

LSI CORP
Form 10-Q
May 01, 2014
Table of Contents

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 March 30, 2014

OR

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

For the transition period from _____ to _____

Commission File Number: 1-10317

LSI CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

94-2712976
(I.R.S. Employer

Identification Number)

1320 Ridder Park Drive

San Jose, California 95131

(Address of principal executive offices) (Zip code)

(408) 433-8000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company.)

Smaller reporting company

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

As of April 24, 2014, there were 565,370,911 shares of the registrant's Common Stock, \$.01 par value, outstanding.

Table of Contents**LSI CORPORATION****FORM 10-Q****For the Quarter Ended March 30, 2014****INDEX**

| | Page No. |
|---|---------------------|
| PART I. FINANCIAL INFORMATION | |
| Item 1. <u>Financial Statements (Unaudited)</u> | 3 |
| <u>Condensed Consolidated Balance Sheets as of March 30, 2014 and December 31, 2013</u> | 3 |
| <u>Condensed Consolidated Statements of Operations for the three months ended March 30, 2014 and March 31, 2013</u> | 4 |
| <u>Condensed Consolidated Statements of Comprehensive Income for the three months ended March 30, 2014 and March 31, 2013</u> | 5 |
| <u>Condensed Consolidated Statements of Cash Flows for the three months ended March 30, 2014 and March 31, 2013</u> | 6 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 7 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 16 |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 23 |
| Item 4. <u>Controls and Procedures</u> | 23 |
| PART II. OTHER INFORMATION | |
| Item 1. <u>Legal Proceedings</u> | 23 |
| Item 1A. <u>Risk Factors</u> | 23 |
| Item 6. <u>Exhibits</u> | 24 |
| <u>Signatures</u> | 25 |
| <u>Exhibit Index</u> | 26 |

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words estimate, plan, intend, expect, anticipate, and similar words are intended to identify forward-looking statements. Although we believe our expectations are based on reasonable assumptions, our actual results could differ materially from those projected in the forward-looking statements. Factors which could cause actual results to differ materially from those projected or contemplated in any such forward-looking statements include, but are not limited to, the following factors: (1) the risk that the conditions to the proposed transactions contemplated by the Agreement and Plan of Merger, by and among us, Avago Technologies Limited, Avago Technologies Wireless (U.S.A.) Manufacturing Inc., and Leopold Merger Sub, Inc., pursuant to which, subject to certain conditions, Leopold Merger Sub will merge with and into us, are not satisfied; (2) litigation relating to the merger; (3) uncertainties as to the timing of the consummation of the merger and the ability of each of us and Avago to consummate the merger; (4) risks that the proposed transaction disrupts our current plans and operations; (5) our ability to retain and hire key personnel; (6) competitive responses to the proposed merger; (7) unexpected costs, charges or expenses resulting from the merger; (8) the failure by Avago to obtain the necessary debt financing arrangements set forth in the commitment letters received in connection with the signing of the merger agreement; (9) potential adverse reactions or changes to business relationships resulting from the

announcement of the merger; and (10) legislative, regulatory and economic developments. The foregoing review of important factors that could cause actual events to differ from expectations should not be construed as exhaustive and should be read in conjunction with statements that are included herein, including the risk factors included in the subsection entitled Risk Factors under Part II, Item 1A of this Form 10-Q. We can give no assurance that the conditions to the merger will be satisfied. Except as required by applicable law, we undertake no obligation to revise or update any forward-looking statement, or to make any other forward-looking statements, whether as a result of new information, future events or otherwise. Except where otherwise indicated, the statements made in this report are made as of the date we filed this report with the Securities and Exchange Commission and should not be relied upon as of any subsequent date.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****LSI CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except per share amounts)****(Unaudited)**

| | March 30, 2014 | December 31, 2013 |
|--|---------------------------|------------------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 642,588 | \$ 542,768 |
| Short-term investments | 240,741 | 267,070 |
| Accounts receivable, less allowances of \$4,349 and \$6,174, respectively | 251,223 | 270,849 |
| Inventories | 161,910 | 156,294 |
| Prepaid expenses and other current assets | 85,018 | 71,600 |
| Total current assets | 1,381,480 | 1,308,581 |
| Property and equipment, net | 298,582 | 302,288 |
| Identified intangible assets, net | 337,537 | 367,603 |
| Goodwill | 255,005 | 255,005 |
| Other assets | 126,873 | 128,228 |
| Total assets | \$ 2,399,477 | \$ 2,361,705 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Accounts payable | \$ 173,614 | \$ 174,213 |
| Accrued salaries, wages and benefits | 111,686 | 135,530 |
| Other accrued liabilities | 168,657 | 173,238 |
| Total current liabilities | 453,957 | 482,981 |
| Pension and post-retirement benefit obligations | 324,037 | 337,063 |
| Income taxes payable | 63,740 | 72,245 |
| Other non-current liabilities | 33,298 | 33,694 |
| Total liabilities | 875,032 | 925,983 |
| Commitments and contingencies (Note 12) | | |
| Stockholders' equity: | | |
| Preferred stock, \$.01 par value: 2,000 shares authorized; none outstanding | | |
| Common stock, \$.01 par value: 1,300,000 shares authorized; 564,011 and 552,409 shares outstanding, respectively | 5,640 | 5,524 |

Edgar Filing: LSI CORP - Form 10-Q

| | | |
|--|--------------|--------------|
| Additional paid-in capital | 5,620,767 | 5,570,478 |
| Accumulated deficit | (3,715,705) | (3,748,938) |
| Accumulated other comprehensive loss | (386,257) | (391,342) |
| Total stockholders' equity | 1,524,445 | 1,435,722 |
| Total liabilities and stockholders' equity | \$ 2,399,477 | \$ 2,361,705 |

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

Table of Contents

LSI CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

| | Three Months Ended | |
|--|--------------------|----------------|
| | March 30, 2014 | March 31, 2013 |
| Revenues | \$ 569,066 | \$ 568,636 |
| Cost of revenues | 277,941 | 279,132 |
| Gross profit | 291,125 | 289,504 |
| Research and development | 174,113 | 171,305 |
| Selling, general and administrative | 76,168 | 89,495 |
| Restructuring of operations and other items, net | 15,473 | 20,452 |
| Income from operations | 25,371 | 8,252 |
| Interest income and other, net | 2,669 | 7,880 |
| Income before income taxes | 28,040 | 16,132 |
| Benefit from income taxes | (5,193) | (2,300) |
| Net income | \$ 33,233 | \$ 18,432 |
| Net income per share: | | |
| Basic | \$ 0.06 | \$ 0.03 |
| Diluted | \$ 0.06 | \$ 0.03 |
| Shares used in computing per share amounts: | | |
| Basic | 558,490 | 550,227 |
| Diluted | 588,455 | 567,092 |

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

Table of Contents**LSI CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(In thousands)****(Unaudited)**

| | Three Months Ended | |
|--|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| Net income | \$ 33,233 | \$ 18,432 |
| Other comprehensive income before tax: | | |
| Foreign currency translation adjustments | 1,275 | (342) |
| Available-for-sale securities: | | |
| Unrealized gain | 556 | 1,980 |
| Reclassification of net realized (gain)/loss to net income | (128) | 17 |
| Derivative financial instruments: | | |
| Unrealized loss | (30) | (32) |
| Reclassification of net realized loss/(gain) to net income | 562 | (162) |
| Amortization of net actuarial loss, prior service cost and transition asset on benefit plans | 3,193 | 5,044 |
| Other comprehensive income before tax | 5,428 | 6,505 |
| Income tax expense on net unrealized gain on investments and derivatives | 343 | 740 |
| Other comprehensive income, net of tax | 5,085 | 5,765 |
| Comprehensive income | \$ 38,318 | \$ 24,197 |

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

Table of Contents**LSI CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

| | Three Months Ended | |
|--|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| Operating activities: | | |
| Net income | \$ 33,233 | \$ 18,432 |
| Adjustments: | | |
| Depreciation and amortization | 45,929 | 44,285 |
| Stock-based compensation expense | 20,985 | 25,546 |
| Non-cash restructuring of operations and other items, net | 434 | 6,596 |
| Gain on sale of property and equipment | | (4) |
| Unrealized foreign exchange loss | 494 | 589 |
| Deferred taxes | (51) | (26) |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | 19,626 | 40,652 |
| Inventories | (5,616) | 25,123 |
| Prepaid expenses and other assets | (32,903) | (7,955) |
| Accounts payable | 7,936 | (33,054) |
| Accrued and other liabilities | (47,054) | (57,354) |
| Net cash provided by operating activities | 43,013 | 62,830 |
| Investing activities: | | |
| Purchases of debt securities available-for-sale | (26) | (53,345) |
| Proceeds from maturities and sales of debt securities available-for-sale | 25,601 | 24,117 |
| Purchases of other investments | (232) | (750) |
| Purchases of property and equipment | (20,527) | (25,075) |
| Proceeds from sale of property and equipment | 12 | 27 |
| Net cash provided by/(used in) investing activities | 4,828 | (55,026) |
| Financing activities: | | |
| Issuances of common stock | 51,965 | 8,165 |
| Purchases of common stock under repurchase programs | | (60,765) |
| Net cash provided by/(used in) financing activities | 51,965 | (52,600) |
| Effect of exchange rate changes on cash and cash equivalents | 14 | (1,507) |
| Net change in cash and cash equivalents | 99,820 | (46,303) |

| | | |
|--|------------|------------|
| Cash and cash equivalents at beginning of period | 542,768 | 471,528 |
| Cash and cash equivalents at end of period | \$ 642,588 | \$ 425,225 |

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

Table of Contents**LSI CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Note 1 Basis of Presentation**

For financial reporting purposes, LSI Corporation (LSI or the Company) reports on a 13- or 14-week quarter with the year ending December 31. The first quarters of 2014 and 2013 consisted of 13 weeks each and ended on March 30, 2014 and March 31, 2013, respectively. The results of operations for the quarter ended March 30, 2014 are not necessarily indicative of the results to be expected for the full year.

On December 15, 2013, the Company entered into a definitive agreement with Avago Technologies Limited (Avago) and certain of its subsidiaries under which Avago will acquire LSI for \$11.15 per share in an all-cash transaction valued at approximately \$6.6 billion. On April 9, 2014, the Company s stockholders adopted the merger agreement. The merger is expected to close in early May 2014, subject to satisfaction of customary closing conditions.

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from these estimates.

In management s opinion, the accompanying unaudited condensed consolidated financial statements contain all normal recurring adjustments necessary for a fair statement of the Company s financial position, results of operations, comprehensive income and cash flows for the interim periods presented. While the Company believes that the disclosures are adequate to make the information not misleading, these financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Accounting Pronouncement

In July 2013, the Financial Accounting Standards Board issued additional guidance regarding the presentation of unrecognized tax benefits. The guidance requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset if a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is available. This guidance is effective for fiscal years and interim periods beginning after December 15, 2013. The Company adopted this guidance in the first quarter of 2014. The adoption did not impact the Company s financial position.

Note 2 Stock-Based Compensation

Stock-based compensation expense, net of estimated forfeitures, related to the Company s stock options, Employee Stock Purchase Plan (ESPP) and restricted stock units (RSUs) by expense category was as follows:

| Three Months Ended | |
|---------------------------|-----------------------|
| March 30, 2014 | March 31, 2013 |
| (In thousands) | |

| | | |
|--|-----------|-----------|
| Cost of revenues | \$ 2,458 | \$ 2,875 |
| Research and development | 10,295 | 12,409 |
| Selling, general and administrative | 8,232 | 10,262 |
| Total stock-based compensation expense | \$ 20,985 | \$ 25,546 |

The income tax benefit that the Company realized for the tax deduction from option exercises and other awards was not material for any period presented.

Stock Options

The fair value of each option grant is estimated as of the date of grant using a reduced-form calibrated binomial lattice model (lattice model). The following table summarizes the weighted-average assumptions that the Company applied in the lattice model:

| | Three Months Ended | |
|---|--------------------|----------------|
| | March 30, 2014 | March 31, 2013 |
| Estimated grant date fair value per share | \$ 2.87 | \$ 2.33 |
| Expected life (years) | 4.45 | 4.38 |
| Risk-free interest rate | 1% | 1% |
| Volatility | 34% | 49% |

Table of Contents

The following table summarizes changes in stock options outstanding:

| | Number of Shares (In thousands) | Weighted-Average Exercise Price Per Share | Weighted-Average Remaining Contractual Term (In years) | Aggregate Intrinsic Value (In thousands) |
|--|---------------------------------------|---|---|---|
| Options outstanding at December 31, 2013 | 43,948 | \$ 5.87 | | |
| Granted | 3,360 | \$ 11.09 | | |
| Exercised | (7,801) | \$ 6.66 | | |
| Canceled | (228) | \$ 6.72 | | |
| Options outstanding at March 30, 2014 | 39,279 | \$ 6.16 | 3.93 | \$ 193,014 |
| Options exercisable at March 30, 2014 | 25,110 | \$ 5.28 | 2.92 | \$ 145,388 |

As of March 30, 2014, the total unrecognized compensation expense related to unvested stock options, net of estimated forfeitures, was \$32.6 million, which is expected to be recognized over the next 2.4 years on a weighted-average basis.

Restricted Stock Units

The cost of service-based and performance-based RSUs is determined using the fair value of the Company's common stock on the date of grant. For performance-based RSU expense, the Company also considers the probability that those RSUs will vest.

Service-based:

The vesting of service-based RSUs requires that the employees remain employed by the Company for a specified period of time.

The following table summarizes changes in service-based RSUs outstanding:

| | Number of Units (In thousands) | Weighted-Average Grant Date Fair Value per Share |
|--|--------------------------------------|--|
| Unvested service-based RSUs outstanding at December 31, 2013 | 19,543 | \$ 7.07 |
| Granted | 5,163 | \$ 11.09 |
| Vested | (5,508) | \$ 6.89 |
| Forfeited | (464) | \$ 7.24 |

| | | | |
|---|--------|----|------|
| Unvested service-based RSUs outstanding at March 30, 2014 | 18,734 | \$ | 8.22 |
|---|--------|----|------|

As of March 30, 2014, the total unrecognized compensation expense related to service-based RSUs, net of estimated forfeitures, was \$136.1 million, which will be recognized over the next 2.8 years on a weighted-average basis.

Performance-based:

The vesting of performance-based RSUs is contingent upon the Company meeting specified performance criteria and requires that the employees remain employed by the Company for a specified period of time.

The following table summarizes changes in performance-based RSUs outstanding:

| | Number of Units (In thousands) | | Weighted-Average Grant Date Fair Value per Share |
|--|--------------------------------------|----|--|
| Unvested performance-based RSUs outstanding at December 31, 2013 | 3,516 | \$ | 7.10 |
| Granted | 1,188 | \$ | 11.09 |
| Vested | | \$ | |
| Forfeited | | \$ | |
| Unvested performance-based RSUs outstanding at March 30, 2014 | 4,704 | \$ | 8.11 |

As of March 30, 2014, the total unrecognized compensation expense related to performance-based RSUs, net of estimated forfeitures, was \$25.2 million, and if the performance conditions are fully met, that amount will be recognized over the next 1.5 years on a weighted-average basis.

Table of Contents**Employee Stock Purchase Plan**

Compensation expense for the ESPP is calculated using the fair value of the employees' purchase rights computed under the Black-Scholes model. Under the ESPP, rights to purchase shares are granted during the second and fourth quarters of each year. No shares related to the ESPP were issued during the three months ended March 30, 2014 or March 31, 2013.

The ESPP was terminated in April 2014, pursuant to the merger agreement relating to the Company's acquisition by Avago.

Note 3 Stockholders' Equity

On August 1, 2012, the Company's board of directors authorized a stock repurchase program of up to \$500.0 million of its common stock. As of March 30, 2014, \$315.1 million remained available for repurchases under this program. During the three months ended March 31, 2013, the Company repurchased 8.6 million shares for \$60.8 million. Repurchased shares are retired immediately and are recorded as reductions in common stock and additional paid-in capital.

Pursuant to the merger agreement entered into with Avago in December 2013, the Company discontinued share repurchases and its quarterly dividend.

Note 4 Restructuring of Operations and Other Items**Restructuring**

The following table summarizes items included in restructuring expense:

| | Three Months Ended | |
|---------------------------------|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| | (In thousands) | |
| Leases | \$ 4,071(a) | \$ 1,768(a) |
| Employee severance and benefits | 399 | 4,386 |
| Total | \$ 4,470 | \$ 6,154 |

(a) Includes lease obligation costs and related changes in estimates, changes in time value and other ongoing expenditures.

The following table summarizes the significant activities within, and components of, the Company's restructuring obligations:

| Leases | Employee Severance | Total |
|---------------|-------------------------------|--------------|
|---------------|-------------------------------|--------------|

| | | and Benefits (In thousands) | |
|------------------------------|-------------|--|-----------|
| Balance at December 31, 2013 | \$ 4,029 | \$ 12,775 | \$ 16,804 |
| Expense | 4,071 | 399 | 4,470 |
| Utilized | (3,903)(a) | (7,949)(a) | (11,852) |
| Balance at March 30, 2014 | \$ 4,197(b) | \$ 5,225(b) | \$ 9,422 |

(a) Represents cash payments.

(b) The balance remaining for the lease obligations is expected to be paid during the remaining terms of the leases, which extend through the first quarter of 2015. The majority of the balance remaining for employee severance and benefits is expected to be paid by the second quarter of 2014.

Other Items

The Company recorded net charges of \$11.0 million during the three months ended March 30, 2014 primarily for legal and other transaction costs related to the merger with Avago. The Company recorded net charges of \$14.3 million during the three months ended March 31, 2013 primarily for litigation settlements.

Note 5 Benefit Obligations

The Company provides retirement benefits to certain current and former U.S. employees under defined benefit pension plans, which include a management plan and a represented plan. Benefits under the management plan are provided under either an adjusted career-average-pay program or a cash-balance program. Benefits under the represented plan are based on a dollar-per-month formula. Benefit accruals under the management plan were frozen in 2009. Participants in the adjusted career-average-pay program no longer earn service accruals. Participants in the cash-balance program no longer earn service accruals, but continue to earn 4% interest per year on their cash-balance accounts. There are no active participants under the represented plan.

Table of Contents

The Company also has a non-qualified supplemental pension plan in the U.S. that principally provides benefits based on compensation in excess of amounts that can be considered under the management plan. In addition, the Company provides post-retirement life insurance coverage under a group life insurance plan for certain U.S. employees. The Company also has pension plans covering certain international employees.

The following table summarizes the components of the net periodic benefit cost/(credit):

| | Three Months Ended | | | |
|--|-----------------------------|-------------------------------------|-----------------------------|-------------------------------------|
| | March 30, 2014 | | March 31, 2013 | |
| | Pension Benefits | Post-retirement Benefits | Pension Benefits | Post-retirement Benefits |
| | (In thousands) | | | |
| Service cost | \$ 99 | \$ | \$ 123 | \$ 25 |
| Interest cost | 15,613 | 625 | 14,270 | 600 |
| Expected return on plan assets | (17,826) | (950) | (16,581) | (875) |
| Net actuarial loss, prior service cost and transition asset amortization | 3,168 | 25 | 4,669 | 375 |
| Total benefit cost/(credit) | \$ 1,054 | \$ (300) | \$ 2,481 | \$ 125 |

During the three months ended March 30, 2014, the Company contributed \$11.0 million to its pension plans. The Company expects to contribute an additional \$64.9 million to its pension plans during the remainder of 2014. The Company does not expect to contribute to its post-retirement benefit plan in 2014.

Note 6 Cash Equivalents and Investments

The following tables summarize the Company's cash equivalents and investments measured at fair value:

| | Fair Value Measurements as of March 30, 2014 | | |
|---|---|-------------------|-------------------|
| | Level 1 | Level 2 | Total |
| | (In thousands) | | |
| Cash equivalents: | | | |
| Money-market funds | \$ 541,663(a) | \$ | \$ 541,663 |
| Short-term investments: | | | |
| Asset-backed and mortgage-backed securities: | | | |
| Agency securities | \$ | \$ 132,122(b) | \$ 132,122 |
| Non-agency securities | | 570(b) | 570 |
| Government and agency securities | 35,534(a) | 48,470(b) | 84,004 |
| Corporate debt securities | | 15,050(b) | 15,050 |
| Commercial paper | | 8,995(b) | 8,995 |
| Total available-for-sale debt securities | \$ 35,534 | \$ 205,207 | \$ 240,741 |
| Long-term investments in equity securities: | | | |

| | | | |
|---|-------------|----|----------|
| Marketable available-for-sale equity securities | \$ 3,051(c) | \$ | \$ 3,051 |
|---|-------------|----|----------|

Fair Value Measurements as of December 31, 2013

| | Level 1 | Level 2 | Total |
|---|-----------------------|-------------------|-------------------|
| | (In thousands) | | |
| Cash equivalents: | | | |
| Money-market funds | \$ 444,480(a) | \$ | \$ 444,480 |
| Short-term investments: | | | |
| Asset-backed and mortgage-backed securities: | | | |
| Agency securities | \$ | \$ 142,756(b) | \$ 142,756 |
| Non-agency securities | | 607(b) | 607 |
| Government and agency securities | 35,521(a) | 58,875(b) | 94,396 |
| Corporate debt securities | | 15,490(b) | 15,490 |
| Commercial paper | | 13,821(b) | 13,821 |
| Total available-for-sale debt securities | \$ 35,521 | \$ 231,549 | \$ 267,070 |
| Long-term investments in equity securities: | | | |
| Marketable available-for-sale equity securities | \$ 2,921(c) | \$ | \$ 2,921 |

Table of Contents

- (a) The fair value of money-market funds is determined using unadjusted prices in active markets. Level 1 government and agency securities consist of U.S. government and agency securities, and their fair value is determined using quoted prices in active markets.
- (b) These investments are traded less frequently than Level 1 securities and are valued using inputs that include quoted prices for similar assets in active markets and inputs other than quoted prices that are observable for the asset, such as interest rates, yield curves, prepayment speeds, collateral performance, broker/dealer quotes and indices that are observable at commonly quoted intervals.
- (c) The fair value of marketable equity securities is determined using quoted prices in active markets. These amounts are included in non-current other assets.

As of March 30, 2014 and December 31, 2013, the aggregate carrying value of the Company's non-marketable securities was \$44.5 million and \$44.3 million, respectively, which are included in non-current other assets.

The following tables summarize the Company's available-for-sale securities:

| | March 30, 2014 | | | |
|---|---------------------------|----------------------------------|----------------------------------|-------------------|
| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
| | (In thousands) | | | |
| Short-term debt securities: | | | | |
| Asset-backed and mortgage-backed securities | \$ 130,434 | \$ 4,097 | \$ (1,839) | \$ 132,692 |
| Government and agency securities | 83,858 | 306 | (160) | 84,004 |
| Corporate debt securities | 14,991 | 82 | (23) | 15,050 |
| Commercial paper | 8,995 | | | 8,995 |
| Total short-term debt securities | \$ 238,278 | \$ 4,485 | \$ (2,022) | \$ 240,741 |
| Long-term marketable equity securities | \$ 669 | \$ 2,382 | \$ | \$ 3,051 |

| | December 31, 2013 | | | |
|---|---------------------------|----------------------------------|----------------------------------|-------------------|
| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
| | (In thousands) | | | |
| Short-term debt securities: | | | | |
| Asset-backed and mortgage-backed securities | \$ 141,263 | \$ 4,329 | \$ (2,229) | \$ 143,363 |
| Government and agency securities | 94,245 | 352 | (201) | 94,396 |
| Corporate debt securities | 15,447 | 85 | (42) | 15,490 |
| Commercial paper | 13,821 | | | 13,821 |
| Total short-term debt securities | \$ 264,776 | \$ 4,766 | \$ (2,472) | \$ 267,070 |
| Long-term marketable equity securities | \$ 669 | \$ 2,252 | \$ | \$ 2,921 |

Edgar Filing: LSI CORP - Form 10-Q

As of March 30, 2014, there were 188 investments in an unrealized loss position. The following tables summarize the gross unrealized losses and fair values of the Company's short-term investments that have been in a continuous unrealized loss position for less than and greater than 12 months, aggregated by investment category:

| | March 30, 2014 | | | |
|---|----------------------------|--------------------------|-------------------------------|--------------------------|
| | Less than 12 Months | | Greater than 12 Months | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | |
| Asset-backed and mortgage-backed securities | \$ 54,072 | \$ (1,340) | \$ 17,484 | \$ (499) |
| Government and agency securities | 18,507 | (160) | | |
| Corporate debt securities | 2,983 | (23) | | |
| Total | \$ 75,562 | \$ (1,523) | \$ 17,484 | \$ (499) |

Table of Contents

| | December 31, 2013 | | | |
|---|----------------------------|--------------------------|-------------------------------|--------------------------|
| | Less than 12 Months | | Greater than 12 Months | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | |
| Asset-backed and mortgage-backed securities | \$ 63,788 | \$ (1,856) | \$ 11,668 | \$ (373) |
| Government and agency securities | 27,053 | (201) | | |
| Corporate debt securities | 6,126 | (42) | | |
| Total | \$ 96,967 | \$ (2,099) | \$ 11,668 | \$ (373) |

Net realized losses on sales of available-for-sale securities were not material for the three months ended March 30, 2014 or March 31, 2013.

Contractual maturities of available-for-sale debt securities as of March 30, 2014 were as follows (in thousands):

| | |
|---------------------|-------------------|
| Due within one year | \$ 30,657 |
| Due in 1-5 years | 80,503 |
| Due in 5-10 years | 7,725 |
| Due after 10 years | 121,856 |
| Total | \$ 240,741 |

The maturities of asset-backed and mortgage-backed securities were determined based on contractual principal maturities assuming no prepayments.

Note 7 Supplemental Financial Information**Inventories**

| | March 30, 2014 | December 31, 2013 |
|--------------------------|-----------------------|--------------------------|
| | (In thousands) | |
| Raw materials | \$ 69 | \$ 66 |
| Work-in-process | 32,213 | 23,940 |
| Finished goods | 129,628 | 132,288 |
| Total inventories | \$ 161,910 | \$ 156,294 |

Accumulated Other Comprehensive Loss

The following table presents the components of, and changes in, accumulated other comprehensive loss, net of taxes:

| | Balance at December 31, 2013 | Net Current Period Other Comprehensive Income (a) (In thousands) | Balance at March 30, 2014 |
|---|---|---|--------------------------------------|
| Foreign currency translation adjustments | \$ 34,527 | \$ 1,275 | \$ 35,802 |
| Net unrealized gain on investments | 2,797 | 275 | 3,072 |
| Net unrealized loss on derivatives | (573) | 342 | (231) |
| Benefit plans | (428,093) | 3,193 | (424,900) |
| Total accumulated other comprehensive loss | \$ (391,342) | \$ 5,085 | \$ (386,257) |

- (a) The reclassified components of defined benefit pension and post-retirement plans were included in the computation of net periodic benefit cost/(credit) (see Note 5). All other reclassified amounts were insignificant for the period presented.

Table of Contents**Reconciliation of Basic and Diluted Shares**

The following table provides a reconciliation of basic and diluted shares:

| | Three Months Ended | |
|---|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| | (In thousands) | |
| Basic shares | 558,490 | 550,227 |
| Dilutive effect of stock options, employee stock purchase rights and RSUs | 29,965 | 16,865 |
| Diluted shares | 588,455 | 567,092 |

The weighted-average common share equivalents that were excluded from the computation of diluted shares because their inclusion would have had an anti-dilutive effect on net income per share were as follows:

| | Three Months Ended | |
|----------------------------------|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| | (In thousands) | |
| Anti-dilutive securities: | | |
| Stock options | 1,186 | 29,420 |
| RSUs | | 1,632 |

Note 8 Derivative Instruments

The Company has foreign subsidiaries that operate and sell the Company's products in various markets around the world. As a result, the Company is exposed to changes in foreign-currency exchange rates. The Company utilizes forward contracts to manage its exposure associated with net assets and liabilities denominated in non-functional currencies and to reduce the volatility of earnings and cash flows related to forecasted foreign-currency transactions. The Company does not hold derivative financial instruments for speculative or trading purposes. As of March 30, 2014 and December 31, 2013, the total fair value of derivative assets and liabilities was immaterial.

Cash-Flow Hedges

The Company enters into forward contracts that are designated as foreign-currency cash-flow hedges of selected forecasted payments denominated in currencies other than U.S. dollars. These forward contracts generally mature within twelve months. As of March 30, 2014 and December 31, 2013, the total notional value of outstanding forward contracts, designated as foreign-currency cash-flow hedges, was \$21.9 million and \$42.7 million, respectively.

Other Foreign-Currency Derivatives

The Company enters into foreign-exchange forward contracts that are used to manage currency risk for certain assets or liabilities denominated in non-functional currencies and that do not qualify for hedge accounting. These forward contracts generally mature within three months. Changes in the fair value of these forward contracts are recorded immediately in earnings. As of March 30, 2014 and December 31, 2013, the total notional value of these outstanding

forward contracts was \$54.0 million and \$56.0 million, respectively. For the three months ended March 30, 2014 and March 31, 2013, the Company recognized a gain of \$0.1 million and a loss of \$1.2 million on other foreign-currency derivatives, respectively. These amounts are included in interest income and other, net and were substantially offset by the loss and gain on the underlying foreign-currency-denominated assets or liabilities.

Note 9 Segment, Geographic and Product Information

The Company operates in one reportable segment – the Semiconductor segment. The Company’s chief executive officer is the chief operating decision maker (CODM). The Company’s CODM bears ultimate responsibility for, and is actively engaged in, the allocation of resources and the evaluation of the Company’s operating and financial results.

Table of Contents**Information about Geographic Areas**

The following table summarizes the Company's revenues by geography based on the ordering location of the customer. Because the Company sells its products primarily to other sellers of technology products and not to end users, the information in the table below may not accurately reflect geographic end-user demand for its products.

| | Three Months Ended | |
|----------------------------|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| | (In thousands) | |
| North America* | \$ 148,343 | \$ 146,650 |
| Asia | 353,710 | 373,933 |
| Europe and the Middle East | 67,013 | 48,053 |
| Total | \$ 569,066 | \$ 568,636 |

* Primarily the United States.

Information about Product Groups

The following table presents the Company's revenues by product groups:

| | Three Months Ended | |
|---------------------|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| | (In thousands) | |
| Storage products | \$ 446,829 | \$ 437,901 |
| Networking products | 84,039 | 92,603 |
| Other | 38,198 | 38,132 |
| Total | \$ 569,066 | \$ 568,636 |

Note 10 Income Taxes

The Company recorded income tax benefits of \$5.2 million and \$2.3 million for the three months ended March 30, 2014 and March 31, 2013, respectively.

The income tax benefit for the three months ended March 30, 2014 included a reversal of \$11.2 million of liabilities for uncertain tax positions, which included previously unrecognized tax benefits of \$5.7 million and interest and penalties of \$5.5 million, as a result of the expiration of statutes of limitations in multiple jurisdictions and the settlement of an audit.

The income tax benefit for the three months ended March 31, 2013 included a reversal of \$8.6 million of liabilities for uncertain tax positions, which included previously unrecognized tax benefits of \$3.8 million and interest and penalties of \$4.8 million, as a result of the expiration of statutes of limitations in multiple jurisdictions.

The Company computes its tax provision using an estimated annual tax rate. The Company excludes certain loss jurisdictions from the computation of the estimated annual rate when no benefit can be realized on those losses. Historically, the Company has sustained losses from its U.S. operations and, as a result, has maintained a full valuation allowance against U.S. net deferred tax assets. Management does not believe there is sufficient positive evidence to reach a conclusion that it is more likely than not that the Company will generate sufficient future taxable income in the U.S. to realize the benefits of its deferred tax assets. Depending on future results and projected trends, it is reasonably possible that the Company may determine in the foreseeable future that it is more likely than not that a significant portion of its U.S. deferred tax assets will be realized, resulting in a release of a significant portion of the valuation allowance.

As of March 30, 2014, the Company had \$185.8 million of unrecognized tax benefits for which the Company is unable to make a reasonably reliable estimate as to when cash settlement with a taxing authority may occur. It is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease in the next 12 months. Such changes could occur based on the normal expiration of statutes of limitations, the possible conclusion of ongoing tax audits in various jurisdictions around the world or other negotiations with tax authorities. If those events occur within the next 12 months, the Company estimates that the unrecognized tax benefits, plus accrued interest and penalties, could decrease by up to \$17.1 million.

Table of Contents**Note 11 Related Party Transactions**

A member of the Company's board of directors is also a member of the board of directors of Seagate Technology (Seagate). The Company sells semiconductors used in storage product applications to Seagate for prices comparable to those charged to an unrelated third party. Sales to Seagate were \$121.6 million and \$153.7 million for the three months ended March 30, 2014 and March 31, 2013, respectively. The Company had accounts receivable from Seagate of \$64.2 million and \$77.7 million as of March 30, 2014 and December 31, 2013, respectively.

The Company has an equity interest in a joint venture, Silicon Manufacturing Partners Pte Ltd. (SMP), with GLOBALFOUNDRIES, a manufacturing foundry for integrated circuits. SMP operates an integrated circuit manufacturing facility in Singapore. The Company accounts for its ownership position under the equity method of accounting. The Company purchased \$12.4 million and \$9.4 million of inventory from SMP during the three months ended March 30, 2014 and March 31, 2013, respectively. As of March 30, 2014 and December 31, 2013, the amounts payable to SMP were \$11.6 million and \$8.6 million, respectively.

Note 12 Commitments, Contingencies and Legal Matters**Purchase Commitments**

The Company maintains purchase commitments with certain suppliers, primarily for raw materials and manufacturing services and for some non-production items. Purchase commitments for inventory materials are generally restricted to a forecasted time horizon as mutually agreed upon between the parties. This forecasted time horizon can vary for different suppliers. As of March 30, 2014, the Company had purchase commitments of \$376.1 million, which are due through 2018.

The Company has a take-or-pay agreement with SMP under which it has agreed to purchase 51% of the managed wafer capacity from SMP's integrated circuit manufacturing facility and GLOBALFOUNDRIES has agreed to purchase the remaining managed wafer capacity. SMP determines its managed wafer capacity each year based on forecasts provided by the Company and GLOBALFOUNDRIES. If the Company fails to purchase its required commitments, it will be required to pay SMP for the fixed costs associated with the unpurchased wafers. GLOBALFOUNDRIES is similarly obligated with respect to the wafers allotted to it. The agreement may be terminated by either party upon two years written notice. The agreement may also be terminated for material breach, bankruptcy or insolvency.

Guarantees**Product Warranties:**

The following table sets forth a summary of changes in product warranties (in thousands):

| | |
|---|----------|
| Balance as of December 31, 2013 | \$ 8,550 |
| Accruals for warranties issued during the period | |
| Adjustments to pre-existing accruals (including changes in estimates) | (363) |
| Settlements made during the period (in cash or in kind) | |
| Balance as of March 30, 2014 | \$ 8,187 |

Standby Letters of Credit:

The Company had outstanding obligations relating to standby letters of credit of \$6.1 million and \$4.0 million, respectively, as of March 30, 2014 and December 31, 2013. Standby letters of credit are financial guarantees provided by third parties for leases, customs, taxes and certain self-insured risks. If the guarantees are called, the Company must reimburse the provider of the guarantee. The fair value of the letters of credit approximates the contract amounts. The standby letters of credit generally renew annually.

Table of Contents

Indemnifications

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party. These obligations arise primarily in connection with sales contracts, license agreements or agreements for the sale of assets, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of warranties, representations and covenants related to such matters as title to assets sold, validity of certain intellectual property rights, non-infringement of third-party rights, and certain income tax-related matters. In each of these circumstances, payment by the Company is typically subject to the other party making a claim to and cooperating with the Company pursuant to the procedures specified in the particular contract. This usually allows the Company to challenge the other party's claims or, in case of breach of intellectual property representations or covenants, to control the defense or settlement of any third-party claims brought against the other party. Further, the Company's obligations under these agreements may be limited in terms of activity (typically to replace or correct the products or terminate the agreement with a refund to the other party), duration and/or amounts. In some instances, the Company may have recourse against third parties covering certain payments made by the Company.

Legal Matters

The Company and its subsidiaries are parties to litigation matters and claims in the normal course of business. The Company does not believe, based on currently available facts and circumstances, that the final outcome of these matters, taken individually or as a whole, will have a material adverse effect on the Company's consolidated results of operations or financial position. However, the pending unsettled lawsuits may involve complex questions of fact and law and may require the expenditure of significant funds and the diversion of other resources to defend. From time to time, the Company may enter into confidential discussions regarding the potential settlement of such lawsuits. However, there can be no assurance that any such discussions will occur or will result in a settlement. Moreover, the settlement of any pending litigation could require the Company to incur substantial costs and, in the case of the settlement of any intellectual property proceeding against the Company, may require the Company to obtain a license to a third-party's intellectual property that could require royalty payments in the future and the Company to grant a license to certain of its intellectual property to a third party under a cross-license agreement. The results of litigation are inherently uncertain, and material adverse outcomes are possible.

The Company has not provided accruals for any legal matters in its financial statements as potential losses for such matters are not considered probable and reasonably estimable. However, because such matters are subject to many uncertainties, the ultimate outcomes are not predictable, and there can be no assurances that the actual amounts required to satisfy any liabilities arising from the matters described above will not have a material adverse effect on the Company's consolidated results of operations, financial position or cash flows.

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

This management's discussion and analysis should be read in conjunction with the other sections of this Form 10-Q, including Part I, Item 1- Financial Statements.

Where more than one significant factor contributed to changes in results from year to year, we have quantified these factors throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where practicable and material to understanding the discussion.

OVERVIEW

We design, develop and market complex, high-performance storage and networking semiconductors. We offer a broad portfolio of capabilities including custom and standard product integrated circuits that are used in hard disk drives, solid state drives, high-speed communications systems, computer servers, storage systems and personal computers. We deliver our products to our customers as stand-alone integrated circuits as well as incorporated onto circuit boards that offer additional functionality. We also license our intellectual property to other entities.

We derive the majority of our revenues from sales of products for the hard disk and solid state drive, server and networking equipment end markets and our revenues depend on market demand for these types of products. We believe that these markets offer us attractive opportunities because of the growing demand to create, store, manage and move digital content efficiently. Our products are sold primarily to original equipment manufacturers, or OEMs, in the storage, server and networking industries. We also sell some of our products through a network of resellers and distributors. The markets in which we operate are highly competitive and our revenues depend on our ability to compete successfully. We face competition not only from makers of products similar to ours, but also from competing technologies.

Table of Contents

On December 15, 2013, we entered into a definitive agreement with Avago and certain of its subsidiaries under which Avago will acquire LSI for \$11.15 per share in an all-cash transaction valued at approximately \$6.6 billion. On April 9, 2014, our stockholders adopted the merger agreement. The merger is expected to close in early May 2014, subject to satisfaction of customary closing conditions.

Sixteen purported class action complaints have been filed by alleged stockholders of LSI against us, our individual directors, and, in fifteen of the cases, against Avago. These actions generally allege that the members of our board of directors breached their fiduciary duties in connection with the merger because the merger was not in the best interest of the company, the merger consideration is unfair, and certain other terms of the merger agreement are unfair. Among other remedies, the lawsuits seek to enjoin the merger, or in the event that an injunction is not entered and the merger closes, to rescind the merger or obtain unspecified money damages, costs and attorneys' fees. After arm's-length negotiations, on March 7, 2014, the parties, through their respective counsel, reached a settlement, which was filed with the state court in Delaware on April 15, 2014. A hearing to approve the settlement is currently scheduled for June 10, 2014. We do not expect the settlement, if approved, to have a material impact on our results of operations.

Our results of operations were as follows:

| | Three Months Ended | | |
|---|--|-----------------------|---------------|
| | March 30, 2014 | March 31, 2013 | Change |
| | (Dollars in millions, except per share amounts) | | |
| Revenues | \$ 569.1 | \$ 568.6 | \$ 0.5 |
| Gross profit margin as a percentage of revenues | 51.2% | 50.9% | 0.3% |
| Net income | \$ 33.2 | \$ 18.4 | \$ 14.8 |
| Net income per diluted share | \$ 0.06 | \$ 0.03 | \$ 0.03 |

We are working to manage our operating expenses while at the same time continuing work on products under development. We are focusing our research and development operations on products that we believe provide favorable growth opportunities for our business. We are also working to expand our sales of products in newer areas such as flash memory-based server adapter cards, where we are working directly with large, Internet-based datacenter operators, in addition to our more traditional customer base of OEMs and distributors.

Our board of directors authorized a stock repurchase program of up to \$500.0 million on August 1, 2012. Pursuant to the merger agreement entered into with Avago in December 2013, we discontinued share repurchases and our quarterly dividend. We ended the first quarter of 2014 with cash and cash equivalents, together with short-term investments, of \$883.3 million, compared to \$809.8 million at the end of 2013.

RESULTS OF OPERATIONS**Revenues**

| | Three Months Ended | | | % Change |
|----------|------------------------------|-----------------------|------------------|-----------------|
| | March 30, 2014 | March 31, 2013 | \$ Change | |
| | (Dollars in millions) | | | |
| Revenues | \$ 569.1 | \$ 568.6 | \$ 0.5 | 0.1% |

Revenues were essentially flat as increased sales from the ramping of PCIe flash memory-based storage products and increased unit sales of semiconductors used in hard disk drives in the first quarter of 2014 were partially offset by lower unit sales of semiconductors used in our older networking products and lower unit sales of flash controllers.

Significant Customers:

The following table provides information about sales to Seagate, which was our only customer that accounted for 10% or more of our revenues in each of the three months ended March 30, 2014 and March 31, 2013:

| | Three Months Ended | |
|------------------------|---------------------------|-----------------------|
| | March 30, 2014 | March 31, 2013 |
| Percentage of revenues | 21% | 27% |

Table of Contents***Revenues by Geography:***

The following table summarizes our revenues by geography based on the ordering location of the customer. Because we sell our products primarily to other sellers of technology products and not to end users, the information in the table below may not accurately reflect geographic end-user demand for our products.

| | Three Months Ended | | | |
|----------------------------|------------------------------|-----------------------|------------------|-----------------|
| | March 30, 2014 | March 31, 2013 | \$ Change | % Change |
| | (Dollars in millions) | | | |
| North America* | \$ 148.4 | \$ 146.6 | \$ 1.8 | 1.2% |
| Asia | 353.7 | 373.9 | (20.2) | (5.4)% |
| Europe and the Middle East | 67.0 | 48.1 | 18.9 | 39.3% |
| Total | \$ 569.1 | \$ 568.6 | \$ 0.5 | 0.1% |

* Primarily the United States.

The increase in revenues in North America was primarily attributable to increased sales from the ramping of PCIe flash memory-based storage products. The decrease in revenues in Asia was primarily attributable to lower unit sales of flash controllers and lower unit sales of semiconductors used in our older networking products, offset in part by increased unit sales of semiconductors used in hard disk drives. The increase in revenues in Europe and the Middle East was primarily due to higher unit sales of flash controllers.

Revenues by Product Groups:

The following table presents our revenues by product groups:

| | Three Months Ended | | | |
|---------------------|------------------------------|-----------------------|------------------|-----------------|
| | March 30, 2014 | March 31, 2013 | \$ Change | % Change |
| | (Dollars in millions) | | | |
| Storage products | \$ 446.8 | \$ 437.9 | \$ 8.9 | 2.0% |
| Networking products | 84.1 | 92.6 | (8.5) | (9.2)% |
| Other | 38.2 | 38.1 | 0.1 | 0.3% |
| Total | \$ 569.1 | \$ 568.6 | \$ 0.5 | 0.1% |

The increase in revenues from storage products was attributable to increased unit sales from the ramping of PCIe flash memory-based storage products and increased unit sales of semiconductors used in hard disk drives in the first quarter of 2014. The increase was partially offset by lower unit sales of flash controllers.

The decrease in revenues from networking products was primarily the result of lower unit sales of semiconductors used in our older networking products.

Other revenues consist primarily of fees from the licensing of our intellectual property.

Gross Profit Margin

| | Three Months Ended | | | |
|---------------------|------------------------------|-----------------------|-------------------------------|-----------------------|
| | Dollar Amount | | Percentage of Revenues | |
| | March 30, 2014 | March 31, 2013 | March 30, 2014 | March 31, 2013 |
| | (Dollars in millions) | | | |
| Gross profit margin | \$ 291.1 | \$ 289.5 | 51.2% | 50.9% |

Various factors affect and may continue to affect our product gross margin. These factors include, but are not limited to, changes in our production mix and volume of product sales, the timing of production ramps and margin structures for new products, the positions of our products in their life cycles, the effects of competition, the price of commodities used in our products, provisions for excess and obsolete inventories, changes in the costs charged by foundry, assembly and test subcontractors, and amortization of acquired intangible assets.

The 0.3% increase in gross profit margin as a percentage of revenues was primarily attributable to lower commodity costs used in manufacturing our products, offset in part by increased revenues from lower margin products.

ended March 31, 2013 primarily for litigation settlements.

Interest Income and Other, net

The following table summarizes components of interest income and other, net:

| | Three Months Ended | | | % Change |
|-------------------|------------------------------|-----------------------|------------------|-----------------|
| | March 30, 2014 | March 31, 2013 | \$ Change | |
| | (Dollars in millions) | | | |
| Interest income | \$ 1.5 | \$ 0.3 | \$ 1.2 | 400.0% |
| Other income, net | 1.2 | 7.6 | (6.4) | (84.2)% |
| Total | \$ 2.7 | \$ 7.9 | \$ (5.2) | (65.8)% |

The increase in interest income primarily resulted from higher interest rates on investments in the first quarter of 2014 as compared to the first quarter of 2013.

Other income, net for the three months ended March 31, 2013 primarily included \$6.1 million of insurance proceeds we received for covered losses related to the 2011 Thailand flooding.

Table of Contents

Income Taxes

We recorded income tax benefits of \$5.2 million and \$2.3 million for the three months ended March 30, 2014 and March 31, 2013, respectively.

The income tax benefit for the three months ended March 30, 2014 included a reversal of \$11.2 million of liabilities for uncertain tax positions, which included previously unrecognized tax benefits of \$5.7 million and interest and penalties of \$5.5 million, as a result of the expiration of statutes of limitations in multiple jurisdictions and the settlement of an audit.

The income tax benefit for the three months ended March 31, 2013 included a reversal of \$8.6 million of liabilities for uncertain tax positions, which included previously unrecognized tax benefits of \$3.8 million and interest and penalties of \$4.8 million, as a result of the expiration of statutes of limitations in multiple jurisdictions.

We compute our tax provision using an estimated annual tax rate. We exclude certain loss jurisdictions from the computation of the estimated annual rate when no benefit can be realized on those losses. Historically, we have sustained losses from our U.S. operations and, as a result, have maintained a full valuation allowance against U.S. net deferred tax assets. We do not believe there is sufficient positive evidence to reach a conclusion that it is more likely than not that we will generate sufficient future taxable income in the U.S. to realize the benefits of our deferred tax assets. Depending on future results and projected trends, it is reasonably possible that we may determine in the foreseeable future that it is more likely than not that a significant portion of our U.S. deferred tax assets will be realized, resulting in a release of a significant portion of the valuation allowance.

FINANCIAL CONDITION, CAPITAL RESOURCES AND LIQUIDITY

Cash, cash equivalents, short-term investments and cash generated from our operations are our primary sources of liquidity. Short-term investments consist primarily of U.S. government and agency securities. We believe that our existing liquid resources and cash generated from operations will be adequate to meet our operating and capital requirements and other obligations for more than the next 12 months. We may, however, find it desirable to obtain additional debt or equity financing. Such financing may not be available to us at all or on acceptable terms if we determine that it would be desirable to obtain additional financing.

Cash, cash equivalents and short-term investments increased to \$883.3 million as of March 30, 2014 from \$809.8 million as of December 31, 2013. The increase was mainly due to cash inflows generated from operating and financing activities, offset in part by purchases of property and equipment as described below.

Working Capital

Working capital increased by \$101.9 million to \$927.5 million as of March 30, 2014 from \$825.6 million as of December 31, 2013. The increase was primarily attributable to the following:

Cash, cash equivalents and short-term investments increased by \$73.5 million primarily due to net cash provided by operating activities of \$43.0 million and proceeds from issuances of common stock of \$52.0 million, offset in part by \$20.5 million used for purchases of property and equipment;

Edgar Filing: LSI CORP - Form 10-Q

Accrued salaries, wages and benefits decreased by \$23.8 million primarily due to the timing of payments for salaries, benefits and performance-based compensation;

Prepaid expenses and other current assets increased by \$13.4 million primarily as a result of the timing of certain prepayments and other receivables;

Inventories increased by \$5.6 million as a result of increased inventory purchases to support expected demand in the second quarter of 2014; and

Other accrued liabilities decreased by \$4.6 million primarily due to the utilization of restructuring reserves. These increases in working capital were offset in part by a decrease in accounts receivable of \$19.6 million primarily as a result of lower shipments toward the end of the first quarter of 2014 as compared to the fourth quarter of 2013.

Working capital decreased by \$18.6 million to \$691.3 million as of March 31, 2013 from \$709.9 million as of December 31, 2012. The decrease was attributable to the following:

Accounts receivable decreased by \$40.9 million primarily as a result of decreased revenues in the first quarter of 2013 as compared to the fourth quarter of 2012;

Inventories decreased by \$25.3 million, which primarily reflects our continued proactive management of inventory levels;

Table of Contents

Cash, cash equivalents and short-term investments decreased by \$17.5 million primarily due to \$60.8 million used to repurchase our common stock; \$30.0 million used for purchases of investments, net of proceeds from maturities and sales; and \$25.0 million used for purchases of property and equipment, net of proceeds from sales, offset in part by net cash provided by operating activities of \$62.8 million and proceeds from issuances of common stock of \$8.2 million; and

Prepaid expenses and other current assets decreased by \$10.3 million primarily as a result of decreases in prepaid software maintenance.

These decreases in working capital were offset in part by the following:

Accounts payable decreased by \$39.4 million primarily due to a decrease in inventory purchases and the timing of invoice receipts and payments;

Accrued salaries, wages and benefits decreased by \$24.8 million primarily as a result of the timing of payments for salaries, benefits and performance-based compensation; and

Other accrued liabilities decreased by \$11.2 million primarily due to the utilization of restructuring reserves and decreases in tax and other accruals.

Operating Activities

During the three months ended March 30, 2014, we generated \$43.0 million of cash from operating activities as a result of the following:

Net income adjusted for non-cash items and other non-operating adjustments, which are quantified in our statements of cash flows included in Item 1;

Offset in part by a net decrease of \$58.0 million in assets and liabilities, including changes in working capital components, from December 31, 2013 to March 30, 2014, as discussed above.

During the three months ended March 31, 2013, we generated \$62.8 million of cash from operating activities as a result of the following:

Net income adjusted for non-cash items and other non-operating adjustments, which are quantified in our statements of cash flows included in Item 1;

Offset in part by a net decrease of \$32.6 million in assets and liabilities, including changes in working capital components, from December 31, 2012 to March 31, 2013, as discussed above.

Investing Activities

Cash provided by investing activities for the three months ended March 30, 2014 was \$4.8 million. Our investing activities during the three months ended March 30, 2014 were the following:

Proceeds from maturities and sales of available-for-sale debt securities and other investments, net of purchases, of \$25.3 million;

Substantially offset by purchases of property and equipment, net of proceeds from sales, totaling \$20.5 million.

Cash used in investing activities for the three months ended March 31, 2013 was \$55.0 million. Our investing activities during the three months ended March 31, 2013 were the following:

Purchases of available-for-sale debt securities and other investments, net of proceeds from maturities and sales, of \$30.0 million; and

Purchases of property and equipment, net of proceeds from sales, totaling \$25.0 million.

We expect capital expenditures to be approximately \$55 million in 2014. We use semiconductor foundries and outside assembly and test companies to manufacture products, which enable us to have access to advanced manufacturing capacity without significant capital spending requirements.

Table of Contents**Financing Activities**

Cash provided by financing activities for the three months ended March 30, 2014 was \$52.0 million, representing cash received from issuances of common stock under our employee stock plans.

Cash used in financing activities for the three months ended March 31, 2013 was \$52.6 million. This amount included \$60.8 million used to repurchase our common stock, offset in part by \$8.2 million of cash received from issuances of common stock under our employee stock plans.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations as of March 30, 2014:

| | Payments Due by Period | | | | | Total |
|-----------------------------|------------------------|----------------|----------------|---------------|----------------|-----------------|
| | Less Than 1 Year | 1-3 Years | 4-5 Years | After 5 Years | Other | |
| | (In millions) | | | | | |
| Operating lease obligations | \$ 31.1 | \$ 25.7 | \$ 13.7 | \$ 2.5 | \$ | \$ 73.0 |
| Purchase commitments | 351.2 | 21.9 | 3.0 | | | 376.1 |
| Pension contributions | 64.9 | * | * | * | * | 64.9 |
| Uncertain tax positions | | | | | 63.7** | 63.7 |
| Total | \$ 447.2 | \$ 47.6 | \$ 16.7 | \$ 2.5 | \$ 63.7 | \$ 577.7 |

* We have pension plans covering certain U.S. and international employees. Although additional future contributions will be required, the amount and timing of these contributions will be affected by actuarial assumptions, the actual rate of return on plan assets, the level of market interest rates, legislation changes and the amount of voluntary contributions to the plans. The amount shown in the table represents our planned contributions to our pension plans during the remainder of 2014. Because any contributions for 2015 and later will depend on the value of the plan assets in the future and thus are uncertain, we have not included any amounts for 2015 and beyond in the above table.

** This amount represents the non-current tax payable obligation. We are unable to make a reasonably reliable estimate as to when cash settlement with a taxing authority may occur.

Operating Lease Obligations

We lease real estate and certain non-manufacturing equipment under non-cancellable operating leases. We also include non-cancellable obligations under certain software licensing arrangements in this category.

Purchase Commitments

We maintain purchase commitments with certain suppliers, primarily for raw materials and manufacturing services and for some non-production items. Purchase commitments for inventory materials are generally restricted to a forecasted time horizon as mutually agreed upon between the parties. This forecasted time horizon can vary for different suppliers.

Uncertain Tax Positions

As of March 30, 2014, we had \$185.8 million of unrecognized tax benefits, for which we are unable to make a reasonably reliable estimate as to when cash settlement with a taxing authority may occur. It is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease in the next 12 months. Such changes could occur based on the normal expiration of statutes of limitations, the possible conclusion of ongoing tax audits in various jurisdictions around the world or other negotiations with tax authorities. If those events occur within the next 12 months, we estimate that the unrecognized tax benefits, plus accrued interest and penalties, could decrease by up to \$17.1 million.

Standby Letters of Credit

We had outstanding obligations relating to standby letters of credit of \$6.1 million and \$4.0 million, respectively, as of March 30, 2014 and December 31, 2013. Standby letters of credit are financial guarantees provided by third parties for leases, customs, taxes and certain self-insured risks. If the guarantees are called, we must reimburse the provider of the guarantee. The fair value of the letters of credit approximates the contract amounts. The standby letters of credit generally renew annually.

Table of Contents

CRITICAL ACCOUNTING POLICIES

There have been no significant changes in our critical accounting estimates or significant accounting policies during the three months ended March 30, 2014 as compared to the discussion in Part II, Item 7 and in Note 2 to our financial statements in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2013.

RECENT ACCOUNTING PRONOUNCEMENT

The information is included in Note 1 to our financial statements in Part I, Item 1 under the heading Recent Accounting Pronouncement.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

There have been no significant changes in the market risk disclosures during the three months ended March 30, 2014 as compared to the discussion in Part II, Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2013.

Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures: The Securities and Exchange Commission defines the term disclosure controls and procedures to mean a company's controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or furnishes under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required or necessary disclosures. Our chief executive officer and chief financial officer have concluded, based on the evaluation of the effectiveness of the disclosure controls and procedures by our management with the participation of our chief executive officer and chief financial officer, as of the end of the period covered by this report, that our disclosure controls and procedures were effective for this purpose.

Changes in Internal Control: During the first quarter of 2014, there were no changes in our internal control over financial reporting that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

None.

Item 1A. *Risk Factors*

Set forth below are risks and uncertainties, many of which are discussed in greater detail in our Annual Report on Form 10-K for the year ended December 31, 2013, that, if they were to occur, could materially adversely affect our business or could cause our actual results to differ materially from the results contemplated by the forward-looking statements in this report and other public statements we make:

The announcement and pendency of our agreement to be acquired by Avago may have an adverse effect on our business.

The failure to complete the merger with Avago may adversely affect our business.

We depend on a small number of customers. The loss of, or a significant reduction in revenues from, any of these customers would harm our results of operations.

A significant portion of our revenues is derived from the sale of products for use in hard disk drives and dynamics in that industry as well as competing technologies could have an adverse impact on our revenues.

We operate in intensely competitive markets, and our failure to compete effectively would harm our results of operations.

Customer orders and ordering patterns can change quickly, making it difficult for us to predict our revenues and making it possible that our actual revenues may vary materially from our expectations, which could harm our results of operations and stock price.

Table of Contents

We depend on outside suppliers to manufacture, assemble, package and test our products; accordingly, any failure to secure and maintain sufficient manufacturing capacity at attractive prices or to maintain the quality of our products could harm our business and results of operations.

Failure to qualify our semiconductor products or our suppliers' manufacturing lines with key customers could harm our business and results of operations.

We are seeking to expand our business by selling to new types of customers and may be unsuccessful in doing so, which could have a negative impact on our results of operations.

If we fail to keep pace with technological advances, or if we pursue technologies that do not become commercially accepted, customers may not buy our products and our results of operations may be harmed.

Any defects in our products could harm our reputation, customer relationships and results of operations.

Our pension plans are underfunded, and may require significant future contributions, which could have an adverse impact on our business.

We may be subject to intellectual property infringement claims and litigation, which could cause us to incur significant expenses or prevent us from selling our products.

If we are unable to protect or assert our intellectual property rights, our business and results of operations may be harmed.

Volatility in the price of commodities used in the production of our products or lack of availability of these materials could negatively impact our results of operations.

We are exposed to legal, business, political and economic risks associated with our international operations.

We use indirect channels of product distribution over which we have limited control.

We have engaged, and may in the future engage, in acquisitions and strategic alliances, which may disrupt our business or may not be successful and could harm our business and operating results.

The semiconductor industry is highly cyclical, which may cause our operating results to fluctuate.

Our failure to attract, retain and motivate key employees could harm our business.

Our operations and our suppliers' operations are subject to natural disasters and other events outside of our control that may disrupt our business and harm our operating results.

Class action litigation due to stock price volatility or other factors could cause us to incur substantial costs and divert our management's attention and resources.

Laws and regulations to which we are subject, as well as customer requirements in the area of environmental protection and social responsibility, could impose substantial costs on us and may adversely affect our business.

We rely on our information technology systems to run our business and any failure of these systems or any malicious intrusion into those systems could result in harm to our business, results of operations and financial condition.

Our blank check preferred stock and Delaware law contain provisions that may inhibit potential acquisition bids, which may harm our stock price, discourage merger offers or prevent changes in our management.

Item 6. Exhibits

See the Exhibit Index, which follows the signature page to this report.

Table of Contents

SIGNATURES

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

LSI CORPORATION
(Registrant)

Date: May 1, 2014

By /s/ Bryon Look
Bryon Look
Executive Vice President, Chief Financial Officer
and

Chief Administrative Officer

Table of Contents

EXHIBIT INDEX

| | |
|---------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350 |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350 |
| 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 |