SILICON LABORATORIES INC
Form 10-Q
August 01, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 2, 2011

or

o 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: 000-29823

SILICON LABORATORIES INC.

(Exact name of registrant as specified in its charter)

Delaware	**74-2793174**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
400 West Cesar Chavez, Austin, Texas	**78701**
(Address of principal executive offices)	(Zip Code)

(512) 416-8500

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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. x Yes o 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). x Yes o No

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

As of July 20, 2011, 44,257,508 shares of common stock of Silicon Laboratories Inc. were outstanding.

Table of Contents

Cautionary Statement

Except for the historical financial information contained herein, the matters discussed in this report on Form 10-Q (as well as documents incorporated herein by reference) may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include declarations regarding the intent, belief or current expectations of Silicon Laboratories Inc. and its management and may be signified by the words believe, estimate, expect, intend, anticipate, plan, project, will or similar language. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Factors that could cause or contribute to such differences include those discussed under Risk Factors and elsewhere in this report. Silicon Laboratories disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

Silicon Laboratories Inc.

Condensed Consolidated Balance Sheets

(In thousands, except per share data)

(Unaudited)

		July 2, 2011		January 1, 2011
Assets				
Current assets:				
Cash and cash equivalents	$	134,824	$	138,567
Short-term investments		198,766		227,295
Accounts receivable, net of allowance for doubtful accounts of $727 at July 2, 2011 and $772 at January 1, 2011		70,351		45,030
Inventories		38,097		39,450
Deferred income taxes		10,271		9,140
Prepaid expenses and other current assets		34,499		34,447
Total current assets		486,808		493,929
Long-term investments		17,196		17,500
Property and equipment, net		28,399		29,945
Goodwill		117,215		112,296
Other intangible assets, net		66,280		53,242
Other assets, net		28,359		20,746
Total assets	$	744,257	$	727,658
Liabilities and Stockholders Equity				
Current liabilities:				
Accounts payable	$	26,064	$	24,433
Accrued expenses		26,944		25,604
Deferred income on shipments to distributors		32,034		26,127
Income taxes		1,102		3,692
Total current liabilities		86,144		79,856
Long-term obligations and other liabilities		21,521		22,372
Total liabilities		107,665		102,228
Commitments and contingencies				
Stockholders equity:				
Preferred stock $0.0001 par value; 10,000 shares authorized; no shares issued and outstanding				
Common stock $0.0001 par value; 250,000 shares authorized; 44,292 and 43,933 shares issued and outstanding at July 2, 2011 and January 1, 2011, respectively		4		4
Additional paid-in capital		49,041		49,947
Retained earnings		590,539		579,127
Accumulated other comprehensive loss		(2,992)		(3,648)
Total stockholders equity		636,592		625,430
Total liabilities and stockholders equity	$	744,257	$	727,658

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

Table of Contents

Silicon Laboratories Inc.

Condensed Consolidated Statements of Income

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Revenues	$ 126,197	$ 134,577	$ 245,833	$ 261,296
Cost of revenues	49,985	43,684	97,463	86,813
Gross margin	76,212	90,893	148,370	174,483
Operating expenses:				
Research and development	34,173	30,509	69,533	60,431
Selling, general and administrative	26,055	29,737	57,914	57,740
Operating expenses	60,228	60,246	127,447	118,171
Operating income	15,984	30,647	20,923	56,312
Other income (expense):				
Interest income	473	633	1,044	1,299
Interest expense	(5)	(22)	(10)	(45)
Other income (expense), net	164	(586)	373	(883)
Income before income taxes	16,616	30,672	22,330	56,683
Provision for income taxes	3,244	9,625	10,918	14,557
Net income	$ 13,372	$ 21,047	$ 11,412	$ 42,126
Earnings per share:				
Basic	$ 0.30	$ 0.46	$ 0.26	$ 0.92
Diluted	$ 0.29	$ 0.44	$ 0.25	$ 0.88
Weighted-average common shares outstanding:				
Basic	44,602	45,387	44,435	45,602
Diluted	45,951	47,371	45,998	47,649

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

Table of Contents

Silicon Laboratories Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended	
	July 2, 2011	July 3, 2010
Operating Activities		
Net income	$ 11,412	$ 42,126
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation of property and equipment	6,680	5,821
Amortization of other intangible assets and other assets	6,077	3,651
Stock-based compensation expense	18,074	20,931
Income tax benefit from employee stock-based awards	2,083	2,523
Excess income tax benefit from employee stock-based awards	(1,963)	(1,784)
Deferred income taxes	181	(319)
Changes in operating assets and liabilities:		
Accounts receivable	(23,562)	(19,946)
Inventories	2,022	2,537
Prepaid expenses and other assets	(1,021)	3,208
Accounts payable	259	3,015
Accrued expenses	(2,841)	(4,445)
Deferred income on shipments to distributors	5,157	483
Income taxes	3,672	(5,268)
Net cash provided by operating activities	26,230	52,533
Investing Activities		
Purchases of available-for-sale investments	(75,856)	(216,385)
Proceeds from sales and maturities of marketable securities	104,831	158,944
Purchases of property and equipment	(5,058)	(3,311)
Purchases of other assets	(665)	(6,917)
Acquisitions of businesses, net of cash acquired	(27,262)	(18,351)
Net cash used in investing activities	(4,010)	(86,020)
Financing Activities		
Proceeds from issuance of common stock, net of shares withheld for taxes	2,489	17,244
Excess income tax benefit from employee stock-based awards	1,963	1,784
Repurchases of common stock	(23,241)	(100,309)
Payments on debt	(7,174)	
Net cash used in financing activities	(25,963)	(81,281)
Decrease in cash and cash equivalents	(3,743)	(114,768)
Cash and cash equivalents at beginning of period	138,567	195,737
Cash and cash equivalents at end of period	$ 134,824	$ 80,969

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

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The Condensed Consolidated Financial Statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the condensed consolidated financial position of Silicon Laboratories Inc. and its subsidiaries (collectively, the Company) at July 2, 2011 and January 1, 2011, the condensed consolidated results of its operations for the three and six months ended July 2, 2011 and July 3, 2010, and the Condensed Consolidated Statements of Cash Flows for the six months ended July 2, 2011 and July 3, 2010. All intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated results of operations for the three and six months ended July 2, 2011 are not necessarily indicative of the results to be expected for the full year.

The accompanying unaudited Condensed Consolidated Financial Statements do not include certain footnotes and financial presentations normally required under U.S. generally accepted accounting principles (GAAP). Therefore, these Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto for the year ended January 1, 2011, included in the Company s Form 10-K filed with the Securities and Exchange Commission (SEC) on February 10, 2011.

The Company prepares financial statements on a 52-53 week year that ends on the Saturday closest to December 31. Fiscal 2011 will have 52 weeks and fiscal 2010 had 52 weeks. In a 52-week year, each fiscal quarter consists of 13 weeks.

Revenue Recognition

Revenues are generated almost exclusively by sales of the Company s integrated circuits (ICs). The Company recognizes revenue when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists, 2) delivery of goods has occurred, 3) the sales price is fixed or determinable, and 4) collectibility is reasonably assured. Generally, revenue from product sales to direct customers and contract manufacturers is recognized upon shipment.

A portion of the Company s sales are made to distributors under agreements allowing certain rights of return and price protection related to the final selling price to the end customers. Accordingly, the Company defers revenue and cost of revenue on such sales until the distributors sell the product to the end customers. The net balance of deferred revenue less deferred cost of revenue associated with inventory shipped to a distributor but not yet sold to an end customer is recorded in the deferred income on shipments to distributors liability on the Consolidated Balance Sheet. Such net deferred income balance reflects the Company s estimate of the impact of rights of return and price protection.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Update (ASU) No. 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*. This ASU requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and is to be applied retrospectively. The adoption of this ASU is not expected to have a material impact on the Company s financial statements.

In May 2011, the FASB issued FASB ASU No. 2011-04, *Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* This ASU provides a consistent definition of fair value between U.S. GAAP and International Financial Reporting Standards. Additionally, the ASU changes certain fair value measurement principles and expands the disclosures for fair value measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and is to be applied prospectively. The adoption of this ASU is not expected to have a material impact on the Company s financial statements.

2. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	July 2, 2011	**July 3, 2010**	**July 2, 2011**	**July 3, 2010**
Net income	$ 13,372	$ 21,047	$ 11,412	$ 42,126
Shares used in computing basic earnings per share	44,602	45,387	44,435	45,602
Effect of dilutive securities:				
Stock options and awards	1,349	1,984	1,563	2,047
Shares used in computing diluted earnings per share	45,951	47,371	45,998	47,649
Earnings per share:				
Basic	$ 0.30	$ 0.46	$ 0.26	$ 0.92

Diluted	$ 0.29	$ 0.44	$ 0.25	$ 0.88

Approximately 0.5 million, 0.6 million, 0.4 million and 0.6 million weighted-average dilutive potential shares of common stock have been excluded from the earnings per share calculation for the three months ended July 2, 2011 and July 3, 2010, and for the six months ended July 2, 2011 and July 3, 2010, respectively, as they were anti-dilutive.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Cash, Cash Equivalents and Investments

The Company s cash equivalents and short-term investments as of July 2, 2011 consisted of money market funds, corporate bonds, municipal bonds, variable-rate demand notes, U.S. Treasury bills, U.S. government agency bonds and discount notes, international government bonds, commercial paper and certificates of deposit. The Company s long-term investments consist of auction-rate securities. Early in fiscal 2008, auctions for many of the Company s auction-rate securities failed because sell orders exceeded buy orders. As of July 2, 2011, the Company held $19.4 million par value auction-rate securities, all of which have experienced failed auctions. The underlying assets of the securities consisted of student loans and municipal bonds, of which $17.4 million were guaranteed by the U.S. government and the remaining $2.0 million were privately insured. As of July 2, 2011, $17.4 million of the auction-rate securities had credit ratings of AAA and $2.0 million had a credit rating of A. These securities have contractual maturity dates ranging from 2029 to 2046 and with current yields of 0.19% to 3.15% per year at July 2, 2011. The Company is receiving the underlying cash flows on all of its auction-rate securities. The principal amounts associated with failed auctions are not expected to be accessible until a successful auction occurs, the issuer redeems the securities, a buyer is found outside of the auction process or the underlying securities mature. The Company is unable to predict if these funds will become available before their maturity dates.

The Company does not expect to need access to the capital represented by any of its auction-rate securities prior to their maturities. The Company does not intend to sell, and believes it is not more likely than not that it will be required to sell, its auction-rate securities before their anticipated recovery in market value or final settlement at the underlying par value. The Company believes that the credit ratings and credit support of the security issuers indicate that they have the ability to settle the securities at par value. As such, the Company has determined that no other-than-temporary impairment losses existed as of July 2, 2011.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Company s cash, cash equivalents and investments consist of the following (in thousands):

	July 2, 2011			
	Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Cash and Cash Equivalents:				
Cash on hand	$ 34,590			$ 34,590
Available-for-sale securities:				
Money market funds	98,736	$	$	98,736
U.S. government agency	1,000	(2)		998
U.S. Treasury bills	500			500
Total available-for-sale securities	100,236	(2)		100,234
Total cash and cash equivalents	$ 134,826	$ (2)	$	$ 134,824
Short-term Investments:				
Available-for-sale securities:				
Corporate bonds	$ 80,806	$ (17)	$ 443	$ 81,232
Municipal bonds	47,342	(3)	115	47,454
Variable-rate demand notes	36,725			36,725
U.S. Treasury bills	11,898			11,898
U.S. government agency	10,043		27	10,070
International government bonds	7,815	(1)	5	7,819
Commercial paper	1,998			1,998
Certificates of deposit	1,570			1,570
Total short-term investments	$ 198,197	$ (21)	$ 590	$ 198,766
Long-term Investments:				
Available-for-sale securities:				
Auction rate securities	$ 19,425	$ (2,229)	$	$ 17,196
Total long-term investments	$ 19,425	$ (2,229)	$	$ 17,196

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

	January 1, 2011			
	Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Cash and Cash Equivalents:				
Cash on hand	$ 40,644			$ 40,644
Available-for-sale securities:				
U.S. Treasury bills	50,096	$	$ 1	50,097
Money market funds	45,167			45,167
Commercial paper	2,659			2,659
Total available-for-sale securities	97,922		1	97,923
Total cash and cash equivalents	$ 138,566	$	$ 1	$ 138,567
Short-term Investments:				
Available-for-sale securities:				
Corporate bonds	$ 88,183	$ (46)	$ 381	$ 88,518
Variable-rate demand notes	39,425			39,425
Municipal bonds	38,408	(18)	24	38,414
U.S. government agency	34,635	(5)	50	34,680
International government bonds	10,792		38	10,830
U.S. Treasury bills	6,998		1	6,999
Certificates of deposit	5,744	(2)		5,742
Commercial paper	2,687			2,687
Total short-term investments	$ 226,872	$ (71)	$ 494	$ 227,295
Long-term Investments:				
Available-for-sale securities:				
Auction rate securities	$ 19,725	$ (2,225)	$	$ 17,500
Total long-term investments	$ 19,725	$ (2,225)	$	$ 17,500

The available-for-sale investments that were in a continuous unrealized loss position, aggregated by length of time that individual securities have been in a continuous loss position, were as follows (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
As of July 2, 2011	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Auction rate securities	$	$	$ 17,196	$ (2,229)	$ 17,196	$ (2,229)
Municipal bonds	6,354	(3)			6,354	(3)
Corporate bonds	6,279	(17)			6,279	(17)
International government bonds	5,014	(1)			5,014	(1)
U.S. government agency	6,003	(2)			6,003	(2)
	$ 23,650	$ (23)	$ 17,196	$ (2,229)	$ 40,846	$ (2,252)

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

As of January 1, 2011	Less Than 12 Months Fair Value	Less Than 12 Months Gross Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
Municipal bonds	$ 22,272	$ (18)	$	$	$ 22,272	$ (18)
Corporate bonds	17,538	(44)	1,298	(2)	18,836	(46)
Auction rate securities			17,500	(2,225)	17,500	(2,225)
U.S. government agency	17,007	(5)			17,007	(5)
Certificates of deposit	1,569	(2)			1,569	(2)
	$ 58,386	$ (69)	$ 18,798	$ (2,227)	$ 77,184	$ (2,296)

The gross unrealized losses as of July 2, 2011 and January 1, 2011 were due primarily to the illiquidity of the Company s auction-rate securities and, to a lesser extent, to changes in market interest rates.

The following summarizes the contractual underlying maturities of the Company s available-for-sale investments at July 2, 2011 (in thousands):

	Cost	Fair Value
Due in one year or less	$ 199,095	$ 199,279
Due after one year through ten years	63,813	64,196
Due after ten years	54,950	52,721
	$ 317,858	$ 316,196

4. Derivative Financial Instruments

The Company is exposed to interest rate fluctuations in the normal course of its business, including through its corporate headquarters leases. The base rents for these leases are calculated using a variable interest rate based on the three-month LIBOR. The Company has entered into interest rate swap agreements with notional values of $44.3 million and $50.1 million and, effectively, fixed the rent payment amounts on these leases through March 2011 and March 2013, respectively. The Company s swap agreement with a notional value of $44.3 million matured in March 2011 and was not renewed. The Company s objective in entering into such swap agreements was to offset increases and decreases in expenses resulting from changes in interest rates with losses and gains on the derivative contracts, thereby reducing volatility of earnings. The Company does not use derivative contracts for speculative purposes.

The interest rate swap agreements are designated and qualify as cash flow hedges. The effective portion of the gain or loss on interest rate swaps is recorded in accumulated other comprehensive loss as a separate component of stockholders equity and is subsequently recognized in earnings when the hedged exposure affects earnings. Cash flows from derivatives are classified as cash flows from operating activities in the

Consolidated Statement of Cash Flows.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Company estimates the fair values of derivatives based on quoted prices and market observable data of similar instruments. If the lease agreements or the interest rate swap agreements are terminated prior to maturity, the fair value of the interest rate swaps recorded in accumulated other comprehensive loss may be recognized in the Consolidated Statement of Income based on an assessment of the agreements at the time of termination. The Company did not discontinue any cash flow hedges in any of the periods presented.

The Company measures the effectiveness of its cash flow hedges by comparing the change in fair value of the hedged item with the change in fair value of the interest rate swap. The Company recognizes ineffective portions of the hedge, as well as amounts not included in the assessment of effectiveness, in the Consolidated Statement of Income. As of July 2, 2011, no portion of the gains or losses from the Company s hedging instrument was excluded from the assessment of effectiveness. There was no hedge ineffectiveness for any of the periods presented.

The Company s derivative financial instrument consisted of the following (in thousands):

	July 2, 2011		
	Balance Sheet Location		**Fair Value**
Interest rate swap:	Long-term obligations and other liabilities	$	2,941

The before-tax effect of derivative instruments in cash flow hedging relationships was as follows (in thousands):

	Loss Recognized in OCI on Derivatives (Effective Portion) during the: Three Months Ended				**Location of Loss Reclassified into Income**	**Loss Reclassified from Accumulated OCI into Income (Effective Portion) during the: Three Months Ended**			
	July 2, 2011		**July 3, 2010**			**July 2, 2011**		**July 3, 2010**	
Interest rate swaps	$	(405)	$	(1,035)	Rent expense	$	(473)	$	(850)
	Six Months Ended					**Six Months Ended**			
	July 2, 2011		**July 3, 2010**			**July 2, 2011**		**July 3, 2010**	
Interest rate swaps	$	(427)	$	(1,898)	Rent expense	$	(1,297)	$	(1,690)

The Company expects to reclassify $1.8 million of its interest rate swap losses included in accumulated other comprehensive loss as of July 2, 2011 into earnings in the next 12 months, which is offset by lower rent payments.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The Company s interest rate swap agreement contains provisions that require it to maintain unencumbered cash and highly-rated short-term investments of at least $150 million. If the Company s unencumbered cash and highly-rated short-term investments are less than $150 million, it would be required to post collateral with the counterparty in the amount of the fair value of the interest rate swap agreements in net liability positions. The Company s interest rate swap was in a net liability position at July 2, 2011. No collateral has been posted with the counterparty as of July 2, 2011.

5. Fair Value of Financial Instruments

The fair values of the Company s financial instruments are recorded using a hierarchal disclosure framework based upon the level of subjectivity of the inputs used in measuring assets and liabilities. The three levels are described below:

Level 1 - Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 - Inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - Inputs are unobservable for the asset or liability and are developed based on the best information available in the circumstances, which might include the Company s own data.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The following summarizes the valuation of the Company s financial instruments (in thousands). The tables do not include either cash on hand or assets and liabilities that are measured at historical cost or any basis other than fair value.

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements at July 2, 2011 Using Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Cash Equivalents:				
Money market funds	$ 98,736	$	$	$ 98,736
U.S. government agency	998			998
Commercial paper	500			500
Total cash equivalents	$ 100,234	$	$	$ 100,234
Short-term Investments:				
Corporate bonds	$ 81,232	$	$	$ 81,232
Municipal bonds	47,454			47,454
Variable-rate demand notes	36,725			36,725
U.S. Treasury bills	11,898			11,898
U.S. government agency	10,070			10,070
International government bonds	7,819			7,819
Commercial paper	1,998			1,998
Certificates of deposit	1,570			1,570
Total short-term investments	$ 198,766	$	$	$ 198,766
Long-term Investments:				
Auction rate securities	$	$	$ 17,196	$ 17,196
Total long-term investments	$	$	$ 17,196	$ 17,196
Total	$ 299,000	$	$ 17,196	$ 316,196
Liabilities:				
Derivative instruments	$	$ 2,941	$	$ 2,941
Contingent consideration			2,034	2,034
Total	$	$ 2,941	$ 2,034	$ 4,975

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

	Fair Value Measurements at January 1, 2011 Using			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets:				
Cash Equivalents:				
U.S. Treasury bills	$ 50,097	$	$	$ 50,097
Money market funds	45,167			45,167
Commercial paper	2,659			2,659
Total cash equivalents	$ 97,923	$	$	$ 97,923
Short-term Investments:				
Corporate bonds	$ 88,518	$	$	$ 88,518
Variable-rate demand notes	39,425			39,425
Municipal bonds	38,414			38,414
U.S. government agency	34,680			34,680
International government bonds	10,830			10,830
U.S. Treasury bills	6,999			6,999
Certificates of deposit	5,742			5,742
Commercial paper	2,687			2,687
Total short-term investments	$ 227,295	$	$	$ 227,295
Long-term Investments:				
Auction rate securities	$	$	$ 17,500	$ 17,500
Total long-term investments	$	$	$ 17,500	$ 17,500
Total	$ 325,218	$	$ 17,500	$ 342,718
Liabilities:				
Derivative instruments	$	$ 3,811	$	$ 3,811
Contingent consideration			1,780	1,780
Total	$	$ 3,811	$ 1,780	$ 5,591

The Company s cash equivalents and short-term investments are valued using quoted prices and other relevant information generated by market transactions involving identical assets. The Company s auction-rate securities are valued using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, amount of cash flows, expected holding periods of the securities and a discount to reflect the Company s inability to liquidate the securities. The Company s derivative instruments are valued using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include quoted interest swap rates and market observable data of similar instruments. The Company s contingent consideration is valued using a probability weighted discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for possible outcomes if certain milestone goals are achieved, the probability of achieving each outcome and discount rates.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The following summarizes the activity in Level 3 financial instruments for the three and six months ended July 2, 2011 (in thousands):

Assets

Auction Rate Securities	**Three Months Ended**	**Six Months Ended**
Beginning balance	$ 16,965	$ 17,500
Settlements	(125)	(300)
Unrealized gains (losses)	356	(4)
Balance at July 2, 2011	$ 17,196	$ 17,196

Liabilities

Contingent Consideration (1)	**Three Months Ended**	**Six Months Ended**
Beginning balance	$ 2,974	$ 1,780
Issuances		1,025
Recognized net gain (2)	(940)	(771)
Balance at July 2, 2011	$ 2,034	$ 2,034
Net gain for period included in earnings attributable to contingent consideration still held at July 2, 2011:	$ 940	$ 771

(1) In connection with the acquisitions of Spectra Linear and ChipSensors, the Company recorded contingent consideration based upon the achievement of certain milestone goals. Changes to the fair value of contingent consideration due to changes in assumptions used in preparing the discounted cash flow model are recorded in selling, general and administrative expenses in the Consolidated Statement of Income. Changes resulting from foreign currency remeasurement adjustments to the contingent consideration liability are recorded in other income (expense), net.

(2) In the three months ended July 2, 2011, the Company reduced the estimated fair value of contingent consideration by $1.0 million based on the expectation that a milestone goal will no longer be achieved.

The Company s other financial instruments, including cash, accounts receivable and accounts payable, are recorded at amounts that approximate their fair values due to their short maturities.

6. Balance Sheet Details

Inventories (in thousands):

	July 2, 2011	January 1, 2011
Work in progress	$ 33,925	$ 32,977
Finished goods	4,172	6,473
	$ 38,097	$ 39,450

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

7. Acquisitions

Spectra Linear

On January 25, 2011, the Company acquired Spectra Linear, Inc., a late-stage private company offering integrated timing solutions. The Company acquired Spectra Linear for approximately $28.6 million, including contingent consideration with an estimated fair value of $1.0 million at the date of acquisition. The contingent consideration could be as much as $10.0 million and is payable on a dollar for dollar basis to the extent that revenue of the acquired products exceed $16.0 million during 2011. In addition, the Company assumed approximately $8.0 million of Spectra Linear net liabilities in connection with the acquisition.

The Company paid an additional approximately $4.5 million of consideration to certain Spectra Linear employees in connection with an agreement between the employees and Spectra Linear. This agreement provided that upon the sale of Spectra Linear, a portion of the proceeds would be paid to such employees as bonuses. The agreement was accounted for as a transaction separate from the business combination based on its economic substance and was recorded as post-combination expenses in the Company s financial statements during the three months ended April 2, 2011.

Approximately $6.0 million of the consideration was deposited in escrow as security for breaches of representations and warranties and certain other expressly enumerated matters.

The Company recorded the purchase of Spectra Linear using the acquisition method of accounting and accordingly, recognized the assets acquired and liabilities assumed at their fair values as of the date of the acquisition. The results of Spectra Linear s operations are included in the Company s consolidated results of operations beginning with the date of the acquisition. Pro forma results of operations related to this acquisition have not been presented since Spectra Linear operating results up to the date of acquisition were not material to the Company s consolidated financial statements.

The Company believes that the acquisition adds a broad family of ICs that will enable it to accelerate penetration in high-volume applications, while further scaling the Company s engineering team. These factors contributed to a purchase price that was in excess of the fair value of the net assets acquired and, as a result, the Company recorded goodwill. The goodwill was allocated to the Company s operating segment and is not expected to be deductible for tax purposes. The purchase price was allocated as follows (in thousands):

		Amount	Weighted-Average Amortization Period (Years)
Intangible assets:			
Core and developed technology	$	16,560	9.6
Customer relationships		1,400	10.0
		17,960	
Accounts receivable		1,759	
Inventories		1,199	
Other current assets		1,658	
Goodwill		4,919	
Deferred tax assets non-current		11,494	
Other non-current assets		597	
Notes payable current portion		(4,641)	
Current liabilities		(3,112)	
Non-current liabilities		(3,254)	
Total purchase price	$	28,579	

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The purchase price allocation is preliminary and subject to revision as more detailed analysis is completed and additional information about the fair value of assets and liabilities becomes available. Adjustments in the fair value of the net assets acquired may affect the calculation of goodwill.

One of the Company s directors, Harvey B. Cash, is a General Partner with InterWest Partners and InterWest Partners was one of the principal stockholders of Spectra Linear. Mr. Cash abstained from the decision-making process with respect to the acquisition.

Silicon Clocks

In April 2010, the Company acquired Silicon Clocks, Inc., a privately held company that designed and developed microelectromechanical system (MEMS) technology to enable the manufacture of silicon resonators and sensors directly on standard complementary metal oxide semiconductor (CMOS) wafers. The Company acquired Silicon Clocks for approximately $21.0 million in cash. Of such consideration, $2.0 million was deposited in escrow as security for breaches of representations and warranties and certain other expressly enumerated matters.

The Company recorded the purchase of Silicon Clocks using the acquisition method of accounting and accordingly, recognized the assets acquired and liabilities assumed at their fair values as of the date of the acquisition. The results of Silicon Clocks operations are included in the Company s consolidated results of operations beginning with the date of the acquisition. Revenues and earnings of Silicon Clocks and pro forma financial information have not been presented because the results of Silicon Clocks operations were not material. Acquisition-related costs were not significant.

The Company believes that the acquisition will enable the Company to accelerate its entry into the low end timing market while further scaling the Company s engineering team. These factors contributed to a purchase price that was in excess of the fair value of the net assets acquired and, as a result, the Company recorded goodwill. The goodwill was allocated to the Company s one operating segment and is not deductible for tax purposes. The purchase price was allocated as follows (in thousands):

		Amount	Weighted-Average Amortization Period (Years)
Intangible assets:			
In-process research and development	$	9,470	Not amortized
Developed technology		230	3.0
Customer relationships		30	2.0
		9,730	

Cash and cash equivalents		514
Other current assets		473
Deferred tax assets non-current		10,617
Other non-current assets		322
Goodwill		4,113
Current liabilities		(1,338)
Deferred tax liabilities non-current		(3,406)
Total purchase price	$	21,025

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

In-process research and development (IPR&D) represents acquired technology that had not achieved technological feasibility as of the acquisition closing date and had no alternative future use. These costs were recorded as indefinite-lived intangible assets. The assets are tested for impairment through their completion and then amortized to research and development expense over their useful lives. The fair value of each project was determined using the income approach. The discount rate applicable to the cash flows was 19.0%. This rate reflects the weighted-average cost of capital and the risks inherent in the development process. The IPR&D recorded in connection with the acquisition consisted of the following (in thousands):

Project		Fair Value
Resonator	$	5,200
Clocks		4,270
	$	9,470

8. Stockholders Equity

Common Stock

The Company issued 1.0 million shares of common stock during the six months ended July 2, 2011, net of 0.2 million shares withheld to satisfy employee tax obligations for the vesting of certain stock grants made under the Company s stock incentive plans.

Share Repurchase Programs

In July 2010, the Board of Directors adopted a share repurchase program to repurchase up to $150 million of the Company s common stock through 2011. The new program became effective immediately and terminated the remaining share repurchase authorization of the prior program. The most recent prior program, which was announced in October 2009, authorized the repurchase up to $150 million of the Company s common stock through 2010. These programs allow for repurchases to be made in the open market or in private transactions, including structured or accelerated transactions, subject to applicable legal requirements and market conditions. During the six months ended July 2, 2011, the Company repurchased 0.6 million shares of its common stock for $24.0 million. During the six months ended July 3, 2010, the Company repurchased 2.2 million shares of its common stock for $100.3 million.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Comprehensive Income

The changes in the components of comprehensive income, net of taxes, were as follows (in thousands):

	Three Months Ended	
	July 2, 2011	July 3, 2010
Net income	$ 13,372	$ 21,047
Net unrealized gains on available-for-sale securities, net of tax of $(205) and $(166), respectively	381	308
Net unrealized gains (losses) on cash flow hedges, net of tax of $(24) and $65, respectively	44	(120)
Comprehensive income	$ 13,797	$ 21,235

	Six Months Ended	
	July 2, 2011	July 3, 2010
Net income	$ 11,412	$ 42,126
Net unrealized gains on available-for-sale securities, net of tax of $(49) and $(697), respectively	91	1,294
Net unrealized gains (losses) on cash flow hedges, net of tax of $(305) and $73, respectively	565	(136)
Comprehensive income	$ 12,068	$ 43,284

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of taxes, were as follows (in thousands):

	Unrealized Losses on Cash Flow Hedges	Net Unrealized Losses on Available-For-Sale Securities	Total
Balance at January 1, 2011	$ (2,477)	$ (1,171)	$ (3,648)
Change associated with current period transactions, net of tax	(277)	91	(186)
Amount reclassified into earnings, net of tax	842		842
Balance at July 2, 2011	$ (1,912)	$ (1,080)	$ (2,992)

20

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

9. Stock-Based Compensation

In fiscal 2009, the stockholders of the Company approved the 2009 Stock Incentive Plan (the 2009 Plan) and the 2009 Employee Stock Purchase Plan (the 2009 Purchase Plan). The 2009 Plan is currently effective, and no further grants will be issued under the Company s 2000 Stock Incentive Plan (the 2000 Plan) as of the effective date of the 2009 Plan. The 2009 Plan has a term of 10 years from the shareholders approval date. The 2009 Purchase Plan became effective upon the termination of the previous Employee Stock Purchase Plan (the Purchase Plan), on April 30, 2010.

Stock-based compensation costs are generally based on the fair values on the date of grant for stock options and on the date of enrollment for the employee stock purchase plans, estimated by using the Black-Scholes option-pricing model. The fair values of stock awards and restricted stock units (RSUs) generally equal their intrinsic value on the date of grant. There were no stock options granted during the six months ended July 2, 2011 or July 3, 2010.

The following are the stock-based compensation costs recognized in the Company s Condensed Consolidated Statements of Income (in thousands):

	Three Months Ended		Six Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Cost of revenues	$ 342	$ 351	$ 679	$ 706
Research and development	3,709	4,386	7,703	8,550
Selling, general and administrative	4,550	5,938	9,692	11,675
	8,601	10,675	18,074	20,931
Provision for income taxes	788	1,519	1,815	3,007
	$ 7,813	$ 9,156	$ 16,259	$ 17,924

The Company had approximately $56.1 million of total unrecognized compensation costs related to stock options and stock awards at July 2, 2011 that are expected to be recognized over a weighted-average period of 1.7 years. There were no significant stock-based compensation costs capitalized into assets in any of the periods presented.

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

10. Commitments and Contingencies

Securities Litigation

On December 6, 2001, a class action complaint for violations of U.S. federal securities laws was filed in the United States District Court for the Southern District of New York against the Company, four officers individually and the three investment banking firms who served as representatives of the underwriters in connection with the Company s initial public offering of common stock. The Consolidated Amended Complaint alleges that the registration statement and prospectus for the Company s initial public offering did not disclose that (1) the underwriters solicited and received additional, excessive and undisclosed commissions from certain investors, and (2) the underwriters had agreed to allocate shares of the offering in exchange for a commitment from the customers to purchase additional shares in the aftermarket at pre-determined higher prices. The Complaint alleges violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. The action seeks damages in an unspecified amount and is being coordinated with approximately 300 other nearly identical actions filed against other companies. A court order dated October 9, 2002 dismissed without prejudice the four officers of the Company who had been named individually. On December 5, 2006, the Second Circuit vacated a decision by the District Court granting class certification in six of the coordinated cases, which are intended to serve as test, or focus cases. The plaintiffs selected these six cases, which do not include the Company. On April 6, 2007, the Second Circuit denied a petition for rehearing filed by the plaintiffs, but noted that the plaintiffs could ask the District Court to certify more narrow classes than those that were rejected.

The parties in the approximately 300 coordinated cases, including the parties in the case against the Company, reached a settlement. The insurers for the issuer defendants in the coordinated cases will make the settlement payment on behalf of the issuers, including the Company. On October 5, 2009, the Court granted final approval of the settlement. Judgment was entered on January 10, 2010. The settlement approval was appealed to the United States Court of Appeals for the Second Circuit. One appeal was dismissed and the second appeal was remanded to the District Court to determine if the appellant is a class member with standing to appeal.

As the litigation process is inherently uncertain, the Company is unable to predict the outcome of the above described matter if the settlement does not survive appeal. While the Company does maintain liability insurance, it could incur losses that are not covered by its liability insurance or that exceed the limits of its liability insurance. Such losses could have a material impact on the Company s business and its results of operations or financial position.

Other

The Company is involved in various other legal proceedings that have arisen in the normal course of business. While the ultimate results of these matters cannot be predicted with certainty, the Company does not expect them to have a material adverse effect on its consolidated financial position or results of operations.

Table of Contents

Silicon Laboratories Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Operating Leases

In March 2006, the Company entered into an operating lease agreement and a related participation agreement for a facility at 400 W. Cesar Chavez (400 WCC) in Austin, Texas for its corporate headquarters. In March 2008, the Company entered into an operating lease agreement and a related participation agreement for a facility at 200 W. Cesar Chavez (200 WCC) in Austin, Texas for the expansion of its corporate headquarters. During the terms of the leases, the Company has on-going options to purchase the buildings for purchase prices of approximately $44.3 million for 400 WCC and $50.1 million for 200 WCC. Alternatively, the Company can cause each such property to be sold to third parties provided it is not in default under that property s lease. The Company is contingently liable on a first dollar loss basis for up to $35.3 million to the extent that the 400 WCC sale proceeds are less than the $44.3 million purchase option and up to $40.0 million to the extent that the 200 WCC sale proceeds are less than the $50.1 million purchase option.

Discontinued Operations Indemnification

In fiscal 2007, the Company sold its Aero® transceiver, AeroFONE single-chip phone and power amplifier product lines (the Aero product lines) to NXP B.V. and NXP Semiconductors France SAS (collectively NXP). In connection with the sale of the Aero product lines, the Company agreed to indemnify NXP with respect to liabilities for certain tax matters. There is no contractual limit on exposure with respect to such matters. As of July 2, 2011, the Company had no material liabilities recorded with respect to this indemnification obligation.

11. Income Taxes

Provision for income taxes includes both domestic and foreign income taxes at the applicable statutory rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences. Income tax expense was $3.2 million and $9.6 million for the three months ended July 2, 2011 and July 3, 2010, respectively, resulting in effective tax rates of 19.5% and 31.4%, respectively. Income tax expense was $10.9 million and $14.6 million for the six months ended July 2, 2011 and July 3, 2010, respectively, resulting in effective tax rates of 48.9% and 25.7%, respectively. The effective tax rate for the three months ended July 2, 2011 decreased from the prior period, primarily due to the prior period tax charge related to the intercompany license of certain technology obtained in the acquisition of Silicon Clocks and the non-renewal of the federal research and development tax credit reflected in the prior period effective tax rate, partially offset by a decrease in the foreign tax rate benefit. The effective tax rate for the six months ended July 2, 2011 increased from the prior period, primarily due to the tax charge related to the intercompany license of certain technology obtained in the acquisition of Spectra Linear and other one-time nondeductible costs associated with the acquisition of Spectra Linear recorded in the first quarter of 2011, along with a decrease in the foreign tax rate benefit.

At July 2, 2011, the Company had gross unrecognized tax benefits of $12.1 million, all of which would affect the effective tax rate if recognized. The Company recognizes interest and penalties related to unrecognized tax benefits in the provision for income taxes.

The tax years 2004 through 2011 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company is not currently under audit in any major taxing jurisdiction.

Table of Contents

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related notes thereto included elsewhere in this report. This discussion contains forward-looking statements. Please see the Cautionary Statement above and Risk Factors below for discussions of the uncertainties, risks and assumptions associated with these statements. Our fiscal year-end financial reporting periods are a 52- or 53- week year ending on the Saturday closest to December 31st. Fiscal 2011 will have 52 weeks and fiscal 2010 had 52 weeks. Our second quarter of fiscal 2011 ended July 2, 2011. Our second quarter of fiscal 2010 ended July 3, 2010.

Overview

We design and develop proprietary, analog-intensive, mixed-signal integrated circuits (ICs) for a broad range of applications. Mixed-signal ICs are electronic components that convert real-world analog signals, such as sound and radio waves, into digital signals that electronic products can process. Therefore, mixed-signal ICs are critical components in a broad range of applications in a variety of markets, including communications, consumer, industrial, automotive, medical and power management. Our major customers include Apple, Cisco, Huawei, LG Electronics, Pace, Panasonic, Sagem, Samsung, Technicolor and Varian Medical Systems.

As a fabless semiconductor company, we rely on third-party semiconductor fabricators in Asia, and to a lesser extent the United States and Europe, to manufacture the silicon wafers that reflect our IC designs. Each wafer contains numerous die, which are cut from the wafer to create a chip for an IC. We rely on third-parties in Asia to assemble, package, and, in most cases, test these devices and ship these units to our customers. Testing performed by such third parties facilitates faster delivery of products to our customers (particularly those located in Asia), shorter production cycle times, lower inventory requirements, lower costs and increased flexibility of test capacity.

Our expertise in analog-intensive, high-performance, mixed-signal ICs enables us to develop highly differentiated solutions that address multiple markets. We group our products into the following categories:

- Broad-based products, which include our microcontrollers, timing products (clocks and oscillators), wireless receivers, isolation devices and human interface sensors;

- Broadcast products, which include our broadcast audio and video products;

- Access products, which include our embedded modems, Voice over IP (VoIP) products and our Power over Ethernet devices; and

- Mature products, which include certain devices that are at the end of their respective life cycles and therefore receive minimal or no continued research and development investment, including our DSL analog front end ICs and IRDA devices.

Through acquisitions and internal development efforts, we have continued to diversify our product portfolio and introduce next generation ICs with added functionality and further integration. In January 2011, we acquired Spectra Linear, Inc. Spectra Linear s family of low-power, highly programmable and small-footprint silicon clocking solutions is optimized for consumer electronics and embedded applications. The acquired products complement our existing timing product line by adding a broad family of ICs that we believe will accelerate penetration in high-volume applications.

Table of Contents

In the first six months of fiscal 2011, we introduced an energy-efficient wireless sensor node solution powered by a solar energy harvesting source, high-performance clock ICs for high-speed optical transport network (OTN) applications, two microcontroller families that simplify the addition of USB connectivity to embedded designs, next-generation infrared and ambient light sensors for human interface applications and a family of crystal oscillators and voltage-controlled crystal oscillators designed to minimize jitter, system cost and design complexity for a wide range of high-performance, cost-sensitive applications . We plan to continue to introduce products that increase the content we provide for existing applications, thereby enabling us to serve markets we do not currently address and expanding our total available market opportunity.

During the six months ended July 2, 2011, one customer, Samsung, represented more than 10% of our revenues. No other single end customer accounted for more than 10% of our revenues during the six months ended July 2, 2011. In addition to direct sales to customers, some of our end customers purchase products indirectly from us through distributors and contract manufacturers. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer. Three of our distributors, Edom Technology, Avnet and Macnica, represented 23%, 13% and 11% of our revenues during the six months ended July 2, 2011, respectively. There were no other distributors or contract manufacturers that accounted for more than 10% of our revenues during the six months ended July 2, 2011.

The percentage of our revenues derived from customers located outside of the United States was 85% during the six months ended July 2, 2011. All of our revenues to date have been denominated in U.S. dollars. We believe that a majority of our revenues will continue to be derived from customers outside of the United States.

The sales cycle for our ICs can be as long as 12 months or more. An additional three to six months or more are usually required before a customer ships a significant volume of devices that incorporate our ICs. Due to this lengthy sales cycle, we typically experience a significant delay between incurring research and development and selling, general and administrative expenses, and the corresponding sales. Consequently, if sales in any quarter do not occur when expected, expenses and inventory levels could be disproportionately high, and our operating results for that quarter and, potentially, future quarters would be adversely affected. Moreover, the amount of time between initial research and development and commercialization of a product, if ever, can be substantially longer than the sales cycle for the product. Accordingly, if we incur substantial research and development costs without developing a commercially successful product, our operating results, as well as our growth prospects, could be adversely affected.

Because many of our ICs are designed for use in consumer products such as televisions, personal video recorders, set-top boxes, portable navigation devices and mobile handsets, we expect that the demand for our products will be typically subject to some degree of seasonal demand. However, rapid changes in our markets and across our product areas make it difficult for us to accurately estimate the impact of seasonal factors on our business.

Table of Contents

Results of Operations

The following describes the line items set forth in our Condensed Consolidated Statements of Income:

Revenues. Revenues are generated almost exclusively by sales of our ICs. We recognize revenue on sales when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists, 2) delivery of goods has occurred, 3) the sales price is fixed or determinable, and 4) collectibility is reasonably assured. Generally, we recognize revenue from product sales to direct customers and contract manufacturers upon shipment. Certain of our sales are made to distributors under agreements allowing certain rights of return and price protection on products unsold by distributors. Accordingly, we defer the revenue and cost of revenue on such sales until the distributors sell the product to the end customer. Our products typically carry a one-year replacement warranty. Replacements have been insignificant to date. Our revenues are subject to variation from period to period due to the volume of shipments made within a period, the mix of products we sell and the prices we charge for our products. The vast majority of our revenues were negotiated at prices that reflect a discount from the list prices for our products. These discounts are made for a variety of reasons, including: 1) to establish a relationship with a new customer, 2) as an incentive for customers to purchase products in larger volumes, 3) to provide profit margin to our distributors who resell our products or 4) in response to competition. In addition, as a product matures, we expect that the average selling price for such product will decline due to the greater availability of competing products. Our ability to increase revenues in the future is dependent on increased demand for our established products and our ability to ship larger volumes of those products in response to such demand, as well as our ability to develop or acquire new products and subsequently achieve customer acceptance of newly introduced products.

Cost of Revenues. Cost of revenues includes the cost of purchasing finished silicon wafers processed by independent foundries; costs associated with assembly, test and shipping of those products; costs of personnel and equipment associated with manufacturing support, logistics and quality assurance; costs of software royalties and amortization of purchased software, other intellectual property license costs and certain acquired intangible assets; and an allocated portion of our occupancy costs.

Research and Development. Research and development expense consists primarily of personnel-related expenses, including stock-based compensation, new product mask, wafer, packaging and test costs, external consulting and services costs, equipment tooling, equipment depreciation, amortization of acquired intangible assets, as well as an allocated portion of our occupancy costs for such operations. Research and development activities include the design of new products, refinement of existing products and design of test methodologies to ensure compliance with required specifications.

Selling, General and Administrative. Selling, general and administrative expense consists primarily of personnel-related expenses, including stock-based compensation, related allocable portion of our occupancy costs, sales commissions to independent sales representatives, applications engineering support, professional fees, legal fees and promotional and marketing expenses.

Interest Income. Interest income reflects interest earned on our cash, cash equivalents and investment balances.

Interest Expense. Interest expense consists of interest on our short and long-term obligations.

Other Income (Expense), Net. Other income (expense), net consists primarily of foreign currency remeasurement adjustments as well as other non-operating income and expenses.

Provision for Income Taxes. Provision for income taxes includes both domestic and foreign income taxes at the applicable statutory rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences.

Table of Contents

The following table sets forth our Condensed Consolidated Statements of Income data as a percentage of revenues for the periods indicated:

	Three Months Ended		Six Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	39.6	32.5	39.6	33.2
Gross margin	60.4	67.5	60.4	66.8
Operating expenses:				
Research and development	27.1	22.7	28.3	23.1
Selling, general and administrative	20.6	22.0	23.6	22.1
Operating expenses	47.7	44.7	51.9	45.2
Operating income	12.7	22.8	8.5	21.6
Other income (expense):				
Interest income	0.4	0.5	0.4	0.5
Interest expense	0.0	0.0	0.0	0.0
Other income (expense), net	0.1	(0.5)	0.2	(0.4)
Income before income taxes	13.2	22.8	9.1	21.7
Provision for income taxes	2.6	7.2	4.5	5.6
Net income	10.6%	15.6%	4.6%	16.1%

Revenues

	Three Months Ended				Six Months Ended			
(in millions)	July 2, 2011	July 3, 2010	Change	% Change	July 2, 2011	July 3, 2010	Change	% Change
Revenues	$ 126.2	$ 134.6	$ (8.4)	(6.2)%	$ 245.8	$ 261.3	$ (15.5)	(5.9)%

The decline in the sales of our products in the recent three and six month periods was driven primarily by demand weakness for our consumer-oriented products. Unit volumes of our products decreased compared to the three and six months ended July 3, 2010 by 11.2% and 12.2%, respectively. Average selling prices increased during the same periods by 6.1% and 7.7%, respectively.

The average selling prices of our products may fluctuate significantly from period to period. In general, as our products become more mature, we expect to experience decreases in average selling prices. We anticipate that newly announced, higher priced, next generation products and product derivatives will offset some of these decreases.

Gross Margin

(in millions)	Three Months Ended July 2, 2011	Three Months Ended July 3, 2010	Change	% Change	Six Months Ended July 2, 2011	Six Months Ended July 3, 2010	Change	% Change
Gross margin	$ 76.2	$ 90.9	$ (14.7)	(16.2)%	$ 148.4	$ 174.5	$ (26.1)	(15.0)%
Percent of revenue	60.4%	67.5%			60.4%	66.8%		

The decrease in gross margin in the recent three and six month periods was primarily due to changes in product mix, decreased sales, charges related to the acquisition of Spectra Linear and a one-time charge for the cancellation of in-process material.

Table of Contents

We may experience declines in the average selling prices of certain of our products. This creates downward pressure on gross margin as a percentage of revenues and may be offset to the extent we are able to: 1) introduce higher margin new products and gain market share with our ICs; 2) achieve lower production costs from our wafer suppliers and third-party assembly and test subcontractors; 3) achieve lower production costs per unit as a result of improved yields throughout the manufacturing process; or 4) reduce logistics costs.

Research and Development

	Three Months Ended				Six Months Ended			
	July 2,	July 3,		%	July 2,	July 3,		%
(in millions)	2011	2010	Change	Change	2011	2010	Change	Change
Research and development	$ 34.2	$ 30.5	$ 3.7	12.0%	$ 69.5	$ 60.4	$ 9.1	15.1%
Percent of revenue	27.1%	22.7%			28.3%			