variations in our results of operations, those of our competitors or those of our largest customers;
- announcements by us or our competitors of acquisitions, design wins, new solutions, significant contracts, commercial relationships or capital commitments;
- general economic conditions and slow or negative growth of related markets;
- our ability to develop and market new and enhanced solutions on a timely basis;
- disruption to our operations;
- the emergence of new sales channels in which we are unable to compete effectively;

any major change in our board of directors or management;

changes in financial estimates including our ability to meet our future net revenue and operating profit or loss projections;

changes in governmental regulations or in the status of our regulatory approvals;

commencement of, or our involvement in, litigation; and

changes in earnings estimates or recommendations by securities analysts.

In addition, the stock market in general, and the market for semiconductor and other technology companies in particular, have from time to time experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our actual operating performance. These trading price fluctuations may also make it more difficult for us to use our common stock as a means to make acquisitions or to use equity-related compensation to attract and retain employees. In addition, in the past, following periods of volatility in the overall market and the market price of a company s securities, securities class action litigation has often been instituted against these companies. This type of litigation, if instituted against us, could result in substantial costs and a diversion of our management s attention and resources.

***Substantial future sales of our common stock in the public market could cause our stock price to fall.***

Sales of substantial amounts of our common stock in the public market, or the perception that such sales could occur, could adversely affect the market price of our common stock. As of December 30, 2012, we had approximately 83.9 million shares of common stock outstanding, of which approximately 36.1 million shares were held by executive officers, directors or their affiliates and may be subject to volume and manner of sale restrictions of Rule 144 of the Securities Act. Sales of our common stock as restrictions end or pursuant to registration rights may make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. These sales also could cause our stock price to fall and make it more difficult for you to sell shares of our common stock.

Table of Contents

***Because we have no plans to pay dividends on our common stock, investors must look solely to stock appreciation for a return on their investment in us.***

We have never declared or paid any cash dividends on our capital stock, and we do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently intend to retain all future earnings to fund the development and growth of our business. Any payment of future dividends will be at the discretion of our board of directors and will depend on, among other things, our earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual restrictions applying to the payment of dividends and other considerations that the board of directors deems relevant. Investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize a return on their investment. Investors seeking cash dividends should not purchase our common stock.

***Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable.***

Provisions in our certificate of incorporation and bylaws, as amended and restated, may have the effect of delaying or preventing a change of control or changes in our management. These provisions include the following:

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

- the establishment of a classified board of directors requiring that only a subset of the members of our board of directors be elected at each annual meeting of stockholders;

- the prohibition of cumulative voting in our election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;

- the requirement that stockholders provide advance notice to nominate individuals for election to our board of directors or to propose matters that can be acted upon at a stockholders meeting. These provisions may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer s own slate of directors or otherwise attempting to obtain control of our company;

- the ability of our board of directors to issue, without stockholder approval, shares of undesignated preferred stock with terms set by the board of directors, which rights could be senior to those of our common stock. The ability to authorize undesignated preferred stock makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us;

- the required approval of the holders of at least two-thirds of the shares entitled to vote at an election of directors to repeal or adopt any provision of our certificate of incorporation regarding the election of directors;

- the required approval of the holders of at least 80% of such shares to amend or repeal the provisions of our bylaws regarding the election and classification of directors; and

- the required approval of the holders of at least a majority of the shares entitled to vote at an election of directors to remove directors without cause.

As a Delaware corporation, we are also subject to certain Delaware anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

***Sales of Unregistered Securities***

None

**ITEM 6. EXHIBITS**

See the Exhibit Index immediately following the signature page to this Quarterly Report on Form 10-Q, which is incorporated by reference here.

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.

| | |
|---|---|
| Dated: February 8, 2013 | INVENSENSE, INC. |
| | By: /s/ Alan Krock<br>Alan Krock<br>Chief Financial Officer<br><br>(Principal Financial Officer and Accounting Officer) |

Table of Contents

## INDEX TO EXHIBITS

| Exhibit Number | Description |
|---|---|
| 31.1 | Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350. |
| 101* | Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of December 30, 2012 and April 1, 2012 , (ii) Condensed Consolidated Statements of Income for the three and nine months ended December 30, 2012 and January 1, 2012, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended December 30, 2012 and January 1, 2012 and (iv) Notes to Condensed Consolidated Financial Statements |

* In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections.