SYNAPTICS INC
Form 10-Q
November 06, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 27, 2014

Commission file number 000-49602

SYNAPTICS INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware	**77-0118518**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1251 McKay Drive

San Jose, California 95131

(Address of principal executive offices) (Zip code)

(408) 904-1100

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer x	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 x

Number of shares of Common Stock outstanding at October 31, 2014: 36,900,176

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SYNAPTICS INCORPORATED

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 27, 2014

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	September 30, 2014	June 30, 2014
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 449,815	$ 447,205
Accounts receivable, net of allowances of $965 and $883 at September 30, 2014 and June 30, 2014, respectively	194,488	195,057
Inventories	76,448	82,311
Prepaid expenses and other current assets	19,881	17,858
Total current assets	740,632	742,431
Property and equipment at cost, net of accumulated depreciation of $53,715 and $49,482 at September 30, 2014 and June 30, 2014, respectively	96,481	80,849
Goodwill	61,030	61,030
Acquired intangibles, net	77,848	82,111
Non-current investments	17,856	19,785
Other assets	30,202	34,127
	$ 1,024,049	$ 1,020,333
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 102,608	$ 97,109
Accrued compensation	20,973	30,682
Income taxes payable	11,967	12,538
Contingent consideration	46,231	57,388
Other accrued liabilities	72,775	56,691
Total current liabilities	254,554	254,408
Other liabilities	51,734	64,768
Stockholders Equity:		
Common stock:		
$0.001 par value; 120,000,000 shares authorized, 56,518,137 and 55,911,513 shares issued, and 36,841,896 and 36,863,802 shares outstanding, at	57	56

September 30, 2014 and June 30, 2014, respectively		
Additional paid-in capital	780,552	740,282
Treasury stock: 19,676,241 and 19,047,711 common treasury shares at September 30, 2014 and June 30, 2014, respectively, at cost	(580,421)	(530,422)
Accumulated other comprehensive income	8,306	8,560
Retained earnings	509,267	482,681
Total stockholders equity	717,761	701,157
	$ 1,024,049	$ 1,020,333

See accompanying notes to condensed consolidated financial statements (unaudited).

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SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30,	
	2014	**2013**
Net revenue	$ 282,741	$ 222,607
Cost of revenue	162,552	113,328
Gross margin	120,189	109,279
Operating expenses:		
Research and development	57,525	40,442
Selling, general, and administrative	30,673	21,124
Acquired intangibles amortization	262	262
Change in contingent consideration	(4,502)	258
Total operating expenses	83,958	62,086
Operating income	36,231	47,193
Interest income, net	624	426
Income before provision for income taxes	36,855	47,619
Provision for income taxes	10,269	12,680
Net income	$ 26,586	$ 34,939
Net income per share:		
Basic	$ 0.72	$ 1.06
Diluted	$ 0.68	$ 1.00
Shares used in computing net income per share:		
Basic	36,998	32,958
Diluted	39,227	35,020

See accompanying notes to condensed consolidated financial statements (unaudited).

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SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended September 30,	
	2014	**2013**
Net income	$ 26,586	$ 34,939
Other comprehensive income:		
Change in unrealized net gain on investments	71	567
Reclassification from accumulated other comprehensive income to interest income for accretion of non-current investments	(325)	(219)
Net current-period other comprehensive income/(loss)	(254)	348
Comprehensive income	$ 26,332	$ 35,287

See accompanying notes to condensed consolidated financial statements (unaudited).

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SYNAPTICS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended September 30,	
	2014	**2013**
Cash flows from operating activities		
Net income	$ 26,586	$ 34,939
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation costs	9,495	7,042
Depreciation and amortization	4,248	3,244
Acquired intangibles amortization	4,263	262
Accretion and remeasurement of contingent consideration liability	(4,502)	258
Deferred taxes	90	188
Non-cash interest income	(325)	(219)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable, net	569	(5,485)
Inventories	5,863	(7,345)
Prepaid expenses and other current assets	(1,424)	(497)
Other assets	3,908	201
Accounts payable	5,231	(2,175)
Accrued compensation	(9,566)	(8,654)
Income taxes payable	(320)	4,502
Other accrued liabilities	16,304	2,659
Net cash provided by operating activities	60,420	28,920
Cash flows from investing activities		
Proceeds from sales of non-current investments	1,400	
Purchases of property and equipment	(19,612)	(10,014)
Net cash used in investing activities	(18,212)	(10,014)
Cash flows from financing activities		
Payment of contingent consideration	(358)	
Purchases of treasury stock	(49,999)	(49,997)
Proceeds from issuance of shares	8,583	7,713
Excess tax benefit from share-based compensation	4,951	1,329
Payroll taxes for deferred stock units	(2,775)	(1,682)
Net cash used in financing activities	(39,598)	(42,637)

Net increase/(decrease) in cash and cash equivalents	2,610	(23,731)
Cash and cash equivalents at beginning of period	447,205	355,303
Cash and cash equivalents at end of period	$ 449,815	$ 331,572
Supplemental disclosures of cash flow information		
Cash paid for taxes	$ 4,446	$ 6,564
Non-cash investing and financing activities:		
Property and equipment received but unpaid	$ 3,545	$ 1,646
Common stock issued in settlement of contingent consideration liability	$ 19,802	$

See accompanying notes to condensed consolidated financial statements (unaudited).

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SYNAPTICS INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC, and U.S. generally accepted accounting principles, or U.S. GAAP. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to SEC rules and regulations. In our opinion, the financial statements include all adjustments, which are of a normal and recurring nature, necessary for the fair presentation of the results of the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future period. These financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended June 28, 2014.

The consolidated financial statements include our financial statements and those of our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. Our fiscal 2015 and 2014 years are 52-week periods ending on June 27, 2015 and June 28, 2014, respectively. The quarterly fiscal periods presented in this report were 13-week periods for the three months ended September 27, 2014 and September 28, 2013. For ease of presentation, the accompanying consolidated financial statements have been shown as ending on calendar quarter end dates for all annual, interim, and quarterly financial statement captions, unless otherwise indicated.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, loss on purchase commitments, product warranty, share-based compensation costs, provision for income taxes, deferred income tax asset valuation allowances, uncertain tax positions, tax contingencies, goodwill, intangible assets, investments, contingent consideration liabilities, and loss contingencies. We base our estimates on historical experience, applicable laws and regulations, and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

2. Revenue Recognition

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred and title has transferred, the price is fixed or determinable, and collection is reasonably assured. We accrue for estimated sales returns, incentives, and other allowances at the time we recognize revenue. Our products contain embedded firmware and software that allow for further differentiation and customer integration, which together with, or consisting of, our ASIC chip, deliver the essential functionality of our products and, as such, software revenue recognition guidance is not applicable.

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3. Net Income Per Share

The computation of basic and diluted net income per share was as follows (in thousands, except per share data):

	Three Months Ended September 30,	
	2014	2013
Numerator:		
Net income	$ 26,586	$ 34,939
Denominator:		
Shares, basic	36,998	32,958
Effect of dilutive share-based awards	2,229	2,062
Shares, diluted	39,227	35,020
Net income per share:		
Basic	$ 0.72	$ 1.06
Diluted	$ 0.68	$ 1.00

Our basic net income per share amounts for each period presented have been computed using the weighted average number of shares of common stock outstanding. Our diluted net income per share amounts for each period presented include the weighted average effect of potentially dilutive shares. We use the treasury stock method to determine the dilutive effect of our stock options, deferred stock units, or DSUs, and market stock units, or MSUs.

Dilutive net income per share amounts do not include the potential weighted average effect of 107,101 of shares of common stock related to certain share-based awards that were outstanding during the three months ended September 30, 2014, or 503,115 shares of common stock related to certain share-based awards that were outstanding during the three months ended September 30, 2013, respectively. These share-based awards were not included in the computation of diluted net income per share because their effect would have been antidilutive.

4. Fair Value

Financial assets and liabilities, measured at fair value on a recurring basis by level within the fair value hierarchy, consisted of the following (in thousands):

	September 30, 2014		June 30, 2014	
	Level 1	Level 3	Level 1	Level 3
Assets:				
Money market funds	$ 441,985	$	$ 439,675	$
Auction rate securities		18,456		19,785

Total available-for-sale securities	$ 441,985	$ 18,456	$ 439,675	$ 19,785
Liabilities:				
Contingent consideration liabilities recorded for business combinations	$	$ 85,460	$	$ 110,122

In our condensed consolidated balance sheets as of September 30, 2014 and June 30, 2014, money market balances were included in cash and cash equivalents and auction rate securities, or ARS investments, were included in non-current investments and $600,000 of the ARS investments were included in prepaid expenses and other current assets as of September 30, 2014. The short-term portion of the contingent consideration liability recorded for business combinations was a separate line item in current liabilities and the long-term portion of $39.2 million and $52.7 million was included in the non-current portion of other liabilities as of September 30, 2014 and June 30, 2014, respectively.

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Changes in fair value of our Level 3 financial assets as of September 30, 2014 were as follows (in thousands):

Balance as of June 30, 2014	$ 19,785
Net unrealized gain	71
Redemptions	(1,400)
Balance as of September 30, 2014	$ 18,456

Changes in fair value of our Level 3 contingent consideration liabilities as of September 30, 2014 were as follows (in thousands):

Balance as of June 30, 2014	$ 110,122
Cash settlement of contingent consideration liability	(358)
Issuance of common stock in settlement of liability	(19,802)
Accretion and remeasurement	(4,502)
Balance as of September 30, 2014	$ 85,460

In connection with our acquisition of Validity Sensors, Inc., or Validity, we entered into a contingent consideration arrangement and as of September 30, 2014, we may be required to make additional cash payments of up to $145.8 million as consideration to the former Validity stockholders and option holders based on unit sales of products utilizing Validity technology through March 2016.

In connection with our acquisition of Pacinian Corporation, or Pacinian, we entered into a contingent consideration arrangement and subsequently paid $5.0 million of additional consideration to the former Pacinian stockholders upon customer acceptance of a ThinTouch product. As of September 30, 2014, we may be required to make additional cash payments of up to $10.0 million as consideration to the former Pacinian stockholders based on unit sales of products utilizing ThinTouch technology through June 2016.

There were no transfers in or out of our Level 1, 2, or 3 assets or liabilities during the three months ended September 30, 2014 and 2013.

The fair values of our accounts receivable and accounts payable approximate their carrying values because of the short-term nature of those instruments. Intangible assets, property and equipment, and goodwill are measured at fair value on a non-recurring basis if impairment is indicated.

5. Auction Rate Securities

Our ARS investments have failed to settle in auctions and are not liquid. In the event we need to access these funds prior to their maturity, we will not be able to do so without a loss of principal, unless redeemed by the issuers or a future auction on these investments is successful. During the three months ended September 30, 2014, $1.4 million of our ARS investments were redeemed.

As there are currently no active markets for our various failed ARS investments, we have estimated the fair value as of September 30, 2014 using a trinomial discounted cash flow analysis. The analysis considered, among others, the following factors:

- the collateral underlying the security investments;
- the creditworthiness of the counterparty;
- the timing of expected future cash flows;
- the probability of a successful auction in a future period;
- the underlying structure of each investment;
- the present value of future principal and interest payments discounted at rates considered to reflect current market conditions;
- a consideration of the probabilities of default, passing a future auction, or redemption at par for each period; and
- estimates of the recovery rates in the event of default for each investment.

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When possible, our ARS investments were compared to other observable market data or securities with similar characteristics. Our estimate of the fair value of our ARS investments could change materially from period to period based on future market conditions.

We have ARS investments with a fair value of $12.5 million maturing from fiscal years 2016 to 2018, $3.2 million fair value maturing from calendar years 2044 to 2046, and $2.8 million fair value with no maturity date. Of our ARS investments, $4.1 million par value are investment grade, and the remaining $18.5 million par value are below investment grade.

The various types of ARS investments we held as of September 30, 2014, including the original cost basis, other-than-temporary impairment included in retained earnings, new cost basis, unrealized gain/(loss), and fair value, consisted of the following (in thousands):

	Original Cost Basis	Other-than-temporary Impairment in Retained Earnings	New Cost Basis	Unrealized Gain/(Loss)	Fair Value
Student loans	$ 3,500	$ (179)	$ 3,321	$ (143)	$ 3,178
Credit linked notes	13,500	(7,188) (1)	6,312	5,628	11,940
Preferred stock	5,000	(5,000)		2,750	2,750
Municipals	600	(83)	517	71	588
Total ARS	$ 22,600	$ (12,450)	$ 10,150	$ 8,306	$ 18,456

(1) Other-than-temporary impairment in retained earnings is partially offset by cumulative accretion of $1.6 million on non-current investments. Accretion is reclassified from accumulated other comprehensive income and recorded in the condensed consolidated statements of income as non-cash interest income.

The various types of ARS investments we held as of June 30, 2014, including the original cost basis, other-than-temporary impairment included in retained earnings, new cost basis, unrealized gain/(loss), and fair value, consisted of the following (in thousands):

	Original Cost Basis	Other-than-temporary Impairment in Retained Earnings	New Cost Basis	Unrealized Gain/(Loss)	Fair Value
Student loans	$ 3,500	$ (179)	$ 3,321	$ (149)	$ 3,172
Credit linked notes	13,500	(7,513) (1)	5,987	5,891	11,878
Preferred stock	5,000	(5,000)		2,750	2,750
Municipals	2,000	(83)	1,917	68	1,985
Total ARS	$ 24,000	$ (12,775)	$ 11,225	$ 8,560	$ 19,785

(1) Other-than-temporary impairment in retained earnings is partially offset by cumulative accretion of $1.3 million on non-current investments. Accretion is reclassified from accumulated other comprehensive income and recorded in the condensed consolidated statements of income as non-cash interest income.

The ARS investments in each of the above tables with unrealized losses have been in a continuous unrealized loss position for more than 12 months.

We have accounted for all of our ARS investments as non-current as we are not able to reasonably determine when the ARS markets will recover or be restructured. Based on our ability to access our cash and cash equivalents, our expected operating cash flows, and our other sources of cash, we do not intend to sell the ARS investments, and it is not more likely than not that we will be required to sell the investments before the recovery of the amortized cost basis.

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6. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (estimated net realizable value) and consisted of the following (in thousands):

	September 30, 2014	June 30, 2014
Raw materials	$ 61,816	$ 58,717
Finished goods	14,632	23,594
	$ 76,448	$ 82,311

7. Acquired Intangibles

The following table summarizes the life, the gross carrying value of our acquired intangible assets, and the related accumulated amortization as of September 30, 2014 and June 30, 2014 (in thousands):

	Life	September 30, 2014	June 30, 2014
Fingerprint developed technology	2-4 years	$ 75,650	$ 18,650
ThinTouch developed technology	7 years	8,900	8,900
Customer relationships	5 years	3,800	3,800
Licensed technology and other	5 years	1,335	1,335
Backlog	Less than 1 year	750	750
Patents	5 years	100	100
In-process research and development	Not applicable		57,000
		90,535	90,535
Accumulated amortization		(12,687)	(8,424)
Acquired intangibles, net		$ 77,848	$ 82,111

The total amortization expense for the acquired intangible assets was $4.3 million and $262,000 for the three months ended September 30, 2014 and 2013, respectively. During the first quarter of fiscal 2015, the in-process research and development projects were completed, have been included in fingerprint developed technology, and amortization commenced. Amortization expense was included in our condensed consolidated statements of income in cost of revenue and acquired intangibles amortization.

The following table presents expected annual fiscal year aggregate amortization expense as of September 30, 2014 (in thousands):

Remainder of 2015	$ 18,688

2016	21,374
2017	17,579
2018	15,218
2019	3,239
2020	1,271
Thereafter	479
Future amortization	$ 77,848

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8. Other Accrued Liabilities

Other accrued liabilities consisted of the following (in thousands):

	September 30, 2014	June 30, 2014
Customer obligations	$ 52,475	$ 38,758
Inventory obligations	3,800	4,096
Warranty	1,759	1,659
Other	14,741	12,178
	$ 72,775	$ 56,691

9. Product Warranties, Indemnifications, and Contingencies

Product Warranties

We generally warrant our products for a period of 12 months from the date of sale and estimate probable product warranty costs at the time we recognize revenue. Factors that affect our warranty liability include historical and anticipated rates of warranty claims, materials usage, rework, and delivery costs. We assess the adequacy of our warranty obligations each reporting period and adjust the accrued warranty liability on the basis of our estimates.

Indemnifications

In connection with certain agreements, we are obligated to indemnify the counter-party against third-party claims alleging infringement of certain intellectual property rights by us. We have also entered into indemnification agreements with our officers and directors. Maximum potential future payments cannot be estimated because these agreements do not have a maximum stated liability. However, historical costs related to these indemnification provisions have not been significant. We have not recorded any liability in our consolidated financial statements for such indemnification obligations.

Contingencies

We have in the past and may in the future receive notices from third parties that claim our products infringe their intellectual property rights. We cannot be certain that our technologies and products do not and will not infringe issued patents or other proprietary rights of third parties.

Any infringement claims, with or without merit, could result in significant litigation costs and diversion of management and financial resources, including the payment of damages, which could have a material adverse effect on our business, financial condition, and results of operations.

10. Share-Based Compensation

Share-based compensation and the related tax benefit recognized in our condensed consolidated statements of income were as follows (in thousands):

	Three Months Ended September 30,	
	2014	2013
Cost of revenue	$ 302	$ 254
Research and development	5,400	3,927
Selling, general, and administrative	3,793	2,861
Total	$ 9,495	$ 7,042
Income tax benefit on share-based compensation	$ 2,686	$ 1,972

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Historically, we have issued new shares in connection with our share-based compensation plans; however, treasury shares were also available for issuance as of September 30, 2014. Any additional shares repurchased under our common stock repurchase program would be available for issuance under our share-based compensation plans.

Stock Options

Stock option activity, including stock options granted, exercised, and forfeited, and weighted average exercise prices for stock options outstanding and exercisable, and the aggregate intrinsic value were as follows:

	Stock Option Awards Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance at June 30, 2014	3,693,375	$ 30.08	
Granted	99,890	78.38	
Exercised	(290,411)	29.56	
Forfeited	(13,269)	34.32	
Balance at September 30, 2014	3,489,585	31.48	$ 152,296
Exercisable at September 30, 2014	2,474,570	26.02	$ 121,196

The aggregate intrinsic value was determined using the closing price of our common stock on September 26, 2014, of $75.00 and excludes the impact of stock options that were not in-the-money.

Deferred Stock Units

Deferred Stock Units, or DSU, activity, including DSUs granted, delivered, and forfeited, and the balance and aggregate intrinsic value of DSUs was as follows:

	DSU Awards Outstanding	Aggregate Intrinsic Value (in thousands)
Balance at June 30, 2014	1,058,243	
Granted	47,802	
Delivered	(133,112)	
Forfeited	(19,704)	
Balance at September 30, 2014	953,229	$ 71,492

The aggregate intrinsic value was determined using the closing price of our common stock on September 26, 2014 of $75.00.

Of the shares delivered, 38,414 shares valued at $2.8 million were withheld to meet statutory minimum tax withholding requirements.

Market Stock Units

Our Amended and Restated 2010 Incentive Compensation Plan provides for the grant of MSU awards, which are a type of DSU award, to our employees, consultants, and directors. An MSU is a promise to deliver shares of our common stock at a future date based on the achievement of market-based performance requirements in accordance with the terms of the MSU grant agreement. We began granting MSUs in November 2012.

We have granted MSUs to our executive officers, which were designed to vest in three tranches with the target quantity for each tranche equal to one-third of the total MSU grant. The first tranche vests based on a one-year performance period; the second tranche vests based on a two-year performance period; and the third tranche vests based on a three-year performance period. Performance is measured based on the achievement of a specified level of total stockholder return, or TSR, relative to the TSR of the Philadelphia Semiconductor Index, or SOX Index. The potential payout ranges from 0% to 200% of the grant target quantity and is adjusted on a two-to-one ratio based on our TSR performance relative to the SOX Index TSR performance using the following formula:

(100% + ([Synaptics TSR - SOX Index TSR] x 2))

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Delivery of shares earned, if any, will take place on the dates provided in the applicable MSU grant agreement, assuming the grantee is still an employee, consultant, or director of our company at the end of the applicable performance period. On the delivery date, we withhold shares to cover statutory minimum tax withholding requirements and deliver a net quantity of shares to the employee, consultant, or director after such withholding. Until delivery of shares, the grantee has no rights as a stockholder with respect to any shares underlying the MSU award.

During the three months ended September 30, 2014, there were no MSUs granted, delivered, or forfeited. The aggregate intrinsic value of MSUs as of September 30, 2014 was $9.0 million.

We value the MSUs using the Monte Carlo simulation model and amortize the compensation expense over the three-year performance and service period on a straight-line basis. The unrecognized share-based compensation cost of our outstanding MSUs was approximately $3.9 million as of September 30, 2014, which will be recognized over a weighted average period of approximately 0.9 years. The aggregate intrinsic value was determined using the closing price of our common stock on September 26, 2014 of $75.00.

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11. Income Taxes

We account for income taxes under the asset and liability method. We consider the operating earnings of our foreign subsidiaries to be indefinitely invested outside the United States. Accordingly, no provision has been made for the federal, state, or foreign taxes that may result from future remittances of undistributed earnings of our foreign subsidiaries.

The provision for income taxes of $10.3 million and $12.7 million for the three months ended September 30, 2014 and 2013, respectively, represented estimated federal, foreign, and state income taxes. The provision for income taxes recorded in interim periods is recorded by applying the estimated annual effective tax rate to year-to-date income before income taxes, excluding the effects of significant unusual or infrequently occurring discrete items and the change in contingent consideration liability which is not reliably estimable. The tax effects of discrete items and the change in contingent consideration liability are recorded in the same period that the related item is reported and resulted in the difference between the actual effective tax rate for the three months ended September 30, 2014 and 2013, and the estimated annual effective tax rates for those same periods of 32.6% and 27.3%, respectively. Our annual effective tax rate diverged from the combined U.S. federal and state statutory tax rate primarily because of foreign income taxed at lower tax rates, partially offset by foreign withholding taxes, nondeductible amortization, and net unrecognized tax benefits associated with qualified stock options. Discrete items recognized in the three months ended September 30, 2014 and 2013, included additional penalty and interest related to uncertain tax positions related to prior fiscal years and tax benefits realized from share-based compensation.

Unrecognized Tax Benefits

The total liability for gross unrecognized tax benefits increased $223,000 during the three months ended September 30, 2014 to $10.4 million from $10.2 million at June 30, 2014 and was included in other liabilities on our condensed consolidated balance sheets. If recognized, this total amount would affect the effective tax rate on income from continuing operations. Accrued interest and penalties related to unrecognized tax benefits as of September 30, 2014 was $971,000; this balance increased by $36,000 from June 30, 2014. We classify interest and penalties, as components of income tax expense.

In May 2011, we were notified by the Internal Revenue Service, or the Service, that our fiscal 2003 through 2006 and fiscal 2008 through 2010 returns would be subject to examination. In March 2013, we received the Revenue Agent s Report resolving our examination with the Service and paid an assessment that had no material impact on our condensed consolidated financial statements. Our case is pending review by the Joint Committee on Taxation, which we anticipate will conclude in our fiscal 2015. Any prospective adjustments to our unrecognized tax benefits will be recorded as an increase or decrease to income tax expense and cause a corresponding change to our effective tax rate. Accordingly, our effective tax rate could fluctuate materially from period to period.

Our major tax jurisdictions are the United States, California, and Hong Kong SAR, and fiscal 2003 onward remain subject to examination by one or more of these jurisdictions.

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12. Segment, Customers, and Geographic Information

We operate in one segment: the development, marketing, and sale of interactive user interface solutions for electronic devices and products. We generate our revenue from two broad product categories: the mobile product market and the personal computing, or PC, product market.

Net revenue within geographic areas based on our customers locations for the periods presented was as follows (in thousands):

	Three Months Ended September 30,	
	2014	2013
China	$ 148,170	$ 107,366
South Korea	46,841	69,158
United States	40,752	495
Taiwan	36,236	32,300
Japan	5,736	12,079
Other	5,006	1,209
	$ 282,741	$ 222,607

Net revenue from external customers for each group of similar products was as follows (in thousands):

	Three Months Ended September 30,	
	2014	2013
Mobile product applications	$ 199,734	$ 162,664
PC product applications	83,007	59,943
	$ 282,741	$ 222,607

Net revenue from major customers as a percentage of total net revenue for the periods presented was as follows:

	Three Months Ended September 30,	
	2014	2013
Customer A	24%	22%
Customer B	*	10%

* Less than 10%

We sell our products to original equipment manufacturers, or OEMs, and to contract manufacturers that provide manufacturing services to OEMs. We extend credit based on an evaluation of a customer s financial condition, and we generally do not require collateral. Major customer accounts receivable as a percentage of total accounts receivable at the dates presented were as follows:

	September 30, 2014	June 30, 2014
Customer A	18%	28%

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13. Comprehensive Income

Our comprehensive income generally consists of net income plus the effect of unrealized gains and losses on our investments, primarily due to temporary changes in market value of certain of our ARS investments. In addition, we recognize the noncredit portion of other-than-temporary impairment on debt securities in other comprehensive income. We recognize foreign currency remeasurement adjustments and transaction gains and losses in our condensed consolidated statements of income as the U.S. dollar is the functional currency of our foreign entities.

14. Subsequent events

On June 11, 2014, we entered into a stock purchase agreement to acquire all of the outstanding stock of Renesas SP Drivers, Inc., or RSP, a leading provider of small and medium-sized display driver integrated circuits for smartphones and tablets (the Acquisition). The Acquisition is intended to accelerate our product roadmap for high-performance, low-cost display integration products, strengthen our relationships with key customers, and create opportunities to drive increased revenue. Effective as of October 1, 2014, or the Closing Date, we completed the Acquisition of 100% of the outstanding capital stock of RSP for a purchase price of approximately ¥50.6 billion (or approximately $463 million), with Japanese yen converted into US dollars at a reference conversion rate of 109.4 JPY to USD. The purchase price at the closing of the Acquisition was paid entirely in cash, with ¥7.25 billion (or approximately $66 million) held back until the date that is 18 months after the Closing Date to address any post-closing adjustments or claims, or the Indemnification Holdback, and ¥5.25 billion (or approximately $48 million) held back in respect of a potential post-closing working capital, cash balance, indebtedness and transaction expenses adjustments, or the Working Capital Holdback. Under the stock purchase agreement, RSP entered into an inventory purchase obligation with Renesas Electronics Corporation, or REL, to acquire closing date inventory held by REL at the target amount of ¥12.53 billion (or approximately $115 million). The Working Capital Holdback and the inventory purchase obligation are expected to be settled in fiscal 2015. This acquisition will be accounted for as a business combination in the quarter ending in December 2014.

In connection with the Acquisition, on September 30, 2014, we entered into a credit agreement, or the Credit Agreement, with the lenders party thereto, or the Lenders, and Wells Fargo Bank, National Association, as administrative agent for the Lenders.

The Credit Agreement provides for, among other things, (i) a revolving credit facility of up to $150 million, which includes a $20 million sublimit for letters of credit and a $20 million sublimit for swingline loans, and (ii) a term loan facility in an amount of $150 million. Under the terms of the Credit Agreement, we may, subject to the satisfaction of certain conditions, request increases in the revolving credit facility commitments and additional term loan commitments in an aggregate principal amount of up to $100 million to the extent existing or new lenders agree to provide such increased or additional commitments, as applicable. We borrowed $150 million under the term loan facility and $100 million under the revolving credit facility to finance a portion of the Acquisition purchase price. Debt issuance costs were approximately $5.0 million, including a financing commitment provided to the seller at the acquisition signing date and legal fees.

Our obligations under the Credit Agreement are guaranteed by the material domestic subsidiaries of our company, subject to certain exceptions (such material subsidiaries, together with our company, collectively, the Credit Parties). The obligations of the Credit Parties under the Credit Agreement and the other loan documents delivered in connection therewith are secured by a first priority security interest in substantially all of the existing and future personal property of the Credit Parties, including, without limitation, 65% of the voting capital stock of certain of the Credit Parties direct foreign subsidiaries, subject to certain exceptions.

Under the Credit Agreement, there are restrictive operating covenants, including three financial covenants which limit; the consolidated total leverage ratio, or leverage ratio; the consolidated interest coverage ratio, or interest coverage ratio; and places a restriction on the amount of capital expenditures that may be made in any fiscal year. The leverage ratio is the ratio of debt as of the measurement date to earnings before interest, taxes, depreciation and amortization, or EBITDA, for the four consecutive quarters ending with the quarter of measurement. The leverage ratio must not exceed 2.50 to 1.0 during the first two years of the agreement, and 2.0 to 1.0 during the last three years of the agreement. The interest coverage ratio is EBITDA to interest expense for the four consecutive quarters ending with the quarter of measurement. The interest coverage ratio must not be less than 3.50 to 1.0 during the term of the agreement.

As of the date of the filing of this Form 10-Q, the purchase price allocation is preliminary and has not been finalized. Additional information, which existed as of the acquisition date but is yet unknown to us, may become known to us during the remainder of the measurement period, which will not exceed 12 months from the acquisition date. Changes to amounts recorded as assets or liabilities will be recorded as retrospective adjustments to the provisional amounts recognized as of the acquisition date and may result in a corresponding adjustment to goodwill.

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The following table summarizes the estimated fair values of the assets acquired and liabilities assumed as of the acquisition date (in thousands):

Cash	$ 54,702
Restricted cash	36,617
Accounts receivable	136,647
Inventory	4,542
Property and equipment	5,401
Acquired intangible assets	289,000
Other assets	4,770
Total identifiable assets acquired	531,679
Accounts payable	71,492
Income taxes payable	36,599
Deferred tax liability	101,150
Other accrued liabilities	4,615
Net identifiable assets acquired	317,823
Goodwill	144,893
Net assets acquired	$ 462,716

Of the $289.0 million of acquired intangible assets, $147.0 million was assigned to developed technology and will amortize over estimated useful lives of 4 to 6 years; $68.0 million was assigned to customer relationships and will be amortized over an estimated useful life of 1 to 3 years, $29.0 million was assigned to inventory to be acquired and will be amortized during the quarter ending in December 2014, $26.0 million was assigned to in-process research and development and will be amortized over an estimated useful life to be determined at the date the underlying projects are deemed to be substantively complete, and $19.0 million was assigned to backlog and will be amortized during the quarter ending in December 2014. We estimated the fair value of the identified intangible assets using a discounted cash flow model for each of the underlying identified intangible assets. These fair value measurements were based on significant inputs not observable in the market and thus represent a Level 3 measurement. Key assumptions in applying the discounted cash flow model to the identified intangible assets included discount rates ranging from 9% to 13%.

Developed technology consists of established small- and medium-sized display driver technology designed for and sold into the smartphone and tablet markets. The value of goodwill reflects the anticipated synergies of the combined operations and workforce of RSP as of the acquisition date.

None of the goodwill is expected to be deductible for income tax purposes.

Prior to the acquisition, we did not have an existing relationship or transactions with RSP.

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

Forward-Looking Statements and Factors That May Affect Results

This Quarterly Report on Form 10-Q for the quarter ended September 27, 2014 contains forward-looking statements that are subject to the safe harbors created under the Securities Act of 1933, as amended (the Securities Act), and the Securities Act of 1934, as amended (the Exchange Act). Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business, and can be identified by the fact that they do not relate strictly to historical or current facts. Such forward-looking statements may include words such as expect, anticipate, intend, believe, estimate, plan, ta strategy, continue, may, will, should, variations of such words, or other words and terms of similar meaning. All forward-looking statements reflect our best judgment and are based on several factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Such factors include, but are not limited to, the risks as identified in the Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business sections of our Annual Report on Form 10-K for the fiscal year ended June 28, 2014, and other risks as identified from time to time in our Securities and Exchange Commission reports. Forward-looking statements are based on information available to us on the date hereof, and we do not have, and expressly disclaim, any obligation to publicly release any updates or any changes in our expectations, or any change in events, conditions, or circumstances on which any forward-looking statement is based. Our actual results and the timing of certain events could differ materially from the forward-looking statements. These forward-looking statements do not reflect the potential impact of any mergers, acquisitions, or other business combinations that had not been completed as of the date of this filing.

Overview

We are a leading worldwide developer and supplier of custom-designed human interface solutions that enable people to interact more easily and intuitively with a wide variety of mobile computing, communications, entertainment, and other electronic devices. We believe our results to date reflect the combination of our customer focus, the strength of our intellectual property, and our engineering know-how, which allow us to develop or engineer products that meet the demanding design specifications of OEMs.

Many of our customers have manufacturing operations in China, and many of our OEM customers have established design centers in that region. With our expanded global presence, including offices in China, Finland, Hong Kong, India, Japan, Korea, Switzerland, Taiwan, and the United States, we are well positioned to provide local sales, operational, and engineering support services to our existing customers, as well as potential new customers, on a global basis.

Our manufacturing operations are based on a variable cost model in which we outsource all of our production requirements and generally drop ship our products directly to our customers from our contract manufacturers facilities, reducing the need for significant capital expenditures and allowing us to minimize our investment in inventories. This approach requires us to work closely with our contract manufacturers and semiconductor foundries to ensure adequate production capacity to meet our forecasted volume requirements. We provide our contract manufacturers with six-month rolling forecasts and issue purchase orders based on our anticipated requirements for the next 90 days. However, we do not have any long-term supply contracts with any of our contract manufacturers. We use two third-party semiconductor wafer manufacturers to supply us with silicon wafers integrating our proprietary design specifications. The completed silicon wafers are forwarded to third-party package and test processors for further processing into die and packaged ASICs, as applicable, which are then utilized in our custom

interface products or processed as our ASI