

InvenSense Inc  
Form 10-Q  
January 30, 2015  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

**FORM 10-Q**

(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended December 28, 2014**

**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**

**INVENSENSE, INC.**

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

**Delaware**  
**(State or other jurisdiction of**  
**Incorporation or organization)**

**01-0789977**  
**(I.R.S. Employer**  
**Identification No.)**

**1745 Technology Drive, Suite 200, San Jose, CA 95110**  
**(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  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  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:

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Large accelerated filer  Accelerated filer   
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

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

<b>Class</b>	<b>Shares Outstanding at January 23, 2015</b>
Common Stock, \$0.001 par value	90,309,000

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**Table of Contents**

**INVENSENSE, INC.**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1. Financial Statements (Unaudited)</u></b>	3
<u>Condensed Consolidated Balance Sheets as of December 28, 2014 and March 30, 2014</u>	3
<u>Condensed Consolidated Statements of Operations for the three and nine months ended December 28, 2014 and December 29, 2013</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for three and nine months ended December 28, 2014 and December 29, 2013</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended December 28, 2014 and December 29, 2013</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	28
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	35
<b><u>Item 4. Controls and Procedures</u></b>	35
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1. Legal Proceedings</u></b>	36
<b><u>Item 1A. Risk Factors</u></b>	36
<b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	36
<b><u>Item 6. Exhibits</u></b>	36
<b><u>SIGNATURES</u></b>	37

**Table of Contents**

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

**INVENSENSE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except par value)**

	<b>December 28, 2014</b>	<b>March 30, 2014</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 65,057	\$ 26,025
Short-term investments	103,863	91,307
Accounts receivable	73,935	39,009
Inventories	67,801	73,032
Prepaid expenses and other current assets	20,061	19,587
Total current assets	330,717	248,960
Property and equipment, net	42,537	25,239
Intangible assets, net	45,461	35,360
Goodwill	139,175	50,952
Long-term investments	3,501	128,755
Other assets	11,558	5,469
Total assets	\$ 572,949	\$ 494,735
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 20,472	\$ 18,964
Accrued liabilities	33,457	14,985
Total current liabilities	53,929	33,949
Long-term debt	141,104	135,583
Other long-term liabilities	29,050	11,375
Total liabilities	224,083	180,907
Commitments and contingencies (Note 4)		
Stockholders equity:		
Preferred stock:		

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Preferred stock, \$0.001 par value 20,000 shares authorized, no shares issued and outstanding at December 28, 2014 and March 30, 2014

Common stock:

Common stock, \$0.001 par value 750,000 shares authorized, 90,180 shares issued and outstanding at December 28, 2014, 88,332 shares issued and outstanding at March 30, 2014

	252,460	215,958
Accumulated other comprehensive income (loss)	(23)	(38)
Retained earnings	96,429	97,908
<b>Total stockholders' equity</b>	<b>348,866</b>	<b>313,828</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 572,949</b>	<b>\$ 494,735</b>

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

**Table of Contents****INVENSENSE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(In thousands, except per share amounts)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28, 2014</b>	<b>December 29, 2013</b>	<b>December 28, 2014</b>	<b>December 29, 2013</b>
Net revenue	\$ 115,864	\$ 66,684	\$ 272,740	\$ 193,534
Costs of revenue	65,468	35,094	159,827	96,050
Gross profit	50,396	31,590	112,913	97,484
Operating expenses:				
Research and development	24,391	14,522	65,392	32,446
Selling, general and administrative	15,551	15,663	44,061	36,243
Litigation settlement		14,500		14,500
Total operating expenses	39,942	44,685	109,453	83,189
Income (loss) from operations	10,454	(13,095)	3,460	14,295
Interest (expense)	(2,690)	(1,463)	(7,894)	(1,463)
Other income (expense), net	(281)	(220)	1,099	73
Income (loss) before income taxes	7,483	(14,778)	(3,335)	12,905
Income tax provision (benefit)	(2,738)	(2,599)	(1,856)	1,154
Net income (loss)	\$ 10,221	\$ (12,179)	\$ (1,479)	\$ 11,751
Net income (loss) per share of common stock:				
Basic	\$ 0.11	\$ (0.14)	\$ (0.02)	\$ 0.14
Diluted	\$ 0.11	\$ (0.14)	\$ (0.02)	\$ 0.13
Weighted average shares outstanding used in computing net income (loss) per share:				
Basic	89,779	87,047	89,026	86,145
Diluted	92,336	87,047	89,026	89,364

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 (LOSS)****(Unaudited)****(In thousands)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income (loss)	\$ 10,221	\$ (12,179)	\$ (1,479)	\$ 11,751
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale securities, net of tax	(24)	(94)	15	(185)
Comprehensive income (loss)	\$ 10,197	\$ (12,273)	\$ (1,464)	\$ 11,566

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

Table of Contents

## INVENSENSE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended	
	December 28, 2014	December 29, 2013
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (1,479)	\$ 11,751
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	7,356	2,933
Amortization of intangible assets	4,929	829
Write-off of in-process research and development	770	
Loss on disposal of property and equipment	457	
Gain on equity investment	(890)	
Stock-based compensation expense	22,937	10,896
Deferred income tax assets	(5,212)	1
Tax effect of employee benefit plan	42	3,231
Excess tax benefit from stock-based compensation	(42)	(3,231)
Non cash interest expense	5,579	1,069
Changes in operating assets and liabilities:		
Accounts receivable	(34,308)	(4,681)
Inventories	5,232	(29,643)
Prepaid expenses and other assets	1,000	(2,547)
Other assets	(160)	(1,400)
Accounts payable	628	(2,341)
Accrued liabilities	8,224	24,926
Net cash provided by operating activities	15,063	11,793
<b>Cash flows from investing activities:</b>		
Acquisitions, net of cash acquired	(71,326)	(99,324)
Purchase of property and equipment	(25,289)	(14,682)
Sales and maturities of available-for-sale investments	112,728	63,145
Purchase of available-for-sale investments		(189,106)
Net cash provided by (used in) investing activities	16,113	(239,967)
<b>Cash flows from financing activities:</b>		
Proceeds from debt issuance, net of issuance costs		169,750
Proceeds from sale of warrants		25,643
Proceeds from the issuance of common stock	7,818	8,960

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Payment for purchase of convertible notes hedge		(39,118)
Payments of long-term debt and capital lease obligations	(4)	(8)
Excess tax benefit from stock-based compensation	42	3,231
<b>Net cash provided by financing activities</b>	<b>7,856</b>	<b>168,458</b>
Net increase in cash and cash equivalents	39,032	(59,716)
Cash and cash equivalents:		
Beginning of period	26,025	100,843
End of period	\$ 65,057	\$ 41,127
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 2,960	\$
Cash received (paid) for income taxes	\$ (340)	\$ 166
Noncash investing and financing activities:		
Unpaid purchases of property and equipment	\$ 847	\$ 1,444
Unpaid contingent consideration from business acquisition	\$ 16,034	\$
Unrealized gain from available-for-sale investments	\$ (37)	\$ 260
Non-cash warrant exercises	\$	\$ 90
Unpaid debt issuance cost	\$	\$ 491
Proceeds receivable from the exercise of stock options	\$ 65	\$ 43

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

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**Table of Contents**

**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 is the world's leading provider of intelligent sensor system on chip (SoC) for Motion and Sound in consumer electronic devices. The company's patented InvenSense Fabrication Platform and MotionFusion technology address the emerging needs of many mass-market consumer applications via improved performance, accuracy, and intuitive motion-, gesture- and sound-based interfaces. InvenSense technology can be found in Mobile, Wearables, Smart Home, Industrial, and Automotive products.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the fiscal year ended March 30, 2014 included in the Company's Annual Report on Form 10-K filed on May 29, 2014 with the Securities and Exchange Commission (SEC). No material changes have been made to the Company's significant accounting policies since the Company's Annual Report on Form 10-K for the fiscal year ended March 30, 2014.

**Certain Significant Business Risks and Uncertainties**

The Company participates in the high-technology industry and believes that adverse changes in any of the following areas could have a material effect on the Company's future financial position, results of operations, or cash flows: reliance on a limited number of primary customers to support the Company's revenue generating activities; advances and trends in new technologies and industry standards; market acceptance of the Company's products; development of sales channels; strategic relationships, including key component suppliers; litigation or claims against the Company based on intellectual property, patent, product, regulatory, or other factors; and the Company's ability to attract and retain employees necessary to support its growth.

**Basis of Consolidation**

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP), and include our accounts and the accounts of our wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in 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 operations.

**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 2014) ended on March 30, 2014 (March 2014). The third fiscal quarter in each of the two most recent fiscal years ended on December 28, 2014 (three months ended December 28, 2014 or December 2014) and December 29, 2013 (three months ended December 29, 2013 or December 2013), respectively, and each quarter period included 13 weeks.

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with 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.

**Table of Contents**

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

The condensed consolidated balance sheet as of March 30, 2014, 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 (loss) and cash flows for the interim periods. The results of operations for the period ended December 28, 2014 is not necessarily indicative of the results to be expected for the fiscal year ending March 29, 2015 or for any future year or interim period.

**Use of Estimates**

The preparation of the Company's Condensed Consolidated Financial Statements and notes thereto 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 Condensed Consolidated Financial Statements and notes thereto and the reported amounts of income and expenses during the reporting period. Significant estimates included in the Consolidated Financial Statements and notes thereto include income taxes, inventory valuation, stock-based compensation, goodwill, loss contingencies, warranty reserves, valuation of acquired assets and contingent consideration, and valuation of convertible senior notes, including the related convertible notes hedges and warrants. These estimates are based upon information available as of the date of the consolidated financial statements, and actual results could differ from those estimates.

**Goodwill**

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. In accordance with ASC 350, the Company reviews goodwill for impairment at the reporting unit level on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company performed the first step of the two-step goodwill impairment test. As the Company uses the market approach to assess impairment, its common stock price is an important component of the fair value calculation. The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. The Company performed its annual impairment test during the quarter ended December 28, 2014 and determined that its goodwill was not impaired.

**Table of Contents****INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Concentration of Credit Risk**

The majority of the Company's products are shipped through its distributors or contract manufacturers, which are the legal counter-party on the sale. The Company does not refer to these intermediaries as our customers in this report. When the Company references customers in this report, the Company is referring to the manufacturers of consumer electronics devices that are the end customer that these intermediaries sell the Company's products to or that incorporate the Company's products into finished products. These manufacturers of consumer electronics devices are categorized as our customers. For accounting purposes, any disclosure about the composition of the Company's accounts receivable refers to the intermediary, which is the legal counter-party in a particular contract, and any disclosure about the composition of the Company's revenue (e.g., greater than 10% customers in the footnotes to our financial statements) refers to the end customers of both those intermediaries and the Company. Some of the Company's intermediaries may serve as such for more than one or more of the Company's customers. As a result, attempting to compare or correlate disclosures about our accounts receivable composition as of a particular date with the disclosures regarding revenues generated by our customers for the period ending on the same date can be difficult or misleading.

A distributor and a customer accounted for 77% and 12% of accounts receivable, respectively, at December 28, 2014. At March 30, 2014, three customers accounted for 28%, 19% and 19% of accounts receivable.

For the three months ended December 28, 2014, two customers accounted for 45% and 24% of net revenue. For the nine months ended December 28, 2014, two customers accounted for 29% and 28% of net revenue. For the three months ended December 29, 2013, three customers accounted for 32%, 16% and 10% of net revenue. For the nine months ended December 29, 2013, one customer accounted for 32% of net revenue.

**Warranty**

The Company's warranty agreements are contract and component specific and can be for a period of up to three years after shipment to the customer or intermediary for selected components. The accrual includes management's judgment regarding anticipated rates of warranty claims and associated repair costs. The following table summarizes the activity related to product warranty liability during the nine months ended December 28, 2014 and December 29, 2013:

	<b>Nine Months Ended</b>	
	<b>December 28, 2014</b>	<b>December 29, 2013</b>
	<b>(in thousands)</b>	
Beginning balance	\$ 80	\$ 123
Provision for warranty	60	69
Adjustments related to changes in estimate	55	(73)

Less: actual warranty costs	(68)	(30)
Ending balance	\$ 127	\$ 89

**Net Income (Loss) Per Share**

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding during the period, which excludes dilutive unvested restricted stock.

Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding, including unvested restricted stock, certain warrants to purchase common stock and potential dilutive shares from the dilutive effect of outstanding stock options 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 (loss) per share:

	Three Months Ended		Nine Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands, except per share data)			
<b>Numerator:</b>				
Basic and Diluted				
Net income (loss)	\$ 10,221	\$ (12,179)	\$ (1,479)	\$ 11,751
<b>Denominator:</b>				
Basic shares:				
Weighted-average shares used in computing basic net income (loss) per share	89,779	87,047	89,026	86,145
Diluted shares:				
Weighted-average shares used in computing basic net income (loss) per share	89,779	87,047	89,026	86,145
Effect of potentially dilutive securities:				
Stock options and unvested restricted stock	2,557			3,165
Common stock warrants				54
Weighted-average shares used in computing diluted net income (loss) per share	92,336	87,047	89,026	89,364
Net income (loss) per share				
Basic	\$ 0.11	\$ (0.14)	\$ (0.02)	\$ 0.14
Diluted	\$ 0.11	\$ (0.14)	\$ (0.02)	\$ 0.13

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

Three Months Ended

Nine Months Ended

	<b>December 28, 2014</b>	<b>December 29, 2013</b>	<b>December 28, 2014</b>	<b>December 29, 2013</b>
	<b>(in thousands)</b>			
Employee stock options	2,785	9,016	8,621	2,922
Unvested restricted stock units	738	2,369	3,637	830
<b>Total antidilutive securities</b>	<b>3,523</b>	<b>11,385</b>	<b>12,258</b>	<b>3,752</b>

In November 2013, the Company issued \$175.0 million aggregate principal amount of 1.75% Convertible Senior Notes due on November 1, 2018 (the Notes). On or after August 1, 2018 until the maturity date, the Notes may be converted at the option of the holders under certain circumstances. The conversion rate is initially 45.683 shares per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$21.89 per share of common stock), subject to certain adjustments (see Note 5).

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**Table of Contents**

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Recent Accounting Pronouncements**

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU No. 2014-09 provides guidance that companies will recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the payment to which a company expects to be entitled in exchange for those goods or services. The Company will be required to implement the new revenue recognition standard for the first quarter of fiscal year 2018. The Company is currently evaluating the impact on its consolidated financial statements.

**2. Cash Equivalents and Available-for-sale Investments, and Fair Value of Financial Instruments**

At December 28, 2014, of the \$65.1 million of the Company's cash and cash equivalents, \$47.9 million was cash and \$17.2 million was cash equivalents invested in money market funds and commercial paper. At December 28, 2014, \$47.0 million of the \$65.1 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 28, 2014, the Company had short-term available-for-sale investments of \$103.9 million and long-term available-for-sale investments of \$3.5 million totaling \$107.4 million. Long-term investments as of December 28, 2014 of \$3.5 million had scheduled maturities between one and two years from the balance sheet date.

At March 30, 2014, of the \$26.0 million of the Company's cash and cash equivalents, \$15.3 million was cash and \$10.7 million was cash equivalents invested in money market funds. At March 30, 2014, \$9.8 million of the \$26.0 million of cash and cash equivalents were held by our foreign subsidiaries. As of March 30, 2014, the Company had short-term available-for-sale investments of \$91.3 million and long-term available-for-sale investments of \$128.8 million totaling \$220.1 million which was held in the US entity. Long-term investments as of March 30, 2014 of \$128.8 million had scheduled maturities between one and two years from the balance sheet date.

The Company applies the provisions of 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;

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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 fair values of our money market funds were derived from quoted market prices as active markets for these instruments exist. 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:**Level 1 and 2 financial assets:*

The fair values of money market funds were derived from quoted market prices as active markets for these instruments exist. The fair values of corporate notes and bonds, commercial paper, municipal notes and bonds and U.S. Agency Securities were derived from non-binding market consensus prices that are corroborated by observable market data.

**December 28, 2014:**

Assets and liabilities measured at fair value on a recurring basis were presented in the Company's condensed consolidated balance sheet as of December 28, 2014.

	December 28, 2014 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)				
<b>Assets</b>				
Money Market Funds	\$ 17,244	\$ 17,244	\$	\$
Corporate Notes and Bonds	103,766		103,766	
Municipal Notes and Bonds	1,098		1,098	
U.S. Agency Securities	2,500		2,500	
 Total investments	 \$ 124,608	 \$ 17,244	 \$ 107,364	 \$
<b>Liabilities</b>				
Contingent consideration	\$ 16,909			\$ 16,909
<b>Assets</b>				
Cash equivalents	\$ 17,244	\$ 17,244	\$	\$
Short-term investments	103,863		103,863	
Long-term investments	3,501		3,501	
 Total investments	 \$ 124,608	 \$ 17,244	 \$ 107,364	 \$

**Liabilities**

Accrued liabilities	\$ 14,183			\$ 14,183
Long-term liabilities	2,726			2,726
Total contingent consideration	\$ 16,909	\$	\$	\$ 16,909

	December 28, 2014 Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	December 28, 2014 Estimated FMV
Corporate Notes and Bonds	\$ 103,803	\$ 6	\$ (43)	\$ 103,766
Municipal Notes and Bonds	1,097	1		1,098
U.S. Agency Securities	2,500			2,500
Total Available-for-sale investments	\$ 107,400	\$ 7	\$ (43)	\$ 107,364
Cash equivalents				17,244
Total Aggregate Fair Value				\$ 124,608

There were no transfers of assets measured at fair value between Level 1 and Level 2 during the nine months ended December 28, 2014.

Table of Contents

## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

March 30, 2014:

Assets measured at fair value on a recurring basis were presented in the Company's consolidated balance sheet as of March 30, 2014.

	March 30, 2014 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	\$ 10,657	\$ 10,657	\$	\$
Corporate Notes and Bonds	204,683		204,683	
Municipal Notes and Bonds	3,895		3,895	
Commercial Paper	8,988		8,988	
U.S. Agency Securities	2,496		2,496	
Total	\$ 230,719	\$ 10,657	\$ 220,062	\$
Cash equivalents	\$ 10,657	\$ 10,657	\$	\$
Short-term investments	91,307		91,307	
Long-term investments	128,755		128,755	
Total	\$ 230,719	\$ 10,657	\$ 220,062	
	March 30, 2014 Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	March 30, 2014 Estimated FMV
(in thousands)				
Corporate Notes and Bonds	\$ 204,747	\$	\$ (64)	\$ 204,683
Municipal Notes and Bonds	3,888	7		3,895
Commercial Paper	8,986	2		8,988
U.S. Agency Securities	2,500		(4)	2,496
Total Available-for-sale investments	\$ 220,121	\$ 9	\$ (68)	\$ 220,062

Cash equivalents	10,657
<b>Total Aggregate Fair Value</b>	<b>\$ 230,719</b>

There were no transfers of assets measured at fair value between Level 1 and Level 2 during Fiscal 2014.

*Level 3 financial liabilities:*

The following table provides a summary of changes in fair value of the Company's contingent consideration categorized as Level 3 for the nine months ended December 28, 2014:

	<b>Nine Months Ended December 28, 2014 (in thousands)</b>
Beginning balance	\$
Add: Contingent consideration in connection with acquisitions	16,034
Payments made on contingent liabilities	
Change in fair value and other	875
Ending balance	\$ 16,909



Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Contingent consideration on acquired businesses (See Note 8) was measured at fair value using Level 3 inputs as defined in the fair value hierarchy. The following table presents certain information about the significant unobservable inputs used in the fair value measurement for the contingent consideration measured at fair value on a recurring basis using significant unobservable inputs:

<b>Description</b>	<b>Valuation Techniques</b>	<b>Significant Unobservable Inputs</b>
Liabilities: Contingent consideration	Present value of a Probability Weighted Earn-out model using an appropriate discount rate.	Estimate of achieving the milestones.

An increase in the estimate of probability of meeting the milestones could result in a significantly higher estimated fair value of the contingent consideration liability. Alternatively, a decrease in the estimate of probability of meeting the milestones could result in a significantly lower estimated fair value of contingent consideration liability.

The fair value of contingent consideration was derived from a probability weighted earn-out model of future contingent payments. The cash payments are expected to be made upon meeting the milestones (See Note 8). The valuation of the contingent consideration was based on a collaborative effort of the Company's engineering and finance departments, and third party valuation experts. The estimate of meeting the milestones and discount rates will be reviewed quarterly and updated as and when necessary. Potential valuation adjustments will be made to adjust the contingent consideration payments. These adjustments will be recorded in the statements of operations.

**3. Balance Sheet Details****Inventories**

Inventories at December 28, 2014 and March 30, 2014 consist of the following:

	<b>December 28, 2014</b>	<b>March 30, 2014</b>
	<b>(in thousands)</b>	
Work in process	\$ 44,270	\$ 58,641
Finished goods	23,531	14,391
<b>Total inventories</b>	<b>\$ 67,801</b>	<b>\$ 73,032</b>

**Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets at December 28, 2014 and March 30, 2014 consist of the following:

	<b>December 28, 2014</b>	<b>March 30, 2014</b>
	<b>(in thousands)</b>	
Prepaid expenses	\$ 5,032	\$ 3,495
Income tax receivable	7,565	5,932
Other receivables	3,099	5,356
Deferred tax assets	2,571	2,487
Advance to vendors	843	1,026
Other current assets	951	1,291
<b>Total prepaid expenses and other current assets</b>	<b>\$ 20,061</b>	<b>\$ 19,587</b>

Table of Contents

## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Property and Equipment**

Property and equipment at December 28, 2014 and March 30, 2014 consist of the following:

	December 28, 2014	March 30, 2014,
	(in thousands)	
Production and lab equipment	\$ 44,171	\$ 25,890
Computer equipment and software	5,864	4,335
Equipment under construction	3,712	2,298
Leasehold improvements and furniture and fixtures	7,113	3,918
Subtotal	60,860	36,441
Accumulated depreciation and amortization	(18,323)	(11,202)
Property and equipment net	\$ 42,537	\$ 25,239

Depreciation expense for the three and nine months ended December 28, 2014 was \$3.0 million and \$7.4 million, respectively. Depreciation expense for the three and nine months ended December 29, 2013 was \$1.4 million and \$2.9 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. All of the equipment under construction is expected to be completed and placed in service by the end of fiscal 2015.

**Accrued Liabilities**

Accrued liabilities at December 28, 2014 and March 30, 2014 consist of the following:

	December 28, 2014	March 30, 2014,
	(in thousands)	
Contingent consideration	\$ 14,183	\$
Payroll-related expenses	6,759	4,207
Bonuses	3,837	3,019
Legal fees	579	2,527
Accrued contractual coupon interest payable on convertible senior notes	488	1,158
Deferred revenue	1,574	800

Income tax payable	176	117
Other accrued liabilities	5,861	3,157
Total accrued liabilities	\$ 33,457	\$ 14,985

#### 4. Commitments and Contingencies

##### Operating Lease Obligations

The Company has non-cancelable operating leases for its facilities through fiscal year 2021.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Future minimum lease payments under operating leases as of December 28, 2014 are as follows:

	<b>Amount</b>
	<b>(in thousands)</b>
<b>Fiscal Years Ending:</b>	
2015 (remainder)	\$ 1,398
2016	6,300
2017	6,384
2018	6,327
2019	6,443
Beyond	6,617
<b>Total</b>	<b>\$ 33,469</b>

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 \$1.3 million and \$3.6 million for the three and nine months ended December 28, 2014, respectively. The Company's rental expense under operating leases was approximately \$1.6 million and \$3.4 million for the three and nine months ended December 29, 2013, respectively.

**Legal Proceedings**

From time to time, the Company is involved in legal proceedings concerning matters arising in connection with the conduct of its business activities. The Company regularly evaluates the status of legal proceedings in which the Company is involved to assess whether a loss is probable or there is a reasonable possibility that a loss or additional loss may have been incurred and to determine if accruals are appropriate. The Company further evaluates each legal proceeding to assess whether an estimate of possible loss or range of loss can be made.

On January 7, 2015 a purported shareholder filed a class action complaint in the U.S. District Court, Northern District of California against the Company and two of the Company's current and former executives (the Securities Case). Jim McMillan, Individually and on Behalf of All Others Similarly Situated v. InvenSense, Inc., et al. Civil Action No. 3:15-cv-00084-JD. The complaint alleges that the defendants violated the federal securities laws by making materially false and misleading statements regarding our business results between July 29, 2014 and October 28, 2014, and seeks unspecified damages along with plaintiff's costs and expenses, including attorneys' fees. A second complaint, William Lendales v. InvenSense, Inc. et al., Case No. 3:15-cv-00142-VC, was filed on January 12, 2015, by a different purported shareholder, in the same court, setting forth substantially the same allegations. A third complaint, Plumber & Steamfitters Local 21 Pension Fund v. InvenSense, Inc., et al., Civil Action No 5:15-cv-00249-BLF, was filed on

January 16, 2015, by a different purported shareholder, in the same court, setting forth substantially the same allegations. The Company has undertaken an evaluation of these complaints. A fourth complaint, William B. Davis vs. InvenSense, Inc., et al., Civil Action No. 5:15-cv-00425-RMW, was filed on January 29, 2015, by a different purported shareholder, in the same court, setting forth substantially the same allegations.

On January 13, 2015, another purported shareholder filed a shareholder derivative complaint against two of our current and former officers and several of our current directors in the U.S. District Court, Northern District of California (the Derivative Case ). George Rollins, derivatively on behalf of InvenSense, Inc. v. Behrooz Abdi, et. al., Civil Action No 5:15-cv-00184-PSG. In this complaint, the plaintiff makes allegations similar to those presented in the Securities Case, but the plaintiff asserts various state law causes of action, including claims of breach of fiduciary duty and unjust enrichment. A second complaint, Linda Karr, derivatively on behalf of InvenSense, Inc. v. Behrooz Abdi, et. al., Civil Action No. 5:15-cv-00200-NC, was filed on January 14, 2015, by a different purported shareholder, in the same court, setting forth substantially the same allegations. The Company has undertaken an evaluation of these complaints

## **5. Convertible Senior Notes**

In November 2013, the Company issued \$175.0 million aggregate principal amount of 1.75% Convertible Senior Notes due on November 1, 2018 (the Notes ), in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933 (the Securities Act ). The Notes offered have not been registered under the Securities Act, or applicable state securities laws or blue sky laws, and may not be offered or sold in the United States absent registration under the Securities Act and applicable state securities laws or available exemptions from the registration requirements.

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**Table of Contents**

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

The Notes are senior unsecured obligation of the Company and rank equally in right of payment with all of the Company's existing and future senior unsecured indebtedness and are junior to any of the Company's existing and future secured indebtedness. The Notes pay interest in cash semi-annually (May and November) at a rate of 1.75% per annum. Net proceeds received by the Company, after issuance costs, were approximately \$169.3 million.

On or after August 1, 2018 until the maturity date, the Notes may be converted at the option of the holders. Holders may convert the Notes at their option prior to August 1, 2018 only under the following circumstances:

- 1) During any calendar quarter commencing after the calendar quarter ending on March 31, 2014 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- 2) During the five business day period after any five consecutive trading day period in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or
- 3) Upon the occurrence of specified corporate events, including if there is a fundamental change.

Upon conversion, the Company will pay cash up to the aggregate principal amount of the Notes to be converted and pay or deliver cash, shares of its own common stock or a combination of cash and shares of its own common stock, at the Company's election, in respect of the remainder, if any, of its conversion obligation in excess of the aggregate principal amount of the notes being converted.

The conversion rate is initially 45.683 shares per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$21.89 per share of common stock), subject to certain adjustments.

The Notes are not redeemable by the Company prior to the maturity date. At the event of default or fundamental change, the principal amount of the notes plus accrued and unpaid interest may become due immediately at the Note holders' option.

The Company used and plans to use the net proceeds of approximately \$169.3 million from the offering of the Notes (after the issuance costs) for general corporate purposes, including to replace cash used for business acquisitions (see Note 8), for the cost of the Note hedge transactions (see below) and for capital expenditures and working capital. However, the Company has not designated with certainty all of the particular uses for the net proceeds from the Notes.

The Company separately accounts for the liability and equity components of the Notes. The initial debt component of the Notes was valued at \$135.7 million based on the contractual cash flows discounted at an appropriate comparable market non-convertible debt borrowing rate at the date of issuance of 7.3%, with the equity component representing

the residual amount of the proceeds of \$39.3 million which was recorded as a debt discount. The issuance costs were allocated pro-rata based on the relative initial carrying amounts of the debt and equity components, including the Note hedges and warrants transactions described below. As a result, \$2.5 million of the issuance costs was allocated to the equity component of the Notes, \$3.0 million of issuance costs paid to the initial purchaser was accounted for as a debt discount and \$0.25 million of the issuance costs was classified as other non-current assets. The debt discount and the issuance costs allocated to the debt component are amortized as additional interest expense over the term of the Notes using the effective interest method. As of December 28, 2014 the remaining amortization period of the debt discount and the issuance costs is 3.9 years. The effective interest rate of the Notes is 7.84% per annum (1.75% coupon rate plus 6.09% of non-cash accretion expense).

### **Convertible Notes Hedges and Warrants**

Concurrent with the issuance of the Notes on November 6 and 7, 2013, the Company purchased call options for its own common stock to hedge the Notes (the Note Hedge ) and sold call options for its own common stock (the Warrants ). The Note Hedges and Warrants transactions are structured to reduce the potential future economic dilution associated with the conversion of the Notes and are excluded from the computation of diluted earnings per share for each period presented, as the Company's average stock price during each period is less than the conversion price.



Table of Contents

## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

*The Note Hedges* On November 6 and 7, 2013, the Company purchased call options from a counterparty for an aggregate price of approximately \$39.1 million, which gives the Company the right to buy from the counterparty up to approximately 8.0 million shares of the Company's common stock at a price of \$21.89 per share, subject to adjustments. The Note Hedge is exercisable upon conversion of the Note for a number of shares equal to the product of 0.045683 and amount of the converted Note. Upon exercise of the Note Hedge the Company will receive from the counterparty cash, shares of Company's common stock, or a combination thereof, equal to the amount by which the market price per share of the Company's common stock exceeds \$21.89 during the applicable valuation period. By the Note Hedge terms the Company will receive cash and shares in a combination that offsets share dilution caused by conversion of the Note.

*Warrants* On November 6 and 7, 2013, the Company sold call options to the same counterparty for approximately \$25.6 million, which gives the counterparty the right to buy from the Company up to approximately 8.0 million shares of the Company's common stock at an exercise price of \$28.66 per share, subject to adjustments, on a series of days commencing on February 1, 2019 and ending May 13, 2019. Upon exercise of the Warrants, the Company has the option to deliver cash or shares of its common stock equal to the difference between the market price on the exercise date and the strike price of the warrants. Upon exercise of the Warrants, the Company will pay to the Initial Purchaser cash, shares of Company's common stock, or a combination thereof (at the Company's choice), equal to the amount by which the market price per share of the Company's common stock exceeds \$28.66 during the applicable valuation period.

The Note Hedges and Warrants above are classified in stockholders' equity in the Company's consolidated balance sheets.

The following table summarizes the principal amounts and related unamortized discount on the Notes:

	<b>December 28, 2014</b>
	<b>(in thousands)</b>
Principal amount of the Notes	\$ 175,000
Unamortized discount on the Notes	33,896
Net carrying value	\$ 141,104

The following table presents the amount of interest expense recognized related to the Notes for the three and nine months ended December 28, 2014:

**Three Months Ended****Nine Months Ended**

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	<b>December 28, 2014</b>	<b>December 29, 2013</b>	<b>December 28, 2014</b>	<b>December 29, 2013</b>
	<b>(in thousands)</b>			
Contractual coupon interest expense	\$ 764	\$ 394	\$ 2,296	\$ 394
Accretion of debt discount	1,875	1,062	5,522	1,062
Amortization of debt issuance costs	13	7	38	7
 Total interest expense related to the Notes	 \$ 2,652	 \$ 1,463	 \$ 7,856	 \$ 1,463

As of December 28, 2014, our aggregate future principal debt maturities are as follows (in thousands):

<b>Fiscal Year</b>	<b>December 28, 2014 (in thousands)</b>
2015-2018	\$
2019	175,000
 Total	 \$ 175,000

Table of Contents

## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The convertible notes issued by the Company in November 2013 are shown in the accompanying consolidated balance sheets at their original issuance value, net of unamortized discount, and are not marked to market each period. The approximate fair value of the convertible notes as of December 28, 2014 was \$174.3 million. The fair value of the convertible notes was determined using quoted market prices for similar securities, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

**6. 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 3.5 million shares for fiscal year 2015.

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.

Incentive stock options may only be granted to employees and at an exercise price of no less than 100% of 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 are 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
Outstanding March 30, 2014	12,595	8,276	\$ 10.37	7.87	\$ 102,072
Increase to stock option pool	3,533				

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Options granted	(1,632)	1,632	19.85		
Exercised options		(1,024)	6.27		
Cancelled options	401	(401)	11.98		
Outstanding December 28, 2014	14,897	8,483	\$ 12.62	7.59	\$ 39,188
Vested and expected to vest December 28, 2014		7,569	\$ 12.19	7.46	\$ 37,497
Vested December 28, 2014		3,522	\$ 9.23	6.52	\$ 25,544

Table of Contents

## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**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 condensed consolidated statements of operations 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 28, 2014 was \$2.3 million and \$16.5 million respectively. The aggregate intrinsic value of the stock options exercised during the three and nine months ended December 29, 2013 was \$5.8 million and \$28.5 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 \$18.0 million, and \$19.9 million at December 28, 2014 and December 29, 2013, respectively, and will be amortized over a weighted-average remaining period of approximately 2.5 and 2.9 years, respectively. Total unrecognized expense will be adjusted for future changes in estimated forfeitures.

The Company used the following weighted-average assumptions in determining stock-based compensation expense for options granted in the three and nine months ended December 28, 2014 and December 29, 2013.

	Three Months Ended		Nine Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
Expected term (in years)	5.0	4.8	4.5	4.7
Volatility	45.9%	40.5%	42.1%	41.5%
Risk-free interest rate	1.6%	1.0%	1.5%	1.2%
Dividend rate	0%	0%	0%	0%

The weighted average fair value of the stock options granted was \$6.65 and \$7.28 per share for the three and nine months ended December 28, 2014, respectively. The weighted average fair value of the stock options granted was \$6.61 and \$5.76 per share for the three and nine months ended December 29, 2013, respectively.

**Restricted Stock Units and Restricted Stock**

Restricted stock unit and restricted stock activity of the Company under the Plans are as follows:

Restricted stock units and restricted stock activities	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value Per Share</b>
	<b>(in thousands, except per share amount)</b>	
Unvested at March 30, 2014	3,325	\$ 16.63
Granted	1,213	21.08
Released	(534)	14.32
Forfeited	(235)	17.42
Unvested at December 28, 2014	3,769	\$ 18.34

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Restricted stock units and restricted stock granted to employees are generally subject to the employee's continued service to the Company over that period. The fair value of restricted stock units and restricted stock is determined using the fair value of the Company's common stock on the date of the grant. Compensation expense is generally recognized on a straight-line basis over the requisite service period of each grant adjusted for estimated forfeitures. At December 28, 2014, there was approximately \$44.4 million of total unrecognized compensation cost related to restricted stock units and restricted stock, which the Company expects to recognize over a weighted-average period of 3.0 years. The weighted-average grant-date fair value per share of restricted stock units and restricted stock awarded in the nine months ended December 28, 2014 and December 29, 2013 was \$21.08 and \$15.55, respectively.

**Common Stock**

As of December 28, 2014 and March 30, 2014, common stock reserved for future issuance was as follows:

<b>Common stock reserved for issuance</b>	<b>December 28, 2014 March 30, 2014, (in thousands)</b>	
Stock plans		
Outstanding stock options	8,483	8,276
Outstanding restricted stock units and restricted stocks	3,769	3,325
Reserved for future equity incentive grants	11,022	9,697
	23,274	21,298
Purchase plan	230	400
Warrants to purchase common stock	8,000	7,995
Total common stock reserved for future issuances	31,504	29,693

**2013 Employee Stock Purchase Plan**

Under the 2013 Employee Stock Purchase Plan, effective September 13, 2013, (the "Purchase Plan"), eligible employees may apply accumulated payroll deductions, which may not exceed 10% of an employee's compensation, to the purchase of shares of the Company's common stock at periodic intervals. The purchase price of stock under the Purchase Plan is equal to 85% of the lower of (i) the fair market value of the Company's common stock on the first day of each offering period, or (ii) the fair market value of the Company's common stock on the purchase date (as defined in the Purchase Plan). Each offering period consists of one purchase period of approximately nine months duration.

An aggregate of 400,000 shares of common stock were reserved for issuance to employees under the Purchase Plan. As of December 28, 2014, 170,000 shares had been purchased.

**Stock-Based Compensation Expense**

Total employee stock-based compensation costs for the Company's stock plans for the three and nine months ended December 28, 2014 and December 29, 2013 are as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			
Cost of revenue	\$ 589	\$ 349	\$ 1,900	\$ 845
Research and development	3,821	1,665	10,536	3,941
Selling, general and administrative	3,890	2,705	10,501	6,110
Total stock-based compensation expense	\$ 8,300	\$ 4,719	\$ 22,937	\$ 10,896



**Table of Contents**

**INVENSENSE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**7. Income Taxes**

In the three and nine months ended December 28, 2014, the Company recorded an income tax provision (benefit) of (\$2.7) million and (\$1.9) million respectively. In the three and nine months ended December 29, 2013, the Company recorded an income tax provision (benefit) of \$(2.6) million and \$1.2 million respectively. The Company's estimated 2015 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 and the extension of 2014 R&D Tax Credit. The Tax Increase Prevention Act of 2014(H.R.5771), signed into law by the President in December 2014, extends the 2014 R&D Tax Credit retroactively.

The Company files U.S. federal income tax returns as well as income tax returns in California, Massachusetts 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 28, 2014 because such earnings are to be reinvested indefinitely.

The Company has recorded \$11.6 million of uncertain tax positions within Other long-term liabilities on the condensed consolidated balance sheet as at December 28, 2014. The Company does not expect any significant increases or decreases to its 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.

The Company's tax year from 2003 and onwards could be subject to examinations by tax authorities in one or more tax jurisdictions. The Internal Revenue Service (the IRS) is currently examining the fiscal years 2011 through 2013. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

**8. Business Combinations**

***Movea S.A***

On July 22, 2014, the Company acquired 100% equity interest of Movea, a company formed under the laws of France, and a leading provider of software for ultra-low power location, activity tracking and context sensing. The acquisition of Movea further scales the Company's leadership in motion software.

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The Company paid \$60.9 million in cash as consideration for the acquisition and could pay an additional \$13.0 million in cash contingent upon the achievement of certain milestones within one year of the acquisition.

In addition, the Company, under its 2011 Stock Incentive Plan granted restricted stock units (RSUs) with a fair value of \$6.6 million, to certain Movea employees. The RSUs will vest over a five year requisite service period.

Table of Contents

## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The table below is a summary of the preliminary purchase price allocation of the fair value of assets acquired and liabilities assumed in connection with the acquisition of Movea (in thousands):

Cash consideration	\$ 60,900
Contingent consideration	8,400
	\$ 69,300
<b>Preliminary allocation of purchase price:</b>	
Current assets	\$ 3,082
Fixed assets	209
Other non-current assets	592
Developed technology	7,200
Goodwill	68,330
Current liabilities	(5,016)
Long-term liabilities	(5,097)
Total preliminary purchase price	\$ 69,300

The purchase price includes contingent considerations of (i) \$8.0 million payable in cash to the former Movea shareholders upon a design win with a major smartphone manufacturer within one year of closing date, and (ii) \$5.0 million payable in cash to the former Movea shareholders upon a specific product development milestone before December 29, 2014. The fair value of the contingent consideration of \$8.4 million was derived from a probability weighted earn-out model of future contingent payments and recorded in accrued liabilities. The product development milestone of \$5.0 million was achieved in the quarter ended December 28, 2014 and the payment is expected to be made in the fourth quarter of fiscal 2015. The difference between the contractual amount of \$5.0 million and the fair value of this contingent consideration was recorded in the research and development expense for the three months ended December 28, 2014.

The purchase price exceeded the fair value of the net tangible and identifiable intangible assets acquired and, as a result, the Company recorded goodwill in connection with this transaction. The acquisition will provide assembled workforce and synergy with other of the Company's offerings. These factors primarily contributed to a purchase price that resulted in goodwill.

The following table presents certain information on acquired identifiable intangible assets related to the Movea acquisition:

	<b>Estimated Fair Value (in thousands)</b>	<b>Estimated Useful Life (in years)</b>
Developed technology	\$ 7,200	5

The fair value of developed technology was determined using a cost approach, which includes an estimate of time and expenses required to recreate the intangible asset. The fair value of developed technology was capitalized as of the acquisition date and will be amortized using a straight-line method to cost of revenue over the estimated useful life of 5 years.

#### ***Unaudited Pro Forma Financial Information***

The following unaudited pro forma financial information presents the combined results of operations of InvenSense and Movea as if the acquisition had occurred as of the beginning of fiscal 2014:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28, 2014</b>	<b>December 29, 2013</b>	<b>December 28, 2014</b>	<b>December 29, 2013</b>
Net revenue	\$ 115,864	\$ 67,755	\$ 273,414	\$ 196,030
Net income (loss)	\$ 10,221	\$ (14,231)	\$ (4,496)	\$ 5,024

Table of Contents

## INVENSENSE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

*Trusted Positioning, Inc.*

On August 29, 2014, the Company completed the acquisition of Trusted Positioning, Inc., ( TPI ), a Canadian corporation, which is an indoor/outdoor positioning software company with the vision to provide Positioning Everywhere . The acquisition of TPI, particularly its advanced location tracking software, strengthens the Company s position as a provider of intelligent sensor System on Chips (SoC) for the fast growing mobile market.

The Company s acquisition of TPI was completed through a step acquisition. In fiscal 2014, the Company made investments totaling \$0.3 million to own approximately 4.57% of TPI s outstanding common stock. On August 29, 2014, the Company purchased the remaining outstanding common stock of TPI for a total consideration of \$25.9 million. The total purchase price, as presented in the table below, consists of (i) cash of \$11.4 million (ii) issuance of 236,000 shares of the Company s common stock with a fair value of \$5.7 million (iii) contingent considerations with a combined fair value of \$7.6 million payable upon TPI s achievement of certain product development milestones, and (iv) initial investments with a fair value of \$1.2 million.

In addition, the Company, under its 2011 Stock Incentive Plan, granted equity awards (RSUs and stock options), to certain TPI employees with an aggregate fair value of \$5.0 million. The equity awards will vest over a 5 year requisite service period.

The table below is a summary of the preliminary purchase price allocation for the 100% equity interest of the fair value of assets acquired and liabilities assumed in connection with the acquisition of TPI (in thousands):

Cash consideration	\$ 11,379
Issuance of common stock	5,703
Contingent consideration	7,634
Fair value of previously held 4.57% equity interest	1,215
	\$ 25,931
<b>Preliminary allocation of purchase price:</b>	
Current assets	\$ 392
Fixed assets	50
Other non-current assets	546
Developed technology	8,600
Goodwill	19,893
Current liabilities	(1,247)
Long-term liabilities	(2,303)

Total preliminary purchase price

\$ 25,931

The purchase price includes contingent consideration comprised of (i) \$5 million payable upon a design win within one year of acquisition, (ii) \$3 million payable upon achieving a development milestone before December 29, 2014, (iii) \$2 million payable upon successful development of cloud application within two years of acquisition and (iv) \$2 million upon first deployment of cloud application which is expected within one year of successful development of cloud application. The contingent considerations, which was derived from a probability weighted earn-out model of future contingent payments, have a combined fair value of \$7.6 million, of which \$4.9 million was recorded in accrued liabilities and \$2.7 million was recorded in other long-term liabilities. The development milestone of \$3 million was achieved by the quarter ended December 28, 2014 and the payment is expected to be made in the fourth quarter of fiscal 2015. The difference between the contractual amount of \$3.0 million and the fair value of this contingent consideration was recorded in the research and development expense for the three months ended December 28, 2014.

The following table presents certain information on acquired identifiable intangible assets related to the TPI acquisition:

	<b>Estimated Fair Value (in thousands)</b>	<b>Estimated Useful Life (in years)</b>
Developed technology	\$ 8,600	5

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The fair value of developed technology was determined using a cost approach, which includes an estimate of time and expenses required to recreate the intangible asset. The fair value of developed technology was capitalized as of the acquisition date and will be amortized using a straight-line method to cost of revenue over the estimated useful life of 5 years.

In connection with the acquisition of TPI, the Company recorded a non-cash gain of approximately \$0.9 million resulting from the difference between carrying value of its initial investments in TPI of \$0.3 million and fair value of such investments of \$1.2 million, as of the acquisition date. This non-cash gain is recorded in Other income, net on the Condensed Consolidated Statement of Operations.

***MEMS Microphone Business of Analog Devices, Inc.***

In the third quarter of fiscal 2014, the Company acquired certain assets relating to Analog Devices, Inc. ( ADI ) MEMS microphone business for a purchase price of \$100 million in cash, of which the Company is entitled to certain contingent future expense reimbursements of approximately \$2.2 million. The Company also agreed to a contingent cash payment of up to \$70.0 million payable upon the achievement of certain revenue performance targets within one year of the transaction close date. Due to a low probability of achieving the revenue targets, the fair value of the contingent consideration is estimated to be zero in the purchase price allocation described below. ADI licensed certain technology related to the MEMS microphone business to the Company on a royalty-free, worldwide basis, and provides certain transition services to the Company following the closing.

The strategic rationale for the acquisition was to accelerate the Company's audio roadmap and complement its current MEMS System on Chip product offerings at existing mobile, gaming and wearable device customers, while gaining entry into new markets. The acquisition expands the Company's patent portfolio and existing tier one customer base, which includes major OEM brands worldwide.

The allocation of the purchase price of the assets acquired and liabilities assumed based on their fair values was as follows:

	<b>Total Amount (in thousands)</b>
Inventories	\$ 5,107
Property and equipment, net	4,339
Intangible assets:	
Developed technology	28,520
In-Process Research & Development	7,330
Customer Relationships	1,560
Goodwill	50,952

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Total assets acquired	\$	97,808
Total purchase price (net of \$2.2 million of contingent expense reimbursements)	\$	97,808

The fair value of intangible assets of \$37.4 million has been allocated to the following three asset categories: 1) developed technology, 2) in-process research & development and 3) customer relationships. Developed technology and customer relationships are amortized on a straight line basis over the estimated useful life of the assets.



Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The table below presents certain information on acquired identifiable intangible assets related to the ADI acquisition:

	<b>Estimated Fair Value (in thousands)</b>	<b>Estimated Useful Life (in years)</b>
Developed technology	\$ 28,520	6
Customer relationships	\$ 1,560	7

The amounts of revenue and earnings of the Microphone Product Line since the acquisition date included in the consolidated statements of operations for the current reporting periods have not been presented because the impact was not material to the Company's consolidated results of operations.

**9. Goodwill and Purchased Intangible Assets**

The Company monitors the recoverability of goodwill recorded in connection with acquisitions annually, or whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company performed the annual goodwill impairment analysis during the third quarter of fiscal year 2015 and concluded that goodwill was not impaired.

The following table summarizes the activity related to the carrying value of goodwill (in thousands):

Balance as of March 30, 2014	\$ 50,952
Goodwill recorded in connection with the acquisition of Movea S.A	68,330
Goodwill recorded in connection with the acquisition of Trusted Positioning, Inc.	19,893
Balance as of December 28, 2014	\$ 139,175

Purchased intangible assets subject to amortization consist primarily of developed technology and customer relationships and are reported net of accumulated amortization. Developed technology and customer relationships are amortized on a straight line basis over the estimated useful life of the assets. In-process research and development is assessed for impairment until the development is completed and products are available for sale. The Company expects to complete the in-process research and development projects at various dates during fiscal year 2015 at which time amortization will commence. The costs that the Company incurred on the in-process research and development projects after the acquisition were expensed. During the second quarter of fiscal 2015, the Company recorded \$0.8 million of impairment on in-process research and development on one of the ADI acquisition projects.

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Amortization for purchased intangible assets for the three months and nine months ended December 28, 2014 was approximately \$2.0 million and \$4.9 million respectively. Amortization for acquired intangible assets was approximately \$0.8 million for both the three and nine months ended December 29, 2013. The following table represents intangible assets and accumulated amortization:

	<b>December 28, 2014</b>		
	<b>Gross</b>	<b>Accumulated Amortization</b>	<b>Net</b>
	<b>(in thousands)</b>		
Developed technology	\$ 44,320	\$ 6,719	\$ 37,601
Customer relationships	1,560	260	1,300
<b>Total intangible assets subject to amortization</b>	<b>\$ 45,880</b>	<b>\$ 6,979</b>	<b>\$ 38,901</b>

	<b>March 30, 2014</b>		
	<b>Gross</b>	<b>Accumulated Amortization</b>	<b>Net</b>
	<b>(in thousands)</b>		
Developed technology	\$ 28,520	\$ 1,980	\$ 26,540
Customer relationships	1,560	93	1,467
<b>Total intangible assets subject to amortization</b>	<b>\$ 30,080</b>	<b>\$ 2,073</b>	<b>\$ 28,007</b>

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**Table of Contents****INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The estimated future amortization expense related to intangible assets at December 28, 2014 is as follows:

Fiscal Year	<b>Estimated Amortization (in thousands)</b>
2015 (remaining 3 months)	\$ 2,034
2016	8,136
2017	8,136
2018	8,136
2019	8,136
Thereafter	4,323
<b>Total</b>	<b>\$ 38,901</b>

**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 March 30, 2014, and with management's discussion and analysis of our financial condition and results of operations included in our Annual Report on Form 10-K with the Securities and Exchange Commission (SEC) on May 29, 2014.*

*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 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 referred to under Item 1A. of Part I "Risk Factors", included in the Company's Annual Report on Form 10-K filed on May 29, 2014 with the SEC and Item 2 of Part I "Management's Discussion and Analysis of Financial Condition and Results of Operations", and discussed 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****Business Overview**

We are the world's leading provider of intelligent sensor system on chip (SoC) for Motion and Sound in consumer electronic devices. We entered the audio sensor (microphone) markets through the acquisition of the MEMS Microphone product line of Analog Devices, Inc., in fiscal 2014. In the second quarter of fiscal 2015, we acquired Movea, a leading provider of software for ultra-low power location, activity tracking and context sensing and Trusted Positioning, Inc. (TPI), an indoor/outdoor positioning software company.

Our intelligent sensor system on chip (SoC) for Motion and Sound solutions combine micro-electro-mechanical system (MEMS) motion sensors, such as accelerometers, gyroscopes, microphones 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 devices are differentiated by their small form factor, high level of integration, performance, reliability and cost effectiveness.

While our solutions have broad applicability, we currently target Mobile, Wearables, Smart Home, Industrial, and Automotive products. We utilize a fabless model, leveraging current CMOS and MEMS foundries and semiconductor packaging supply chains. We utilize a fabless model, leveraging current CMOS and MEMS foundries and semiconductor packaging supply chains.

Our current vision of Sensing Everything targets the consumer electronics and industrial markets with integrated Motion and Sound solutions 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 Motion and Sound solutions.

**Table of Contents****Net Revenue**

We derive our net revenue from sales of our Motion and Sound solutions. We primarily sell our products through our worldwide sales organization to manufacturers of consumer electronics devices from whom we have secured a design win. 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. The majority of our products are shipped through distributors or contract manufacturers. When we reference customers in this report, we are referring to the manufacturers of consumer electronics devices that are the end customer that these intermediaries sell our products to or incorporate our products into finished products.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			

Net revenue	\$ 115,864	\$ 66,684	\$ 272,740	\$ 193,534
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Net revenue increased by \$49.2 million, or 74%, in the third quarter of fiscal 2015 and increased by \$79.2 million, or 41%, in the nine months ended December 28, 2014 compared to the corresponding periods of last year. The increases in net revenue were primarily due to higher volume shipments, partially offset by lower per unit average selling prices. Total unit shipments increased by 118% and 77% in the three and nine months ended December 28, 2014, respectively. Our overall average unit selling price for the three and nine months ended December 28, 2014 decreased 20% as a result of the change in our product mix and declines in average selling prices. We expect average unit selling prices for our products to decrease during their life cycles.

For the three months ended December 28, 2014, two customers accounted for 45% (Apple Inc., or Apple) and 24% (Samsung Electronics Co., Ltd., or Samsung) of net revenue. For the nine months ended December 28, 2014, two customers accounted for 29% (Apple) and 28% (Samsung) of net revenue. For the three months ended December 29, 2013, three customers each accounted for 32% (Samsung), 16% (Xiaomi Inc.) and 10% (LG Electronics Inc.) of total net revenue. For the nine months ended December 29, 2013, one customer accounted for 32% (Samsung) of net revenue.

**Net Revenue by End Market**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			

Smartphone and tablet devices	\$ 93,394	\$ 55,594	\$ 218,417	\$ 149,515
% of net revenue	81%	83%	80%	77%
Gaming	\$ 3,706	\$ 4,437	\$ 9,505	\$ 16,044
% of net revenue	3%	7%	4%	8%
Optical image stabilization and other	\$ 18,764	\$ 6,653	\$ 44,818	\$ 27,975
% of net revenue	16%	10%	16%	15%

Net revenue growth and contribution to net revenue for the smartphone/tablet end market in the three and nine months ended December 28, 2014 reflects expansion of the smartphone portion of the handset market. The growth in the market for Optical image stabilization and other devices reflects increased adoption of our technologies in those devices during that time period.

**Table of Contents****Net Revenue by Geographic Region**

Region	Three Months Ended		Nine Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands)			
Korea	\$ 33,012	\$ 28,475	\$ 96,984	\$ 78,816
United States	56,871	10,103	94,323	41,161
China	16,879	1,663	46,784	14,722
Japan	5,109	6,848	14,842	21,509
Taiwan	2,417	18,642	15,212	31,224
Rest of world	1,576	953	4,595	6,102
	\$ 115,864	\$ 66,684	\$ 272,740	\$ 193,534

We report revenue by geographic region based upon the location of the headquarters of our customers. We primarily sell our products directly to customers and distributors in Asia and North America. We may be subject to economic and political events and other developments that impact our customers due to the regional customer concentration in Asia. For more information, see the section 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, referred to under Item 1A of Part I in our Annual Report on Form 10-K filed on May 29, 2014 with the SEC.

**Gross Profit and Gross Margin**

Gross profit is the difference between net revenue and cost of revenue and gross margin is gross profit as a percentage of sales.

	Three Months Ended		Nine Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands)			
Gross profit	\$ 50,396	\$ 31,590	\$ 112,913	\$ 97,484
% of net revenue	43%	47%	41%	50%

Gross profit increased by \$18.8 million, or 60%, in the third quarter of fiscal 2015 and increased by \$15.4 million, or 16%, in the nine months ended December 28, 2014 compared to corresponding periods of last year. In the three months ended December 28, 2014, gross profit as a percentage of sales, or gross margin, decreased primarily due to lower average unit selling prices resulted from a shift of revenue mix towards lower margin, high volume customers. In the nine months ended December 28, 2014, gross margin decreased significantly primarily due to lower average unit selling prices resulted from a shift of revenue mix towards lower margin, high volume customers combined with a \$8.1 million inventory charge largely related to excess and obsolete inventories.

We expect gross margins to fluctuate during future periods due to changes in product mix, average unit selling prices, manufacturing costs, manufacturing yields, amortization of acquired intangible assets, levels of inventory valuation and excess reserves recorded, if any, and levels of product demand.



**Research and Development**

Research and development expense primarily consists of personnel related expenses (including employee cash compensation and benefits, and stock-based compensation), intellectual property license costs, reference design development

**Table of Contents**

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, in absolute dollar terms, to expand our product offerings and enhance existing products.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			
Research and development	\$ 24,391	\$ 14,522	\$ 65,392	\$ 32,446
% of net revenue	21%	22%	24%	17%

Research and development expense increased by \$9.9 million, or 68%, in the three months ended December 28, 2014 compared to the corresponding period of last year. The increase in research and development expense were primarily attributable to a \$3.5 million increase in employee compensation and benefits costs mainly due to an increase in headcount partially as a result of the acquisitions of Movea and TPI, a \$2.2 million increase in stock-based compensation expense due to an increase in headcount, a \$1.2 million increase in engineering supplies, \$0.8 million increase in IT and infrastructure expenses, \$0.8 million increase in contingent consideration expense related to the Movea and TPI acquisitions and a \$0.7 million increase in outside services.

Research and development expense increased by \$32.9 million, or 102%, in the nine months ended December 28, 2014 compared to the corresponding period of last year. The increase in research and development expense was primarily attributable to a \$12.6 million increase in employee compensation and benefits costs due to an increase in headcount partially as a result of the acquisitions of Movea and TPI, a \$6.6 million increase in engineering supplies, a \$6.6 million increase in stock-based compensation expense due to an increase in headcount, \$2.8 million increase in IT and infrastructure expenses, and a \$2.5 million increase in outside services.

**Selling, General and Administrative**

Selling, general and administrative expense primarily consists of personnel related expenses (including employee cash compensation and benefits, and 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, hire personnel to expand our sales, marketing, finance, legal and other administrative personnel and pay the costs associated with litigation, if any.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			
Selling, general and administrative	\$ 15,551	\$ 15,663	\$ 44,061	\$ 36,243
% of net revenue	13%	24%	16%	19%

Selling, general and administrative expense decreased by \$0.1 million, or 1%, in the three months ended December 28, 2014 compared to the corresponding period of last year. The decrease was primarily attributable to a decrease of \$3.1 million in outside services due to the settlement with ST Microelectronics, Inc. in fiscal 2014, partially offset by a \$1.2 million increase in stock-based compensation expense and a \$1.2 million increase in employee compensation and benefits costs due to an increase in headcount.

Selling, general and administrative expense increased by \$7.8 million, or 22%, in the nine months ended December 28, 2014 compared to the corresponding period of last year. The increase was primarily attributable to a \$4.4 million increase in stock-based compensation expense due to an increase in headcount and a change in estimate of our stock award forfeiture rate and a \$4.2 million increase in employee cash compensation and benefits costs due to an increase in headcount and an \$0.8 million increase in depreciation expense partially offset by a decrease of \$2.9 million in outside services due to the settlement with ST Microelectronics, Inc. in fiscal 2014,

### **Patent Litigation Settlement**

On February 9, 2014, the Company and STI settled and resolved all litigation and re-examination proceedings pending between them for a one-time cash payment of \$15.0 million to STI, and entered into a patent cross license agreement. The other terms of the settlement and the patent cross license agreement remain confidential and are not expected to have a material impact on the future results of the Company. This settlement and patent cross license resolves all outstanding legal proceeding between the Company and STI. The settlement resulted in the Company recognizing a pre-tax charge of \$14.5 million during the quarter ended December 29, 2013.

**Table of Contents****Interest Expense**

	Three Months Ended		Nine Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands)			
Interest expense	(2,690)	(1,463)	(7,894)	(1,463)
% of net revenue	(2)%	(2)%	(3)%	(1)%

Interest (expense) increased by \$1.2 million and \$6.4 million in the three and nine months ended December 28, 2104, respectively, entirely attributable to interest expense related to the Convertible Senior Notes issued in the third quarter of fiscal year 2014.

**Other Income (Expense), Net**

	Three Months Ended		Nine Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands)			
Other income, net	(281)	(220)	1,099	73
% of net revenue	(0)%	(0)%	0%	0%

Other income (expense), net stayed flat for the three months ended December 28, 2014 and increased by \$1.0 million for the nine months ended December 28, 2014 compared to the corresponding period of last year. The increase in other income for the nine months ended December 28, 2014 was primarily due to gain on equity investment in TPI of \$0.9 million.

**Income Tax Provision (Benefit)**

	Three Months Ended		Nine Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands)			
Income tax provision (benefit)	(2,738)	(2,599)	(1,856)	1,154
% of income (loss) before income tax	(37)%	18%	56%	9%

In the three and nine months ended December 28, 2014, we recorded an income tax provision (benefit) of (\$2.7) million and (\$1.9) million, respectively. In the three and nine months ended December 29, 2013, the Company recorded an income tax provision (benefit) of \$(2.6) million and \$1.2 million, respectively. The provision for income taxes for the three and nine months ended December 28, 2014 differs from the U.S. statutory tax rate of 35% primarily due to the tax impact of earnings from foreign operations, non-deductibility of certain share-based compensation and the extension of the 2014 R&D Tax Credits. Earnings in countries where tax rates are lower than the U.S. notional rate contributed to the majority of the difference between the rate of our tax provision and the U.S. statutory tax rate. The Tax Increase Prevention Act of 2014 (H. R. 5771), signed into law by the President in December 2014, extends the

2014 R&D Tax Credits retroactively, is now set to expire at the end of calendar year 2014. The swing of the effective tax rate for the nine months ended December 28, 2014, compared to the same period in fiscal year 2013, due to amount of income before provision for income taxes in multiple jurisdictions, including the portion of our stock-based compensation that will not generate tax benefits, and the effect of acquisition and integration of those acquisition.

Included in our gross unrecognized tax benefits balance of \$14.2 million at December 2014 are \$11.6 million of tax positions which would affect income tax expense if recognized. As of December 28, 2014, approximately \$2.6 million of unrecognized tax benefits would be offset by a change in valuation allowance. 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 tables above.

## **Table of Contents**

### **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, 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 May 29, 2014.

### **Liquidity and Capital Resources**

As of December 28, 2014, we had \$172.4 million of cash, cash equivalents and investments. We believe our current cash, cash equivalents and investments will be sufficient to satisfy our liquidity requirements for the next 12 months. 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. Additionally, \$47.0 million of the \$65.1 million of cash and cash equivalents were held by our foreign subsidiaries as of December 28, 2014. If these funds are needed for our operations in the United States, we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to indefinitely reinvest these funds outside of the United States, and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

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

Our primary sources of cash are cash receipts on accounts receivable from our shipment of products to customers and distributors. 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.

The change in cash and cash equivalents for the nine months ended December 28, 2014 and 2013 was as follows:

**Nine Months Ended  
December 28,      December 29,**

	<b>2014</b>	<b>2013</b>
Net cash provided by operating activities	\$ 15,063	\$ 11,793
Net cash provided by (used in) investing activities	16,113	(239,967)
Net cash provided by financing activities	7,856	168,458
Net increase (decrease) in cash and cash equivalents	\$ 39,032	\$ (59,716)

### **Net Cash Provided by Operating Activities**

Net cash provided by operating activities for the nine months ended December 28, 2014 of \$15.1 million is primarily due to non-cash expenses of \$35.9 million partially offset by a net decrease in operating assets and liabilities of \$19.4 million and a net loss of \$1.5 million.

**Table of Contents**

The non-cash expenses of \$35.9 million consisted primarily of stock-based compensation of \$22.9 million, depreciation and amortization of \$12.3 million, non-cash interest expense of \$5.6 million, partially offset by deferred income tax assets of \$5.2 million. The net decrease in operating assets and liabilities of \$19.4 million consisted primarily of increases in Accounts receivable of \$34.3 million, partially offset by increases in Accrued liabilities of \$8.2 million and decreases in Inventories of \$5.2 million. The increase in Accounts receivable is primarily attributable to an increase in net revenue.

Net cash provided by operating activities for the nine months ended December 29, 2013 of \$11.8 million primarily reflected net income of \$11.8 million, non-cash expenses of \$15.7 million, off-set by a net change in operating assets and liabilities of \$15.7 million consisting primarily of increase in Inventories of \$29.6 million, an increase in Accounts receivable of \$4.7 million and an increase in Prepaid expenses and other current assets of \$2.5 million, partially off-set by an increase in Accrued liabilities of \$24.9 million. Non-cash expenses of \$15.7 million consisted primarily of stock-based compensation of \$10.9 million and depreciation and amortization of \$3.8 million. The \$29.6 million increase in Inventories was attributable to increased production to meet future demand. The \$4.7 million increase in Accounts receivable principally relates to increased sales associated with an upward trend in demand in December 2013 compared with March 2013. The \$2.5 million increase in Prepaid expenses and other current assets was primarily due to an increase in other receivables. The \$24.9 million increase in Accrued liabilities is due primarily to higher accrued legal and payroll related expenses and accrued patent litigation settlement for the nine months ended December 29, 2013.

**Net Cash Provided By (Used In) Investing Activities**

Net cash provided by investing activities in the nine months ended December 28, 2014 of \$16.1 million primarily from the sale and maturity of available-for-sale investments of \$112.7 million, partially offset by cash paid for acquisitions of \$71.3 million (net of cash acquired), and purchase of property and equipment of \$25.3 million.

Net cash used in investing activities in the nine months ended December 29, 2013 of \$240.0 million, primarily reflected the purchase of available-for-sale investments of \$189.1 million, acquisition of a business of \$99.3 million, the purchase of property and equipment of \$14.7 million, partially off-set by the sale and maturity of available-for-sale investments of \$63.1 million.

**Net Cash Provided by Financing Activities**

Net cash provided by financing activities in the nine months ended December 28, 2014 of \$7.9 million resulted primarily from the proceeds from the issuance of common stock on stock options exercises and ESPP purchases.

Net cash provided by financing activities in the nine months ended December 29, 2013 of \$168.5 million resulted primarily from proceeds from debt issuance of \$169.8 million, proceeds from issuance of call options of \$25.6 million and proceeds from the issuance of common stock of \$10.0 million, partially off-set by payment for purchase call options of \$39.1 million.

**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 28, 2014, we were not involved in any unconsolidated SPE transactions





## **Table of Contents**

Convertible senior notes and interest on convertible senior notes obligations relate to the convertible senior notes issued in November 2013. See Note 5 to the Condensed Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q for a full description of the convertible senior notes.

Operating leases consist of contractual obligations from agreements for non-cancelable office space.

Purchase obligations consist of the minimum purchase commitments made to contract manufacturers.

Included in our gross unrecognized tax benefits balance of \$14.2 million at December 2014 are \$11.6 million of tax positions which would affect income tax expense if recognized. As of September 2014, approximately \$2.6 million of unrecognized tax benefits would be offset by a change in valuation allowance. 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 tables above.

## **Recent Accounting Pronouncements**

See Item 1 of Part I, Financial Statements Note 1 Organization and Summary of Significant Accounting Policies.

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

For quantitative and qualitative disclosures about market risk affecting InvenSense, see Quantitative and Qualitative Disclosures About Market Risk in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended March 30, 2014. Our exposure to market risk has not changed materially since March 30, 2014.

## **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.

### **Changes in Internal Control**

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Inherent Limitations of Internal Controls**

Our management, including our Chief Executive Officer and Chief Financial Officer, 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. Due to the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

See Item 1 of Part I, Financial Statements Note 4 Commitments and Contingencies.

**ITEM 1A. RISK FACTORS**

Our operations and financial results are subject to various risks and uncertainties, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock. The risks facing our business have not changed substantively from those discussed in our Annual Report on Form 10-K for the fiscal year ended March 30, 2014.

**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: January 30, 2015

INVENSENSE, INC.

By: /s/ Mark P. Dentinger  
Mark P. Dentinger  
Chief Financial Officer (Principal Financial Officer  
and Accounting Officer)

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**Table of Contents****INDEX TO EXHIBITS**

<b>Exhibit</b>	
<b>Number</b>	<b>Description</b>
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 28, 2014 and March 30, 2014, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended December 28, 2014 and December 29, 2013, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for three and nine months ended December 28, 2014 and December 29, 2013, (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended December 28, 2014 and December 29, 2013 and (v) Notes to Condensed Consolidated Financial Statements.