

MICROCHIP TECHNOLOGY INC

Form 10-Q

August 04, 2017

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017.

OR

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

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

Commission File Number: 0-21184

MICROCHIP TECHNOLOGY INCORPORATED  
(Exact Name of Registrant as Specified in Its Charter)

Delaware 86-0629024  
(State or Other Jurisdiction of Incorporation or Organization) (IRS Employer Identification No.)

2355 W. Chandler Blvd., Chandler, AZ 85224-6199  
(480) 792-7200  
(Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Registrant's  
Principal Executive Offices)

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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

Yes  No

Shares Outstanding of Registrant's Common Stock

Class	Outstanding at July 26, 2017
Common Stock, \$0.001 par value	232,728,449 shares

MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

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## MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

## Item 1. Financial Statements

	June 30, 2017	March 31, 2017
<b>ASSETS</b>		
Cash and cash equivalents	\$773,036	\$908,684
Short-term investments	457,210	394,088
Accounts receivable, net	528,954	478,373
Inventories	426,843	417,202
Prepaid expenses	43,778	41,354
Assets held for sale	—	6,459
Other current assets	68,941	58,880
Total current assets	2,298,762	2,305,040
Property, plant and equipment, net	693,995	683,338
Long-term investments	420,458	107,457
Goodwill	2,299,009	2,299,009
Intangible assets, net	2,026,575	2,148,092
Long-term deferred tax assets	74,065	68,870
Other assets	75,027	75,075
Total assets	\$7,887,891	\$7,686,881
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable	\$171,857	\$149,233
Accrued liabilities	244,533	212,450
Deferred income on shipments to distributors	308,797	292,815
Current portion of long-term debt	11,256	49,952
Total current liabilities	736,443	704,450
Long-term debt	2,983,908	2,900,524
Long-term income tax payable	187,255	184,945
Long-term deferred tax liability	347,216	409,045
Other long-term liabilities	220,515	217,206
Stockholders' equity:		
Preferred stock, \$0.001 par value; authorized 5,000,000 shares; no shares issued or outstanding	—	—
Common stock, \$0.001 par value; authorized 450,000,000 shares; 252,698,952 shares issued and 232,726,199 shares outstanding at June 30, 2017; 249,463,733 shares issued and 229,093,658 shares outstanding at March 31, 2017	233	229
Additional paid-in capital	2,583,575	2,537,344
Common stock held in treasury: 19,972,753 shares at June 30, 2017; 20,370,075 shares at March 31, 2017	(719,180 )	(731,884 )
Accumulated other comprehensive loss	(19,133 )	(14,378 )
Retained earnings	1,567,059	1,479,400
Total stockholders' equity	3,412,554	3,270,711
Total liabilities and stockholders' equity	\$7,887,891	\$7,686,881
See accompanying notes to condensed consolidated financial statements		



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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended	
	June 30,	
	2017	2016
Net sales	\$972,141	\$799,411
Cost of sales (1)	387,702	450,921
Gross profit	584,439	348,490
Research and development (1)	130,480	147,883
Selling, general and administrative (1)	114,272	157,505
Amortization of acquired intangible assets	120,845	80,171
Special (income) charges and other, net	(2,756 )	22,035
Operating expenses	362,841	407,594
Operating income (loss)	221,598	(59,104 )
Losses on equity method investment	(55 )	(56 )
Other income (expense):		
Interest income	3,526	819
Interest expense	(49,490 )	(34,416 )
Loss on settlement of convertible debt	(13,826 )	—
Other income, net	4,452	2,010
Income (loss) before income taxes	166,205	(90,747 )
Income tax (benefit) provision	(4,382 )	18,478
Net income (loss) from continuing operations	170,587	(109,225 )
Discontinued operations:		
Loss from discontinued operations	—	(5,473 )
Income tax benefit	—	(1,335 )
Net loss from discontinued operations	—	(4,138 )
Net income (loss)	\$170,587	\$(113,363)
Basic net income (loss) per common share		
Net income (loss) from continuing operations	\$0.74	\$(0.51 )
Net loss from discontinued operations	—	(0.02 )
Net income (loss)	\$0.74	\$(0.53 )
Diluted net income (loss) per common share		
Net income (loss) from continuing operations	\$0.70	\$(0.51 )
Net loss from discontinued operations	—	(0.02 )
Net income (loss)	\$0.70	\$(0.53 )
Dividends declared per common share	\$0.3615	\$0.3595
Basic common shares outstanding	229,429	214,345
Diluted common shares outstanding	242,902	214,345
(1) Includes share-based compensation expense as follows:		
Cost of sales	\$3,394	\$7,897
Research and development	10,289	17,517

Selling, general and administrative	8,725	34,165
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See accompanying notes to condensed consolidated financial statements

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MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	Three Months Ended June 30,	
	2017	2016
Net income (loss)	\$ 170,587	\$(113,363)
Components of other comprehensive income (loss):		
Available-for-sale securities:		
Unrealized holding losses, net of tax effect	(844 )	(1,325 )
Reclassification of realized transactions, net of tax effect	—	82
Defined benefit plans:		
Actuarial losses related to defined benefit pension plans, net of tax benefit of \$926 and \$3,003, respectively	(4,114 )	(6,805 )
Reclassification of realized transactions, net of tax effect	203	—
Change in net foreign currency translation adjustment	—	(3,023 )
Other comprehensive income (loss), net of tax effect	(4,755 )	(11,071 )
Comprehensive income (loss)	\$ 165,832	\$(124,434)

See accompanying notes to condensed consolidated financial statements



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## MICROCHIP TECHNOLOGY INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended	
	June 30,	
	2017	2016
Cash flows from operating activities:		
Net income (loss)	\$ 170,587	\$(113,363)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	151,801	113,141
Deferred income taxes	(21,878)	) 32,906
Share-based compensation expense related to equity incentive plans	22,408	59,579
Loss on settlement of convertible debt	13,826	—
Amortization of debt discount on convertible debt	25,953	12,106
Amortization of debt issuance costs	1,621	1,057
Losses on equity method investments	55	56
Gains on sale of assets	(4,565)	) (61 )
Losses on write-down of fixed assets	48	269
Impairment of intangible assets	128	1,984
Realized losses on available-for-sale investment	—	82
Realized gains on equity method investment	—	(468 )
Amortization of premium on available-for-sale investments	476	13
Changes in operating assets and liabilities, excluding impact of acquisitions:		
(Increase) in accounts receivable	(50,581)	) (9,901 )
(Increase) decrease in inventories	(9,904)	) 121,102
Increase in deferred income on shipments to distributors	15,982	29,739
Increase (decrease) in accounts payable and accrued liabilities	36,331	(18,000 )
Change in other assets and liabilities	(7,296)	) (12,270 )
Operating cash flows related to discontinued operations	—	5,996
Net cash provided by operating activities	344,992	223,967
Cash flows from investing activities:		
Purchases of available-for-sale investments	(487,435)	) (25 )
Sales and maturities of available-for-sale investments	110,000	470,551
Sale of equity method investment	—	468
Acquisition of Atmel, net of cash acquired	—	(2,747,516)
Investments in other assets	(1,933)	) (765 )
Proceeds from sale of assets	10,226	52
Capital expenditures	(22,130)	) (18,494 )
Net cash used in investing activities	(391,272)	) (2,295,729)
Cash flows from financing activities: <sup>(1)</sup>		
Repayments of revolving loan under credit facility	(60,000)	) (602,000 )
Proceeds from borrowings on revolving loan under credit facility	60,000	1,280,000
Payment of cash dividends	(82,928)	) (77,237 )
Proceeds from sale of common stock	4,474	4,630
Tax payments related to shares withheld for vested restricted stock units	(10,719)	) (25,183 )
Capital lease payments	(195)	) (195 )
Net cash (used in) provided by financing activities	(89,368)	) 580,015
Effect of foreign exchange rate changes on cash and cash equivalents	—	(478 )

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Net decrease in cash and cash equivalents	(135,648 )	(1,492,225)
Cash and cash equivalents at beginning of period	908,684	2,092,751
Cash and cash equivalents at end of period	\$773,036	\$600,526

Schedule of significant non-cash financing activity:

(1) During the three months ended June 30, 2017, the Company issued \$111.3 million principal amount of 2017 Junior Notes and 3.2 million shares of common stock in exchange for \$111.3 million principal amount of 2007 Junior Notes. Refer to Note 13 Debt and Credit Facility for further discussion.

See accompanying notes to condensed consolidated financial statements

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Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Microchip Technology Incorporated and its majority-owned and controlled subsidiaries (the Company). All intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP), pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The information furnished herein reflects all adjustments which are, in the opinion of management, of a normal recurring nature and necessary for a fair statement of the results for the interim periods reported. Certain information and footnote disclosures normally included in audited consolidated financial statements have been condensed or omitted pursuant to such SEC rules and regulations. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2017. The results of operations for the three months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2018 or for any other period.

Note 2. Recently Issued Accounting Pronouncements

Recently Adopted Accounting Pronouncements

During the three months ended June 30, 2017, the Company adopted ASU 2015-11-Simplifying the Measurement of Inventory. This standard requires that entities measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. ASU 2015-11 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016 and is applied prospectively. The adoption of this standard did not have a material impact on the Company's financial statements.

In March 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-07-Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This standard improves the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amendment will require the employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost will be presented separately in the income statement from the service cost component outside of income from operations. The amendment is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted at the beginning of an annual period (in the first interim period) for which financial statements have not yet been issued. During the three months ended June 30, 2017, the Company elected to early adopt ASU 2017-07 and the adoption of this standard did not have a material impact on its financial statements.

Recently Issued Accounting Pronouncements Not Yet Adopted

In January 2017, the FASB issued ASU 2017-04-Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount

of goodwill. The amendment is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2019, and early adoption is permitted. The Company does not expect this standard to have an impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18-Statement of Cash Flows: Restricted Cash. This standard requires that the statement of cash flows explain the change during the period in total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The standard is to be applied using a retrospective transition method to each period presented. The Company does not expect this standard to have a material impact on its consolidated financial statements.

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In October 2016, the FASB issued ASU 2016-16-Intra-Entity Transfers of Assets Other Than Inventory. This standard addresses the recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset other than inventory. Prior to the adoption of ASU 2016-16, a company will defer for financial reporting purposes the income tax expense resulting from an intra-entity asset transfer, including the taxes currently payable or paid. Upon adoption of ASU 2016-16, a company will recognize current and deferred income taxes that result from such transfers in the period in which they occur. ASU 2016-16 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 and is applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the impact the adoption of this standard will have on its condensed consolidated financial statements but expects to recognize its previously deferred tax related to intra-entity transfers upon adoption of ASU 2016-16 as of April 1, 2018 with a cumulative-effect reduction to retained earnings.

In June 2016, the FASB issued ASU 2016-13-Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments. This standard requires entities to use a current lifetime expected credit loss methodology to measure impairments of certain financial assets. Using this methodology will result in earlier recognition of losses than under the current incurred loss approach, which requires waiting to recognize a loss until it is probable of having been incurred. The amendments in ASU 2016-13 broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually and can include forecasted information. There are other provisions within the standard affecting how impairments of other financial assets may be recorded and presented, as well as expanded disclosures. ASU 2016-13 is effective for interim and annual periods beginning after December 15, 2019, and permits early adoption, but not before December 15, 2018. The standard is to be applied using a modified retrospective approach. The Company is currently evaluating the impact the adoption of this standard will have on its condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02-Leases. This standard requires lessees to recognize a lease liability and a right-of-use asset on the balance sheet and aligns many of the underlying principles of the new lessor model with those in Accounting Standards Codification Topic 606, Revenue from Contracts with Customers. ASU 2016-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, with early adoption permitted. The standard is to be applied using the modified retrospective approach to all periods presented. The Company is currently evaluating the impact the adoption of this standard will have on its condensed consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01-Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is not permitted. The Company is currently evaluating the impact the adoption of this standard will have on its condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09-Revenue from Contracts with Customers (Topic 606), which will supersede nearly all existing revenue recognition guidance under US GAAP. In July 2015, the FASB issued ASU 2015-14-Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delayed the effective date of the new standard by one year to December 15, 2017, for annual and interim reporting periods beginning after that date. In accordance with the delay, the new standard will be effective for the Company beginning no later than April 1, 2018. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard allows for the amendment to be applied either

retrospectively to each prior reporting period presented or retrospectively as a cumulative-effect adjustment as of the date of adoption. In March 2016, the FASB issued ASU 2016-08 - Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10 - Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which clarifies the implementation guidance on identifying performance obligations. In May 2016, the FASB issued ASU 2016-12 - Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which addresses implementation issues that were raised by stakeholders and discussed by the Revenue Recognition Transition Resource Group. As described in the Company's significant accounting policies, the Company currently defers the revenue and cost of sales on shipments to distributors until the distributor sells the product to their end customer. Upon adoption of ASU 2014-09, ASU 2015-14, ASU 2016-08, ASU 2016-10 and ASU 2016-12, the Company will no longer defer revenue until sale by the distributor to the end customer, but rather, will be required to estimate the effects of returns and allowances provided to distributors and record revenue at the time of sale to the distributor. The Company is currently evaluating the impact that the adoption of the standards will have on its condensed consolidated financial statements. The Company currently expects to

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adopt the standard under the full retrospective method. The final adoption method will depend on the results of the Company's ongoing assessment of the standard, which is expected to be completed later in fiscal 2018.

Note 3. Business Acquisitions

Acquisition of Atmel

On April 4, 2016, the Company acquired Atmel, a publicly traded company based in San Jose, California. The Company paid an aggregate of approximately \$2.98 billion in cash and issued an aggregate of 10.1 million shares of its common stock to Atmel stockholders valued at \$486.1 million based on the closing price of the Company's common stock on April 4, 2016 and incurred transaction and other fees of approximately \$14.9 million. The total consideration transferred in the acquisition, including approximately \$7.5 million of non-cash consideration for the exchange of certain share-based payment awards of Atmel for stock awards of the Company, was approximately \$3.47 billion. In addition to the consideration transferred, the Company recognized in its consolidated financial statements \$653.1 million in liabilities of Atmel consisting of debt, taxes payable and deferred, pension obligations, restructuring, and contingent and other liabilities. The Company financed the cash portion of the purchase price using approximately \$2.04 billion of cash held by certain of its foreign subsidiaries and approximately \$0.94 billion from additional borrowings under its existing credit agreement. As a result of the acquisition, Atmel became a wholly owned subsidiary of the Company. Atmel is a worldwide leader in the design and manufacture of microcontrollers, capacitive touch solutions, advanced logic, mixed-signal, nonvolatile memory and radio frequency components. The Company's primary reason for this acquisition was to expand the Company's range of solutions, products and capabilities by extending its served available market.

The acquisition was accounted for under the acquisition method of accounting, with the Company identified as the acquirer, and the operating results of Atmel have been included in the Company's consolidated financial statements as of the closing date of the acquisition. Under the acquisition method of accounting, the aggregate amount of consideration paid by the Company was allocated to Atmel's net tangible assets and intangible assets based on their estimated fair values as of April 4, 2016. The excess of the purchase price over the value of the net tangible assets and intangible assets was recorded to goodwill. The factors contributing to the recognition of goodwill were based upon the Company's conclusion that there are strategic and synergistic benefits that are expected to be realized from the acquisition. The goodwill has been allocated to the Company's semiconductor products reporting segment. None of the goodwill related to the Atmel acquisition is deductible for tax purposes. The Company retained independent third-party appraisers to assist management in its valuation.

The table below represents the allocation of the final purchase price to the net assets acquired based on their estimated fair values, as well as the associated estimated useful lives of the acquired intangible assets (amounts in thousands).

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Assets acquired	
Cash and cash equivalents	\$230,266
Accounts receivable	141,359
Inventories	335,163
Prepaid expenses and other current assets	28,360
Assets held for sale	32,006
Property, plant and equipment	129,884
Goodwill	1,286,371
Purchased intangible assets	1,888,392
Long-term deferred tax assets	46,700
Other assets	7,535
Total assets acquired	4,126,036

Liabilities assumed	
Accounts payable	(55,686 )
Other current liabilities	(120,955 )
Long-term line of credit	(192,000 )
Deferred tax liabilities	(27,552 )
Long-term income tax payable	(115,177 )
Other long-term liabilities	(141,688 )
Total liabilities assumed	(653,058 )
Purchase price allocated	\$3,472,978

Purchased Intangible Assets	Weighted Average Useful Life	
	(in years)	(in thousands)
Core and developed technology	11	\$1,074,987
In-process research and development	—	140,700
Customer-related	6	630,600
Backlog	1	40,300
Other	5	1,805
Total purchased intangible assets		\$1,888,392

Purchased intangible assets include core and developed technology, in-process research and development, customer-related intangibles, acquisition-date backlog and other intangible assets. The estimated fair values of the core and developed technology and in-process research and development were determined based on the present value of the expected cash flows to be generated by the respective existing technology or future technology. The core and developed technology intangible assets are being amortized in a manner based on the expected cash flows used in the initial determination of fair value. In-process research and development is capitalized until such time as the related projects are completed or abandoned at which time the capitalized amounts will begin to be amortized or written off. Customer-related intangible assets consist of Atmel's contractual relationships and customer loyalty related to its distributor and end-customer relationships, and the fair values of the customer-related intangibles were determined based on Atmel's projected revenues. An analysis of expected attrition and revenue growth for existing customers was prepared from Atmel's historical customer information. Customer relationships are being amortized in a manner based on the estimated cash flows associated with the existing customers and anticipated retention rates. Backlog relates to the value of orders not yet shipped by Atmel at the acquisition date, and the fair values were based on the





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estimated profit associated with those orders. Backlog related assets had a one year useful life and were being amortized on a straight-line basis over that period. The total weighted average amortization period of intangible assets acquired as a result of the Atmel transaction is 9 years. Amortization expense associated with acquired intangible assets is not deductible for tax purposes. Thus, approximately \$178.1 million was established as a net deferred tax liability for the future amortization of the intangible assets.

## Note 4. Discontinued Operations

Discontinued operations include the mobile touch operations that the Company acquired as part of its acquisition of Atmel. The mobile touch assets had been marketed for sale since the Company's acquisition of Atmel on April 4, 2016 based on management's decision that it was not a strategic fit for the Company's product portfolio. On November 10, 2016, the Company completed the sale of the mobile touch assets to Solomon Systech (Limited) International, a Hong Kong based semiconductor company. The transaction included the sale of certain semiconductor products, equipment, customer list, backlog, patents, and a license to certain other intellectual property and patents related to the Company's mobile touch product line. The Company also agreed to provide certain transition services to Solomon Systech, which were substantially complete as of March 31, 2017. For financial statement purposes, the results of operations for this discontinued business have been segregated from those of the continuing operations and are presented in the Company's condensed consolidated financial statements as discontinued operations.

As the Company completed the sale of the mobile touch assets on November 10, 2016, there are no discontinued operations for the three months ended June 30, 2017. The results of discontinued operations for the three months ended June 30, 2016 are as follows (amounts in thousands):

	Three Months Ended June 30, 2016
Net sales	\$9,376
Cost of sales	8,424
Operating expenses	6,425
Income tax benefit	(1,335 )
Net loss from discontinued operations	\$(4,138)

## Note 5. Special (Income) Charges and Other, Net

The following table summarizes activity included in the "special (income) charges and other, net" caption on the Company's condensed consolidated statements of operations (amounts in thousands):

	Three Months Ended June 30,	
	2017	2016
Restructuring		
Employee separation costs	\$1,086	\$19,616
Gain on sale of assets	(4,447 )	—
Impairment charges	100	1,961
Contract exit costs	586	38

Other	(81	)	420
Total	\$(2,756)		\$22,035

The Company continuously evaluates its existing operations in an attempt to identify and realize cost savings opportunities and operational efficiencies. This same approach is applied to businesses that are acquired by the Company and often the operating models of acquired companies are not as efficient as the Company's operating model which enables the Company to realize significant savings and efficiencies. As a result, following an acquisition, the Company will from time to

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time incur restructuring expenses; however, the Company is often not able to estimate the timing or amount of such costs in advance of the period in which they occur. The primary reason for this is that the Company regularly reviews and evaluates each position, contract and expense against the Company's strategic objectives, long-term operating targets and other operational priorities. Decisions related to restructuring activities are made on a "rolling basis" during the course of the integration of an acquisition whereby department managers, executives and other leaders work together to evaluate each of these expenses and make recommendations. As a result of this approach, at the time of an acquisition, the Company is not able to estimate the total amount of expected employee separation or exit costs that it will incur in connection with its restructuring activities.

The Company's restructuring expenses during fiscal 2017 were related to the Company's recent business combinations, including the acquisitions of Atmel and Micrel, and resulted from workforce, property and other operating expense rationalizations as well as combining product roadmaps and manufacturing operations. These expenses were for employee separation costs, contract exit costs, other operating expenses and intangible asset impairment losses. At March 31, 2017, these activities were substantially complete; however, the Company may continue to incur additional costs in the future as additional synergies or operational efficiencies are identified. The Company is not able to estimate the amount of such future expenses, if any, at this time.

All of the Company's restructuring activities occurred in its semiconductor products segment. The Company incurred \$52.2 million since the start of fiscal 2015 in connection with employee separation activities, of which \$1.1 million and \$19.6 million was incurred during the first quarter of fiscal 2018 and fiscal 2017, respectively. These employee separation activities are now substantially complete and any future amounts are not expected to be material. The Company has incurred \$45.3 million in connection with contract exit activities since the start of fiscal 2015 of which \$0.6 million was incurred during the first quarter of fiscal 2018 and an immaterial amount in the first quarter of fiscal 2017. These contract exit activities are now substantially complete and any future amounts are not expected to be material.

In the three months ended June 30, 2017, the Company completed the sale of an asset it acquired as part of its acquisition of Micrel for proceeds of \$10.0 million and the gain is included in the gain on sale of assets in the above table. As of March 31, 2017, these assets consisting of property, plant and equipment were presented as held for sale in the Company's consolidated financial statements. The impairment losses were recognized as a result of changes in the combined product roadmaps after the acquisition of Atmel that affected the use and life of these assets. The following is a rollforward of accrued restructuring charges from April 1, 2017 to June 30, 2017 (amounts in thousands):

	Employee Separation Costs	Exit Costs	Total
Balance at April 1, 2017 - Restructuring Accrual	\$ 5,474	\$34,751	\$40,225
Charges	1,086	586	1,672
Payments	(2,995 )	(2,896 )	(5,891 )
Non-cash - Other	(220 )	(76 )	(296 )
Foreign exchange gains	170	—	170
Balance at June 30, 2017 - Restructuring Accrual	\$ 3,515	\$32,365	\$35,880

The restructuring liability of \$35.9 million is included in accrued liabilities and other long-term liabilities on the Company's condensed consolidated balance sheet as of June 30, 2017.

## Note 6. Segment Information

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

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The following table represents net sales and gross profit for each segment for the three months ended June 30, 2017 (amounts in thousands):

	Three Months Ended June 30, 2017	
	Net Sales	Gross Profit
Semiconductor products	\$947,106	\$559,404
Technology licensing	25,035	25,035
Total	\$972,141	\$584,439

The following table represents net sales and gross profit for each segment for the three months ended June 30, 2016 (amounts in thousands):

	Three Months Ended June 30, 2016	
	Net Sales	Gross Profit
Semiconductor products	\$778,823	\$327,902
Technology licensing	20,588	20,588
Total	\$799,411	\$348,490

## Note 7. Investments

The Company's investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations, and delivers an appropriate yield in relationship to the Company's investment guidelines and market conditions. The following is a summary of available-for-sale securities at June 30, 2017 (amounts in thousands):

	Available-for-sale Securities			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government agency bonds	\$544,638	\$ 5	\$ (1,125 )	\$543,518
Municipal bonds - tax-exempt	9,920	—	—	9,920
Municipal bonds - taxable	10,000	5	—	10,005
Corporate bonds and debt	312,668	64	(246 )	312,486
Marketable equity securities	707	1,032	—	1,739
Total	\$877,933	\$ 1,106	\$ (1,371 )	\$877,668

The following is a summary of available-for-sale securities at March 31, 2017 (amounts in thousands):

	Available-for-sale Securities			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government agency bonds	\$227,089	\$ 3	\$ (227 )	\$226,865
Municipal bonds - tax-exempt	55,289	—	(10 )	55,279
Municipal bonds - taxable	10,000	43	—	10,043
Corporate bonds and debt	207,888	53	(169 )	207,772

Marketable equity securities	707	879	—	1,586
Total	\$500,973	\$ 978	\$ (406 )	\$501,545

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At June 30, 2017, the Company's available-for-sale securities are presented on the condensed consolidated balance sheets as short-term investments of \$457.2 million and long-term investments of \$420.5 million. At March 31, 2017, the Company's available-for-sale securities are presented on the condensed consolidated balance sheets as short-term investments of \$394.1 million and long-term investments of \$107.5 million.

The Company had no proceeds from sales of available-for-sale investments during the three months ended June 30, 2017. The Company sold available-for-sale investments for proceeds of \$470.6 million during the three months ended June 30, 2016 to finance a portion of the purchase price of its Atmel acquisition which closed on April 4, 2016. The Company had no material realized gains from the sale of available-for-sale securities during the three months ended June 30, 2017 and 2016. The Company determines the cost of available-for-sale debt securities sold on a FIFO basis at the individual security level for sales from multiple lots. For sales of marketable equity securities, the Company uses an average cost basis at the individual security level. Gains and losses recognized in earnings are credited or charged to other income (expense) on the consolidated statements of operations.

The following tables show all investments in an unrealized loss position for which an other-than-temporary impairment has not been recognized and the related gross unrealized losses and fair value, aggregated by investment category and the length of time that the individual securities have been in a continuous unrealized loss position (amounts in thousands):

	June 30, 2017					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Government agency bonds	\$500,561	\$(1,125)	\$—	—	—\$500,561	\$(1,125)
Municipal bonds - tax exempt	—	—	—	—	—	—
Corporate bonds and debt	192,708	(246)	—	—	192,708	(246)
Total	\$693,269	\$(1,371)	\$—	—	—\$693,269	\$(1,371)
	March 31, 2017					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Government agency bonds	\$196,875	\$(227)	\$—	—	—\$196,875	\$(227)
Municipal bonds	55,279	(10)	—	—	55,279	(10)
Corporate bonds and debt	132,820	(169)	—	—	132,820	(169)
Total	\$384,974	\$(406)	\$—	—	—\$384,974	\$(406)

Management does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of June 30, 2017 and the Company's intent is to hold these investments until these assets are no longer impaired.

The amortized cost and estimated fair value of the available-for-sale securities at June 30, 2017, by contractual maturity, excluding marketable equity securities of \$1.7 million, which have no contractual maturity, are shown below (amounts in thousands). Expected maturities can differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations.





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	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale				
Due in one year or less	\$400,654	\$ 5	\$ (306 )	\$400,353
Due after one year and through five years	476,572	69	(1,065 )	475,576
Due after five years and through ten years	—	—	—	—
Due after ten years	—	—	—	—
Total	\$877,226	\$ 74	\$ (1,371 )	\$875,929

## Note 8. Fair Value Measurements

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

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

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

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

## Marketable Debt Instruments

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

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## Assets Measured at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis at June 30, 2017 are as follows (amounts in thousands):

	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total Balance
Assets			
Cash and cash equivalents:			
Money market mutual funds	\$ 111,766	\$—	\$ 111,766
Deposit accounts	—	661,270	661,270
Short-term investments:			
Marketable equity securities	1,739	—	1,739
Corporate bonds and debt	—	235,856	235,856
Government agency bonds	—	199,689	199,689
Municipal bonds - tax exempt	—	9,920	9,920
Municipal bonds - taxable	—	10,005	10,005
Long-term investments:			
Corporate bonds and debt	—	76,630	76,630
Government agency bonds	—	343,829	343,829
Total assets measured at fair value	\$ 113,505	\$ 1,537,199	\$ 1,650,704

Assets measured at fair value on a recurring basis at March 31, 2017 are as follows (amounts in thousands):

	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total Balance
Assets			
Cash and cash equivalents:			
Money market mutual funds	\$ 343,815	\$—	\$ 343,815
Deposit accounts	—	564,869	564,869
Short-term investments:			
Marketable equity securities	1,586	—	1,586
Corporate bonds and debt	—	165,207	165,207
Government agency bonds	—	161,973	161,973
Municipal bonds - non-taxable	—	55,279	55,279
Municipal bonds - taxable	—	10,043	10,043
Long-term investments:			
Corporate bonds and debt	—	42,565	42,565
Government agency bonds	—	64,892	64,892
Total assets measured at fair value	\$ 345,401	\$ 1,064,828	\$ 1,410,229

There were no transfers between Level 1 and Level 2 during the three months ended June 30, 2017 or the fiscal year ended March 31, 2017. There were no assets measured at fair value on a recurring basis classified as Level 3 at June 30, 2017 or March 31, 2017.

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

The Company's non-marketable equity, cost method investments, certain acquired liabilities and non-financial assets, such as intangible assets, assets held for sale and property, plant and equipment, are recorded at fair value on a non-recurring basis. These assets are subject to fair value adjustments in certain circumstances, for example, when there is evidence of impairment.

The Company's non-marketable and cost method investments are monitored on a quarterly basis for impairment charges. The fair values of these investments have been determined as Level 3 fair value measurements because the valuations use unobservable inputs that require management's judgment due to the absence of quoted market prices. There were no impairment charges recognized on these investments during each of the three-month periods ended June 30, 2017 and June 30, 2016. These investments are included in other assets on the condensed consolidated balance sheet.

The fair value measurements related to the Company's non-financial assets, such as intangible assets, assets held for sale and property, plant and equipment are based on available market prices at the measurement date based on transactions of similar assets and third-party independent appraisals, less costs to sell where appropriate. The Company classifies these measurements as Level 2.

## Note 9. Fair Value of Financial Instruments

The carrying amount of cash equivalents approximates fair value because their maturity is less than three months. Management believes the carrying amount of the equity and cost-method investments materially approximated fair value at June 30, 2017 based upon unobservable inputs. The fair values of these investments have been determined as Level 3 fair value measurements. The carrying amount of accounts receivable, accounts payable and accrued liabilities approximates fair value due to the short-term maturity of the amounts and are considered Level 2 in the fair value hierarchy.

## Fair Value of Subordinated Convertible Debt

The Company measures the fair value of its senior and junior subordinated convertible debt for disclosure purposes. These fair values are based on observable market prices for this debt, which is traded in less active markets and are therefore classified as a Level 2 fair value measurement.

The following table shows the carrying amounts and fair values of the Company's senior and junior subordinated convertible debt as of June 30, 2017 and March 31, 2017 (amounts in thousands). As of June 30, 2017 and March 31, 2017, the carrying amounts of the Company's senior and junior subordinated convertible debt have been reduced by debt issuance costs of \$37.0 million and \$38.3 million, respectively.

	June 30, 2017		March 31, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
2017 Senior Debt	\$ 1,397,808	\$ 2,187,907	\$ 1,384,914	\$ 2,106,225
2015 Senior Debt	\$ 1,273,559	\$ 2,591,002	\$ 1,261,787	\$ 2,481,708
2017 Junior Debt	\$ 320,254	\$ 718,662	\$ 262,298	\$ 586,609
2007 Junior Debt	\$ 11,256	\$ 110,356	\$ 49,952	\$ 445,142



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## Note 10. Other Financial Statement Details

## Accounts Receivable

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

	June 30, 2017	March 31, 2017
Trade accounts receivable	\$525,101	\$473,238
Other	5,991	7,219
Total accounts receivable, gross	531,092	480,457
Less allowance for doubtful accounts	2,138	2,084
Total accounts receivable, net	\$528,954	\$478,373

## Inventories

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

	June 30, 2017	March 31, 2017
Raw materials	\$16,274	\$14,430
Work in process	279,192	268,281
Finished goods	131,377	134,491
Total inventories	\$426,843	\$417,202

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

## Property, Plant and Equipment

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

	June 30, 2017	March 31, 2017
Land	\$73,504	\$73,447
Building and building improvements	501,476	499,668
Machinery and equipment	1,801,169	1,774,920
Projects in process	114,023	104,318
Total property, plant and equipment, gross	2,490,172	2,452,353
Less accumulated depreciation and amortization	1,796,177	1,769,015
Total property, plant and equipment, net	\$693,995	\$683,338

Depreciation expense attributed to property, plant and equipment was \$29.0 million and \$30.6 million for the three months ended June 30, 2017 and 2016, respectively.

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## Note 11. Intangible Assets and Goodwill

Intangible assets consist of the following (amounts in thousands):

	June 30, 2017		
	Gross Amount	Accumulated Amortization	Net Amount
Core and developed technology	\$1,938,816	\$ (474,650 )	\$1,464,166
Customer-related	716,945	(186,694 )	530,251
Trademarks and trade names	11,700	(10,152 )	1,548
In-process research and development	29,379	—	29,379
Distribution rights	5,578	(5,357 )	221
Other	1,449	(439 )	1,010
Total	\$2,703,867	\$ (677,292 )	\$2,026,575

	March 31, 2017		
	Gross Amount	Accumulated Amortization	Net Amount
Core and developed technology	\$1,932,329	\$ (419,468 )	\$1,512,861
Customer-related	716,945	(123,616 )	593,329
Trademarks and trade names	11,700	(9,636 )	2,064
In-process research and development	38,511	—	38,511
Distribution rights	5,578	(5,346 )	232
Other	1,449	(354 )	1,095
Total	\$2,706,512	\$ (558,420 )	\$2,148,092

The Company amortizes intangible assets over their expected useful lives, which range between 1 and 15 years. During the three months ended June 30, 2017, \$8.9 million of in-process research and development reached technological feasibility and was reclassified as core and developed technology and began being amortized over its estimated useful life. The following is an expected amortization schedule for the intangible assets for the remainder of fiscal 2018 through fiscal 2022, absent any future acquisitions or impairment charges (amounts in thousands):

Fiscal Year Ending	Projected Amortization Expense
March 31, 2018	\$367,731
2019	362,023
2020	313,447
2021	257,054
2022	190,017

Amortization expense attributed to intangible assets was \$122.8 million and \$82.5 million for the three months ended June 30, 2017 and 2016, respectively. In the three months ended June 30, 2017, approximately \$2.0 million was charged to cost of sales, and approximately \$120.8 million was charged to operating expenses. In the three months ended June 30, 2016, approximately \$0.9 million was charged to cost of sales, and approximately \$81.6 million was charged to operating expenses. The Company recognized an immaterial amount of intangible asset impairment charges in the three months ended June 30, 2017. In connection with its acquisition of Atmel, the Company recognized intangible asset impairment charges of \$2.0 million for the three months ended June 30, 2016. The impairment losses were recognized as a result of changes in the combined product roadmaps after the acquisition of Atmel that affected the use and life of these assets.





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The following shows the goodwill balance as of June 30, 2017 and March 31, 2017 by segment (amounts in thousands):

Semiconductor Products Reporting Unit	Technology Licensing Reporting Unit
Goodwill \$ 2,279,809	\$ 19,200

At March 31, 2017, the Company applied a qualitative goodwill impairment test to its two reporting units, concluding it was not more likely than not that goodwill was impaired. Through June 30, 2017, the Company has never recorded an impairment charge against its goodwill balance.

## Note 12. Income Taxes

The provision for income taxes reflects tax on foreign earnings and federal and state tax on U.S. earnings. The Company had a negative effective tax rate of 2.6% for the three months ended June 30, 2017 and a negative effective tax rate of 20.4% for the three months ended June 30, 2016. The Company's effective tax rate for the three months ended June 30, 2017 is higher compared to the prior year primarily due to acquisition related expenses in the prior year. The Company's effective tax rate is lower than statutory rates in the U.S. due primarily to its mix of earnings in foreign jurisdictions with lower tax rates as well as numerous tax holidays it receives related to its Thailand manufacturing operations based on its investment in property, plant and equipment in Thailand. The Company's tax holiday periods in Thailand expire at various times in the future, however, the Company actively seeks to obtain new tax holidays. The Company does not expect the future expiration of any of its tax holiday periods in Thailand to have a material impact on its effected tax rate. The material components of foreign income taxed at a rate lower than the U.S. are earnings accrued in Thailand and Ireland, and earnings accrued by the Company's offshore technology company which is resident in the Cayman Islands.

The Company files U.S. federal, U.S. state, and foreign income tax returns. For U.S. federal, and in general for U.S. state tax returns, the fiscal 2005 and later tax years remain effectively open for examination by tax authorities. For foreign tax returns, the Company is generally no longer subject to income tax examinations for years prior to fiscal 2007.

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

The Company believes it maintains appropriate reserves to offset any potential income tax liabilities that may arise upon final resolution of matters for open tax years. If such reserve amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined. Although the timing of the resolution or closure of audits is highly uncertain, the Company does not believe it is reasonably possible that the unrecognized tax benefits would materially change in the next 12 months.



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## Note 13. Debt and Credit Facility

Debt obligations included in the consolidated balance sheets consisted of the following (in millions):

	Coupon Interest Rate	Effective Interest Rate	Fair Value of Liability Component at Issuance <sup>(1)</sup>	June 30, 2017	March 31, 2017
Senior Indebtedness					
Credit Facility				\$—	\$—
Senior Subordinated Convertible Debt - Principal Outstanding					
2017 Senior Debt, maturing					
February 15, 2027 (2017 Senior Debt)	1.625%	6.0%	\$1,396.3	\$2,070.0	\$2,070.0
2015 Senior Debt, maturing					
February 15, 2025 (2015 Senior Debt)	1.625%	5.9%	1,160.1	1,725.0	1,725.0
Junior Subordinated Convertible Debt - Principal Outstanding					
2017 Junior Debt, maturing					
February 15, 2037 (2017 Junior Debt)	2.250%	7.4%	321.1	686.3	575
2007 Junior Debt, maturing					
December 15, 2037 (2007 Junior Debt)	2.125%	9.1%	11.5	32.5	143.8
Total Convertible Debt				4,513.8	4,513.8
Gross long-term debt including current maturities				4,513.8	4,513.8
Less: Debt discount <sup>(2)</sup>				(1,473.9 )	(1,516.5 )
Less: Debt issuance costs <sup>(3)</sup>				(44.7 )	(46.8 )
Net long-term debt including current maturities				2,995.2	2,950.5
Less: Current maturities <sup>(4)</sup>				(11.3 )	(50.0 )
Net long-term debt				\$2,983.9	\$2,900.5

<sup>(1)</sup> As each of the convertible instruments may be settled in cash upon conversion, for accounting purposes, they were bifurcated into a liability component and an equity component, which are both initially recorded at fair value. The amount allocated to the equity component is the difference between the principal value of the instrument and the fair value of the liability component at issuance. The resulting debt discount is being amortized to interest expense at the respective effective interest rate over the contractual term of the debt.

<sup>(2)</sup> The unamortized discount includes the following (in millions):

	June 30, 2017	March 31, 2017
2017 Senior Debt	\$(654.9 )	\$(667.5 )
2015 Senior Debt	(435.3 )	(446.6 )
2017 Junior Debt	(362.6 )	(309.3 )
2007 Junior Debt	(21.1 )	(93.1 )
Total unamortized discount	\$(1,473.9)	\$(1,516.5)



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(3) Debt issuance costs include the following (in millions):

	June 30, 2017	March 31, 2017
Senior Credit Facility	\$(7.7 )	\$ (8.5 )
2017 Senior Debt	(17.3 )	(17.6 )
2015 Senior Debt	(16.2 )	(16.6 )
2017 Junior Debt	(3.4 )	(3.4 )
2007 Junior Debt	(0.1 )	(0.7 )
Total debt issuance costs	\$(44.7)	\$ (46.8 )

(4) Current maturities include the full balance of the 2007 Junior Debt.

**Ranking of Indebtedness** - The Senior Subordinated Convertible Debt and Junior Subordinated Convertible Debt (collectively, the Convertible Debt) are unsecured obligations which are subordinated in right of payment to the amounts outstanding under the Company's Credit Facility. The Junior Subordinated Convertible Debt is expressly subordinated in right of payment to any existing and future senior debt of the Company (including the Credit Facility and the Senior Subordinated Convertible Debt) and is structurally subordinated in right of payment to the liabilities of the Company's subsidiaries. The Senior Subordinated Convertible Debt is subordinated to the Credit Facility; ranks senior to the Company's indebtedness that is expressly subordinated in right of payment, including the Junior Subordinated Convertible Debt; ranks equal in right of payment to any of the Company's unsubordinated indebtedness that does not provide that it is senior to the Senior Subordinated Convertible Debt; ranks junior in right of payment to any of the Company's secured, unsubordinated indebtedness to the extent of the value of the assets securing such indebtedness; and ranks junior to all indebtedness and other liabilities of the Company's subsidiaries.

**Summary of Conversion Features** - Each series of Convertible Debt is convertible, subject to certain conditions, into cash, shares of the Company's common stock or a combination thereof, at the Company's election, at specified Conversion Rates (see table below), adjusted for certain events including the declaration of cash dividends. Up until the three-months immediately preceding the maturity date of the applicable series of Convertible Debt, each series of Convertible Debt is convertible only upon the occurrence of (1) the closing price of the Company's common stock exceeds the Conversion Price (see table below) by 130% for 20 days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter or (2) during the 5 business day period after any 10 consecutive trading day period, or the measurement 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 the Company's common stock and the conversion rate on each such trading day or (3) upon the occurrence of certain corporate events specified in the indenture of such series of Convertible Debt. In addition, for each series other than the 2007 Junior Debt, if at the time of conversion the applicable price of the Company's common stock exceeds the applicable Conversion Price at such time, the applicable Conversion Rate will be increased by up to an additional maximum incremental shares rate, as determined pursuant to a formula specified in the indenture for the applicable series of Convertible Debt, and as adjusted for cash dividends paid since the issuance of such series of Convertible Debt. However, in no event will the applicable Conversion Rate exceed the applicable Maximum Conversion Rate specified in the indenture for the applicable series of Convertible Debt (see table below). The following table sets forth the applicable Conversion Rates adjusted for dividends declared since issuance of such series of Convertible Debt and the applicable Maximum Incremental Share Rate (with the exception of the 2007 Junior Debt) and applicable Conversion Rates as adjusted for dividends paid since the applicable issuance date:

Dividend adjusted rates as of June 30, 2017

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	Conversion Rate, adjusted	Approximate Conversion Price, adjusted	Maximum Incremental Rate, adjusted	Maximum Conversion Rate, adjusted
2017 Senior Debt	9.9890	\$ 100.11	4.9945	14.2344
2015 Senior Debt	15.5772	\$ 64.20	7.7886	21.8081
2017 Junior Debt	10.1674	\$ 98.35	5.0838	14.2344
2007 Junior Debt	42.3241	\$ 23.63	NA	48.6727

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As of June 30, 2017, the holders of the 2007 Junior Debt had the right to convert their debentures between July 1, 2017 and September 30, 2017 because the Company's common stock has exceeded the Conversion Price by 130% for the specified period of time during the quarter ended June 30, 2017. In June 2017, the Company received notification from certain holders of the 2007 Junior Debt of their intent to convert \$15.2 million in principal value according to the terms of the debt and the Company settled the principal amount in cash and issued 0.5 million shares of its common stock in respect of the conversion value in excess of the principal amount in the second quarter of fiscal 2018. In addition, the Company has the option and intent to call the remaining outstanding 2007 Junior Debt on or after December 15, 2017. Therefore, the 2007 Junior Debt is classified as a current liability on the consolidated balance sheet as of June 30, 2017 and March 31, 2017. If the Company does not call the 2007 Junior Debt in December 2017, additional interest will be due on the notes based on the trading value of the notes of 0.25% if the debentures are trading at less than \$400 and a 0.5% additional interest rate if the debentures are trading at greater than \$1,500. Based on the current trading price of the debentures, the contingent interest rate beginning in December 2017 would be 0.5% of the average trading price. The if-converted value of the debentures exceeded the principal amount by \$73.5 million at June 30, 2017.

As of June 30, 2017, the 2015 Senior Debt is not convertible but had a value if converted above par of \$348.9 million.

The Company may not redeem any series of Convertible Debt prior to the relevant maturity date and no sinking fund is provided for any series of Convertible Debt. Upon the occurrence of a fundamental change as defined in the applicable indenture of such series of Convertible Debt, holders of such series may require the Company to purchase all or a portion of their Convertible Debt for cash at a price equal to 100% of the principal amount plus any accrued and unpaid interest.

Interest expense includes the following (in millions):

	Three Months Ended June 30, 2017 2016	
Debt issuance amortization	\$0.9	\$0.4
Amortization of debt discount - non cash interest expense	25.9	12.1
Coupon interest expense	19.4	10.1
Total	\$46.2	\$22.6

The remaining period over which the unamortized debt discount will be recognized as non-cash interest expense is 9.63 years, 7.63 years, 19.63 years, 20.46 years for the 2017 Senior Debt, 2015 Senior Debt, 2017 Junior Debt and 2007 Junior Debt, respectively.

Issuances and Settlements - In June 2017, the Company exchanged in privately negotiated transactions \$111.3 million aggregate principal amount of its 2007 Junior Debt for (i) \$111.3 million principal amount of 2017 Junior Debt with a market value of \$119.3 million plus (ii) the issuance of 3.2 million shares of the Company's common stock with a value of \$254.6 million, of which \$56.3 million was allocated to the fair value of the liability and \$321.1 million was allocated to the reacquisition of the equity component for total consideration of \$374.0 million. The transaction resulted in a loss on settlement of the 2007 Junior Debt of approximately \$13.8 million, which represented the difference between the fair value of the liability component at time of repurchase and the sum of the carrying values of the debt component and any unamortized debt issuance costs. The debt discount on the new 2017 Junior Debt was the difference between the par value and the fair value of the debt resulting in a debt discount of \$55.1 million which will be amortized to interest expense using the effective interest method over the term of the debt.



In February 2017, the Company issued the 2017 Senior Debt and 2017 Junior Debt for net proceeds of \$2,043.6 million and \$567.7 million, respectively. In connection with the issuance of these instruments, the Company incurred issuance costs of \$33.7 million, of which \$17.8 million and \$3.4 million was recorded as debt issuance costs related to the 2017 Senior Debt and 2017 Junior Debt, respectively, and will be amortized using the effective interest method over the term of the debt. The balance of \$12.5 million in fees was recorded to equity. Interest on both instruments is payable semi-annually on February 15 and August 15 of each year.

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In February 2015, the Company issued the 2015 Senior Debt for net proceeds of approximately \$1,694.7 million. In connection with the issuance, the Company incurred issuance costs of \$30.3 million, of which \$20.4 million was recorded as debt issuance costs and will be amortized using the effective interest method over the term of the debt. The balance of \$9.9 million was recorded to equity.

The Company utilized the proceeds from the issuances of the 2017 debt and 2015 debt to reduce amounts borrowed under its Credit Facility and to settle a portion of the 2007 Junior Debt in privately negotiated transactions. In February 2017 and February 2015, the Company settled \$431.3 million and \$575.0 million, respectively, in aggregate principal of its 2007 Junior Debt. The 2015 repurchase consisted solely of cash. In February 2017, the Company used cash of \$431.3 million and an aggregate of 12.0 million in shares of the Company's common stock valued at \$862.7 million for total consideration of \$1,293.9 million to settle \$431.3 million of the 2007 Junior Debt, of which \$188.0 million was allocated to the liability component and \$1,105.9 million was allocated to the equity component. In addition, in February 2017, there was an inducement fee of \$5.0 million which was recorded in the consolidated statement of operations in loss on settlement of convertible debt. The consideration transferred in February 2015 was \$1,134.6 million, of which \$238.3 million was allocated to the liability component and \$896.3 million was allocated to the equity component. In the case of both settlements of the 2007 Junior Debt, the consideration was allocated to the liability and equity components using the equivalent rate that reflected the borrowing rate for a similar non-convertible debt prior to the retirement. The transactions resulted in a loss on settlement of convertible debt of approximately \$43.9 million and \$50.6 million in fiscal 2017 and fiscal 2015, respectively, which represented, in each case, the difference between the fair value of the liability component at time of repurchase and the sum of the carrying values of the debt component and any unamortized debt issuance costs.

#### Credit Facility

The Company maintains a \$2.774 billion credit facility which is made up of two tranches, one available until February 4, 2020 and another available through June 27, 2018. The Credit Facility was amended in February 2017 and February 2015. The financial covenants include, among others, limits on the Company's consolidated senior ratio and total leverage ratio. The maximum Total Leverage Ratio (capitalized terms not otherwise defined in this Form 10-Q have the meaning of the defined terms in the applicable agreements) cannot exceed 5.00 to 1.00 and is calculated as Consolidated Total Indebtedness, excluding the Junior Debt up to a \$700 million maximum, to Consolidated EBIDTA for a period of four quarters. The Total Leverage Ratio may be temporarily increased to 5.50 to 1.00 for a period of four consecutive quarters in conjunction with a Permitted Acquisition occurring during the first four quarters following the acquisition. The Total Leverage Ratio then decreases to 5.25 to 1.00 for three consecutive quarters, finally returning to the stated 5.00 to 1.00 Total Leverage Ratio after a period of seven consecutive fiscal periods. The Company can elect to use this special feature, also referred to as an Adjusted Covenant Period, not more than one time from and after February 8, 2017, the effective date of the February 2017 amendment (discussed below), and may elect to terminate an Adjusted Covenant Period prior to the end of the Adjusted Covenant Period. The Credit Facility also requires that the Senior Leverage Ratio not exceed 3.50 to 1.00, which is calculated as Consolidated Senior Indebtedness to Consolidated EBIDTA for four consecutive quarters. The Company is also required to comply with an Interest Coverage Ratio of less than 3.50 to 1.00, measured quarterly.

In June 2017, in connection with the settlement of the 2007 Junior Debt, the Company amended the Credit Agreement to (i) extend the time period during which the Company is permitted to repurchase, redeem or exchange the 2007 Junior Debt and (ii) amend the maximum total leverage ratio covenant to extend the time period for permitted refinancings or exchanges of the 2007 Junior Debt that may be excluded from the calculation of the ratio, subject to certain conditions.

The Credit Agreement has a \$125 million foreign currency sublimit, a \$25 million letter of credit sublimit and a \$25 million swingline loan sublimit. The Company has the option to obtain additional tranche commitments or additional indebtedness as long as the Senior Leverage Ratio is equal to or less than 2.50 to 1.00.

In February 2017, the Company used \$1,682.5 million of the proceeds from the issuance of the 2017 Senior Debt and 2017 Junior Debt to pay off the entire balance on its line of credit. In connection with the February 2017 amendment to the Credit Agreement, the Company incurred \$2.1 million of issuance fees which will be amortized over the term of the facility and for which the balance is recorded net of any outstanding Credit Facility balance. At June 30, 2017 and March 31, 2017, there were no outstanding borrowings under the revolving credit facility.

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The Company's obligations under the credit agreement are guaranteed by certain of its subsidiaries meeting materiality thresholds set forth in the credit agreement. To secure the Company's obligations under the credit agreement, the Company and its domestic subsidiaries are required to pledge the equity securities of certain of their respective material subsidiaries, subject to certain exceptions and limitations. In addition, in connection with the February 2017 amendment, the Company and the guarantor subsidiaries granted a security interest in substantially all of their personal property to secure the obligations under the credit agreement.

The loans under the credit agreement bear interest, at the Company's option, at the base rate plus a spread of 0.25% to 1.25% or an adjusted LIBOR rate (based on one, two, three, or six-month interest periods) plus a spread of 1.25% to 2.25%, in each case with such spread being determined based on the consolidated leverage ratio for the preceding four fiscal quarters (in the case of the 2018 tranche revolving loans) or the consolidated senior leverage ratio (in the case of the 2020 tranche revolving loans). The base rate means the highest of JPMorgan Chase Bank, N.A.'s prime rate, the federal funds rate plus a margin equal to 0.50% and the adjusted LIBOR rate for a 1-month interest period plus a margin equal to 1.00%. Swingline loans accrue interest at a per annum rate based on the base rate plus the applicable margin for base rate loans. Base rate loans may only be made in U.S. Dollars. The Company is also obligated to pay other customary administration fees and letter of credit fees for a credit facility of this size and type.

Interest is due and payable in arrears quarterly for loans bearing interest at the base rate and at the end of an interest period (or at each three-month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. Interest expense related to the credit agreement was approximately \$2.7 million in the three months ended June 30, 2017 and \$11.6 million for the three months ended June 30, 2016. Principal, together with all accrued and unpaid interest, is due and payable on the respective tranche maturity date, which is June 27, 2018 and February 4, 2020. The Company pays a quarterly commitment fee on the available but unused portion of its line of credit which is calculated on the average daily available balance during the period. The Company may prepay the loans and terminate the commitments, in whole or in part, at any time without premium or penalty, subject to certain conditions including minimum amounts in the case of commitment reductions and reimbursement of certain costs in the case of prepayments of LIBOR loans.

The credit agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries' ability to, among other things, incur subsidiary indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into certain transactions with affiliates, pay dividends or make distributions, repurchase stock, enter into restrictive agreements and enter into sale and leaseback transactions, in each case subject to customary exceptions for a credit facility of this size and type. The Company is also required to maintain compliance with a senior leverage ratio, a total leverage ratio and an interest coverage ratio, all measured quarterly and calculated on a consolidated bases. At June 30, 2017, the Company was in compliance with these covenants.

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

Note 14. Pension Plans

In connection with its acquisition of Atmel, the Company assumed unfunded defined benefit pension plans that cover certain French and German employees. Plan benefits are provided in accordance with local statutory requirements. Benefits are based on years of service and employee compensation levels. Pension liabilities and charges are based upon various assumptions, updated annually, including discount rates, future salary increases, employee turnover, and mortality rates. The Company's French pension plan provides for termination benefits paid to covered French employees only at retirement, and consists of approximately one to five months of salary. The Company's German pension plan provides for defined benefit payouts for covered German employees following retirement.

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The aggregate net pension expense relating to these two plans are as follows (amounts in thousands):

	Three Months Ended June 30,	
	2017	2016
Service costs	\$353	\$364
Interest costs	240	243
Amortization of actuarial loss	203	—
Settlements	—	231
Net pension period cost	\$796	\$838

Interest costs and amortization of actuarial losses are recorded in the other income, net line item in the statement of operations. The Company's net periodic pension cost for fiscal 2018 is expected to be approximately \$2.6 million. Cash funding for benefits paid was \$0.1 million for the three months ended June 30, 2017. The Company expects total contributions to these plans to be approximately \$0.7 million in fiscal 2018.

## Note 15. Contingencies

In the ordinary course of the Company's business, it is exposed to various liabilities as a result of contracts, product liability, customer claims and other matters. Additionally, the Company is involved in a limited number of legal actions, both as plaintiff and defendant. Consequently, the Company could incur uninsured liability in any of those actions. The Company also periodically receives notifications from various third parties alleging infringement of patents or other intellectual property rights, or from customers requesting reimbursement for various costs. With respect to pending legal actions to which the Company is a party and other claims, although the outcomes are generally not determinable, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on its financial position, cash flows or results of operations. Litigation and disputes relating to the semiconductor industry are not uncommon, and the Company is, from time to time, subject to such litigation and disputes. As a result, no assurances can be given with respect to the extent or outcome of any such litigation or disputes in the future.

As a result of its acquisition of Atmel, which closed April 4, 2016, the Company became involved with the following lawsuits:

**In re: Continental Airbag Products Liability Litigation.** On May 11, 2016, an Amended and Consolidated Class Action Complaint ("Complaint") was filed in the United States District Court for the Southern District of Florida (Miami Division) against Atmel, Continental Automotive Systems, Inc., Honda Motor Co., Ltd. and an affiliate, and Daimler AG and an affiliate. The Complaint which includes claims arising under federal law and Florida, California, New Jersey, Michigan and Louisiana state law alleges that class members unknowingly purchased or leased vehicles containing defective airbag control units (incorporating allegedly defective application specific integrated circuits manufactured by the Company's Atmel subsidiary between 2006 and 2010), and thereby suffered financial harm, including a loss in the value of their purchased or leased vehicles. The plaintiffs are seeking, individually and on behalf of a putative class, unspecified compensatory and exemplary damages, statutory penalties, pre- and post-judgment interest, attorneys' fees, and injunctive and other relief. The Company's Atmel subsidiary contested plaintiffs' claims vigorously, and on May 23, 2017 the case was ordered to be dismissed.

**Continental Claim ICC Arbitration.** On December 29, 2016, Continental Automotive GmbH ("Continental") filed a Request for Arbitration with the ICC, naming as respondents the Company's subsidiaries Atmel Corporation, Atmel SARL, Atmel Global Sales Ltd., and Atmel Automotive GmbH (collectively, "Atmel"). The Request alleges that a

quality issue affecting Continental airbag control units in certain recalled vehicles stems from allegedly defective Atmel application specific integrated circuits ("ASICs"). The Continental airbag control units, ASICs and vehicle recalls are also at issue in In re: Continental Airbag Products Liability Litigation, described above. Continental seeks to recover from Atmel all related costs and damages incurred as a result of the vehicle manufacturers' airbag control unit-related recalls, currently alleged to be \$61.6 million (but subject to increase). The Company's Atmel subsidiaries intend to defend this action vigorously.

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Southern District of New York Action by LFoundry Rousset ("LFR") and LFR Employees. On March 4, 2014, LFR and Jean-Yves Guerrini, individually and on behalf of a putative class of LFR employees, filed an action in the United States District Court for the Southern District of New York (the "District Court") against the Company's Atmel subsidiary, French subsidiary, Atmel Rousset S.A.S. ("Atmel Rousset"), and LFoundry GmbH ("LF"), LFR's German parent. The case purports to relate to Atmel Rousset's June 2010 sale of its wafer manufacturing facility in Rousset, France to LF, and LFR's subsequent insolvency, and later liquidation, more than three years later. The District Court dismissed the case on August 21, 2015, and the United States Court of Appeals for the Second Circuit affirmed the dismissal on June 27, 2016. On July 25, 2016, the plaintiffs filed a notice of appeal from the District Court's June 27, 2016 denial of their motion for relief from the dismissal judgment. On May 19, 2017, the United States Court of Appeals for the Second Circuit affirmed the June 27, 2016 order dismissing the case.

Individual Labor Actions by former LFR Employees. In the wake of LFR's insolvency and liquidation, over 500 former employees of LFR have filed individual labor actions against Atmel Rousset in a French labor court. The Company's Atmel Rousset subsidiary believes that each of these actions is entirely devoid of merit, and, further, that any assertion by any of the Claimants of a co-employment relationship with the Atmel Rousset subsidiary is based substantially on the same specious arguments that the Paris Commercial Court summarily rejected in 2014 in related proceedings. The Company's Atmel Rousset subsidiary therefore intends to defend vigorously against each of these claims.

The Company accrues for claims and contingencies when losses become probable and reasonably estimable. As of the end of each applicable reporting period, the Company reviews each of its matters and, where it is probable that a liability has been or will be incurred, the Company accrues for all probable and reasonably estimable losses. Where the Company can reasonably estimate a range of losses it may incur regarding such a matter, the Company records an accrual for the amount within the range that constitutes its best estimate. If the Company can reasonably estimate a range but no amount within the range appears to be a better estimate than any other, the Company uses the amount that is the low end of such range. As of June 30, 2017, the Company's estimate of the aggregate potential liability that is possible but not probable is approximately \$100 million in excess of amounts accrued.

The Company's technology license agreements generally include an indemnification clause that indemnifies the licensee against liability and damages (including legal defense costs) arising from any claims of patent, copyright, trademark or trade secret infringement by the Company's proprietary technology. The terms of these indemnification provisions approximate the terms of the outgoing technology license agreements, which are typically perpetual unless terminated by either party for breach. The possible amount of future payments the Company could be required to make based on agreements that specify indemnification limits, if such indemnifications were required on all of these agreements, is approximately \$151.5 million. There are some licensing agreements in place that do not specify indemnification limits. As of June 30, 2017, the Company had not recorded any liabilities related to these indemnification obligations and the Company believes that any amounts that it may be required to pay under these agreements in the future will not have a material adverse effect on its financial position, cash flows or results of operations.

Note 16. Derivative Instruments

Freestanding Derivative Forward Contracts

The Company has international operations and is thus subject to foreign currency rate fluctuations. Approximately 99% of the Company's sales are U.S. Dollar denominated. However, a significant amount of the Company's expenses and liabilities are denominated in foreign currencies and subject to foreign currency rate fluctuations. To help manage the risk of changes in foreign currency rates, the Company periodically enters into derivative contracts comprised of foreign currency forward contracts to hedge its asset and liability foreign currency exposure and a portion of its foreign currency operating expenses. Foreign exchange rate fluctuations after the effects of hedging activity resulted in net gains of \$4.5 million and \$1.4 million during the three month periods ended June 30, 2017 and 2016,



respectively. As of June 30, 2017 and March 31, 2017, the Company had no foreign currency forward contracts outstanding. The Company recognized an immaterial amount of net realized gains and losses on foreign currency forward contracts in each of the three months ended June 30, 2017 and 2016. Gains and losses from changes in the fair value of these foreign currency forward contracts and foreign currency exchange rate fluctuations are credited or charged to other income (expense). The Company does not apply hedge accounting to its foreign currency derivative instruments.

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## Note 17. Comprehensive Income (Loss)

The following table presents the changes in the components of accumulated other comprehensive income (loss) (AOCI), net of tax, for the three months ended June 30, 2017 (amounts in thousands):

	Unrealized holding gains (losses) available-for-sale securities	Defined benefit pension plans	Foreign Currency	Total
Accumulated other comprehensive income (loss) at March 31, 2017	\$ 312	\$(5,263)	\$(9,427)	\$(14,378)
Other comprehensive loss before reclassifications	(844 )	(4,114 )	—	(4,958 )
Amounts reclassified from accumulated other comprehensive loss	—	203	—	203
Net other comprehensive loss	(844 )	(3,911 )	—	(4,755 )
Accumulated other comprehensive loss at June 30, 2017	\$ (532 )	\$(9,174)	\$(9,427)	\$(19,133)

The table below details where reclassifications of realized transactions out of AOCI are recorded on the condensed consolidated statements of operations (amounts in thousands):

Description of AOCI Component	Three Months Ended June 30, 2017	2016	Related Statement of Income Line
Unrealized (losses) gains on available-for-sale securities	\$—	\$(82)	Other income

## Note 18. Share-Based Compensation

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

	Three Months Ended June 30,	
	2017	2016
Cost of sales <sup>(1)</sup>	\$3,394	\$7,897
Research and development	10,289	17,517
Selling, general and administrative	8,725	34,165
Pre-tax effect of share-based compensation	22,408	59,579
Income tax benefit <sup>(2)</sup>	7,428	20,888
Net income effect of share-based compensation	\$14,980	\$38,691

<sup>(1)</sup> During the three months ended June 30, 2017, \$2.7 million of share-based compensation expense was capitalized to inventory and \$3.4 million of previously capitalized share-based compensation expense in inventory was sold. During the three months ended June 30, 2016, \$2.8 million of share-based compensation expense was capitalized to inventory. The amount of share-based compensation included in cost of sales during the three months ended June 30, 2016 included \$3.7 million of previously capitalized share-based compensation expense in inventory that was sold and \$4.2 million of share-based compensation expense related to the Company's acquisition of Atmel that was not previously capitalized to inventory.

(2) Amounts exclude excess tax benefits related to share-based compensation of \$5.9 million for the three months ended June 30, 2017 and \$6.7 million for the three months ended June 30, 2016.

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## Atmel Acquisition-related Equity Awards

During the three months ended June 30, 2016, the Company recognized \$43.2 million of share-based compensation expense in connection with awards assumed in the acquisition of Atmel, of which \$37.1 million was due to the accelerated vesting of outstanding equity awards upon termination of certain Atmel employees.

## Note 19. Net Income (Loss) Per Common Share From Continuing Operations

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

	Three Months Ended June 30,	
	2017	2016
Net income (loss) from continuing operations	\$170,587	\$(109,225)
Weighted average common shares outstanding	229,429	214,345
Dilutive effect of stock options and RSUs	4,514	—
Dilutive effect of 2007 Junior debt	4,129	—
Dilutive effect of 2015 Senior debt	4,830	—
Dilutive effect of 2017 Senior debt	—	—
Dilutive effect of 2017 Junior debt	—	—
Weighted average common and potential common shares outstanding	242,902	214,345
Basic net income (loss) per common share from continuing operations	\$0.74	\$(0.51 )
Diluted net income (loss) per common share from continuing operations	\$0.70	\$(0.51 )

The Company computed basic net income (loss) per common share from continuing operations using net income (loss) from continuing operations available to common stockholders and the weighted average number of common shares outstanding during the period. The Company computed diluted net income per common share from continuing operations using net income (loss) from continuing operations available to common stockholders and the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period.

Potentially dilutive common shares from employee equity incentive plans are determined by applying the treasury stock method to the assumed exercise of outstanding stock options and the assumed vesting of outstanding RSUs. Weighted average common shares exclude the effect of option shares which are not dilutive. There were no anti-dilutive option shares for the three months ended June 30, 2017. For the three months ended June 30, 2016, the calculation of diluted net loss per common share excluded 4,159,273 common shares from employee equity incentive plans as the related impact would have been anti-dilutive as the Company generated a net loss.

Diluted net income (loss) per common share from continuing operations for the three months ended June 30, 2017, includes 4,128,673 shares, issuable upon the exchange of the Company's 2007 Junior Debt and 4,829,550 issuable upon the exchange of the Company's 2015 Senior Debt. Diluted net income per common share from continuing operations attributable to stockholders for the three months ended June 30, 2016 excludes 12,165,812 shares issuable upon the exchange of the Company's 2007 Junior Debt as the related impact would have been anti-dilutive as the Company generated a net loss for such period. The convertible debt has no impact on diluted net income per common share unless the average price of the Company's common stock exceeds the conversion price because the principal amount of the debentures will be settled in cash upon



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conversion. Prior to conversion, the Company will include, in the diluted net income per common share calculation, the effect of the additional shares that may be issued when the Company's common stock price exceeds the conversion price using the treasury stock method. The following is the weighted average conversion price per share used in calculating the dilutive effect (See Note 13 for details on the convertible debt):

	June 30,	
	2017	2016
2007 Junior Debt	\$23.69	\$24.23
2015 Senior Debt	\$64.35	\$65.82
2017 Senior Debt	\$100.35	\$—
2017 Junior Debt	\$98.59	\$—

## Note 20. Stock Repurchase

The Company's Board of Directors previously approved a share repurchase program under which up to 15.0 million shares of our common stock may be repurchased in the open market or in privately negotiated transactions. There were no repurchases of common stock during the three months ended June 30, 2017. There is no expiration date associated with this repurchase program. As of June 30, 2017, the Company held approximately 20.0 million shares as treasury shares.

## Note 21. Dividends

A quarterly cash dividend of \$0.3615 per share was paid on June 6, 2017 in the aggregate amount of \$82.9 million. A quarterly cash dividend of \$0.362 per share was declared on August 3, 2017 and will be paid on September 5, 2017 to stockholders of record as of August 21, 2017. The Company expects the September 2017 payment of its quarterly cash dividend to be approximately \$84.4 million.

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

This report, including "Part I – Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II - Item 1A Risk Factors" contains certain forward-looking statements that involve risks and uncertainties, including statements regarding our strategy, financial performance and revenue sources. We use words such as "anticipate," "believe," "plan," "expect," "future," "continue," "intend" and similar expressions to identify forward-looking statements. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth under "Risk Factors," beginning at page 48 and elsewhere in this Form 10-Q. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. We disclaim any obligation to update information contained in any forward-looking statement. These forward-looking statements include, without limitation, statements regarding the following:

- The effects that adverse global economic conditions and fluctuations in the global credit and equity markets may have on our financial condition and results of operations;
- The effects and amount of competitive pricing pressure on our product lines;
- Our ability to moderate future average selling price declines;
- The effect of product mix, capacity utilization, yields, fixed cost absorption, competition and economic conditions on gross margin;
- The amount of, and changes in, demand for our products and those of our customers;
- Our expectation that in the future we will acquire additional businesses that we believe will complement our existing businesses;
- Our expectation that in the future we will enter into joint development agreements or other business or strategic relationships with other companies;
- The level of orders that will be received and shipped within a quarter;
- Our expectation that our days of inventory levels in the September 2017 quarter will be flat compared to the June 2017 levels. Our belief that our existing level of inventory will allow us to maintain competitive lead times and provide strong delivery performance to our customers.
- The effect that distributor and customer inventory holding patterns will have on us;
- Our belief that customers recognize our products and brand name and use distributors as an effective supply channel;
- Anticipating increased customer requirements to meet voluntary criteria related to the reduction or elimination of substances in our products;
- Our belief that deferred cost of sales are recorded at their approximate carrying value and will have low risk of material impairment;
- Our belief that our direct sales personnel combined with our distributors provide an effective means of reaching our customer base;
- Our ability to increase the proprietary portion of our analog and interface product lines and the effect of such an increase;
- Our belief that our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs;
- The impact of any supply disruption we may experience;
- Our ability to effectively utilize our facilities at appropriate capacity levels and anticipated costs;
- That we adjust capacity utilization to respond to actual and anticipated business and industry-related conditions;
- That our existing facilities will provide sufficient capacity to respond to increases in demand with modest incremental capital expenditures;
- That manufacturing costs will be reduced by transition to advanced process technologies;
- Our ability to maintain manufacturing yields;

Continuing our investments in new and enhanced products;

The cost effectiveness of using our own assembly and test operations;

Our anticipated level of capital expenditures;

Continuation and amount of quarterly cash dividends;

That the Atmel acquisition was structured in a manner that enabled us to utilize a substantial portion of the cash, cash equivalents, short-term investments and long-term investments held by certain of our foreign subsidiaries in a tax efficient manner and that our determinations with respect to the tax consequences of the acquisition are reasonable;

The sufficiency of our existing sources of liquidity to finance anticipated capital expenditures and otherwise meet our anticipated cash requirements, and the effects that our contractual obligations are expected to have on them;



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That our U.S. operations and capital requirements are funded primarily by cash generated from U.S. operating activities, which has been and is expected to be sufficient to meet our business needs in the U.S. for the foreseeable future;

• The impact of seasonality on our business;

• The accuracy of our estimates used in valuing employee equity awards;

• That the resolution of legal actions will not have a material effect on our business, and the accuracy of our assessment of the probability of loss and range of potential loss;

• The recoverability of our deferred tax assets;

• The adequacy of our tax reserves to offset any potential tax liabilities, having the appropriate support for our income tax positions and the accuracy of our estimated tax rate;

• Our belief that our determinations with respect to the tax consequences of the Atmel acquisition are reasonable;

• Our belief that the expiration of any tax holidays will not have a material impact on our overall tax expense or effective tax rate;

• Our belief that the estimates used in preparing our consolidated financial statements are reasonable;

• Our actions to vigorously and aggressively defend and protect our intellectual property on a worldwide basis;

• Our ability to obtain patents and intellectual property licenses and minimize the effects of litigation;

• The level of risk we are exposed to for product liability claims or indemnification claims;

• The effect of fluctuations in market interest rates on our income and/or cash flows;

• The effect of fluctuations in currency rates;

That our offshore earnings are considered to be permanently reinvested offshore and that we could determine to repatriate some of our offshore earnings in future periods to fund stockholder dividends, share repurchases, acquisitions or other corporate activities;

• That a significant portion of our future cash generation will be in our foreign subsidiaries;

• Our intention to satisfy the lesser of the principal amount or the conversion value of our debentures in cash;

• Our intention to indefinitely reinvest undistributed earnings of certain non-US subsidiaries in those subsidiaries;

• Our intent to maintain a high-quality investment portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield; and

• Our ability to collect accounts receivable.

We begin our Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) with a summary of our overall business strategy to give the reader an overview of the goals of our business and the overall direction of our business and products. This is followed by a discussion of the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. We then discuss our Results of Operations for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. We then provide an analysis of changes in our balance sheet and cash flows, and discuss our financial commitments in sections titled "Liquidity and Capital Resources," "Contractual Obligations" and "Off-Balance Sheet Arrangements."

## Strategy

Our goal is to be a worldwide leader in providing specialized semiconductor products for a wide variety of embedded control applications. Our strategic focus is on embedded control solutions, including general purpose and specialized microcontrollers, development tools and related software, analog, interface, mixed signal and timing products, wired and wireless connectivity products, memory products and technology licensing. We provide highly cost-effective embedded control solutions that also offer the advantages of small size, high performance, extreme low power usage, wide voltage range operation, mixed signal integration and ease of development, thus enabling timely and cost-effective integration of our solutions by our customers in their end products. We license our SuperFlash

technology and other technologies to wafer foundries, integrated device manufacturers and design partners throughout the world for use in the manufacture of advanced microcontroller products, gate array, radio frequency (RF) and analog products that require embedded non-volatile memory.

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

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Our manufacturing operations include wafer fabrication, wafer probe and assembly and test. The ownership of a substantial portion of our manufacturing resources is an important component of our business strategy, enabling us to maintain a high level of manufacturing control resulting in us being one of the lowest cost producers in the embedded control industry. By owning wafer fabrication facilities and assembly and test operations, and by employing statistical process control techniques, we have been able to achieve and maintain high production yields. Direct control over manufacturing resources allows us to shorten our design and production cycles. This control also allows us to capture a portion of the wafer manufacturing and the assembly and test profit margin. We do outsource a significant portion of our manufacturing requirements to third parties.

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

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

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

See "Our operating results are impacted by both seasonality and the wide fluctuation of supply and demand in the semiconductor industry," on page 52 for discussion of the impact of seasonality on our business.

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### Critical Accounting Policies and Estimates

#### General

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

#### Revenue Recognition - Distributors

Our distributors worldwide generally have broad price protection and product return rights which prevent the sales pricing from being fixed or determinable at the time of shipment to our distributors. Therefore, revenue recognition is deferred until the pricing uncertainty is resolved, which generally occurs when the distributor sells the product to their customer. At the time of shipment to these distributors, we record a trade receivable for the selling price as there is a legally enforceable right to payment, relieve inventory for the carrying value of goods shipped since legal title has passed to the distributor, and record the gross margin in deferred income on shipments to distributors on our condensed consolidated balance sheets.

In connection with our acquisition of Atmel, we acquired certain distributor relationships where revenue was recognized upon shipment to the distributors based on certain contractual terms or prevailing business practices that resulted in the price not being fixed and determinable at such time. Following an acquisition, we undertake efforts to align the contract terms and business practices of the acquired entity with our own. Once these efforts are complete, revenue recognition is changed. With respect to such distributor relationships acquired in the Atmel acquisition, as of October 1, 2016, these business practices were conformed to those of our other distributors resulting in the deferral of revenue recognition until the distributor sells the product to their customers.

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

We sell the majority of the items in our product catalog to our distributors worldwide at a uniform list price. However, distributors resell our products to end customers at a very broad range of individually negotiated price points. The majority of our distributors' resales require a reduction from the original list price paid. Often,

under these circumstances, we remit back to the distributor a portion of their original purchase price after the resale transaction is completed in the form of a credit against the distributors' outstanding accounts receivable balance. The credits are on a per unit basis and are not given to the distributor until they provide information to us regarding the sale to their end customer. The price reductions vary significantly based on the customer, product, quantity ordered, geographic location and other factors. Discounts to a price less than our cost have historically been rare. The effect of granting these credits establishes the net selling price to our distributors for the product and results in the net revenue recognized by us when the product is sold by the distributors to their end customers. Thus, a portion of the "deferred income on shipments to distributors" balance represents the amount of distributors' original purchase price that will be credited back to the distributors in the future. The wide range and variability of negotiated price concessions granted to distributors does not allow us to accurately estimate the portion of the balance in the deferred income on shipments to distributors account that will be credited back to the distributors. Therefore, we do not reduce deferred income on shipments to distributors or accounts receivable by anticipated future concessions; rather, price concessions are typically recorded against deferred income on shipments to distributors and accounts receivable when incurred, which is generally at the time the distributor sells the product. At June 30, 2017, we had approximately \$435.7 million of deferred revenue and \$126.9 million in

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deferred cost of sales recognized as \$308.8 million of deferred income on shipments to distributors. At March 31, 2017, we had approximately \$418.0 million of deferred revenue and \$125.2 million in deferred cost of sales recognized as \$292.8 million of deferred income on shipments to distributors. The deferred income on shipments to distributors that will ultimately be recognized in our income statement will be lower than the amount reflected on the balance sheet due to additional price credits to be granted to the distributors when the product is sold to their customers. These additional price credits historically have resulted in the deferred income approximating the overall gross margins that we recognize in the distribution channel of our business.

Distributor advances, reflected as a reduction of deferred income on shipments to distributors on our condensed consolidated balance sheets, totaled \$202.7 million at June 30, 2017 and \$203.9 million at March 31, 2017. On sales to distributors, our payment terms generally require the distributor to settle amounts owed to us for an amount in excess of their ultimate cost. The sales price to our distributors may be higher than the amount that the distributors will ultimately owe us because distributors often negotiate price reductions after purchasing products from us and such reductions are often significant. It is our practice to apply these negotiated price discounts to future purchases, requiring the distributor to settle receivable balances, on a current basis, generally within 30 days, for amounts originally invoiced. This practice has an adverse impact on the working capital of our distributors. As such, we have entered into agreements with certain distributors whereby we advance cash to the distributors to reduce the distributors' working capital requirements. These advances are reconciled at least on a quarterly basis and are estimated based on the amount of ending inventory as reported by the distributor multiplied by a negotiated percentage. Such advances have no impact on our revenue recognition or our condensed consolidated statements of operations. We process discounts taken by distributors against our deferred income on shipments to distributors' balance and true-up the advanced amounts generally after the end of each completed fiscal quarter. The terms of these advances are set forth in binding legal agreements and are unsecured, bear no interest on unsettled balances and are due upon demand. The agreements governing these advances can be canceled by us at any time.

We reduce product pricing through price protection based on market conditions, competitive considerations and other factors. Price protection is granted to distributors on the inventory they have on hand at the date the price protection is offered. When we reduce the price of our products, it allows the distributor to claim a credit against its outstanding accounts receivable balances based on the new price of the inventory it has on hand as of the date of the price reduction. There is no immediate revenue impact from the price protection, as it is reflected as a reduction of the deferred income on shipments to distributors' balance.

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

### Recent Updates to Revenue Recognition

In May 2014, the FASB issued ASU 2014-09-Revenue from Contracts with Customers (Topic 606) and in August 2015, the FASB subsequently issued ASU 2015-14 "Deferral of the Effective Date," which supersedes existing revenue recognition guidance pursuant to US GAAP and will no longer permit us to defer revenue on sales to distributors until the products are sold to the end customer. Upon our adoption of ASU 2014-09 and 2015-14 beginning April 1, 2018, a portion of this deferred revenue will be required to be estimated and recognized upon sale to the distributor rather than upon the sale by the distributor to the end customer. See Note 2 to our condensed consolidated financial statements for additional information on the new guidance.

## Business Combinations

All of our business combinations are accounted for at fair value under the acquisition method of accounting. Under the acquisition method of accounting, (i) acquisition-related costs, except for those costs incurred to issue debt or equity securities, will be expensed in the period incurred; (ii) non-controlling interests will be valued at fair value at the acquisition date; (iii) in-process research and development will be recorded at fair value as an intangible asset at the acquisition date and amortized once the technology reaches technological feasibility; (iv) restructuring costs associated with a business combination will be expensed subsequent to the acquisition date; and (v) changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date will be recognized through income tax expense or directly in contributed capital. The measurement of the fair value of assets acquired and liabilities assumed requires significant judgment. The valuation of intangible assets, in particular, requires that we use valuation techniques such as the income approach. The income approach includes the use of a discounted cash flow model, which includes discounted cash flow scenarios and requires the following

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significant estimates: revenue, expenses, capital spending and other costs, and discount rates based on the respective risks of the cash flows. Under the acquisition method of accounting, the aggregate amount of consideration we pay for a company is allocated to net tangible assets and intangible assets based on their estimated fair values as of the acquisition date. The excess of the purchase price over the value of the net tangible assets and intangible assets is recorded to goodwill. On an annual basis, we test goodwill for impairment and, through June 30, 2017, we have never recorded an impairment charge against our goodwill balance.

### Share-based Compensation

We measure at fair value and recognize compensation expense for all share-based payment awards, including grants of employee stock options, restricted stock units (RSUs) and employee stock purchase rights, to be recognized in our financial statements based on their respective grant date fair values. For the past several years, we have utilized RSUs as our primary equity incentive compensation instrument for employees. Share-based compensation cost is measured on the grant date based on the fair market value of our common stock discounted for expected future dividends and is recognized as expense straight-line over the requisite service periods. Total share-based compensation during the three months ended June 30, 2017 was \$22.4 million, of which \$19.0 million was reflected in operating expenses and \$3.4 million was reflected in cost of sales. Total share-based compensation included in our inventory balance was \$8.0 million at June 30, 2017.

During the fiscal year ended March 31, 2017, we elected to early adopt ASU 2016-09, Compensation - Stock Compensation, Improvements to Employee Share-Based Payment Accounting (Topic 718). Under this standard, entities are permitted to make an accounting policy election to either estimate forfeitures on share-based payment awards, as previously required, or to recognize forfeitures as they occur. We have elected to recognize forfeitures as they occur. Prior to the adoption of ASU 2016-09, we estimated the number of share-based awards to be forfeited due to employee turnover.

If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees or we assume unvested equity awards in connection with acquisitions.

### Inventories

Inventories are valued at the lower of cost and net realizable value using the first-in, first-out method. We write down our inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated net realizable value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we projected, additional inventory write-downs may be required. Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable. In estimating our inventory obsolescence, we primarily evaluate estimates of demand over a 12-month period and record impairment charges for inventory on hand in excess of the estimated 12-month demand. Estimates for projected 12-month demand are generally based on the average shipments of the prior three-month period, which are then annualized to adjust for any potential seasonality in our business. The estimated 12-month demand is compared to our most recently developed sales forecast to further reconcile the 12-month demand estimate. Management reviews and adjusts the estimates as appropriate based on specific situations. For example, demand can be adjusted up for new products for which historic sales are not representative of future demand. Alternatively, demand can be adjusted down to the extent any existing products are being replaced or discontinued.



In periods where our production levels are substantially below our normal operating capacity, the reduced production levels of our manufacturing facilities are charged directly to cost of sales. There was no charge to cost of sales for reduced production levels in each of the three month periods ended June 30, 2017 and 2016.

#### Income Taxes

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

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will not be realized. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Various taxing authorities in the U.S. and other countries in which we do business scrutinize the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. We are currently being audited by the tax authorities in various foreign jurisdictions. At this time, we do not know what the outcome of these audits will be. We recognize liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon these and other pending audits in the U.S. and other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

The accounting model as defined in ASC 740 related to the valuation of uncertain tax positions requires us to presume that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information and that each tax position will be evaluated without consideration of the possibility of offset or aggregation with other positions. The recognition requirement for the liability exists even if we believe the possibility of examination by a taxing authority or discovery of the related risk matters is remote or where we have a long history of the taxing authority not performing an exam or overlooking an issue. We will record an adjustment to a previously recorded position if new information or facts related to the position are identified in a subsequent period. All adjustments to the positions are recorded through the income statement. Generally, adjustments will be recorded in periods subsequent to the initial recognition if the taxing authority has completed an audit of the period or if the statute of limitation expires. Due to the inherent uncertainty in the estimation process and in consideration of the criteria of the accounting model, amounts recognized in the financial statements in periods subsequent to the initial recognition may significantly differ from the estimated exposure of the position under the accounting model.

## Senior and Junior Subordinated Convertible Debt

We separately account for the liability and equity components of our senior and junior subordinated convertible debt in a manner that reflects our nonconvertible debt (unsecured debt) borrowing rate when interest cost is recognized. This results in a bifurcation of a component of the debt, classification of that component in equity and the accretion of the resulting discount on the debt to be recognized as part of interest expense in our condensed consolidated statements of operations. Lastly, we include the dilutive effect of the shares of our common stock issuable upon conversion of the outstanding senior and junior subordinated convertible debt in our diluted income per share calculation regardless of whether the market price triggers or other contingent conversion features have been met. We apply the treasury stock method as we have the intent and have adopted an accounting policy to settle the principal amount of the senior and junior subordinated convertible debentures in cash. This method results in incremental dilutive shares when the average fair value of our common stock for a reporting period exceeds the conversion prices per share and adjusts as dividends are recorded in the future.

## Contingencies

In the ordinary course of our business, we are exposed to various liabilities as a result of contracts, product liability, customer claims and other matters. Additionally, we are involved in a limited number of legal actions, both as plaintiff and defendant. Consequently, we could incur uninsured liability in any of those actions. We also

periodically receive notifications from various third parties alleging infringement of patents or other intellectual property rights, or from customers requesting reimbursement for various costs. With respect to pending legal actions to which we are a party and other claims, although the outcomes are generally not determinable, we believe that the ultimate resolution of these matters will not have a material adverse effect on our financial position, cash flows or results of operations. Litigation and disputes relating to the semiconductor industry are not uncommon, and we are, from time to time, subject to such litigation and disputes. As a result, no assurances can be given with respect to the extent or outcome of any such litigation or disputes in the future.

We accrue for claims and contingencies when losses become probable and reasonably estimable. As of the end of each applicable reporting period, we review each of our matters and, where it is probable that a liability has been or will be incurred, we accrue for all probable and reasonably estimable losses. Where we can reasonably estimate a range of losses we may incur regarding such a matter, we record an accrual for the amount within the range that constitutes our best estimate. If we can reasonably estimate a range but no amount within the range appears to be a better estimate than any other, we use the amount that is the low end of such range. Contingencies of an acquired company that exist as of the date of the acquisition are measured at fair value if determinable, which generally is based on a probability weighted model. If fair value is not determinable, contingencies of an acquired company are recognized when they become probable and reasonably estimable.

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## Results of Continuing Operations

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

	Three Months Ended June 30,	
	2017	2016
Net sales	100.0 %	100.0 %
Cost of sales	39.9	56.4
Gross profit	60.1	43.6
Research and development	13.4	18.5
Selling, general and administrative	11.8	19.7
Amortization of acquired intangible assets	12.4	10.0
Special (income) charges and other, net	(0.3 )	2.8
Operating income (loss)	22.8 %	(7.4 )%

## Net Sales

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

Our net sales for the quarter ended June 30, 2017 were \$972.1 million, an increase of 7.7% from the previous quarter's net sales of \$902.7 million, and an increase of 21.6% from net sales of \$799.4 million in the quarter ended June 30, 2016. Including the amount of revenue that could not be recognized under US GAAP during the period ended June 30, 2016 relating to Atmel's inventory in the distribution channel on the acquisition date, net sales would have increased 16.1% compared to the quarter ended June 30, 2016. The increase in net sales in the quarter ended June 30, 2017 compared to the quarter ended June 30, 2016 and compared to the previous quarter were due primarily to growth in our business driven by general economic and semiconductor industry conditions and market share gains.

Approximately 2% of the change in net sales compared to the quarter ended June 30, 2016 was due to an increase in the average price of products sold, which was favorably impacted by our adjustment of pricing on Atmel products during fiscal 2017 and the effect of changes in product mix. The balance of the increase was due primarily to an approximately 19% increase in the number of products sold compared to the quarter ended June 30, 2016. We sell a large number of products to a large and diverse customer base and there was not any product, customer or market that accounted for a material portion of the increase. As discussed in the following paragraphs, there were revenue gains across our product lines, with the largest percentage increase in microcontrollers, which is our largest product line. This growth was due to general economic and semiconductor conditions and market share gains. Key factors related to the amount of net sales during the three-month period ended June 30, 2017 compared to the three-month period ended June 30, 2016 include:

- global economic conditions in the markets we serve;
- semiconductor industry conditions;
- our new product offerings that have increased our served available market;
- customers' increasing needs for the flexibility offered by our programmable solutions;

inventory holding patterns of our customers;  
increasing semiconductor content in our customers' products; and  
continued market share gains in the segments of the markets we address.

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Net sales by product line for the three months ended June 30, 2017 and 2016 were as follows (dollars in thousands):

	Three Months Ended			
	June 30, (unaudited)			
	2017	%	2016	%
Microcontrollers	\$635,513	65.3	\$498,310	62.3
Analog, interface, mixed signal and timing products	239,055	24.6	212,335	26.6
Memory products	49,480	5.1	45,914	5.7
Technology licensing	25,035	2.6	20,588	2.6
Multi-market and other	23,058	2.4	22,264	2.8
Total sales	\$972,141	100.0%	\$799,411	100.0%

### Microcontrollers

Our microcontroller product line represents the largest component of our total net sales. Microcontrollers and associated application development systems accounted for approximately 65.3% of our net sales for the three-month period ended June 30, 2017 compared to approximately 62.3% of our net sales for the three-month period ended June 30, 2016.

Net sales of our microcontroller products increased 27.5% in the three-month period ended June 30, 2017 compared to the three-month period ended June 30, 2016. This sales increase was due primarily to growth in our business driven by general economic and semiconductor industry conditions and market share gains.

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

### Analog, Interface, Mixed Signal and Timing Products

Sales of our analog, interface, mixed signal and timing products accounted for approximately 24.6% of our net sales for the three-month period ended June 30, 2017 compared to approximately 26.6% of our net sales for the three-month period ended June 30, 2016.

Net sales of our analog, interface, mixed signal and timing products increased 12.6% in the three-month period ended June 30, 2017 compared to the three-month period ended June 30, 2016. This sales increase was due primarily to growth in our business driven by general economic and semiconductor industry conditions and market share gains.

Analog, interface, mixed signal and timing products can be proprietary or non-proprietary in nature. Currently, we consider a majority of our analog, interface, mixed signal and timing products to be proprietary in nature, where prices are relatively stable, similar to the pricing stability experienced in our microcontroller products. The non-proprietary portion of our analog, interface, mixed signal and timing business will experience price fluctuations driven primarily by the current supply and demand for those products. We may be unable to maintain the average selling prices of our analog, interface, mixed signal and timing products as a result of increased pricing pressure in the future, which would

adversely affect our operating results. We anticipate the proprietary portion of our analog, interface, mixed signal and timing products will increase over time.

#### Memory Products

Sales of our memory products accounted for approximately 5.1% of our net sales for the three-month period ended June 30, 2017 compared to approximately 5.7% of our net sales for the three-month period ended June 30, 2016.

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Net sales of our memory products increased 7.8% in the three-month period ended June 30, 2017 compared to the three-month period ended June 30, 2016. This sales increase was due primarily to growth in our business driven by general economic and semiconductor industry conditions.

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

### Technology Licensing

Technology licensing revenue includes a combination of royalties associated with licenses for the use of our SuperFlash and other technologies and fees for engineering services. Technology licensing accounted for approximately 2.6% of our net sales for each of the three-month periods ended June 30, 2017 and June 30, 2016.

Net sales related to our technology licensing increased 21.6% in the three-month period ended June 30, 2017 compared to the three-month period ended June 30, 2016. Revenue from technology licensing can fluctuate over time based on the production activities of our licensees as well as general economic and semiconductor industry conditions.

### Multi-Market and Other

Multi-market and Other (MMO) consists of manufacturing services (wafer foundry and assembly and test subcontracting), legacy application specific integrated circuits, complex programmable logic devices, and aerospace products. Revenue from these services and products accounted for approximately 2.4% of our net sales for the three-month period ended June 30, 2017 compared to approximately 2.8% of our net sales for the three-month period ended June 30, 2016.

MMO net sales increased 3.6% in the three-month period ended June 30, 2017 compared to the three-month period ended June 30, 2016. This sales increase was due primarily to growth in our business driven by general economic and semiconductor industry conditions.

### Distribution

Distributors accounted for approximately 55.5% of our net sales in the three-month period ended June 30, 2017 and approximately 56.0% of our net sales in the three-month period ended June 30, 2016. Our distributors focus primarily on servicing the product requirements of a broad base of diverse customers. We believe that distributors provide an effective means of reaching this broad and diverse customer base. We believe that customers recognize Microchip for its products and brand name and use distributors as an effective supply channel.

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

At June 30, 2017, our distributors maintained 31 days of inventory of our products compared to 33 days of inventory at our distributors at March 31, 2017. Over the past five fiscal years, the days of inventory maintained by our distributors have fluctuated between 27 days and 37 days. We do not believe that inventory holding patterns at our



distributors will materially impact our net sales, as we do not recognize revenue until the inventory is sold by the distributors.

Sales by Geography

Sales by geography for the three months ended June 30, 2017 and 2016 were as follows (dollars in thousands):

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	Three Months Ended June 30, (unaudited)			
	2017	%	2016	%
Americas	\$182,282	18.8	\$142,675	17.9
Europe	225,706	23.2	182,465	22.8
Asia	564,153	58.0	474,271	59.3
Total sales	\$972,141	100.0%	\$799,411	100.0%

Americas sales include sales to customers in the U.S., Canada, Central America and South America. Sales to foreign customers accounted for approximately 85% of our total net sales in each of the three-month periods ended June 30, 2017 and June 30, 2016. Substantially all of our foreign sales are U.S. dollar denominated. Sales to customers in Asia have generally increased over time due to many of our customers transitioning their manufacturing operations to Asia and growth in demand from the emerging Asian market. Our sales force in the Americas and Europe supports a significant portion of the design activity for products which are ultimately shipped to Asia.

## Gross Profit

Our gross profit in the three-month period ended June 30, 2017 was \$584.4 million, or 60.1% of net sales, compared to \$348.5 million, or 43.6% of net sales, in the three-month period ended June 30, 2016.

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

charges of approximately \$90.5 million in the three-month period ended June 30, 2016 related to the recognition of acquired inventory at fair value as a result of our acquisitions which increased the value of our acquired inventory and subsequently increased our cost of sales and reduced our gross margins when the related revenue was recognized; for each of the three-month periods ended June 30, 2017 and June 30, 2016, inventory write-downs being higher than the gross margin impact of sales of inventory that was previously written down; and fluctuations in the product mix of microcontrollers, analog, interface, mixed signal and timing products, memory products and technology licensing.

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

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

We adjust our wafer fabrication and assembly and test capacity utilization as required to respond to actual and anticipated business and industry-related conditions. When production levels are below normal capacity, we charge cost of sales for the unabsorbed capacity. During each of the three-month periods ended June 30, 2017 and June 30, 2016, our wafer fabrication facilities and assembly and test facilities operated at normal capacity levels, which we measure as a percentage of the capacity of the installed equipment.

The process technologies utilized in our wafer fabrication facilities impact our gross margins. Our wafer fabrication facility located in Tempe, Arizona (Fab 2) currently utilizes various manufacturing process technologies, but predominantly utilizes our 0.5 micron to 1.0 micron processes. Our wafer fabrication facility located in Gresham, Oregon (Fab 4) predominantly utilizes our 0.13 micron to 0.5 micron processes. We continue to transition products to more advanced process technologies to reduce future manufacturing costs. Substantially all of our production in Fab

2 and Fab 4 has been on 8-inch wafers during the periods covered by this report. We consider normal capacity at Fab 2 and Fab 4 to be 90% to 95%. Our wafer fabrication facility in Colorado Springs, Colorado (Fab 5) currently utilizes processes between 0.25 micron and 1.0 micron that run on 6-inch wafers. We consider normal capacity at Fab 5 to be 70% to 75%. During the three months ended June 30, 2017, we completed the sale of the decommissioned San Jose wafer fabrication facility and assets from our Micrel acquisition for proceeds of \$10.0 million.

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Our overall inventory levels were \$426.8 million at June 30, 2017, compared to \$417.2 million at March 31, 2017. We maintained 100 days of inventory on our balance sheet at June 30, 2017 compared to 103 days of inventory at March 31, 2017. We expect our days of inventory level in the September 2017 quarter to be about flat compared to the June 2017 level. We believe our existing level of inventory will allow us to maintain competitive lead times and provide strong delivery performance to our customers.

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

We operate assembly and test facilities in Thailand and, as a result of our acquisition of Atmel, we acquired a test facility in Calamba, Philippines. During the three months ended June 30, 2017, approximately 38% of our assembly requirements were performed in our Thailand facilities compared to approximately 43% during the three months ended June 30, 2016. The percentage of our assembly work that is performed internally fluctuates over time based on supply and demand conditions in the semiconductor industry, our internal capacity capabilities and our acquisition activities. Third-party contractors located primarily in Asia perform the balance of our assembly operations. During the three months ended June 30, 2017, approximately 58% of our test requirements were performed in our Thailand and Philippines facilities compared to approximately 63% of our test requirements performed in our Thailand and Philippines facilities during the three months ended June 30, 2016. The primary reasons for the percentage reductions in the assembly and test operations performed internally in the three months ended June 30, 2017 compared to the same period last year are increased demand for our products and capacity constraints in our internal assembly and test facilities, which operated at or near full capacity. We believe that the assembly and test operations performed at our internal facilities provide us with significant cost savings compared to contractor assembly and test costs, as well as increased control over these portions of the manufacturing process.

We rely on outside wafer foundries for a significant portion of our wafer fabrication requirements. Approximately 42% of our net sales came from products that were produced at outside wafer foundries in the three months ended June 30, 2017 and approximately 40% of our net sales came from products that were produced at outside wafer foundries in the three months ended June 30, 2016.

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

### Research and Development (R&D)

R&D expenses for the three months ended June 30, 2017 were \$130.5 million, or 13.4% of net sales, compared to \$147.9 million, or 18.5% of net sales, for the three months ended June 30, 2016. We are committed to investing in new and enhanced products, including development systems software, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. R&D costs are expensed as incurred. Assets purchased to support our ongoing research and development activities are capitalized when related to products which have achieved technological feasibility or that have alternative future uses and are amortized over their expected useful lives. R&D expenses include labor, depreciation, masks, prototype wafers, and expenses for the development of process technologies, new packages, and software to support new products and design environments.

R&D expenses decreased \$17.4 million, or 11.8%, for the three months ended June 30, 2017 over the same period last year. The primary reasons for the decrease in R&D costs were reductions in personnel and associated costs in connection with synergies realized from our Atmel acquisition and lower share-based compensation expense due to accelerated vesting of equity awards held by terminated Atmel employees during the period ended June 30, 2016.

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

#### Selling, General and Administrative

Selling, general and administrative expenses for the three months ended June 30, 2017 were \$114.3 million, or 11.8% of net sales, compared to \$157.5 million, or 19.7% of net sales, for the three months ended June 30, 2016. Selling, general and administrative expenses include salary expenses related to field sales, marketing and administrative personnel, advertising and promotional expenditures and legal expenses. Selling, general and administrative expenses also include costs related to our

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direct sales force, CEMs and ESEs who work in sales offices worldwide to stimulate demand by assisting customers in the selection and use of our products.

Selling, general and administrative expenses decreased \$43.2 million, or 27.4%, for the three months ended June 30, 2017 over the same period last year. The primary reasons for the decrease in selling, general and administrative expenses were reductions in personnel and associated costs in connection with synergies realized from our Atmel acquisition and lower share-based compensation expense due to accelerated vesting of equity awards held by terminated Atmel employees during the period ended June 30, 2016.

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

### Amortization of Acquired Intangible Assets

Amortization of acquired intangible assets for the three months ended June 30, 2017 was \$120.8 million, compared to \$80.2 million for the three months ended June 30, 2016. The primary reason for the increase was amortization of in-process R&D assets that were recognized from our acquisition of Atmel, which started being amortized later in fiscal 2017.

### Special (Income) Charges and Other, Net

During the quarter ended June 30, 2017, we incurred special income and other, net of \$2.8 million comprised primarily of a gain on the sale of the decommissioned Micrel San Jose wafer fabrication facility, offset by restructuring costs. During the quarter ended June 30, 2016, we incurred special charges and other, net of \$22.0 million comprised primarily of restructuring charges. Our restructuring activities include workforce, property and other operating expense rationalizations as well as combining product roadmaps and manufacturing operations. In connection with these activities we incurred employee separation costs, contract exit costs, other operating expenses and intangible asset impairment losses. The impairment losses were recognized as a result of changes in the combined product roadmaps after our acquisition of Atmel that affected the use and life of these assets.

### Other Income (Expense)

Interest income in the three months ended June 30, 2017 was \$3.5 million compared to \$0.8 million for the three months ended June 30, 2016. The primary reason for the increase in interest income in the three months ended June 30, 2017 compared to the same period last year relates to higher invested cash balances. During the quarter ended June 30, 2016, we used cash to finance a significant portion of the purchase price of our April 4, 2016 acquisition of Atmel.

Interest expense in the three months ended June 30, 2017 was \$49.5 million compared to \$34.4 million for the three months ended June 30, 2016. The primary reason for the increase in interest expense in the three months ended June 30, 2017 compared to the same period last year relates to the issuance of our 2017 senior and junior debt partially offset by lower interest expense on amounts borrowed under our credit facility to partially finance our acquisition of Atmel. In February 2017, we paid off the remaining balance on our credit facility.

During the three months ended June 30, 2017, we settled \$111.3 million in principal of our 2007 junior debt resulting in a loss on settlement of convertible debt of \$13.8 million.

Other income, net in the three months ended June 30, 2017 was \$4.5 million compared to \$2.0 million for the three months ended June 30, 2016. The primary reason for the increase in other income in the three months ended June 30, 2017 compared to the same period last year relates to foreign currency exchange rate fluctuations.

#### Provision for Income Taxes

Our provision for income taxes reflects tax on foreign earnings and federal and state tax on U.S. earnings. We had a negative effective tax rate of 2.6% for the three months ended June 30, 2017 and a negative effective tax rate of 20.4% for the three months ended June 30, 2016. Our effective tax rate for the three months ended June 30, 2017 is higher compared to the prior year primarily due to acquisition related expenses in the prior year.

The geographic dispersion of our earnings and losses contributes to the period-to-period changes in our effective tax rate. In fiscal 2018, approximately 19% of our net sales are expected to be generated in the U.S. at a combined federal and state effective tax rate that is higher than our overall effective tax rate. We are also subject to taxation in many other jurisdictions

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where we have operations. The effective tax rates that we pay in these jurisdictions vary widely, but they are generally lower than our combined U.S. federal and state effective tax rate. Our domestic statutory tax rates for each of fiscal 2017 and fiscal 2016 were approximately 37%. Our non-U.S. blended statutory tax rates for each of fiscal 2017 and the first quarter of fiscal 2018 were much lower than this amount. The difference in rates applicable in foreign jurisdictions results from a number of factors, including lower statutory rates, historical loss carry-forwards, financing arrangements and other factors. Our effective tax rate has been, and will continue to be impacted by the geographical dispersion of our earnings and losses. To the extent that domestic earnings increase while the foreign earnings remain flat or decrease, or increase at a lower rate, our effective tax rate will increase.

Our Thailand manufacturing operations are currently subject to numerous tax holidays granted to us based on our investment in property, plant and equipment in Thailand. Our tax holiday periods in Thailand expire at various times in the future, however, we actively seek to obtain new tax holidays or will be subject to tax at the statutory tax rate of 20%. We do not expect the future expiration of any of our tax holiday periods in Thailand to have a material impact on our effective tax rate. The remaining material components of foreign income taxed at a rate lower than the U.S. are earnings accrued in Ireland at a 12.5% statutory tax rate and earnings accrued by Microchip's offshore technology company which is resident in the Cayman Islands at a 0% statutory tax rate.

Various taxing authorities in the U.S. and other countries in which we do business are increasing their scrutiny of the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. For U.S. federal, and in general for U.S. state tax returns, our fiscal 2005 and later tax returns remain effectively open for examination by the taxing authorities. We are currently being audited by the tax authorities in various foreign jurisdictions. At this time, we do not know what the outcome of these audits will be. We recognize liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon these and other pending audits in the U.S. and other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than any final assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

## Results of Discontinued Operations

Discontinued operations represent the mobile touch operations that we acquired as part of our acquisition of Atmel. On November 10, 2016, we completed the sale of the mobile touch assets to Solomon Systech (Limited) International, a Hong Kong based semiconductor company. The transaction included the sale of certain semiconductor products, equipment, customer list, backlog, patents, and a license to certain other intellectual property and patents related to Atmel's mobile touch product line. We also agreed to provide certain transition services to Solomon Systech. For financial statement purposes, the results of operations for this discontinued business have been segregated from those of the continuing operations and are presented in our condensed consolidated financial statements as discontinued operations. Net loss from discontinued operations for the three months ended June 30, 2016 was \$4.1 million.

## Liquidity and Capital Resources

We had \$1,650.7 million in cash, cash equivalents and short-term and long-term investments at June 30, 2017, an increase of \$240.5 million from the March 31, 2017 balance.

Net cash provided by operating activities was \$345.0 million in the three months ended June 30, 2017, compared to \$224.0 million in the three months ended June 30, 2016. The increase in net cash provided from operating activities



was primarily due to higher net sales as well as operating cash flows resulting from operating synergies realized from our process efficiency and restructuring efforts related to our acquisition of Atmel.

During the three months ended June 30, 2017, net cash used in investing activities was \$391.3 million compared to \$2,295.7 million in the three months ended June 30, 2016. The three months ended June 30, 2016 investing cash flows include net cash and cash equivalents used to finance our acquisition of Atmel of \$2,747.5 million. Excluding investing cash flows used for acquisitions, net investing activities resulted in a source of cash of \$451.8 million and represented primarily cash generated from purchases and sales and maturities of available-for-sale securities.

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures in the three months ended June 30, 2017 were \$22.1 million compared to \$18.5 million in the three months ended June 30, 2016. Capital expenditures were primarily for the expansion of production capacity and the addition of

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research and development equipment. Capital expenditures in fiscal 2017 were relatively less than we have experienced in recent years as we delayed certain purchases until we had finalized and developed plans following our acquisition of Atmel regarding process technology platforms and other manufacturing activities. We currently intend to spend approximately \$190.0 million during the next twelve months to invest in equipment and facilities. We believe that the capital expenditures anticipated to be incurred over the next twelve months will provide sufficient manufacturing capacity to support the growth of our production capabilities for our new products and technologies and to bring in-house more of the assembly and test operations that are currently outsourced. We expect to finance our capital expenditures through our existing cash balances and cash flows from operations.

Net cash used in financing activities was \$89.4 million in the three months ended June 30, 2017 compared to net cash provided of \$580.0 million in the three months ended June 30, 2016. The cash provided by financing activities was lower in the three months ended June 30, 2017 compared to the three months ended June 30, 2016 because of net proceeds of \$678.0 million from borrowings under our credit facility to fund operations, finance acquisitions and pay dividends in the three months ended June 30, 2016.

In June 2017, in connection with the settlement of \$111.3 million of our 2007 Junior Debt, we amended the credit agreement to (i) extend the time period during which we are permitted to repurchase, redeem or exchange our 2007 Junior Debt and (ii) amend the maximum total leverage ratio covenant to extend the time period for permitted refinancings or exchanges of the 2007 Junior Debt that may be excluded from the calculation of the ratio, subject to certain conditions.

In February 2017, we amended our existing \$2,774.0 million Credit Agreement to, among other things, increase certain covenant compliance ratios. The February 2017 amendment included a new collateral agreement that secures our borrowings with all assets of our guarantor subsidiaries with the exception of real property. Proceeds of loans made under the credit agreement may be used for working capital and general corporate purposes. At June 30, 2017 and March 31, 2017, we had no borrowings outstanding under the credit facility. See Note 13 of the notes to consolidated financial statements for more information regarding our credit agreement.

Our total cash, cash equivalents, short-term investments and long-term investments held by our foreign subsidiaries was \$1,104.9 million at June 30, 2017 and \$909.2 million at March 31, 2017. Under current tax laws and regulations, if accumulated earnings and profits held by our foreign subsidiaries that U.S. taxes had not previously been provided for were to be distributed to the U.S., in the form of dividends or otherwise, we would be subject to additional U.S. income taxes and foreign withholding taxes. Our balance of cash, cash equivalents, short-term investments and long-term investments available for our U.S. operations as of June 30, 2017 and March 31, 2017 was approximately \$545.8 million and \$501.0 million, respectively. Our U.S. operations and capital requirements are funded primarily by cash generated from U.S. operating activities, which has been and is expected to be sufficient to meet our business needs in the U.S. for the foreseeable future. We utilize a variety of tax planning and financing strategies (including borrowings under our credit agreement) with the objective of having our worldwide cash available in the locations in which it is needed. Should our U.S. cash needs exceed funds generated by U.S. operations for any reason, including acquisitions of large capital assets or acquisitions of U.S. businesses, we may require additional funds in the U.S. and would expect to borrow such additional funds under our existing credit facility, pursue other U.S. borrowing alternatives, issue equity securities or utilize a combination of these sources. We consider our offshore earnings to be permanently reinvested offshore. However, we could determine to repatriate some of our offshore earnings in future periods to fund stockholder dividends, share repurchases, acquisitions or other corporate activities. We expect that a significant portion of our future cash generation will be in our foreign subsidiaries.

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

inflationary economy in the last five years, there is no assurance that inflation rates or fluctuations in foreign currency rates in countries where we conduct operations will not adversely affect our operating results in the future. At June 30, 2017, we had no foreign currency forward contracts outstanding.

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On April 4, 2016, we completed our acquisition of Atmel. Under the terms of the merger agreement executed on January 19, 2016, Atmel stockholders received \$8.15 per share consisting of \$7.00 per share in cash and \$1.15 per share in shares of Microchip common stock. We financed the purchase price of our Atmel acquisition using approximately \$2.04 billion of cash held by certain of our foreign subsidiaries, approximately \$941.6 million from additional borrowings under our existing credit agreement and approximately \$486.1 million through the issuance of an aggregate of 10.1 million shares of our common stock. The acquisition price represents a total equity value of approximately \$3.47 billion, and a total enterprise value of approximately \$3.43 billion, after excluding Atmel's cash and investments net of debt on its balance sheet of approximately \$39.3 million. The acquisition was structured in a manner that enabled us to utilize a substantial portion of the cash, cash equivalents, short-term investments and long-term investments held by certain of our foreign subsidiaries in a tax efficient manner. Although we believe our determinations with respect to the tax consequences of the acquisition are reasonable, we are regularly audited by the IRS and may be audited by other taxing authorities, and there can be no assurance as to the outcome of any such audit.

Our Board of Directors previously approved a share repurchase program under which up to 15.0 million shares of our common stock may be repurchased in the open market or in privately negotiated transactions. There were no repurchases of common stock during the three months ended June 30, 2017. There is no expiration date associated with this repurchase program. As of June 30, 2017, we held approximately 20.0 million shares as treasury shares.

On October 28, 2002, we announced that our Board of Directors had approved and instituted a quarterly cash dividend on our common stock. A quarterly dividend of \$0.3615 per share was paid on June 6, 2017 in the aggregate amount of \$82.9 million. A quarterly dividend of \$0.3620 per share was declared on August 3, 2017 and will be paid on September 5, 2017 to stockholders of record as of August 21, 2017. We expect the aggregate cash dividend for September 2017 to be approximately \$84.4 million. Our Board is free to change our dividend practices at any time and to increase or decrease the dividend paid, or not to pay a dividend on our common stock on the basis of our results of operations, financial condition, cash requirements and future prospects, and other factors deemed relevant by our Board. Our current intent is to provide for ongoing quarterly cash dividends depending upon market conditions, our results of operations, and potential changes in tax laws.

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

### Contractual Obligations

There have not been any material changes in our contractual obligations from what we disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017.

### Off-Balance Sheet Arrangements (Including Guarantees)

As of June 30, 2017, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K. In the ordinary course of business, we may provide standby letters of credit or other guarantee instruments to certain parties as required for certain transactions initiated by us or our subsidiaries. We have not recorded any liability in connection with these guarantee arrangements. Based on historical experience and information currently available, we believe we will not be required to make any payments under these guarantee arrangements.

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

Our investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations, and delivers an appropriate yield in relationship to our investment guidelines and market conditions. Our investment portfolio, consisting of fixed income securities, money market funds, cash deposits, and marketable securities that we hold on an available-for-sale basis, was \$1,650.7 million as of June 30, 2017 compared to \$1,410.2 million as of March 31, 2017. The increase is due to cash generated from operations. Our available-for-sale debt securities, like all fixed

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income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. We have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize any material adverse impact in income or cash flows if market interest rates increase. The following table provides information about our available-for-sale securities that are sensitive to changes in interest rates. We have aggregated our available-for-sale securities for presentation purposes since they are all very similar in nature. The amounts for fiscal 2018 refer to the remaining nine months of the current fiscal year (dollars in thousands):

	Financial instruments maturing during the fiscal year ended March 31,					
	2018	2019	2020	2021	2022	Thereafter
Available-for-sale securities	\$368,845	\$41,541	\$216,536	\$249,007	\$ —	\$ —
Weighted-average yield rate	1.11	% 1.49	% 1.69	% 1.69	% —%	— %

## Item 4. Controls and Procedures

## Evaluation of Disclosure Controls and Procedures

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

## Changes in Internal Control over Financial Reporting

During the three months ended June 30, 2017, there was no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 15 to our condensed consolidated financial statements for the information required by Item 103 of Regulation S-K.

Item 1A. Risk Factors

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

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

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

- general economic, industry or political conditions in the U.S. or internationally;
- changes in demand or market acceptance of our products and products of our customers, and market fluctuations in the industries into which such products are sold;
- our ability to ramp our factory capacity to meet customer demand;
- changes in utilization of our manufacturing capacity and fluctuations in manufacturing yields;
- the mix of inventory we hold and our ability to satisfy orders from our inventory;
- our ability to realize the expected benefits of our acquisitions including our acquisition of Atmel;
- changes or fluctuations in customer order patterns and seasonality;
- our ability to secure sufficient wafer foundry, assembly and testing capacity;
- levels of inventories held by our customers;
- risk of excess and obsolete inventories;
- changes in tax regulations and policies in the U.S. and other countries in which we do business;
  - competitive developments including pricing pressures;
- unauthorized copying of our products resulting in pricing pressure and loss of sales;
- availability of raw materials and equipment;
- our ability to successfully transition products to more advanced process technologies to reduce manufacturing costs;
- the level of orders that are received and can be shipped in a quarter;
- the level of sell-through of our products through distribution;
- fluctuations in our mix of product sales;
- announcements of significant acquisitions by us or our competitors;
- disruptions in our business or our customers' businesses due to terrorist activity, armed conflict, war, worldwide oil prices and supply, public health concerns, natural disasters or disruptions in the transportation system;
- constrained availability from other electronic suppliers impacting our customers' ability to ship their products, which in turn may adversely impact our sales to those customers;
- costs and outcomes of any current or future tax audits or any litigation or claims involving intellectual property, customers or other issues;
- fluctuations in commodity prices; and
- property damage or other losses, whether or not covered by insurance.

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



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

We have acquired, and expect in the future to acquire, additional businesses that we believe will complement or augment our existing businesses. On April 4, 2016, we acquired Atmel, which was our largest and most complex acquisition ever. In addition, in August 2015, we completed our acquisition of Micrel; in July 2014, we completed our acquisition of a controlling interest in ISSC; in April 2014, we completed our acquisition of Supertex, Inc.; and in August 2012, we completed our acquisition of SMSC. The integration process for our acquisitions is complex and may be costly and time consuming and include unanticipated issues, expenses and liabilities. We may not be able to successfully or profitably integrate, operate, maintain and manage any newly acquired operations or employees. We may not be able to maintain uniform standards, procedures and policies and we may be unable to realize the expected synergies and cost savings from the integration. There may be increased risk due to integrating financial reporting and internal control systems. We may have difficulty in developing, manufacturing and marketing the products of a newly acquired company, or in growing the business at the rate we anticipate. Following an acquisition, we may not achieve the revenue or net income levels that justify the acquisition. We may suffer loss of key employees, customers and strategic partners of acquired companies and it may be difficult to implement our corporate culture at acquired companies. We have been and may in the future be subject to claims from terminated employees, shareholders of acquired companies and other third parties related to the transaction. In particular, as a result of our Atmel acquisition, we became involved with third-party claims, litigation and disputes related to the Atmel business. See Note 15 to our condensed consolidated financial statements for information regarding pending litigation. Acquisitions may also result in charges (such as acquisition-related expenses, write-offs, restructuring charges, or future impairment of goodwill), contingent liabilities, adverse tax consequences, additional share-based compensation expense and other charges that adversely affect our operating results. To fund our acquisition of Atmel, we used a significant portion of our cash balances, borrowed under our credit agreement and issued approximately 10.1 million shares of our common stock. Additionally, we may fund future acquisitions of new businesses or strategic alliances by utilizing cash, borrowings under our credit agreement, raising debt, issuing shares of our common stock, or other mechanisms.

Further, if we decide to divest assets or a business, we may encounter difficulty in finding or completing divestiture opportunities or alternative exit strategies on acceptable terms or in a timely manner. These circumstances could delay the achievement of our strategic objectives or cause us to incur additional expenses with respect to assets or a business that we want to dispose of, or we may dispose of assets or a business at a price or on terms that are less favorable than we had anticipated. Even following a divestiture, we may be contractually obligated with respect to certain continuing obligations to customers, vendors, landlords or other third parties. We may also have continuing obligations for pre-existing liabilities related to the assets or businesses. Such obligations may have a material adverse impact on our results of operations and financial condition.

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

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

As of June 30, 2017, the principal amount of our outstanding indebtedness was \$4,513.8 million. In February 2017, we issued \$2,645.0 million of aggregate principal value of senior and junior convertible debt and amended our

existing \$2,774.0 million credit agreement to, among other things, increase certain covenant compliance ratios. The February 2017 credit agreement amendment included a new collateral agreement that secures our borrowings with all assets of our guarantor subsidiaries with the exception of real property. We used a portion of the proceeds from the issuance of the 2017 senior and junior convertible debt to settle \$431.3 million in principal value of our 2007 junior convertible debt and \$1,682.5 million to pay off the outstanding balance under the credit facility. In June 2017, we exchanged \$111.3 million of our outstanding 2007 Junior Debt with \$111.3 million of our 2017 Junior Debt. At June 30, 2017, there were no outstanding borrowings under our credit facility which is comprised of two tranches expiring in February 2020 and June 2018. In February 2015, we issued \$1,725.0 million of principal value of our 2015 senior convertible debt. As a result of such transactions, we have a substantially greater amount of debt than we had maintained in the past. Our maintenance of substantial levels of debt could adversely affect our ability to take advantage of corporate opportunities and could adversely affect our financial condition and results of operations. We may need or desire to refinance our convertible debt or any other future indebtedness and there can be no assurance that we will be able to refinance any of our indebtedness on commercially reasonable terms, if at all.

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Servicing our debt may require a significant amount of cash, and we may not have sufficient cash flow from our business to fund future payments.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including our outstanding debentures, depends on our future performance, which is subject to economic, financial, competitive and other factors. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and to fund capital expenditures, dividend payments, share repurchases or acquisitions. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time.

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

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

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

The semiconductor industry is intensely competitive and has been characterized by price erosion and rapid technological change. We compete with major domestic and international semiconductor companies, many of which have greater market recognition and substantially greater financial, technical, marketing, distribution and other resources than we do. The semiconductor industry has experienced significant merger and acquisition activity and consolidation in recent years which has resulted in several of our competitors becoming much larger in terms of revenue, product offerings and scale. We may be unable to compete successfully in the future, which could harm our business. Our ability to compete successfully depends on a number of factors both within and outside our control, including, but not limited to:

- the quality, performance, reliability, features, ease of use, pricing and diversity of our products;
- our success in designing and manufacturing new products including those implementing new technologies;
- our ability to ramp production and increase capacity, as needed, at our wafer fabrication and assembly and test facilities;
- the rate at which customers incorporate our products into their own applications and the success of such applications;
- the rate at which the markets that we serve redesign and change their own products;
- changes in demand in the markets that we serve and the overall rate of growth or contraction of such markets, including but not limited to the automotive, personal computing and consumer electronics markets;
- product introductions by our competitors;

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

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Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller and proprietary analog, interface, mixed signal and timing products have remained relatively constant, while average selling prices of our memory and non-proprietary analog, interface, mixed signal and timing products have declined over time.

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

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

We rely on outside wafer foundries for a significant portion of our wafer fabrication needs. Specifically, during the first three months of fiscal 2018, approximately 42% of our net sales came from products that were produced at outside wafer foundries. During fiscal 2017, approximately 41% of our net sales came from products that were produced at outside wafer foundries. We also use several contractors located primarily in Asia for a portion of the assembly and testing of our products. Specifically, during the first three months of fiscal 2018, approximately 62% of our assembly requirements and 42% of our test requirements were performed by third party contractors compared to approximately 64% of our assembly requirements and 40% of our test requirements during fiscal 2017. Our reliance on third party contractors and foundries increased as a result of our acquisitions of Atmel, Micrel, SMSC, Supertex and ISSC. The disruption or termination of any of our contractors could harm our business and operating results.

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

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

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

The manufacture and assembly of integrated circuits, particularly non-volatile, erasable CMOS memory and logic devices such as those that we produce, are complex processes. These processes are sensitive to a wide variety of factors, including the level of contaminants in the manufacturing environment, impurities in the materials used, the performance of our wafer fabrication and assembly and test personnel and equipment, and other quality issues. As is typical in the semiconductor industry, we have from time to time experienced lower than anticipated manufacturing yields. Our operating results will suffer if we are unable to maintain yields at or above approximately the current levels. This could include delays in the recognition of revenue, loss of revenue or future orders, and customer-imposed penalties for our failure to meet contractual shipment deadlines. Our operating results are also adversely affected when we operate at less than optimal capacity. Although we operated at normal capacity levels during fiscal 2017 and the first quarter of fiscal 2018, there can be no assurance that such production levels will be maintained in future periods.

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

The semiconductor industry is characterized by seasonality and wide fluctuations of supply and demand. Broad fluctuations in our overall business, changes in semiconductor industry and global economic conditions, and our acquisition activity (including our acquisitions of Atmel and Micrel) can have a more significant impact on our results than seasonality. As a result, in periods when these broad fluctuations, changes in business conditions or acquisitions occur, it is difficult to assess the impact of seasonal factors on our business. The semiconductor industry has also experienced significant economic downturns, characterized by diminished product demand and production over-capacity. We have sought to reduce our exposure to this industry cyclically by selling proprietary products, that cannot be easily or quickly replaced, to a geographically diverse customer base across a broad range of market segments. However, we have experienced substantial period-to-period fluctuations in operating results and expect, in the future, to experience period-to-period fluctuations in operating results due to general industry or economic conditions.

Our business is dependent on selling through distributors.

Sales through distributors accounted for approximately 55.5% of our net sales in the first three months of fiscal 2018 and approximately 55.3% of our net sales in fiscal 2017. We do not have long-term agreements with our distributors, and we and our distributors may each terminate our relationship with little or no advance notice.

Any future adverse conditions in the U.S. or global economies or in the U.S. or global credit markets could materially impact the operations of our distributors. Any deterioration in the financial condition of our distributors or any disruption in the operations of our distributors could adversely impact the flow of our products to our end customers and adversely impact our results of operation. In addition, during an industry or economic downturn, it is possible there will be an oversupply of products and a decrease in sell-through of our products by our distributors which could reduce our net sales in a given period and result in an increase in inventory returns. Violations of the Foreign Corrupt Practices Act, or similar laws, by our distributors or other channel partners could have a material adverse impact on our business.

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

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

- proper new product selection;
- timely completion and introduction of new product designs;
- procurement of licenses for intellectual property rights from third parties under commercially reasonable terms;
- timely filing and protection of intellectual property rights for new product designs;
- availability of development and support tools and collateral literature that make complex new products easy for engineers to understand and use; and
- market acceptance of our customers' end products.

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

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

Our technology licensing business exposes us to various risks.

Our technology licensing business is based on our SuperFlash and other technologies. The success of our licensing business depends on the continued market acceptance of these technologies and on our ability to further develop and enhance such technologies and to introduce new technologies in the future. To be successful, any such technology must be able to be



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repeatedly implemented by licensees, provide satisfactory yield rates, address licensee and customer requirements, and perform competitively. The success of our technology licensing business depends on various other factors, including, but not limited to:

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

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

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

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

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

We are currently, and in the future may be, involved in legal proceedings or claims regarding patent infringement, other intellectual property rights, product failures, contracts and other matters. As is typical in the semiconductor industry, we receive notifications from third parties from time to time who believe that we owe them indemnification or other obligations related to claims made against us, our direct or indirect customers or our licensees. These legal proceedings and claims, even if meritless, could result in substantial costs to us and divert our resources. If we are not able to resolve a claim, settle a matter, obtain necessary licenses on commercially reasonable terms, reengineer our

products or processes to avoid infringement, provide a cost-effective remedy, or successfully prosecute or defend our position, we could incur uninsured liability in any of them, be required to take an appropriate charge to operations, be enjoined from selling a material portion of our products or using certain processes, suffer a reduction or elimination in the value of our inventories, and our business, financial condition or results of operations could be harmed.

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

- costs related to writing off the value of our inventory of nonconforming products;
- recalling nonconforming products;

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

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

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

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

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

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

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

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

Sales to foreign customers account for a substantial portion of our net sales. During the first three months of fiscal 2018, approximately 85% of our net sales were made to foreign customers, including 30% in China. During fiscal 2017, approximately 84% of our net sales were made to foreign customers, including 32% in China.

A strong position in the Chinese market is a key component of our global growth strategy. The market for integrated circuit products in China is highly competitive, and both international and domestic competitors are aggressively seeking to increase their market share. Increased competition or economic weakness in the China market may make it difficult for us to achieve our desired sales volumes in China. In particular, economic conditions in China remain uncertain and we are unable to predict whether such uncertainty will continue or worsen in future periods.

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We purchase a substantial portion of our raw materials and equipment from foreign suppliers. In addition, we own product assembly and testing facilities near Bangkok, Thailand, which has experienced periods of political instability in the past. A large portion of our finished goods inventory is maintained in Thailand. From time to time, Thailand has also experienced periods of severe flooding. There can be no assurance that any future flooding or political instability in Thailand would not have a material adverse impact on our operations. As part of our Atmel acquisition, we acquired a test facility in Calamba, Philippines. We use various foundries and other foreign contractors for a significant portion of our assembly and testing and wafer fabrication requirements.

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

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

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

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

We do not typically enter into long-term contracts with our customers and we cannot be certain about future order levels from our customers. When we do enter into customer contracts, the contract is generally cancelable at the convenience of the customer. Even though we had over 115,000 customers and our ten largest direct customers made up approximately 12% of our total revenue for the three month period ended June 30, 2017 and three of our top ten customers are contract manufacturers that perform manufacturing services for many customers, cancellation of customer contracts could have an adverse impact on our revenue and profits.

We have entered into contracts with certain customers that differ from our standard terms of sale. Further, as a result of our acquisitions, we have inherited certain customer contracts that differ from our standard terms of sale. For several of the significant markets that we sell into, such as the automotive and personal computer markets, our current or potential customers may possess significant leverage over us in negotiating the terms and conditions of supply as a result of their market size and position. For example, under certain contracts we may commit to supply specific quantities of products on scheduled delivery dates, or agree to extend our obligations for certain liabilities such as warranties or indemnification for quality issues or claims of intellectual property infringement. If we are unable to supply the customer as required under the contract, the customer may incur additional production costs, lost revenues

due to subsequent delays in their own manufacturing schedule, or quality-related issues. We may be liable for the customer's costs, expenses and damages associated with their claims and we may be obligated to defend the customer against claims of intellectual property infringement and pay the associated legal fees. While we try to minimize the number of contracts which contain such provisions, manage the risks underlying such liabilities, and set caps on our liability exposure, sometimes we are not able to do so. In order to win important designs, avoid losing business to competitors, maintain existing business, or be permitted to bid on new business, we have been, and may in the future be, forced to agree to uncapped liability for such items as intellectual property infringement, product failure, or confidentiality. Such provisions expose us to risk of liability far exceeding the purchase price of the products we sell under such contracts, the lifetime revenues we receive from such products, or various forms of potential consequential damages. These significant additional risks could result in a material adverse impact on our results of operations and financial condition.

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

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

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

Operations at any of our facilities, at the facilities of any of our wafer fabrication or assembly and test subcontractors, or at any of our significant vendors or customers may be disrupted for reasons beyond our control. These reasons may include work stoppages, power loss, cyber attacks, incidents of terrorism or security risk, political instability, public health issues, telecommunications, transportation or other infrastructure failure, radioactive contamination, fire, earthquake, floods, volcanic eruptions or other natural disasters. We have taken steps to mitigate the impact of some of these events should they occur; however, we cannot be certain that our actions will be effective to avoid a significant impact on our business in the event of a disaster or other business interruption.

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

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

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

We use forward currency exchange contracts in an attempt to reduce the adverse earnings impact from the effect of exchange rate fluctuations on our non-U.S. dollar net balance sheet exposures. Nevertheless, in periods when the U.S. dollar significantly fluctuates in relation to the non-U.S. currencies in which we transact business, the value of our non-U.S. dollar transactions can have an adverse effect on our results of operations and financial condition. In particular, in periods when a foreign currency significantly declines in value in relation to the U.S. dollar, customers transacting in that foreign currency may find it more difficult to fulfill their previously committed contractual obligations or to undertake new obligations to make payments or purchase products. In periods when the U.S. dollar is significantly declining in relation to the British pound, Euro and Thai baht, the operational costs in our European and

Thailand subsidiaries are adversely affected. Although our business has not been materially adversely impacted by recent changes in the value of the U.S. dollar, there can be no assurance as to the future impact that the strength of the U.S. dollar will have on our business or results of operations.

Interruptions in our information technology systems, or improper handling of data, could adversely affect our business.

We rely on the efficient and uninterrupted operation of complex information technology systems and networks to operate our business. Any significant disruption to our systems or networks, including, but not limited to, new system implementations, computer viruses, security breaches, facility issues, natural disasters, terrorism, war, telecommunication failures or energy blackouts could have a material adverse impact on our operations, sales and operating results. Such disruption could result in a loss of our intellectual property or the release of sensitive competitive information or supplier, customer or employee personal data. Any loss of such information could harm our competitive position, result in a loss of customer confidence, and cause us to incur significant costs to remedy the damages caused by any such disruptions or security breaches. Additionally, any failure to properly manage the collection, handling, transfer or disposal of personal data of



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employees and customers may result in regulatory penalties, enforcement actions, remediation obligations, litigation, fines and other sanctions.

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

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

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

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

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

We must comply with many federal, state, local and foreign governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous substances used in our products and manufacturing processes. Our failure to comply with applicable regulations could result in fines, suspension of production, cessation of operations or future liabilities. Such environmental regulations have required us in the past, and could require us in the future to buy costly equipment or to incur significant expenses to comply with such regulations. Our failure to control the use of, or adequately restrict the discharge of, hazardous substances could impact the health of our employees and others and could impact our ability to operate. Such failure could also restrict our ability to ship certain products to certain countries, require us to modify our operations logistics, or require us to incur other significant costs and expenses. There is a continuing expansion in environmental laws with a focus on reducing or eliminating hazardous substances and substances of high concern in electronic products and shipping materials. These and other future environmental regulations could require us to reengineer certain of our existing products and may make it more expensive for us to manufacture, sell and ship our products. In addition, the number and complexity of laws focused on the energy efficiency of electronic products and accessories, the recycling of electronic products, and the reduction in the quantity and the recycling of packing materials have expanded significantly. It may be difficult for us to timely comply with these laws and we may not have sufficient quantities of compliant products to meet customers' needs,

thereby adversely impacting our sales and profitability. We may also have to write off inventory in the event that we hold unsaleable inventory as a result of changes to regulations or customer requirements. We expect these risks and trends to continue. In addition, we anticipate increased customer requirements to meet voluntary criteria related to the reduction or elimination of substances of high concern in our products, energy efficiency measures, and supplier practices associated with sourcing and manufacturing. These requirements may increase our own costs, as well as those passed on to us by our supply chain.

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

Some of our customers and potential customers are requiring that we implement operating practices that are more stringent than what is required by applicable laws with respect to workplace and labor requirements, the type of materials we use in our products, environmental matters or other items. To comply with such requirements, we may have to pass these same operating practices on to our suppliers. Our suppliers may refuse to implement these operating practices, or may charge us

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more for complying with them. The cost to implement such practices may cause us to incur higher costs and reduce our profitability, and if we choose not to implement such practices, such customers may disqualify us as a supplier, resulting in decreased revenue opportunities. Developing, administering, monitoring and auditing these customer-requested practices at our own sites and those in our supply chain will increase our costs and may require that we hire more personnel.

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

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, in August 2012, the SEC released investigation, disclosure and reporting requirements regarding the use of "conflict" minerals mined from the Democratic Republic of Congo and adjoining countries and which are necessary to the functionality or production of products. We filed a report on Form SD with the SEC regarding such matters on May 31, 2017. Other countries are considering similar regulations. If we cannot certify that we are using conflict-free minerals, customers may demand that we change the sourcing of minerals and other materials used in the manufacture of our products, even if the costs for compliant minerals and materials significantly increases and availability is limited. If we make changes to materials or suppliers, there will likely be costs associated with qualifying new suppliers and production capacity and quality could be negatively impacted. Our relationships with customers and suppliers may be adversely affected if we are unable to certify that our products are "conflict-free." We have incurred, and expect in the future to incur, additional costs associated with complying with these new disclosure requirements, such as costs related to determining the source of any conflict minerals used in our products. We may also encounter challenges to satisfy those customers who require that all of the components of our products be certified as conflict free in a materially different manner than advocated by the Conflict Free Smelter Initiative or the Dodd-Frank Wall Street Reform and Consumer Protection Act. If we are not able to meet customer requirements, customers may choose to disqualify us as a supplier and we may have to write off inventory in the event that it cannot be sold.

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

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

The outcome of future examinations of our income tax returns could have an adverse effect on our results of operations.

We are subject to examination of our income tax returns by the IRS and other tax authorities for fiscal 2005 and later. We are subject to certain income tax examinations in foreign jurisdictions for fiscal 2007 and later. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our

provision for income taxes. There can be no assurance that the outcomes from these continuing examinations will not have an adverse effect on our future operating results.

We could be subject to changes in tax rates and potential U.S. tax legislation regarding our foreign earnings that could materially and adversely impact our business and financial results.

Currently, a majority of our revenue is generated from customers located outside the U.S., and a substantial portion of our assets, including employees, are located outside of the U.S. Present U.S. income taxes and foreign withholding taxes have not been provided on undistributed earnings for certain of our non-U.S. subsidiaries, because such earnings are intended to be indefinitely reinvested in the operations of those subsidiaries. However, changes to the U.S. income tax regulations and jurisdictions in which we operate, or in the interpretation of such laws, could, significantly increase our tax provisions and ultimately reduce our cash flow from operations and otherwise have a material adverse effect on our financial condition. Other factors or events, including business combinations, changes in the valuation of our deferred tax assets and liabilities, adjustments to income taxes upon finalization of various tax returns or as a result of deficiencies asserted by taxing authorities,

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increases in expenses not deductible for tax purposes, changes in available tax credits, and changes in tax rates could also increase our future effective tax rate.

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

We prepare our financial statements in conformity with accounting principles generally accepted in the U.S. These accounting principles are subject to interpretation or changes by the FASB and the SEC. New accounting pronouncements and varying interpretations of accounting standards and practices have occurred in the past and are expected to occur in the future. New accounting pronouncements or a change in the interpretation of existing accounting standards or practices may have a significant effect on our reported financial results and may even affect our reporting of transactions completed before the change is announced or effective. In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 - Revenue from Contracts with Customers (Topic 606), which will supersede nearly all existing revenue recognition guidance under US GAAP. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. Upon adoption of ASU 2014-09, we will no longer defer revenue until sale by the distributor to the end customer, but rather, will be required to estimate the effects of returns and allowances provided to distributors and record revenue at the time of sale to the distributor. We are currently evaluating the impact that the adoption of the standard may have on our consolidated financial statements. We currently expect to adopt the standard under the full retrospective method. The final adoption method will depend on the results of our ongoing assessment, which is expected to be completed later in fiscal 2018. Refer to Note 2 to our consolidated financial statements for additional information on the new guidance and its potential impact on us.

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

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

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

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

Anti-takeover defenses in our charter documents and under Delaware law could discourage takeover attempts, which could also reduce the market price of our common stock.

Our certificate of incorporation and bylaws contain provisions that could delay or prevent a change in control of Microchip. These provisions could also make it difficult for stockholders to elect directors that are not nominated by the current members of our board of directors or take other corporate actions, including effecting changes in our management. These provisions include:

the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquiror;

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

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the requirement that a special meeting of stockholders may be called only by the holders of 50% or more of the combined voting power of all classes of our capital stock, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;

the ability of our board of directors, by majority vote, to amend the bylaws, which may allow our board of directors to take additional actions to prevent an unsolicited takeover and inhibit the ability of an acquiror to amend the bylaws to facilitate an unsolicited takeover attempt; and

advance notice procedures with which stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of us.

In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us for a certain period of time. The application of Section 203 also could have the effect of delaying or preventing a change in control of us.

Any of these provisions could, under certain circumstances, depress the market price of our common stock.

As a result of our acquisition activity, our goodwill and intangible assets have increased significantly in recent years and we may in the future incur impairments to goodwill or intangible assets.

When we acquire a business, a substantial portion of the purchase price of the acquisition is allocated to goodwill and other identifiable intangible assets. The amount of the purchase price which is allocated to goodwill is determined by the excess of the purchase price over the net identifiable assets acquired. As of June 30, 2017, we had goodwill of \$2,299.0 million and net intangible assets of \$2,026.6 million. We review our indefinite-lived intangible assets, including goodwill, for impairment annually in the fourth fiscal quarter or whenever events or changes in circumstances indicate that the carrying amount of those assets is more likely than not impaired. Factors that may be considered in assessing whether goodwill or intangible assets may be impaired include a decline in our stock price or market capitalization, reduced estimates of future cash flows and slower growth rates in our industry. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. Because we operate in highly competitive environments, projections of our future operating results and cash flows may vary significantly from our actual results. No goodwill impairment charges were recorded in the first three months of fiscal 2018 or fiscal 2017. No material intangible asset impairment charges were recorded in the first three months of fiscal 2018. In fiscal 2017, we recognized \$11.9 million of intangible asset impairment charges. If in future periods, we determine that our goodwill or intangible assets are impaired, we will be required to write down these assets which would have a negative effect on our consolidated financial statements.

Our foreign pension plans are unfunded, and any requirement to fund these plans in the future could negatively affect our cash position and operating capital.

In connection with our acquisition of Atmel, we assumed unfunded defined benefit pension plans that cover certain of our French and German employees. Plan benefits are managed in accordance with local statutory requirements. Benefits are based on years of service and employee compensation levels. The projected benefit obligation totaled \$54.1 million at June 30, 2017. The plans are unfunded in compliance with local statutory regulations, and we have no immediate intention of funding these plans. Benefits are paid when amounts become due, commencing when participants retire. We expect to pay approximately \$0.7 million in fiscal 2018 for benefits earned. Should legislative regulations require complete or partial funding of these plans in the future, it could negatively affect our cash position

and operating capital.

From time to time we receive grants from governments, agencies and research organizations. If we are unable to comply with the terms of those grants, we may not be able to receive or recognize grant benefits or we may be required to repay grant benefits previously paid to us and recognize related charges, which would adversely affect our operating results and financial position.

From time to time, we receive economic incentive grants and allowances from European governments, agencies and research organizations targeted at increasing employment at specific locations. The subsidy grant agreements typically contain economic incentive, headcount, capital and research and development expenditure and other covenants that must be met to receive and retain grant benefits, and these programs can be subjected to periodic review by the relevant governments. Noncompliance by us with the conditions of the grants could result in our forfeiture of all or a portion of any future amounts to be received, as well as the repayment of all or a portion of amounts received to date.

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Conversion of our debentures will dilute the ownership interest of existing stockholders.

The conversion of some or all of our outstanding debentures will dilute the ownership interest of existing stockholders to the extent we deliver common stock upon conversion of the debentures. Upon conversion, we may satisfy our conversion obligation by delivering cash, shares of common stock or any combination, at our option. If upon conversion we elect to deliver cash for the lesser of the conversion value and principal amount of the debentures, we would pay the holder the cash value of the applicable number of shares of our common stock. Upon conversion, we intend to satisfy the lesser of the principal amount or the conversion value of the debentures in cash. If the conversion value of a debenture exceeds the principal amount of the debenture, we may also elect to deliver cash in lieu of common stock for the conversion value in excess of the one thousand dollars principal amount (i.e., the conversion spread). There would be no adjustment to the numerator in the net income per common share computation for the cash settled portion of the debentures as that portion of the debt instrument will always be settled in cash. The conversion spread will be included in the denominator for the computation of diluted net income per common share. Any sales in the public market of any common stock issuable upon conversion of our debentures could adversely affect prevailing market prices of our common stock. In addition, the existence of the debentures may encourage short selling by market participants because the conversion of the debentures could be used to satisfy short positions, or anticipated conversion of the debentures into shares of our common stock could depress the price of our common stock.

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

Climate change regulations at the federal, state or local level or in international jurisdictions could require us to limit emissions, change our manufacturing processes, obtain substitute materials which may cost more or be less available, increase our investment in control technology for greenhouse gas emissions, fund offset projects or undertake other costly activities. These regulations could significantly increase our costs and restrict our manufacturing operations by virtue of requirements for new equipment. New permits may be required for our current operations, or expansions thereof. Failure to timely receive permits could result in fines, suspension of production, or cessation of operations at one or more facilities. In addition, restrictions on carbon dioxide or other greenhouse gas emissions could result in significant costs such as higher energy costs, and utility companies passing down carbon taxes, emission cap and trade programs and renewable portfolio standards. The cost of complying, or of failing to comply, with these and other climate change and emissions regulations could have an adverse effect on our operating results.

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

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

We did not repurchase any shares of our common stock in the three months ended June 30, 2017.

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Item 6. Exhibits

- 10.1 Amendment No. 3 to Amended and Restated Credit Agreement dated as of June 21, 2017, among Microchip Technology Incorporated, the lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent (incorporated by reference to the same numbered exhibit to the Company's Current Report on Form 8-K filed on June 22, 2017).
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

MICROCHIP TECHNOLOGY INCORPORATED

Date: August 4, 2017 By: /s/ J. Eric Bjornholt  
J. Eric Bjornholt  
Vice President and Chief Financial Officer  
(Duly Authorized Officer, and  
Principal Financial and Accounting Officer)