
**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 July 4, 2020

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: 000-29823

SILICON LABORATORIES INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

74-2793174

(I.R.S. Employer Identification No.)

400 West Cesar Chavez, Austin, Texas

(Address of principal executive offices)

78701

(Zip Code)

(512) 416-8500

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|----------------------------------|-------------------|--|
| Common Stock, \$0.0001 par value | SLAB | The NASDAQ Stock Market LLC |

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. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

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

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

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

As of July 21, 2020, 43,795,567 shares of common stock of Silicon Laboratories Inc. were outstanding.

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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.

Part I. Financial Information
Item 1. Financial Statements

Silicon Laboratories Inc.
Condensed Consolidated Balance Sheets
(In thousands, except per share data)
(Unaudited)

| | July 4, 2020 | December 28, 2019 |
|---|---------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 277,659 | \$ 227,146 |
| Short-term investments | 445,685 | 498,825 |
| Accounts receivable, net | 70,487 | 75,639 |
| Inventories | 70,022 | 73,057 |
| Prepaid expenses and other current assets | 53,584 | 69,192 |
| Total current assets | 917,437 | 943,859 |
| Property and equipment, net | 140,200 | 135,939 |
| Goodwill | 631,932 | 398,402 |
| Other intangible assets, net | 189,923 | 134,279 |
| Other assets, net | 44,215 | 62,374 |
| Total assets | <u>\$ 1,923,707</u> | <u>\$ 1,674,853</u> |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 40,245 | \$ 38,899 |
| Deferred revenue and returns liability | 26,358 | 19,251 |
| Other current liabilities | 68,397 | 79,551 |
| Total current liabilities | 135,000 | 137,701 |
| Convertible debt | 571,774 | 368,257 |
| Other non-current liabilities | 59,287 | 53,844 |
| Total liabilities | 766,061 | 559,802 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock – \$0.0001 par value; 10,000 shares authorized; no shares issued | — | — |
| Common stock – \$0.0001 par value; 250,000 shares authorized; 43,796 and 43,496 shares issued and outstanding at July 4, 2020 and December 28, 2019, respectively | 4 | 4 |
| Additional paid-in capital | 173,477 | 133,793 |
| Retained earnings | 981,554 | 980,608 |
| Accumulated other comprehensive income | 2,611 | 646 |
| Total stockholders' equity | 1,157,646 | 1,115,051 |
| Total liabilities and stockholders' equity | <u>\$ 1,923,707</u> | <u>\$ 1,674,853</u> |

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

Silicon Laboratories Inc.
Condensed Consolidated Statements of Operations
(In thousands, except per share data)
(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|--------------------|------------------|--------------------|
| | July 4, 2020 | June 29, 2019 | July 4, 2020 | June 29, 2019 |
| Revenues | \$ 207,533 | \$ 206,709 | \$ 422,410 | \$ 394,822 |
| Cost of revenues | 81,222 | 79,660 | 166,933 | 151,899 |
| Gross profit | 126,311 | 127,049 | 255,477 | 242,923 |
| Operating expenses: | | | | |
| Research and development | 70,838 | 63,856 | 142,061 | 125,422 |
| Selling, general and administrative | 48,404 | 48,637 | 102,400 | 97,853 |
| Operating expenses | 119,242 | 112,493 | 244,461 | 223,275 |
| Operating income | 7,069 | 14,556 | 11,016 | 19,648 |
| Other income (expense): | | | | |
| Interest income and other, net | 3,267 | 3,696 | 6,518 | 6,519 |
| Interest expense | (11,778) | (5,005) | (17,319) | (10,002) |
| Income (loss) before income taxes | (1,442) | 13,247 | 215 | 16,165 |
| Provision (benefit) for income taxes | 381 | 29,276 | (206) | 26,796 |
| Net income (loss) | <u>\$ (1,823)</u> | <u>\$ (16,029)</u> | <u>\$ 421</u> | <u>\$ (10,631)</u> |
| Earnings (loss) per share: | | | | |
| Basic | \$ (0.04) | \$ (0.37) | \$ 0.01 | \$ (0.25) |
| Diluted | \$ (0.04) | \$ (0.37) | \$ 0.01 | \$ (0.25) |
| Weighted-average common shares outstanding: | | | | |
| Basic | 43,761 | 43,386 | 43,699 | 43,287 |
| Diluted | 43,761 | 43,386 | 44,219 | 43,287 |

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

Silicon Laboratories Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(In thousands)
(Unaudited)

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|---|---------------------------|--------------------------|-------------------------|--------------------------|
| | <u>July 4, 2020</u> | <u>June 29, 2019</u> | <u>July 4, 2020</u> | <u>June 29, 2019</u> |
| Net income (loss) | \$ (1,823) | \$ (16,029) | \$ 421 | \$ (10,631) |
| Other comprehensive income, before tax | | | | |
| Net changes to available-for-sale securities | | | | |
| Unrealized gains arising during the period | 3,068 | 1,207 | 2,598 | 2,632 |
| Reclassification for gains included in net income (loss) | (121) | — | (222) | — |
| Net changes to cash flow hedges | | | | |
| Unrealized gains (losses) arising during the period | 496 | 44 | (311) | 56 |
| Reclassification for losses included in net income (loss) | 282 | 194 | 423 | 431 |
| Other comprehensive income, before tax | 3,725 | 1,445 | 2,488 | 3,119 |
| Provision for income taxes | 783 | 304 | 523 | 655 |
| Other comprehensive income | 2,942 | 1,141 | 1,965 | 2,464 |
| Comprehensive income (loss) | <u>\$ 1,119</u> | <u>\$ (14,888)</u> | <u>\$ 2,386</u> | <u>\$ (8,167)</u> |

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

Silicon Laboratories Inc.
Condensed Consolidated Statements of Changes in Stockholders' Equity
(In thousands)
(Unaudited)

| Three Months Ended July 4, 2020 | Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---------------|-------------------------|---|------------------------------|--|---|
| Balance as of April 4, 2020 | 43,670 | \$ 4 | \$ 116,553 | \$ 983,377 | \$ (331) | \$ 1,099,603 |
| Net income (loss) | — | — | — | (1,823) | — | (1,823) |
| Other comprehensive income | — | — | — | — | 2,942 | 2,942 |
| Stock issuances, net of shares withheld for taxes | 126 | — | 7,295 | — | — | 7,295 |
| Stock-based compensation | — | — | 14,458 | — | — | 14,458 |
| Convertible debt issuance | — | — | 35,171 | — | — | 35,171 |
| Balance as of July 4, 2020 | <u>43,796</u> | <u>\$ 4</u> | <u>\$ 173,477</u> | <u>\$ 981,554</u> | <u>\$ 2,611</u> | <u>\$ 1,157,646</u> |
| | | | | | | |
| Three Months Ended June 29, 2019 | Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
| Balance as of March 30, 2019 | 43,341 | \$ 4 | \$ 90,988 | \$ 966,741 | \$ (251) | \$ 1,057,482 |
| Net income (loss) | — | — | — | (16,029) | — | (16,029) |
| Other comprehensive income | — | — | — | — | 1,141 | 1,141 |
| Stock issuances, net of shares withheld for taxes | 127 | — | 6,713 | — | — | 6,713 |
| Repurchases of common stock | (124) | — | (11,712) | — | — | (11,712) |
| Stock-based compensation | — | — | 13,676 | — | — | 13,676 |
| Balance as of June 29, 2019 | <u>43,344</u> | <u>\$ 4</u> | <u>\$ 99,665</u> | <u>\$ 950,712</u> | <u>\$ 890</u> | <u>\$ 1,051,271</u> |
| | | | | | | |
| Six Months Ended July 4, 2020 | Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
| Balance as of December 28, 2019 | 43,496 | \$ 4 | \$ 133,793 | \$ 980,608 | \$ 646 | \$ 1,115,051 |
| Cumulative effect of adoption of accounting standard | — | — | — | 525 | — | 525 |
| Net income (loss) | — | — | — | 421 | — | 421 |
| Other comprehensive income | — | — | — | — | 1,965 | 1,965 |
| Stock issuances, net of shares withheld for taxes | 509 | — | (8,999) | — | — | (8,999) |
| Repurchases of common stock | (209) | — | (16,287) | — | — | (16,287) |
| Stock-based compensation | — | — | 29,799 | — | — | 29,799 |
| Convertible debt issuance | — | — | 35,171 | — | — | 35,171 |
| Balance as of July 4, 2020 | <u>43,796</u> | <u>\$ 4</u> | <u>\$ 173,477</u> | <u>\$ 981,554</u> | <u>\$ 2,611</u> | <u>\$ 1,157,646</u> |
| | | | | | | |
| Six Months Ended June 29, 2019 | Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
| Balance as of December 29, 2018 | 43,088 | \$ 4 | \$ 107,517 | \$ 961,343 | \$ (1,574) | \$ 1,067,290 |
| Net income (loss) | — | — | — | (10,631) | — | (10,631) |
| Other comprehensive income | — | — | — | — | 2,464 | 2,464 |
| Stock issuances, net of shares withheld for taxes | 557 | — | (7,400) | — | — | (7,400) |
| Repurchases of common stock | (301) | — | (26,716) | — | — | (26,716) |
| Stock-based compensation | — | — | 26,264 | — | — | 26,264 |
| Balance as of June 29, 2019 | <u>43,344</u> | <u>\$ 4</u> | <u>\$ 99,665</u> | <u>\$ 950,712</u> | <u>\$ 890</u> | <u>\$ 1,051,271</u> |

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

Silicon Laboratories Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

| | Six Months Ended | |
|--|------------------|------------------|
| | July 4, 2020 | June 29, 2019 |
| Operating Activities | | |
| Net income (loss) | \$ 421 | \$ (10,631) |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: | | |
| Depreciation of property and equipment | 8,428 | 8,447 |
| Amortization of other intangible assets and other assets | 21,568 | 20,476 |
| Amortization of debt discount and debt issuance costs | 8,359 | 6,659 |
| Loss on extinguishment of convertible debt | 3,685 | — |
| Stock-based compensation expense | 29,770 | 26,253 |
| Deferred income taxes | 1,177 | 24,043 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 7,070 | 893 |
| Inventories | 6,767 | 1,118 |
| Prepaid expenses and other assets | 21,821 | 11,326 |
| Accounts payable | (769) | 5,321 |
| Other current liabilities and income taxes | (15,442) | (18,101) |
| Deferred revenue and returns liability | 6,678 | (1,228) |
| Other non-current liabilities | 970 | (3,222) |
| Net cash provided by operating activities | 100,503 | 71,354 |
| Investing Activities | | |
| Purchases of available-for-sale investments | (199,347) | (184,170) |
| Sales and maturities of available-for-sale investments | 255,112 | 151,428 |
| Purchases of property and equipment | (10,394) | (9,402) |
| Purchases of other assets | (820) | (2,588) |
| Acquisition of business, net of cash acquired | (316,809) | — |
| Net cash used in investing activities | (272,258) | (44,732) |
| Financing Activities | | |
| Proceeds from issuance of debt | 845,000 | — |
| Payments on debt | (597,446) | — |
| Repurchases of common stock | (16,287) | (26,716) |
| Payment of taxes withheld for vested stock awards | (16,756) | (14,509) |
| Proceeds from the issuance of common stock | 7,757 | 7,109 |
| Net cash provided by (used in) financing activities | 222,268 | (34,116) |
| Increase (decrease) in cash and cash equivalents | 50,513 | (7,494) |
| Cash and cash equivalents at beginning of period | 227,146 | 197,043 |
| Cash and cash equivalents at end of period | \$ 277,659 | \$ 189,549 |

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

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 4, 2020 and December 28, 2019, the condensed consolidated results of its operations for the three and six months ended July 4, 2020 and June 29, 2019, the Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended July 4, 2020 and June 29, 2019, the Condensed Consolidated Statements of Changes in Stockholders’ Equity for the three and six months ended July 4, 2020 and June 29, 2019, and the Condensed Consolidated Statements of Cash Flows for the six months ended July 4, 2020 and June 29, 2019. All intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated results of operations for the three and six months ended July 4, 2020 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 December 28, 2019, included in the Company’s Form 10-K filed with the Securities and Exchange Commission (SEC) on January 29, 2020.

The Company prepares financial statements on a 52- or 53-week fiscal year that ends on the Saturday closest to December 31. Fiscal 2020 will have 53 weeks with the extra week occurring in the first quarter of the year. Fiscal 2019 had 52 weeks. In a 52-week year, each fiscal quarter consists of 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Among the significant estimates affecting the financial statements are those related to inventories, goodwill, acquired intangible assets, other long-lived assets, revenue recognition, stock-based compensation and income taxes. Actual results could differ from those estimates, and such differences could be material to the financial statements.

Adoption of New Accounting Standard

The Company adopted Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, on December 29, 2019, the first day of its fiscal year ending January 2, 2021. The adoption did not have a material impact on its financial statements.

Revenue Recognition

Revenue is recognized when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. Substantially all of the Company’s contracts with customers contain a single performance obligation, the sale of mixed-signal integrated circuit (IC) products. This performance obligation is satisfied when control of the product is transferred to the customer, which typically occurs upon delivery. Unsatisfied performance obligations primarily represent contracts for products with future delivery dates. The Company has opted to not disclose the amount of unsatisfied performance obligations as these contracts have original expected durations of less than one year.

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The transaction price reflects the Company's expectations about the consideration it will be entitled to receive from the customer and may include fixed or variable amounts. Variable consideration primarily includes sales made to distributors under agreements allowing certain rights of return, referred to as stock rotation, and credits issued to the distributor due to price protection. The Company estimates variable consideration at the most likely amount to which it expects to be entitled. The estimate is based on information available to the Company, including recent sales activity and pricing data. The Company applies a constraint to its variable consideration estimate which considers both the likelihood of a return and the amount of a potential price concession. Variable consideration that does not meet revenue recognition criteria is deferred. The Company records a right of return asset in prepaid expenses and other current assets for the costs of distributor inventory not meeting revenue recognition criteria. A corresponding deferred revenue and returns liability amount is recorded for unrecognized revenue associated with such costs. The Company's products carry a one-year replacement warranty. Payments are typically due within 30 days of invoicing and do not include a significant financing component.

2. Earnings (Loss) Per Share

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

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | July 4, 2020 | June 29, 2019 | July 4, 2020 | June 29, 2019 |
| Net income (loss) | \$ (1,823) | \$ (16,029) | \$ 421 | \$ (10,631) |
| Shares used in computing basic earnings (loss) per share | 43,761 | 43,386 | 43,699 | 43,287 |
| Effect of dilutive securities: | | | | |
| Stock-based awards and convertible debt | — | — | 520 | — |
| Shares used in computing diluted earnings (loss) per share | 43,761 | 43,386 | 44,219 | 43,287 |
| Earnings (loss) per share: | | | | |
| Basic | \$ (0.04) | \$ (0.37) | \$ 0.01 | \$ (0.25) |
| Diluted | \$ (0.04) | \$ (0.37) | \$ 0.01 | \$ (0.25) |

For the three months ended July 4, 2020 and June 29, 2019 and the six months ended July 4, 2020 and June 29, 2019, approximately 0.4 million, 0.0 million, 0.3 million and 0.5 million shares, respectively, consisting of restricted stock awards (RSUs) and market stock awards (MSUs), were not included in the diluted earnings (loss) per share calculation since the shares were anti-dilutive. Further, diluted shares used in calculating net loss per share for the three months ended July 4, 2020 and the three and six months ended June 29, 2019 excluded 0.3 million shares, 0.6 million shares and 0.6 million shares, respectively, due to the Company's net loss for the periods.

The Company intends to settle the principal amount of its convertible senior notes in cash and any excess value in shares in the event of a conversion. Accordingly, shares issuable upon conversion of the principal amount have been excluded from the calculation of diluted earnings per share. If the market value of the notes under certain prescribed conditions exceeds the conversion amount, the excess is included in the denominator for the computation of diluted earnings per share using the treasury stock method. For three and six months ended July 4, 2020, approximately 0.0 million shares and 0.2 million shares, respectively, were included in the denominator for the calculation of diluted earnings per share. See Note 7, *Debt*, to the Condensed Consolidated Financial Statements for additional information.

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

3. Fair Value of Financial Instruments

The fair values of the Company's financial instruments are recorded using a hierarchical 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.

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 | Fair Value Measurements at July 4, 2020 Using | | | Total |
|--------------------------------|---|--|--|-------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$ 179,239 | \$ — | \$ — | \$ 179,239 |
| Corporate debt securities | — | 2,397 | — | 2,397 |
| Government debt securities | — | 22,344 | — | 22,344 |
| Total cash equivalents | \$ 179,239 | \$ 24,741 | \$ — | \$ 203,980 |
| Short-term investments: | | | | |
| Government debt securities | \$ 77,409 | \$ 45,443 | \$ — | \$ 122,852 |
| Corporate debt securities | — | 322,833 | — | 322,833 |
| Total short-term investments | \$ 77,409 | \$ 368,276 | \$ — | \$ 445,685 |
| Other assets, net: | | | | |
| Auction rate securities | \$ — | \$ — | \$ 5,400 | \$ 5,400 |
| Total | \$ — | \$ — | \$ 5,400 | \$ 5,400 |
| Total | \$ 256,648 | \$ 393,017 | \$ 5,400 | \$ 655,065 |

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

| Description | Fair Value Measurements at December 28, 2019 Using | | | Total |
|-------------------------------------|---|--|--|-------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$ 92,379 | \$ — | \$ — | \$ 92,379 |
| Corporate debt securities | — | 1,325 | — | 1,325 |
| Total cash equivalents | \$ 92,379 | \$ 1,325 | \$ — | \$ 93,704 |
| Short-term investments: | | | | |
| Government debt securities | \$ 85,189 | \$ 86,682 | \$ — | \$ 171,871 |
| Corporate debt securities | — | 326,954 | — | 326,954 |
| Total short-term investments | \$ 85,189 | \$ 413,636 | \$ — | \$ 498,825 |
| Other assets, net: | | | | |
| Auction rate securities | \$ — | \$ — | \$ 5,647 | \$ 5,647 |
| Total | \$ — | \$ — | \$ 5,647 | \$ 5,647 |
| Total | \$ 177,568 | \$ 414,961 | \$ 5,647 | \$ 598,176 |

Valuation methodology

The Company's cash equivalents and short-term investments that are classified as Level 2 are valued using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments in active markets; or pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data. Investments classified as Level 3 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 discounted cash flow models. The assumptions used in preparing the valuation models include quoted interest swap rates, foreign exchange rates, forward and spot prices for currencies, and market observable data of similar instruments.

Available-for-sale investments

The Company's investments are reported at fair value, with unrealized gains and losses, net of tax, recorded as a component of accumulated other comprehensive income in the Consolidated Balance Sheet. The following summarizes the contractual underlying maturities of the Company's available-for-sale investments at July 4, 2020 (in thousands):

| | Cost | Fair Value |
|--------------------------------------|-------------------|-------------------|
| Due in one year or less | \$ 438,505 | \$ 439,825 |
| Due after one year through ten years | 207,194 | 209,840 |
| Due after ten years | 6,000 | 5,400 |
| | <u>\$ 651,699</u> | <u>\$ 655,065</u> |

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

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 | |
|--------------------------------|---------------------|-------------------------|----------------------|-------------------------|------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| As of July 4, 2020 | | | | | | |
| Government debt securities | \$ 8,186 | \$ (1) | \$ — | \$ — | \$ 8,186 | \$ (1) |
| Corporate debt securities | 57,574 | (65) | — | — | 57,574 | (65) |
| Auction rate securities | — | — | 5,400 | (600) | 5,400 | (600) |
| | \$ 65,760 | \$ (66) | \$ 5,400 | \$ (600) | \$ 71,160 | \$ (666) |
| | | | | | | |
| | Less Than 12 Months | | 12 Months or Greater | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| As of December 28, 2019 | | | | | | |
| Government debt securities | \$ 11,947 | \$ (19) | \$ 7,183 | \$ (7) | \$ 19,130 | \$ (26) |
| Corporate debt securities | 68,116 | (81) | 20 | — | 68,136 | (81) |
| Auction rate securities | — | — | 5,647 | (353) | 5,647 | (353) |
| | \$ 80,063 | \$ (100) | \$ 12,850 | \$ (360) | \$ 92,913 | \$ (460) |

The gross unrealized losses as of July 4, 2020 and December 28, 2019 were due primarily to changes in market interest rates and the illiquidity of the Company's auction-rate securities. The Company's auction-rate securities have been illiquid since 2008 when auctions for the securities failed because sell orders exceeded buy orders. These securities have a contractual maturity date of 2046. The Company is unable to predict if these funds will become available before their maturity date.

The Company records an allowance for credit loss when a decline in investment market value is due to credit-related factors. When evaluating an investment for impairment, the Company reviews factors such as the severity of the impairment, changes in underlying credit ratings, forecasted recovery, the Company's intent to sell or the likelihood that it would be required to sell the investment before its anticipated recovery in market value and the probability that the scheduled cash payments will continue to be made. As of July 4, 2020, there were no material declines in the market value of available-for-sale investments due to credit-related factors.

At July 4, 2020 and December 28, 2019, there were no material unrealized gains associated with the Company's available-for-sale investments.

Level 3 fair value measurements

The following summarizes quantitative information about Level 3 fair value measurements.

Auction rate securities

| Fair Value at July 4, 2020 (000s) | Valuation Technique | Unobservable Input | Weighted Average |
|---|----------------------|-------------------------|------------------|
| \$ 5,400 | Discounted cash flow | Estimated yield | 2.22% |
| | | Expected holding period | 10 years |
| | | Estimated discount rate | 2.15% |

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

Significant changes in any of the unobservable inputs used in the fair value measurement of auction rate securities in isolation could result in a significantly lower or higher fair value measurement. An increase in expected yield would result in a higher fair value measurement, whereas an increase in expected holding period or estimated discount rate would result in a lower fair value measurement. Generally, a change in the assumptions used for expected holding period is accompanied by a directionally similar change in the assumptions used for estimated yield and discount rate.

The following summarizes the activity in Level 3 financial instruments for the three and six months ended July 4, 2020 (in thousands):

Assets

| Auction Rate Securities | Three Months Ended | Six Months Ended |
|---|-------------------------------|-----------------------------|
| Beginning balance | \$ 5,400 | \$ 5,647 |
| Loss included in other comprehensive income | — | (247) |
| Balance at July 4, 2020 | <u>\$ 5,400</u> | <u>\$ 5,400</u> |

Fair values of other financial instruments

The Company's debt is recorded at cost, but is measured at fair value for disclosure purposes. The fair value of the Company's convertible senior notes is determined using observable market prices. The notes are traded in less active markets and are therefore classified as a Level 2 fair value measurement. As of July 4, 2020 and December 28, 2019, the fair value of the 1.375% convertible senior notes was \$196.5 million and \$524.0 million, respectively. The fair value of the 0.625% convertible senior notes as of July 4, 2020 was \$569.1 million.

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.

4. Derivative Financial Instruments

The Company uses derivative financial instruments to manage certain exposures to the variability of foreign currency exchange rates and interest rates. The Company's objective is to offset increases and decreases in expenses resulting from these exposures with gains and losses on the derivative contracts, thereby reducing volatility of earnings. The Company does not use derivative contracts for speculative or trading purposes. The Company recognizes derivatives, on a gross basis, in the Consolidated Balance Sheet at fair value. Cash flows from derivatives are classified according to the nature of the cash receipt or payment in the Consolidated Statement of Cash Flows.

Cash Flow Hedges

Foreign Currency Forward Contracts

The Company uses foreign currency forward contracts to reduce the earnings impact that exchange rate fluctuations have on operating expenses denominated in currencies other than the U.S. dollar. Changes in the fair value of the contracts are recorded in accumulated other comprehensive income in the Consolidated Balance Sheet and subsequently reclassified into earnings in the period during which the hedged transaction is recognized. The reclassified amount is reported in the same financial statement line item as the hedged item. If the foreign currency forward contracts are terminated or can no longer qualify as hedging instruments prior to maturity, the fair value of the contracts recorded in accumulated other comprehensive income may be recognized in the Consolidated Statement of Operations based on an assessment of the contracts at the time of termination.

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The Company has entered into foreign currency forward contracts for a portion of its forecasted operating expenses denominated in the Norwegian Krone. As of July 4, 2020, the contracts had a maturity of less than one month and an aggregate notional value of \$1.2 million. Losses expected to be reclassified into earnings in the next 12 months were not material. The fair value of the contracts, contract losses recognized in other comprehensive income and amounts reclassified from accumulated other comprehensive income into earnings were not material for any of the periods presented.

Interest Rate Swaps

The Company uses interest rate swap agreements to manage exposure to interest rate risks. The effective portion of the gain or loss on the interest rate swap is recorded in accumulated other comprehensive loss as a separate component of stockholders' equity and is subsequently recognized as interest expense in the Consolidated Statement of Operations when the hedged exposure affects earnings. If the credit facility or the interest rate swap agreement is terminated prior to maturity, the fair value of the interest rate swap recorded in accumulated other comprehensive loss may be recognized in the Consolidated Statement of Operations based on an assessment of the agreements at the time of termination.

The Company entered into an interest rate swap agreement with an original notional value of \$310 million in connection with borrowing from its credit facility on March 27, 2020. The Company terminated the swap agreement on June 1, 2020 in connection with the repayment in full of its credit facility. The termination of the swap agreement resulted in the reclassification of \$0.4 million of unrealized losses that were previously recorded in accumulated other comprehensive income (loss) into earnings.

Non-designated Hedges

Foreign Currency Forward Contracts

The Company uses foreign currency forward contracts to reduce the earnings impact that exchange rate fluctuations have on non-U.S. dollar balance sheet exposures. The Company recognizes gains and losses on the foreign currency forward contracts in interest income and other, net in the Consolidated Statement of Operations in the same period as the remeasurement loss and gain of the related foreign currency denominated asset or liability. The Company does not apply hedge accounting to these foreign currency forward contracts.

As of July 4, 2020, the Company held three foreign currency forward contracts denominated in Singapore Dollars with a notional value of \$17.8 million. The fair value of foreign contracts and contract losses recognized in income were not material for any of the periods presented.

5. Balance Sheet Details

The following shows the details of selected Condensed Consolidated Balance Sheet items (in thousands):

Inventories

| | <u>July 4, 2020</u> | <u>December 28, 2019</u> |
|------------------|-------------------------|------------------------------|
| Work in progress | \$ 48,777 | \$ 52,350 |
| Finished goods | 21,245 | 20,707 |
| | <u>\$ 70,022</u> | <u>\$ 73,057</u> |

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

6. Acquisition*Redpine Signals*

On April 28, 2020, the Company acquired the Wi-Fi® and Bluetooth® business of Redpine Signals. The acquisition will accelerate the Company's roadmap for Wi-Fi and Bluetooth silicon and software solutions. The purchase price was in excess of the fair value of the net assets acquired and, as a result, the Company recorded goodwill. A portion of the goodwill is 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 | \$ 11,753 | Not amortized |
| Developed technology | 61,674 | 8 |
| Customer relationships | 2,450 | 2 |
| Trademarks | 661 | 2 |
| | <u>76,538</u> | |
| Accounts receivable | 1,395 | |
| Inventory | 4,375 | |
| Other current assets | 1,251 | |
| Goodwill | 233,530 | |
| Other non-current assets | 673 | |
| Current liabilities | (856) | |
| Non-current liabilities | (97) | |
| Total purchase price | <u>\$ 316,809</u> | |

In-process research and development (IPR&D) represents Wi-Fi and Bluetooth technology that had not achieved technological feasibility as of the acquisition date. The fair value of IPR&D was determined using the income approach. The discount rate applied to the projected cash flows was 13.8%, which reflects the risks related to the projects. The allocation of the purchase price is preliminary and subject to change, primarily for the valuation of consideration, intangible assets and the finalization of income tax matters.

Revenues attributable to the Redpine Signals business from the date of acquisition to July 4, 2020 were \$2.4 million. Pro forma information related to this acquisition has not been presented because it would not be materially different from amounts reported. The Company recorded approximately \$1.5 million of acquisition-related costs in selling, general and administrative expenses during the six months ended July 4, 2020.

7. Debt*0.625% Convertible Senior Notes*

On June 1, 2020, the Company completed a private offering of \$535 million principal amount convertible senior notes (the "2025 Notes"). The 2025 Notes bear interest semi-annually at a rate of 0.625% per year and mature on June 15, 2025. The Company used \$310.0 million of the proceeds to repay in full the outstanding balance under its credit facility and the remainder of the proceeds, along with cash on hand, to repurchase approximately \$236.8 million aggregate principal amount of its outstanding 1.375% convertible senior notes.

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The 2025 Notes are convertible at an initial conversion rate of 8.1498 shares of common stock per \$1,000 principal amount of the 2025 Notes, or approximately 4.4 million shares of common stock, which is equivalent to a conversion price of approximately \$122.70 per share. The conversion rate is subject to adjustment under certain circumstances. Holders may convert the 2025 Notes under the following circumstances: during any calendar quarter after the calendar quarter ended on September 30, 2020 if the closing price of the Company's common stock for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than or equal to \$159.51 per share, representing 130% of the conversion price of the 2025 Notes; during the five business day period after any ten consecutive trading day period (the "measurement period") in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the closing sale price of our common stock and the conversion rate on each such trading day; if specified distributions or corporate events occur; if the Notes are called for redemption; or at any time after March 15, 2025. The Company may redeem all or any portion of the 2025 Notes, at its option, on or after June 20, 2023, if the last reported sale price of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days during any 30 consecutive trading day period. Upon conversion, the 2025 Notes may be settled in cash, shares of the Company's common stock or a combination of cash and shares, at the Company's election.

The Company incurred debt issuance costs of approximately \$10.4 million, which was allocated to the liability and equity components in proportion to the allocation of the proceeds. The costs allocated to the liability component are being amortized as interest expense over the term of the 2025 Notes using the effective interest method.

1.375% Convertible Senior Notes

On March 6, 2017, the Company completed a private offering of \$400 million principal amount convertible senior notes (the "2022 Notes"). The Notes bear interest semi-annually at a rate of 1.375% per year and mature on March 1, 2022.

The 2022 Notes are convertible at an initial conversion rate of 10.7744 shares of common stock per \$1,000 principal amount of the 2022 Notes, or approximately 4.3 million shares of common stock, which is equivalent to a conversion price of approximately \$92.81 per share. The conversion rate is subject to adjustment under certain circumstances. Holders may convert the 2022 Notes under the following circumstances: during any calendar quarter after the calendar quarter ended on June 30, 2017 if the closing price of the Company's common stock for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than or equal to \$120.66 per share, representing 130% of the conversion price of the 2022 Notes; during the five business day period after any ten consecutive trading day period (the "measurement period") in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the closing sale price of our common stock and the conversion rate on each such trading day; if specified distributions or corporate events occur; if the 2022 Notes are called for redemption; or at any time after December 1, 2021. The Company may redeem all or any portion of the 2022 Notes, at its option, on or after March 6, 2020, if the last reported sale price of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days during any 30 consecutive trading day period. Upon conversion, the 2022 Notes may be settled in cash, shares of the Company's common stock or a combination of cash and shares, at the Company's election.

On June 1, 2020, the Company paid \$276.9 million in cash to repurchase \$236.8 million aggregate principal amount of the 2022 Notes. The Company recognized a loss on debt extinguishment of \$3.7 million during the three months ended July 4, 2020, which was recorded in interest expense in the Condensed Consolidated Statements of Operations.

The principal balances of the notes were separated into liability and equity components, and recorded initially at fair value. The excess of the principal amounts of the liability components over their carrying amounts represent the debt discount, which are amortized to interest expense over the term of the notes using the effective interest method. The carrying amounts of the liability components was estimated by discounting the contractual cash flows of similar non-convertible debt at an appropriate market rate at the date of issuance.

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The carrying amount of the notes consisted of the following (in thousands):

| | July 4, 2020 | December 28, 2019 |
|---------------------------------|-------------------------|------------------------------|
| Liability component | | |
| Principal | \$ 698,217 | \$ 400,000 |
| Unamortized debt discount | (117,008) | (27,580) |
| Unamortized debt issuance costs | (9,435) | (4,163) |
| Net carrying amount | <u>\$ 571,774</u> | <u>\$ 368,257</u> |
| Equity component | | |
| Net carrying amount | <u>\$ 113,932</u> | <u>\$ 57,735</u> |

The liability components of the notes are recorded in convertible debt on the Consolidated Balance Sheet. The equity components of the notes are recorded in additional paid-in capital. The effective interest rate for the liability component was 5.336% for the 2025 Notes and 4.75% for the 2022 Notes. As of July 4, 2020, the remaining period over which the debt discount and debt issuance costs will be amortized was 5.0 years for the 2025 Notes and 1.7 years for the 2022 Notes.

Interest expense related to the notes was comprised of the following (in thousands):

| | Three Months Ended | | Six Months Ended | |
|-------------------------------------|---------------------------|--------------------------|-------------------------|--------------------------|
| | July 4, 2020 | June 29, 2019 | July 4, 2020 | June 29, 2019 |
| Contractual interest expense | \$ 1,374 | \$ 1,360 | \$ 2,841 | \$ 2,750 |
| Amortization of debt discount | 4,132 | 2,900 | 7,378 | 5,786 |
| Amortization of debt issuance costs | 491 | 437 | 981 | 873 |
| | <u>\$ 5,997</u> | <u>\$ 4,697</u> | <u>\$ 11,200</u> | <u>\$ 9,409</u> |

Credit Facility

The Company (and certain of its domestic subsidiaries (the “Guarantors”)) have a \$400 million revolving credit facility with a maturity date of August 7, 2024. The credit facility includes a \$25 million letter of credit sublimit and a \$10 million swingline loan sublimit. The Company also has an option to increase the size of the borrowing capacity by up to the greater of an aggregate of \$250 million and 100% of EBITDA, plus an amount that would not cause a secured leverage ratio (funded debt secured by assets/EBITDA) to exceed 3.25 to 1.00, subject to certain conditions. On March 27, 2020, the Company borrowed \$310 million under the credit facility. On June 1, 2020, the Company repaid in full the outstanding balance of the credit facility.

The credit facility, other than swingline loans, will bear interest at the Eurodollar rate plus an applicable margin or, at the option of the Company, a base rate (defined as the highest of the Wells Fargo prime rate, the Federal Funds rate plus 0.50% and the Eurodollar Base Rate plus 1.00%) plus an applicable margin. Swingline loans accrue interest at the base rate plus the applicable margin for base rate loans. The applicable margins for the Eurodollar rate loans range from 1.00% to 1.75% and for base rate loans range from 0.00% to 0.75%, depending in each case, on the leverage ratio as defined in the credit facility.

The credit facility contains various conditions, covenants and representations with which the Company must be in compliance in order to borrow funds and to avoid an event of default, including financial covenants that the Company must maintain a net leverage ratio (funded indebtedness/EBITDA) of no more than 4.25 to 1, a secured leverage ratio of no more than 3.50 to 1, and a minimum interest coverage ratio (EBITDA/interest payments) of no less than 2.50 to 1. As of July 4, 2020, the Company was in compliance with all covenants of the credit facility. The Company’s obligations under the credit facility are guaranteed by the Guarantors and are secured by a security interest in substantially all assets of the Company and the Guarantors.

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

8. Commitments and Contingencies

Legal Proceedings

The Company is involved in various legal proceedings that have arisen in the normal course of business. While the ultimate results cannot be predicted with certainty, the Company does not expect them to have a material adverse effect on its Consolidated Financial Statements.

9. Stockholders' Equity

Common Stock

The Company issued 0.5 million shares of common stock during the six months ended July 4, 2020.

Share Repurchase Program

In April 2020, the Board of Directors terminated the Company's existing share repurchase program, effective immediately, which had an authorization amount of \$200 million and a termination date of December 2020. The Company repurchased 0.2 million shares and 0.3 million shares of its common stock for \$16.3 million and \$26.7 million during the six months ended July 4, 2020 and June 29, 2019, respectively. These shares were retired upon repurchase.

Reclassifications From Accumulated Other Comprehensive Income (Loss)

The following table summarizes the effect on net income (loss) from reclassifications out of accumulated other comprehensive income (loss) (in thousands):

| Reclassification | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | July 4, 2020 | June 29, 2019 | July 4, 2020 | June 29, 2019 |
| Gains on available-for-sales securities to: | | | | |
| Interest income and other, net | \$ 121 | \$ — | \$ 222 | \$ — |
| Losses on cash flow hedges to: | | | | |
| Operating expenses | (282) | (194) | (423) | (431) |
| | (161) | (194) | (201) | (431) |
| Income tax expense | 34 | 41 | 40 | 91 |
| Total reclassifications | \$ (127) | \$ (153) | \$ (161) | \$ (340) |

10. Revenues

The Company groups its revenues into two categories, based on the markets and applications in which its products may be used. The following disaggregates the Company's revenue by product category (in thousands):

| | Three Months Ended | | Six Months Ended | |
|-------------------------------|--------------------|---------------|------------------|---------------|
| | July 4, 2020 | June 29, 2019 | July 4, 2020 | June 29, 2019 |
| Internet of Things | \$ 115,055 | \$ 124,664 | \$ 233,096 | \$ 231,085 |
| Infrastructure and automotive | 92,478 | 82,045 | 189,314 | 163,737 |
| | \$ 207,533 | \$ 206,709 | \$ 422,410 | \$ 394,822 |

Silicon Laboratories Inc.
Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The Company has combined its previous product groups, Infrastructure, Broadcast and Access, into the Infrastructure and automotive product group. Prior periods were retrospectively adjusted.

A portion of the Company's sales are made to distributors under agreements allowing certain rights of return and/or price protection related to the final selling price to the end customers. These factors impact the timing and uncertainty of revenues and cash flows. During the three months ended July 4, 2020 and June 29, 2019 and the six months ended July 4, 2020 and June 29, 2019, the Company recognized revenue of \$13.5 million, \$13.5 million, \$14.6 million and \$15.4 million, respectively, from performance obligations that were satisfied in previous reporting periods.

The following disaggregates the Company's revenue by sales channel (in thousands):

| | Three Months Ended | | Six Months Ended | |
|------------------|---------------------------|--------------------------|-------------------------|--------------------------|
| | July 4, 2020 | June 29, 2019 | July 4, 2020 | June 29, 2019 |
| Distributors | \$ 167,016 | \$ 151,180 | \$ 330,479 | \$ 285,309 |
| Direct customers | 40,517 | 55,529 | 91,931 | 109,513 |
| | <u>\$ 207,533</u> | <u>\$ 206,709</u> | <u>\$ 422,410</u> | <u>\$ 394,822</u> |

11. 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"). In fiscal 2017, the stockholders of the Company approved amendments to both the 2009 Plan and the 2009 Purchase Plan. These amendments authorized additional shares of common stock for issuance, to comply with changes in applicable law, improve the Company's corporate governance and to implement other best practices.

Stock-based compensation costs are based on the fair values on the date of grant for stock awards and stock options and on the date of enrollment for the employee stock purchase plans. The fair values of stock awards (such as restricted stock units (RSUs), performance stock units (PSUs) and restricted stock awards (RSAs)) are estimated based on their intrinsic values. The fair values of market stock awards (MSUs) are estimated using a Monte Carlo simulation. The fair values of stock options and employee stock purchase plans are estimated using the Black-Scholes option-pricing model.

The following table presents details of stock-based compensation costs recognized in the Condensed Consolidated Statements of Operations (in thousands):

| | Three Months Ended | | Six Months Ended | |
|-------------------------------------|---------------------------|--------------------------|-------------------------|--------------------------|
| | July 4, 2020 | June 29, 2019 | July 4, 2020 | June 29, 2019 |
| Cost of revenues | \$ 376 | \$ 326 | \$ 711 | \$ 645 |
| Research and development | 7,072 | 6,459 | 14,442 | 12,556 |
| Selling, general and administrative | 7,009 | 6,884 | 14,617 | 13,052 |
| | 14,457 | 13,669 | 29,770 | 26,253 |
| Income tax (expense) benefit | 760 | (2,186) | 2,125 | 1,134 |
| | <u>\$ 13,697</u> | <u>\$ 15,855</u> | <u>\$ 27,645</u> | <u>\$ 25,119</u> |

The Company had approximately \$100.1 million of total unrecognized compensation costs related to granted stock options and awards as of July 4, 2020 that are expected to be recognized over a weighted-average period of approximately 2.4 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)

12. Income Taxes

Provision (benefit) for income taxes includes both domestic and foreign income taxes at the applicable tax rates adjusted for non-deductible expenses, research and development tax credits and other permanent differences. Income tax expense (benefit) was \$0.4 million and \$29.3 million for the three months ended July 4, 2020 and June 29, 2019, resulting in effective tax rates of (26.4)% and 221.0%, respectively. Income tax expense (benefit) was \$(0.2) million and \$26.8 million for the six months ended July 4, 2020 and June 29, 2019, resulting in effective tax rates of (95.8)% and 165.8%, respectively. The significant change in the effective tax rate for the three and six months ended July 4, 2020 as compared to the prior periods was primarily due to the impact in the prior periods of a change in the Company's position related to the treatment of stock-based compensation within its intercompany cost-sharing arrangement as well as a change in the proportion of permanent tax impacts relative to a decrease in current year pre-tax book income.

On July 27, 2015, the U.S. Tax Court issued an opinion in *Altera Corp. v. Commissioner* which concluded that related parties in an intercompany cost-sharing arrangement are not required to share costs related to stock-based compensation. On June 7, 2019, the U.S. Court of Appeals for the Ninth Circuit (the "Ninth Circuit") reversed the 2015 decision of the U.S. Tax Court, thus requiring related parties in an intercompany cost-sharing agreement to share stock-based compensation costs. As a result of the Ninth Circuit decision, the Company no longer reflects a tax benefit related to the removal or exclusion of stock-based compensation from its intercompany cost-sharing arrangement within its financial statements. On June 22, 2020, the U.S. Supreme Court denied Altera's petition for writ of certiorari, declining to review the Ninth Circuit's decision. Based on the Supreme Court's denial to hear the Altera case, until and unless there is further litigation on this matter in the future, the Company considers the matter resolved.

Uncertain Tax Positions

As of July 4, 2020, the Company had gross unrecognized tax benefits, inclusive of interest, of \$2.4 million, of which \$2.0 million would affect the effective tax rate if recognized. During the six months ended July 4, 2020, the Company did not release any of its unrecognized tax benefits.

The Company recognizes interest and penalties related to unrecognized tax benefits in the provision for income taxes. These amounts were not material for any of the periods presented.

Following the completion of the Norwegian Tax Administration ("NTA") examination of the Company's Norwegian subsidiary for income tax matters relating to fiscal years 2013, 2014, 2015 and 2016, the Company received an assessment from the NTA in December 2017 concerning an adjustment to its 2013 taxable income related to the pricing of an intercompany transaction. The Company is currently appealing the assessment. The adjustment to the pricing of the intercompany transaction results in approximately 141.3 million Norwegian kroner, or \$14.9 million additional Norwegian income tax. The Company disagrees with the NTA's assessment and believes the Company's position on this matter is more likely than not to be sustained. The Company plans to exhaust all available administrative remedies, and if unable to resolve this matter through administrative remedies with the NTA, the Company plans to pursue judicial remedies.

The Company believes that it has accrued adequate reserves related to all matters contained in tax periods open to examination. Should the Company experience an unfavorable outcome in the NTA matter, however, such an outcome could have a material impact on its financial statements.

Tax years 2015 through 2020 remain open to examination by the major taxing jurisdictions in which the Company operates. The Company is not currently under audit in any major taxing jurisdiction.

The Company does not believe gross unrecognized tax benefits will decrease in the next 12 months.

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 fiscal year that ends on the Saturday closest to December 31. Fiscal 2020 will have 53 weeks with the extra week occurring in the first quarter of the year. Fiscal 2019 had 52 weeks. Our second quarter of fiscal 2020 ended July 4, 2020. Our second quarter of fiscal 2019 ended June 29, 2019.

Impact of COVID-19

A new strain of novel coronavirus which causes a severe respiratory disease ("COVID-19") was identified in 2019, and subsequently declared a worldwide pandemic by the World Health Organization. We implemented a response plan and continued operations while largely transitioning our global workforce to a remote work model. The third parties that perform our semiconductor manufacturing, assembly, packaging and testing have generally remained operational. The extent of the impact of the COVID-19 pandemic on our operational and financial performance will depend on future developments, including the duration, severity and spread of the pandemic, related restrictions on travel and transportation and other actions that may be taken by governmental authorities, the impact to the business of our suppliers or customers, and other items identified under "Risk Factors" below, all of which are uncertain and cannot be predicted. An extended period of global supply chain and economic disruption could materially affect our business, results of operations, access to sources of liquidity and financial condition.

Overview

We are a leading provider of silicon, software and solutions for a smarter, more connected world. Our award-winning technologies are shaping the future of the Internet of Things (IoT), Internet infrastructure, industrial automation, consumer and automotive markets. Our world-class engineering team creates products focused on performance, energy savings, connectivity and simplicity. Our primary semiconductor products are mixed-signal integrated circuits (ICs), which are electronic components that convert real-world analog signals, such as sound and radio waves, into digital signals that electronic products can process.

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 and software enables us to develop highly differentiated solutions that address multiple markets. We group our products into the following categories:

- Internet of Things products, which include wireless connectivity, microcontroller (MCU) and sensor products; and
- Infrastructure and automotive products, which include timing products (clocks and oscillators); power products (isolation and Power over Ethernet (PoE) devices); broadcast products (consumer and automotive radio devices); and access products (Voice over IP (VoIP) products and embedded modems).

We have combined our previous product groups, Infrastructure, Broadcast and Access, into the Infrastructure and automotive product group. Prior periods were retrospectively adjusted.

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.

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Because some of our ICs are designed for use in consumer products such as televisions, set-top boxes and radios, 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.

Current Period Highlights

Revenues increased \$0.8 million in the recent quarter compared to the second quarter of fiscal 2019 due to increased revenues from our Infrastructure and automotive products, offset by decreased revenues from our IoT products. Gross profit decreased \$0.7 million during the same period due primarily to the fair value write-up associated with previously acquired inventory. Gross margin decreased to 60.9% in the recent quarter compared to 61.5% in the second quarter of fiscal 2019 due primarily to variations in product mix. Operating expenses increased by \$6.7 million in the recent quarter compared to the second quarter of fiscal 2019 due primarily to increased personnel-related expenses and amortization of intangible assets, offset in part by decreased acquisition-related costs. Operating income in the recent quarter was \$7.1 million compared to \$14.6 million in the second quarter of fiscal 2019.

We ended the second quarter with \$723.3 million in cash, cash equivalents and short-term investments. Net cash provided by operating activities was \$100.5 million during the recent six-month period. Accounts receivable was \$70.5 million at July 4, 2020, representing 31 days sales outstanding (DSO). Inventory was \$70.0 million at July 4, 2020, representing 78 days of inventory (DOI).

Through acquisitions and internal development efforts, we have continued to diversify our product portfolio and introduce new products and solutions with added functionality and further integration. On April 28, 2020, we acquired the Wi-Fi and Bluetooth business of Redpine Signals for approximately \$317 million in cash. The acquisition will accelerate our roadmap for Wi-Fi and Bluetooth silicon and software solutions.

In the first six months of fiscal 2020, we introduced energy-friendly power management ICs (PMICs) that enhance the energy efficiency of battery-powered applications; a Power over Ethernet (PoE) portfolio that reduces the cost and complexity of adding 90 W PoE to power sourcing equipment (PSE) and powered devices (PD); Secure Vault technology, a suite of state-of-the-art security features designed to help connected device manufacturers address escalating IoT security threats and regulatory pressures; secure, proprietary wireless system-on-chip (SoC) devices designed for power- and size-constrained IoT products such as electronic shelf labels; secure, ultra-low-power SoCs optimized for Zigbee® Green Power applications powered by coin cell batteries or energy-harvesting sources; and a Bluetooth SoC solution delivering a combination of security features, wireless performance, energy efficiency, and software tools and stacks to meet the market demand for high-volume, battery-powered IoT products. 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 expand our total available market opportunity.

During the six months ended July 4, 2020, we had no customer that represented more than 10% of our revenues. 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 who sell to our customers, Arrow Electronics, Edom Technology and Sekorm, each represented more than 10% of our revenues during the six months ended July 4, 2020.

The percentage of our revenues derived from outside of the United States was 90% during the six months ended July 4, 2020. 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.

Results of Operations

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

Revenues. Revenues are generated predominately by sales of our products. 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.

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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, other intellectual property license costs and certain acquired intangible assets; and an allocated portion of our occupancy costs. Our gross margin fluctuates depending on product mix, manufacturing yields, inventory valuation adjustments, average selling prices and other factors.

Research and Development. Research and development expense consists primarily of personnel-related expenses, including stock-based compensation, as well as new product masks, external consulting and services costs, equipment tooling, equipment depreciation, amortization of intangible assets and an allocated portion of our occupancy costs. 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, as well as an allocated portion of our occupancy costs, sales commissions to independent sales representatives, amortization of intangible assets, professional fees, legal fees, and promotional and marketing expenses.

Interest Income and Other, Net. Interest income and other, net reflects interest earned on our cash, cash equivalents and investment balances, foreign currency remeasurement adjustments and other non-operating income and expenses.

Interest Expense. Interest expense consists of interest on our short and long-term obligations, including our convertible senior notes and credit facility. Interest expense on our convertible senior notes includes contractual interest, amortization of the debt discount and amortization of debt issuance costs.

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

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

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|--------------------------------------|---------------------------|----------------------|-------------------------|----------------------|
| | <u>July 4, 2020</u> | <u>June 29, 2019</u> | <u>July 4, 2020</u> | <u>June 29, 2019</u> |
| Revenues | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| Cost of revenues | 39.1 | 38.5 | 39.5 | 38.5 |
| Gross margin | 60.9 | 61.5 | 60.5 | 61.5 |
| Operating expenses: | | | | |
| Research and development | 34.1 | 30.9 | 33.6 | 31.8 |
| Selling, general and administrative | 23.4 | 23.6 | 24.3 | 24.7 |
| Operating expenses | 57.5 | 54.5 | 57.9 | 56.5 |
| Operating income | 3.4 | 7.0 | 2.6 | 5.0 |
| Other income (expense): | | | | |
| Interest income and other, net | 1.6 | 1.8 | 1.6 | 1.6 |
| Interest expense | (5.7) | (2.4) | (4.1) | (2.5) |
| Income (loss) before income taxes | (0.7) | 6.4 | 0.1 | 4.1 |
| Provision (benefit) for income taxes | 0.2 | 14.2 | — | 6.8 |
| Net income (loss) | <u>(0.9)%</u> | <u>(7.8)%</u> | <u>0.1 %</u> | <u>(2.7)%</u> |

Revenues

| (in millions) | Three Months Ended | | | | Six Months Ended | | | |
|-------------------------------|--------------------|---------------|----------|----------|------------------|---------------|---------|----------|
| | July 4, 2020 | June 29, 2019 | Change | % Change | July 4, 2020 | June 29, 2019 | Change | % Change |
| Internet of Things | \$ 115.0 | \$ 124.6 | \$ (9.6) | (7.7)% | \$ 233.1 | \$ 231.1 | \$ 2.0 | 0.9% |
| Infrastructure and automotive | 92.5 | 82.1 | 10.4 | 12.7% | 189.3 | 163.7 | 25.6 | 15.6% |
| | \$ 207.5 | \$ 206.7 | \$ 0.8 | 0.4% | \$ 422.4 | \$ 394.8 | \$ 27.6 | 7.0% |

The change in revenues in the recent three month period was due to:

- Decreased revenues of \$9.6 million for our IoT products, due primarily to decreased demand for our wireless connectivity products, offset by increased demand for our MCU products.
- Increased revenues of \$10.4 million for our Infrastructure and automotive products, due primarily to increased demand for our timing and power products, offset by decreased demand for our consumer products.

The change in revenues in the recent six month period was due to:

- Increased revenues of \$2.0 million for our IoT products, due primarily to increased demand for our MCU products, offset by decreased demand for our wireless connectivity products.
- Increased revenues of \$25.6 million for our Infrastructure and automotive products, due primarily to increased demand for our power and timing products.

Unit volumes of our products increased by 7.6% and average selling prices decreased by 6.4% compared to the three months ended June 29, 2019. Unit volumes of our products increased by 16.9% and average selling prices decreased by 8.3% compared to the six months ended June 29, 2019. The average selling prices of our products may fluctuate significantly from period to period due to changes in product mix and other factors. 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 Profit

| (in millions) | Three Months Ended | | | Six Months Ended | | |
|---------------|--------------------|---------------|----------|------------------|---------------|---------|
| | July 4, 2020 | June 29, 2019 | Change | July 4, 2020 | June 29, 2019 | Change |
| Gross profit | \$ 126.3 | \$ 127.0 | \$ (0.7) | \$ 255.5 | \$ 242.9 | \$ 12.6 |
| Gross margin | 60.9% | 61.5% | (0.6)% | 60.5% | 61.5% | (1.0)% |

Gross profit decreased during the recent three-month period due primarily to the fair value write-up associated with previously acquired inventory. Gross profit increased during the recent six-month period due primarily to increased product sales. The change in gross profit in the recent three-month period was due to a decrease in gross profit of \$7.3 million for our Internet of Things products, offset by an increase in gross profit of \$6.6 million for our Infrastructure and automotive products. The change in gross profit in the recent six-month period was due to an increase in gross profit of \$14.7 million for our Infrastructure and automotive products, offset by a decrease of \$2.1 million for our Internet of Things products. Gross profit in the recent three and six month periods included \$0.5 million in charges for the fair value write-up associated with acquired inventory. Gross margin decreased during the recent three and six month periods primarily due to lower gross margins on our IoT products, which resulted from lower average selling prices on such products in the recent periods.

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

Research and Development

| (in millions) | Three Months Ended | | | | Six Months Ended | | | |
|--------------------------|--------------------|---------------|--------|----------|------------------|---------------|---------|----------|
| | July 4, 2020 | June 29, 2019 | Change | % Change | July 4, 2020 | June 29, 2019 | Change | % Change |
| Research and development | \$ 70.8 | \$ 63.9 | \$ 6.9 | 10.9 % | \$ 142.1 | \$ 125.4 | \$ 16.7 | 13.3 % |
| Percent of revenue | 34.1 % | 30.9 % | | | 33.6 % | 31.8 % | | |

The increase in research and development expense in the three-month period was primarily due to increases of \$5.8 million for personnel-related expenses, including costs associated with increased headcount and an acquisition and \$0.8 million for the amortization of intangible assets. The increase research and development expense in the six-month period was primarily due to increases of \$14.1 million for personnel-related expenses and \$1.0 million for occupancy costs. We expect that research and development expense will remain relatively stable in absolute dollars in the third quarter of fiscal 2020.

Selling, General and Administrative

| (in millions) | Three Months Ended | | | | Six Months Ended | | | |
|-------------------------------------|--------------------|---------------|----------|----------|------------------|---------------|--------|----------|
| | July 4, 2020 | June 29, 2019 | Change | % Change | July 4, 2020 | June 29, 2019 | Change | % Change |
| Selling, general and administrative | \$ 48.4 | \$ 48.6 | \$ (0.2) | (0.5) % | \$ 102.4 | \$ 97.9 | \$ 4.5 | 4.6 % |
| Percent of revenue | 23.4 % | 23.6 % | | | 24.3 % | 24.7 % | | |

The decrease in selling, general and administrative expense in the three-month period was primarily due to a decrease of \$1.0 million for acquisition-related costs, offset by an increase of \$0.9 million for personnel-related expenses, including costs associated with increased headcount. The increase in selling, general and administrative expense in the six-month period was primarily due to an increase of \$4.5 million for personnel-related expenses. We expect that selling, general and administrative expense will remain relatively stable in absolute dollars in the third quarter of fiscal 2020.

Interest Income and Other, Net

Interest income and other, net for the three and six months ended July 4, 2020 was \$3.3 million and \$6.5 million, respectively, compared to \$3.7 million and \$6.5 million for the three and six months ended June 29, 2019, respectively.

Interest Expense

Interest expense for the three and six months ended July 4, 2020 was \$11.8 million and \$17.3 million, respectively, compared to \$5.0 million and \$10.0 million for the three and six months ended June 29, 2019, respectively. The increase in interest expense in the recent three and six month periods was primarily due to a loss of \$3.7 million recorded on the early extinguishment of a portion of the 2022 Notes and \$2.2 million in interest on the 2025 Notes.

Provision (Benefit) for Income Taxes

| (in millions) | Three Months Ended | | | Six Months Ended | | |
|--------------------------------------|--------------------|---------------|-----------|------------------|---------------|-----------|
| | July 4, 2020 | June 29, 2019 | Change | July 4, 2020 | June 29, 2019 | Change |
| Provision (benefit) for income taxes | \$ 0.4 | \$ 29.3 | \$ (28.9) | \$ (0.2) | \$ 26.8 | \$ (27.0) |
| Effective tax rate | (26.4) % | 221.0 % | | (95.8) % | 165.8 % | |

The significant change in the effective tax rate for the three and six months ended July 4, 2020 as compared to the prior periods was primarily due to the impact in the prior periods of a change in the Company's position related to the treatment of stock-based compensation within its intercompany cost-sharing arrangement as well as a change in the proportion of permanent tax impacts relative to a decrease in current year pre-tax book income.

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The effective tax rates for each of the periods presented differ from the U.S. federal statutory tax rates of 21% due to the amount of income earned in foreign jurisdictions where the tax rate may be higher or lower than the federal statutory tax rate, and other permanent items including research and development tax credits, the tax effects of stock-based compensation and GILTI, or global intangible low-tax income.

Business Outlook

The following represents our business outlook for the third quarter of fiscal 2020.

| <u>Income Statement Item</u> | <u>Estimate</u> |
|-----------------------------------|--------------------------------|
| Revenues | \$208 million to \$218 million |
| Gross margin | 60% |
| Operating expenses | \$118 million |
| Effective tax rate | 0.0% |
| Diluted earnings (loss) per share | \$(0.01) to \$0.09 |

Liquidity and Capital Resources

Our principal sources of liquidity as of July 4, 2020 consisted of \$723.3 million in cash, cash equivalents and short-term investments, of which approximately \$543.4 million was held by our U.S. entities. The remaining balance was held by our foreign subsidiaries. Our cash equivalents and short-term investments consisted of government debt securities, which include agency bonds, municipal bonds and U.S. government securities; corporate debt securities, which include asset-backed securities, corporate bonds and commercial paper; and money market funds. Our long-term investments consisted of auction-rate securities.

Operating Activities

Net cash provided by operating activities was \$100.5 million during the six months ended July 4, 2020, compared to net cash provided of \$71.4 million during the six months ended June 29, 2019. Operating cash flows during the six months ended July 4, 2020 reflect our net income of \$0.4 million, adjustments of \$73.0 million for depreciation, amortization, stock-based compensation and deferred income taxes, and a net cash inflow of \$27.1 million due to changes in our operating assets and liabilities.

Accounts receivable decreased to \$70.5 million at July 4, 2020 from \$75.6 million at December 28, 2019. The decrease in accounts receivable resulted primarily from normal variations in the timing of collections and billings. Our average DSO was 31 days at July 4, 2020 and December 28, 2019.

Inventory decreased to \$70.0 million at July 4, 2020 from \$73.1 million at December 28, 2019. Our inventory level is primarily impacted by our need to make purchase commitments to support forecasted demand and variations between forecasted and actual demand. Our DOI was 78 days at July 4, 2020 and 76 days at December 28, 2019.

Investing Activities

Net cash used in investing activities was \$272.3 million during the six months ended July 4, 2020, compared to net cash used of \$44.7 million during the six months ended June 29, 2019. The increase in cash outflows was principally due to a payment of \$316.8 million for the acquisition of the Wi-Fi and Bluetooth business of Redpine Signals, offset by an increase in cash inflows of \$88.5 million from net sales and purchases of marketable securities in the current period.

Financing Activities

Net cash provided by financing activities was \$222.3 million during the six months ended July 4, 2020, compared to net cash used of \$34.1 million during the six months ended June 29, 2019. The increase in cash inflows was principally due to \$845 million in proceeds from the issuance of debt and a decrease of \$10.4 million for repurchases of our common stock, offset by \$597.4 million in payments on debt in the current period.

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As of July 4, 2020, our debt included \$535 million principal amount convertible senior notes (the “2025 Notes”) and \$163 million principal amount convertible senior notes (the “2022 Notes”) and we had an undrawn \$400 million revolving credit facility. We have an option to increase the size of the borrowing capacity of the revolving credit facility by up to the greater of an aggregate of \$250 million and 100% of EBITDA, plus an amount that would not cause a secured leverage ratio to exceed 3.25 to 1.00, subject to certain conditions. On March 27, 2020, we borrowed \$310 million under the revolving credit facility. On June 1, 2020, we used \$310.0 million of the 2025 Notes proceeds to repay the revolving credit facility in full. We used the remainder of the proceeds, along with cash on hand, to repurchase approximately \$236.8 million aggregate principal amount of its outstanding 2022 Notes. We had increased our borrowings as a precautionary measure in order to increase our cash position and preserve financial flexibility in light of current uncertainty in the global markets resulting from the COVID-19 pandemic. See Note 7, *Debt*, to the Condensed Consolidated Financial Statements for additional information.

Our future capital requirements will depend on many factors, including the rate of sales growth, market acceptance of our products, the timing and extent of research and development projects, potential acquisitions of companies or technologies and the expansion of our sales and marketing activities. We believe our existing cash, cash equivalents, investments and credit under our Credit Facility are sufficient to meet our capital requirements through at least the next 12 months, although we could be required, or could elect, to seek additional funding prior to that time. We may enter into acquisitions or strategic arrangements in the future which also could require us to seek additional equity or debt financing.

Critical Accounting Policies and Estimates

The preparation of financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles requires that we make estimates and assumptions that affect the amounts reported. Changes in facts and circumstances could have a significant impact on the resulting estimated amounts included in the financial statements. We believe the following critical accounting policies affect our more complex judgments and estimates.

Inventory valuation - We assess the recoverability of inventories through the application of a set of methods, assumptions and estimates. In determining net realizable value, we write down inventory that may be slow moving or have some form of obsolescence, including inventory that has aged more than 12 months. We also adjust the valuation of inventory when its manufacturing cost exceeds the estimated selling price less costs of completion, disposal and transportation. We assess the potential for any unusual customer returns based on known quality or business issues and write-off inventory losses for scrap or non-saleable material. Inventory not otherwise identified to be written down is compared to an assessment of our 12-month forecasted demand. The result of this methodology is compared against the product life cycle and competitive situations in the marketplace to determine the appropriateness of the resulting inventory levels. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those that we project. In the event that actual demand is lower or market conditions are worse than originally projected, additional inventory write-downs may be required.

Impairment of goodwill and other long-lived assets - We review long-lived assets which are held and used, including fixed assets and purchased intangible assets, for impairment whenever changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Such evaluations compare the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset over its expected useful life and are significantly impacted by estimates of future prices and volumes for our products, capital needs, economic trends and other factors which are inherently difficult to forecast. If the asset is considered to be impaired, we record an impairment charge equal to the amount by which the carrying value of the asset exceeds its fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique.

We test our goodwill for impairment annually as of the first day of our fourth fiscal quarter and in interim periods if certain events occur indicating that the carrying value of goodwill may be impaired. We assess goodwill for impairment by comparing the fair value of a reporting unit to its carrying amount. In determining fair value, the accounting guidance allows for the use of several valuation methodologies, although it states quoted market prices are the best evidence of fair value. If the fair value of the reporting unit is less than its carrying amount, we recognize an impairment loss equal to that excess amount.

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Acquired intangible assets - When we acquire a business, a portion of the purchase price is typically allocated to identifiable intangible assets, such as acquired technology and customer relationships. Fair value of these assets is determined primarily using the income approach, which requires us to project future cash flows and apply an appropriate discount rate. We amortize intangible assets with finite lives over their expected useful lives. Our estimates are based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and unanticipated events and circumstances may occur. Incorrect estimates could result in future impairment charges, and those charges could be material to our results of operations.

Revenue recognition - We recognize revenue when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. In order to achieve this core principle, we apply a five-step process. As part of this process, we analyze the performance obligations in a customer contract and estimate the consideration we expect to receive. The evaluation of performance obligations requires that we identify the promised goods and services in the contract. For contracts that contain more than one promised good and service, we then must determine whether the promises are capable of being distinct and if they are separately identifiable from other promises in the contract. Additionally, for our sales to distributors, we must estimate the impact that price adjustments and rights of return will have on consideration. We make these estimates based on available information, including recent sales activity and pricing data. If our evaluation of performance obligations is incorrect, we may recognize revenue sooner or later than is appropriate. If our estimates of consideration are inaccurate, we may recognize too much or too little revenue in a period.

Stock-based compensation - We recognize the fair-value of stock-based compensation transactions in the Consolidated Statements of Operations. The fair value of our full-value stock awards (with the exception of market-based performance awards) equals the fair market value of our stock on the date of grant. The fair value of our market-based performance awards is estimated at the date of grant using a Monte-Carlo simulation. The fair value of our stock option and employee stock purchase plan grants is estimated at the date of grant using the Black-Scholes option pricing model. In addition, we are required to estimate the expected forfeiture rate of our stock grants and only recognize the expense for those shares expected to vest. If our actual experience differs significantly from the assumptions used to compute our stock-based compensation cost, or if different assumptions had been used, we may have recorded too much or too little stock-based compensation cost. See Note 11, *Stock-Based Compensation*, to the Condensed Consolidated Financial Statements for additional information.

Income taxes - We are required to calculate income taxes in each of the jurisdictions in which we operate. This process involves calculating the actual current tax liability together with assessing temporary differences in recognition of income (loss) for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our Consolidated Balance Sheet. We record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. In assessing the need for a valuation allowance, we are required to estimate the amount of expected future taxable income. Judgment is inherent in this process and differences between the estimated and actual taxable income could result in a material impact on our Consolidated Financial Statements.

We recognize liabilities for uncertain tax positions based on a two-step process. The first step requires us to determine whether the weight of available evidence indicates that the tax position has met the threshold for recognition. Therefore, we must evaluate whether it is more likely than not that the position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step requires us to measure the tax benefit of the tax position taken, or expected to be taken, in an income tax return as the largest amount that is more than 50% likely of being realized upon ultimate settlement. This measurement step is inherently complex and requires subjective estimations of such amounts to determine the probability of various possible outcomes. We re-evaluate the uncertain tax positions each quarter based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, expirations of statutes of limitation, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period.

Although we believe the measurement of our liabilities for uncertain tax positions is reasonable, no assurance can be given that the final outcome of these matters will not be different than what is reflected in the historical income tax provisions and accruals. If additional taxes are assessed as a result of an audit or litigation, they could have a material effect on our income tax provision and net income in the period or periods for which that determination is made. We operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions. These audits can involve complex issues which may require an extended period of time to resolve and could result in additional assessments of income tax. We believe adequate provisions for income taxes have been made for all periods.

Quantitative and Qualitative Disclosures about Market Risk

Interest Income

Our investment portfolio includes cash, cash equivalents, short-term investments and long-term investments. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Our interest income is sensitive to changes in the general level of U.S. interest rates. A 100 basis point decline in yield on our investment portfolio holdings as of July 4, 2020 would decrease our future annual interest income by approximately \$6.6 million. We believe that our investment policy, which defines the duration, concentration, and minimum credit quality of the allowable investments, meets our investment objectives.

Interest Expense

We are exposed to interest rate fluctuations in the normal course of our business, including through our credit facility. The interest rate on the credit facility consists of a variable-rate of interest and an applicable margin. While we have drawn from the credit facility in the past, we have no borrowings as of July 4, 2020. If we borrow from the credit facility in the future, we will again be exposed to interest rate fluctuations.

Foreign currency exchange rate risk

We are exposed to foreign currency exchange rate risk primarily through assets, liabilities and operating expenses of our subsidiaries denominated in currencies other than the U.S. dollar. Our foreign subsidiaries are considered to be extensions of the U.S. parent. The functional currency of the foreign subsidiaries is the U.S. dollar. Accordingly, gains and losses resulting from remeasuring transactions denominated in currencies other than U.S. dollars are recorded in the Consolidated Statements of Operations. We use foreign currency forward contracts to manage exposure to foreign exchange risk. Gains and losses on foreign currency forward contracts are recognized in earnings in the same period during which the hedged transaction is recognized.

Investments in Auction-rate Securities

As of July 4, 2020, we held \$6.0 million par value auction-rate securities, all of which have experienced failed auctions because sell orders exceeded buy orders. We are unable to predict if these funds will become available before their maturity dates. Additionally, if we determine that a credit-related decline in the fair value of any of our available-for-sale auction-rate securities has occurred, we may be required to adjust the carrying value of the investments through an impairment charge.

Available Information

Our website address is www.silabs.com. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the investor relations page of our website free of charge as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). Our website and the information contained therein or connected thereto are not intended to be incorporated into this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information related to quantitative and qualitative disclosures regarding market risk is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations under Item 2 above. Such information is incorporated by reference herein.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of July 4, 2020 to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Such disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There was no change in our internal controls during the fiscal quarter ended July 4, 2020 that materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

Information regarding legal proceedings is provided in Note 8, *Commitments and Contingencies*, to the Condensed Consolidated Financial Statements. Such information is incorporated by reference herein.

Item 1A. Risk Factors

Risks Related to our Business

The COVID-19 pandemic could adversely affect our business, results of operations, and financial condition.

The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains and created significant volatility and disruption of financial markets. The extent of the impact of the COVID-19 pandemic on our operational and financial performance will depend on future developments, including the duration, severity and spread of the pandemic, related restrictions on travel and transportation and other actions that may be taken by governmental authorities, the impact to the business of our suppliers or customers and other items identified in the risk factors below, all of which are uncertain and cannot be predicted.

The impacts of the COVID-19 pandemic, or a similar public health crisis, on our business, customers, suppliers, employees, markets and financial results and condition are uncertain, evolving and dependent on numerous unpredictable factors outside of our control, including:

- The duration and impact of a global economic recession or depression that could further reduce demand and/or pricing for our products;
- Disruptions to our business and supply chain (and the business and supply chains of our customers) in connection with the sourcing of materials, equipment and engineering support, and services from geographic areas impacted by the public health crisis, including disruptions caused by illnesses, quarantines and restrictions on people's ability to work, office and factory closures, disruptions to ports and other shipping infrastructure, border closures, and other travel or health-related restrictions;
- Delays or limitations on the ability of our customers to make timely payments;
- Governmental actions to limit exposure to and spreading of such infectious diseases, such as travel restrictions, quarantines and business shutdowns or slowdowns, facility closures or other restrictions;
- Deterioration of worldwide credit and financial markets that could limit our ability to obtain external financing to fund our operations and capital expenditures or to refinance our existing indebtedness;

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- Potential asset impairments, including goodwill, intangible assets, investments and other assets;
- Complexities related to our employees temporarily working from home as well as increased cyber-related risks due to our employees working from home;
- Potential failure of our computer systems or communication systems; and
- Investment-related risks, including difficulties in liquidating investments due to current market conditions and adverse investment performance.

There can be no assurance that any decrease in sales resulting from the COVID-19 pandemic will be offset by increased sales in subsequent periods. Even after the COVID-19 pandemic has subsided, we may continue to experience materially adverse impacts to our business as a result of its global economic impact, including any recession, economic downturn or increased unemployment that has occurred or may occur in the future. An extended period of global supply chain and economic disruption could materially affect our business, results of operations, access to sources of liquidity and financial condition.

We may not be able to maintain our historical growth and may experience significant period-to-period fluctuations in our revenues and operating results, which may result in volatility in our stock price

Although we have generally experienced revenue growth in our history, we may not be able to sustain this growth. We may also experience significant period-to-period fluctuations in our revenues and operating results in the future due to a number of factors, and any such variations may cause our stock price to fluctuate. In some future period our revenues or operating results may be below the expectations of public market analysts or investors. If this occurs, our stock price may drop, perhaps significantly.

A number of factors, in addition to those cited in other risk factors applicable to our business, may contribute to fluctuations in our revenues and operating results, including:

- The timing and volume of orders received from our customers;
- The timeliness of our new product introductions and the rate at which our new products may cannibalize our older products;
- The rate of acceptance of our products by our customers, including the acceptance of new products we may develop for integration in the products manufactured by such customers, which we refer to as "design wins";
- The time lag and realization rate between "design wins" and production orders;
- The demand for, and life cycles of, the products incorporating our mixed-signal solutions;
- The rate of adoption of mixed-signal products in the markets we target;
- Deferrals or reductions of customer orders in anticipation of new products or product enhancements from us or our competitors or other providers of mixed-signal ICs;
- Changes in product mix;
- The average selling prices for our products could drop suddenly due to competitive offerings or competitive predatory pricing;
- The average selling prices for our products generally decline over time;
- Changes in market standards;
- Impairment charges related to inventory, equipment or other long-lived assets;
- The software used in our products, including software provided by third parties, may not meet the needs of our customers;

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- Our customers may not be able to obtain other components such as capacitors (which are currently in short supply) that they need to incorporate in conjunction with our products, leading to potential downturn in the demand for our products;
- Significant legal costs to defend our intellectual property rights or respond to claims against us; and
- The rate at which new markets emerge for products we are currently developing or for which our design expertise can be utilized to develop products for these new markets.

The markets for consumer electronics, for example, are characterized by rapid fluctuations in demand and seasonality that result in corresponding fluctuations in the demand for our products that are incorporated in such devices. Additionally, the rate of technology acceptance by our customers results in fluctuating demand for our products as customers are reluctant to incorporate a new IC into their products until the new IC has achieved market acceptance. Once a new IC achieves market acceptance, demand for the new IC can quickly accelerate to a point and then level off such that rapid historical growth in sales of a product should not be viewed as indicative of continued future growth. In addition, demand can quickly decline for a product when a new IC product is introduced and receives market acceptance. Due to the various factors mentioned above, the results of any prior quarterly or annual periods should not be relied upon as an indication of our future operating performance.

If we are unable to develop or acquire new and enhanced products that achieve market acceptance in a timely manner, our operating results and competitive position could be harmed

Our future success will depend on our ability to develop or acquire new products and product enhancements that achieve market acceptance in a timely and cost-effective manner. The development of mixed-signal ICs is highly complex, and we have at times experienced delays in completing the development and introduction of new products and product enhancements. Successful product development and market acceptance of our products depend on a number of factors, including:

- Requirements of customers;
- Accurate prediction of market and technical requirements;
- Timely completion and introduction of new designs;
- Timely qualification and certification of our products for use in our customers' products;
- Commercial acceptance and volume production of the products into which our ICs will be incorporated;
- Availability of foundry, assembly and test capacity;
- Achievement of high manufacturing yields;
- Quality, price, performance, power use and size of our products;
- Availability, quality, price and performance of competing products and technologies;
- Our customer service, application support capabilities and responsiveness;
- Successful development of our relationships with existing and potential customers;
- Technology, industry standards or end-user preferences; and
- Cooperation of third-party software providers and our semiconductor vendors to support our chips within a system.

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We cannot provide any assurance that products which we recently have developed or may develop in the future will achieve market acceptance. We have introduced to market or are in development of many products. If our products fail to achieve market acceptance, or if we fail to develop new products on a timely basis that achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected. The growth of the IoT market is dependent on the adoption of industry standards to permit devices to connect and communicate with each other. If the industry cannot agree on a common set of standards, then the growth of the IoT market may be slower than expected.

Our research and development efforts are focused on a limited number of new technologies and products, and any delay in the development, or abandonment, of these technologies or products by industry participants, or their failure to achieve market acceptance, could compromise our competitive position

Our products serve as components and solutions in electronic devices in various markets. As a result, we have devoted and expect to continue to devote a large amount of resources to develop products based on new and emerging technologies and standards that will be commercially introduced in the future. Research and development expense during the six months ended July 4, 2020 was \$142.1 million, or 33.6% of revenues. A number of companies are actively involved in the development of these new technologies and standards. Should any of these companies delay or abandon their efforts to develop commercially available products based on new technologies and standards, our research and development efforts with respect to these technologies and standards likely would have no appreciable value. In addition, if we do not correctly anticipate new technologies and standards, or if the products that we develop based on these new technologies and standards fail to achieve market acceptance, our competitors may be better able to address market demand than we would. Furthermore, if markets for these new technologies and standards develop later than we anticipate, or do not develop at all, demand for our products that are currently in development would suffer, resulting in lower sales of these products than we currently anticipate.

We are a global company, which subjects us to additional business risks including logistical and financial complexity, political instability and currency fluctuations

We have established international subsidiaries and have opened offices in international markets to support our activities in Asia, the Americas and Europe. This has included the establishment of a headquarters in Singapore for non-U.S. operations. During the six months ended July 4, 2020, the percentage of our revenues derived from outside of the United States was 90% (and the revenue associated with end customers in China was 25%, and revenue attributed to China based on shipped-to location was 43%). We may not be able to maintain or increase global market demand for our products. Our international operations are subject to a number of risks, including:

- Complexity and costs of managing international operations and related tax obligations, including our headquarters for non-U.S. operations in Singapore;
- Protectionist laws and business practices, including trade restrictions, tariffs, export controls, quotas and other trade barriers, including China-U.S. trade policies and the potential effects of Brexit;
- Trade tensions, geopolitical uncertainty, or governmental actions, including those arising from the trade dispute between the U.S. and China, may lead customers to favor products from non-US companies which could put us at a competitive disadvantage and result in decreased customer demand for our products and our customers' products;
- Restrictions or tariffs imposed on certain countries and sanctions or export controls imposed on customers or suppliers may affect our ability to sell and source our products;
- Difficulties related to the protection of our intellectual property rights in some countries;
- Public health crises, such as the COVID-19 pandemic, may affect our international operations, suppliers and customers and we may experience delays in product development, a decreased ability to support our customers and reduced design win activity if the travel restrictions or business shutdowns or slowdowns continue for an extended period of time in any of the countries in which we, our suppliers and our customers operate and do business;

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- Multiple, conflicting and changing tax and other laws and regulations that may impact both our international and domestic tax and other liabilities and result in increased complexity and costs, including the impact of the Tax Cuts and Jobs Act, which we expect to increase our effective tax rate, in part due to the impact of the requirement to capitalize and amortize foreign research and development expenses beginning in 2022;
- Longer sales cycles;
- Greater difficulty in accounts receivable collection and longer collection periods;
- High levels of distributor inventory subject to price protection and rights of return to us;
- Political and economic instability;
- Greater difficulty in hiring and retaining qualified personnel; and
- The need to have business and operations systems that can meet the needs of our international business and operating structure.

To date, substantially all of our sales to international customers and purchases of components from international suppliers have been denominated in U.S. dollars. As a result, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive for our international customers to purchase, thus rendering our products less competitive. Similarly, a decrease in the value of the U.S. dollar could reduce our buying power with respect to international suppliers.

Significant litigation over intellectual property in our industry may cause us to become involved in costly and lengthy litigation which could adversely affect our business

The semiconductor and software industries have experienced significant litigation involving patents and other intellectual property rights. From time to time, third parties, including non-practicing entities, allege intellectual property infringement by our products, our customers' products, or products using technologies or communications standards used in our industry. We also receive communications from customers or suppliers requesting indemnification for allegations brought against them by third parties. Some of these allegations have resulted, and may result in the future, in our involvement in litigation. We have certain contractual obligations to defend and indemnify our customers from certain infringement claims. We also have been involved in litigation to protect our intellectual property rights in the past and may become involved in such litigation again in the future.

Given the unpredictable nature of litigation and the complexity of the technology, we may not prevail in any such litigation. Legal proceedings could subject us to significant liability, invalidate our proprietary rights, or harm our businesses and our ability to compete. Legal proceedings initiated by us to protect our intellectual property rights could also result in counterclaims or countersuits against us. Any litigation, regardless of its outcome or merit, could be time-consuming and expensive to resolve and could divert our management's time and attention. Intellectual property litigation also could force us to take specific actions, including:

- Cease using, selling or manufacturing certain products, services or processes;
- Attempt to obtain a license, which license may require the payment of substantial royalties or may not be available on reasonable terms or at all;
- Incur significant costs, time delays and lost business opportunities to develop alternative technologies or redesign products; or
- Pursue legal remedies with third parties to enforce our indemnification rights, which may not adequately protect our interests.

Any acquisitions we make could disrupt our business and harm our financial condition

As part of our growth and product diversification strategy, we continue to evaluate opportunities to acquire other businesses, intellectual property or technologies that would complement our current offerings, expand the breadth of our markets or enhance our technical capabilities. The acquisitions that we have made and may make in the future entail a number of risks that could materially and adversely affect our business and operating results, including:

- Problems integrating the acquired operations, technologies or products with our existing business and products;
- Diversion of management's time and attention from our core business;
- Need for financial resources above our planned investment levels;
- Difficulties in retaining business relationships with suppliers and customers of the acquired company;
- Risks associated with entering markets in which we lack prior experience;
- Risks associated with the transfer of licenses of intellectual property;
- Increased operating costs due to acquired overhead;
- Tax issues associated with acquisitions;
- Acquisition-related disputes, including disputes over earn-outs and escrows;
- Potential loss of key employees of the acquired company; and
- Potential impairment of related goodwill and intangible assets.

In particular, the extent of the impact of the COVID-19 pandemic on our ability to complete and integrate any future acquisition into our business is unpredictable and will depend on future developments, including the duration, severity and spread of the pandemic, related restrictions on travel and transportation, and other actions that may be taken by governmental authorities. Future acquisitions also could cause us to incur debt or contingent liabilities or cause us to issue equity securities that could negatively impact the ownership percentages of existing shareholders.

We may be unable to protect our intellectual property, which would negatively affect our ability to compete

Our products rely on our proprietary technology, and we expect that future technological advances made by us will be critical to sustain market acceptance of our products. Therefore, we believe that the protection of our intellectual property rights is and will continue to be important to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into confidentiality or license agreements with our employees, consultants, intellectual property providers and business partners, and control access to and distribution of our documentation and other proprietary information. Despite these efforts, unauthorized parties may attempt to copy or otherwise obtain and use our proprietary technology. Monitoring unauthorized use of our technology is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. We cannot be certain that patents will be issued as a result of our pending applications nor can we be certain that any issued patents would protect or benefit us or give us adequate protection from competing products. For example, issued patents may be circumvented or challenged and declared invalid or unenforceable. We also cannot be certain that others will not develop effective competing technologies on their own.

Failure to manage our distribution channel relationships could impede our future growth

The future growth of our business will depend in large part on our ability to manage our relationships with current and future distributors and sales representatives, develop additional channels for the distribution and sale of our products and manage these relationships. During the six months ended July 4, 2020, 78% of our revenue was derived from distributors. As we execute our indirect sales strategy, we must manage the potential conflicts that may arise with our direct sales efforts. For example, conflicts with a distributor may arise when a customer begins purchasing directly from us rather than through the distributor. The inability to successfully execute or manage a multi-channel sales strategy could impede our future growth. In addition, relationships with our distributors often involve the use of price protection and inventory return rights. This often requires a significant amount of sales management's time and system resources to manage properly. Because we consolidated our distribution relationships to a single global distributor, Arrow Electronics, in fiscal 2018, termination of the relationship with Arrow Electronics, either by us or by Arrow Electronics, could result in a temporary or permanent loss of revenue. If Arrow Electronics fails to effectively market and sell our products in full compliance with applicable laws, or if we are unable to maintain our existing relationship with Arrow Electronics, we may not be able to find a distributor with the scale and resources of Arrow Electronics, maintain existing levels of international revenue or realize expected long-term international revenue growth. We may not be successful in finding suitable alternative global distributors on satisfactory terms, or at all, and this could adversely affect our ability to effectively sell our solutions in certain geographical locations or to certain end customers.

We do not have long-term commitments from our customers

Our customers regularly evaluate alternative sources of supply in order to diversify their supplier base, which increases their negotiating leverage with us and protects their ability to secure these components. We believe that any expansion of our customers' supplier bases could have an adverse effect on the prices we are able to charge and volume of product that we are able to sell to our customers, which would negatively affect our revenues and operating results.

Customers may decide not to purchase our products at all, purchase fewer products than they did in the past, or alter their purchasing patterns, particularly because:

- We do not have material long-term purchase contracts with our customers;
- Substantially all of our sales to date have been made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty;
- Some of our customers may have efforts underway to actively diversify their vendor base which could reduce purchases of our products; and
- Some of our customers have developed or acquired products that compete directly with products these customers purchase from us, which could affect our customers' purchasing decisions in the future.

We are subject to increased inventory risks and costs because we build our products based on forecasts provided by customers before receiving purchase orders for the products

In order to ensure availability of our products for some of our largest customers, we start the manufacturing of our products in advance of receiving purchase orders based on forecasts provided by these customers. However, these forecasts do not represent binding purchase commitments and we do not recognize sales for these products until they are shipped to the customer. As a result, we incur inventory and manufacturing costs in advance of anticipated sales. Because demand for our products may not materialize, manufacturing based on forecasts subjects us to increased risks of high inventory carrying costs, increased obsolescence and increased operating costs. These inventory risks are exacerbated when our customers purchase indirectly through contract manufacturers or hold component inventory levels greater than their consumption rate because this causes us to have less visibility regarding the accumulated levels of inventory for such customers. A resulting write-off of unusable or excess inventories would adversely affect our operating results.

Our products are complex and may contain errors which could lead to liability, an increase in our costs and/or a reduction in our revenues

Our products are complex and may contain errors, particularly when first introduced and/or when new versions are released. Our products are increasingly designed in more complex processes, including higher levels of software and hardware integration in modules and system-level solutions and/or include elements provided by third parties which further increase the risk of errors. We rely primarily on our in-house testing personnel to design test operations and procedures to detect any errors or vulnerabilities prior to delivery of our products to our customers.

Should problems occur in the operation or performance of our products, we may experience delays in meeting key introduction dates or scheduled delivery dates to our customers. These errors could also cause significant re-engineering costs, the diversion of our engineering personnel's attention from our product development efforts and cause significant customer relations and business reputation problems. Any defects could result in refunds, product replacement, product recall or other liability. Any of the foregoing could impose substantial costs and harm our business.

Product liability, data breach or cyber liability claims may be asserted with respect to our products. Many of our products focus on wireless connectivity and the IoT market and such connectivity may make these products particularly susceptible to cyber-attacks. Our products are typically sold at prices that are significantly lower than the cost of the end-products into which they are incorporated. A defect, failure or vulnerability in our product could cause failure in our customer's end-product, so we could face claims for damages that are disproportionately higher than the revenues and profits we receive from the products involved. Furthermore, product liability risks are particularly significant with respect to medical and automotive applications because of the risk of serious harm to users of these end-products. There can be no assurance that any insurance we maintain will sufficiently protect us from such claims.

We rely on third parties to manufacture, assemble and test our products and the failure to successfully manage our relationships with our manufacturers and subcontractors would negatively impact our ability to sell our products

We do not have our own wafer fab manufacturing facilities. Therefore, we rely on third-party vendors to manufacture the products we design. We also currently rely on Asian third-party assembly subcontractors to assemble and package the silicon chips provided by the wafers for use in final products. Additionally, we rely on these offshore subcontractors for a substantial portion of the testing requirements of our products prior to shipping. We expect utilization of third-party subcontractors to continue in the future.

The cyclical nature of the semiconductor industry drives wide fluctuations in available capacity at third-party vendors. On occasion, we have been unable to adequately respond to unexpected increases in customer demand due to capacity constraints and, therefore, were unable to benefit from this incremental demand. We may be unable to obtain adequate foundry, assembly or test capacity from our third-party subcontractors to meet our customers' delivery requirements even if we adequately forecast customer demand.

There are significant risks associated with relying on these third-party foundries and subcontractors, including:

- Failure by us, our customers or their end customers to qualify a selected supplier;
- Potential insolvency of the third-party subcontractors;
- Reduced control over delivery schedules and quality;
- Limited warranties on wafers or products supplied to us;
- Potential increases in prices or payments in advance for capacity;
- Increased need for international-based supply, logistics and financial management;
- Disruption to our supply chain resulting from cyber-attacks on our suppliers' information technology systems;
- Their inability to supply or support new or changing packaging technologies; and
- Low test yields.

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We typically do not have long-term supply contracts with our third-party vendors which obligate the vendor to perform services and supply products to us for a specific period, in specific quantities, and at specific prices. Our third-party foundry, assembly and test subcontractors typically do not guarantee that adequate capacity will be available to us within the time required to meet demand for our products. In the event that these vendors fail to meet our demand for whatever reason, we expect that it would take up to 12 months to transition performance of these services to new providers. Such a transition may also require qualification of the new providers by our customers or their end customers.

If our suppliers experience closures or reductions in their capacity utilization levels in the future, we may have difficulty sourcing materials necessary to fulfill production requirements. Public health crises, such as the COVID-19 pandemic may affect our suppliers' production capabilities as a result of quarantines, closures of production facilities, lack of supplies or delays caused by restrictions on travel.

Most of the silicon wafers for the products that we have sold were manufactured either by Taiwan Semiconductor Manufacturing Co. (TSMC) or Semiconductor Manufacturing International Corporation (SMIC). Our customers typically complete their own qualification process. If we fail to properly balance customer demand across the existing semiconductor fabrication facilities that we utilize or are required by our foundry partners to increase, or otherwise change the number of fab lines that we utilize for our production, we might not be able to fulfill demand for our products and may need to divert our engineering resources away from new product development initiatives to support the fab line transition, which would adversely affect our operating results.

Our customers require our products to undergo a lengthy and expensive qualification process without any assurance of product sales

Prior to purchasing our products, our customers require that our products undergo an extensive qualification process, which involves testing of the products in the customer's system as well as rigorous reliability testing. This qualification process may continue for six months or longer. However, qualification of a product by a customer does not ensure any sales of the product to that customer. Even after successful qualification and sales of a product to a customer, a subsequent revision to the product or software, changes in the IC's manufacturing process or the selection of a new supplier by us may require a new qualification process, which may result in delays and in us holding excess or obsolete inventory. After our products are qualified, it can take an additional six months or more before the customer commences volume production of components or devices that incorporate our products. Despite these uncertainties, we devote substantial resources, including design, engineering, sales, marketing and management efforts, toward qualifying our products with customers in anticipation of sales. If we are unsuccessful or delayed in qualifying any of our products with a customer, such failure or delay would preclude or delay sales of such product to the customer, which may impede our growth and cause our business to suffer.

Our inability to manage growth could materially and adversely affect our business

Our past growth has placed, and any future growth of our operations will continue to place, a significant strain on our management personnel, systems and resources. We anticipate that we will need to implement a variety of new and upgraded sales, operational and financial enterprise-wide systems, information technology infrastructure, procedures and controls, including the improvement of our accounting and other internal management systems to manage this growth and maintain compliance with regulatory guidelines, including Sarbanes-Oxley Act requirements. To the extent our business grows, our internal management systems and processes will need to improve to ensure that we remain in compliance. We also expect that we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort, and we anticipate that we will require additional management personnel and internal processes to manage these efforts and to plan for the succession from time to time of certain persons who have been key management and technical personnel. If we are unable to effectively manage our expanding global operations, including our international headquarters in Singapore, our business could be materially and adversely affected.

We have recently had a material weakness in our internal control over financial reporting and if we are unable to implement and maintain effective internal control over financial reporting, or our independent registered public accounting firm is unable to provide an unqualified report thereon, we could be materially adversely effected

We identified a material weakness that existed as of the end of our fiscal 2018 regarding our internal controls over business combinations, primarily the maintenance of sufficient contemporaneous documentation of management review controls over assumptions used in the valuation of acquired intangible assets and related recording of goodwill. As a result of this material weakness, management concluded that our disclosure controls and procedures and internal control over financial reporting were not effective as of December 29, 2018.

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This material weakness has been remediated. However, should new material weaknesses arise or be discovered in the future, material misstatements could occur and go undetected in our interim or annual consolidated financial statements and we may be required to restate our financial statements. In addition, we may experience delays in satisfying our reporting obligations or to comply with Securities and Exchange Commission rules and regulations, which could result in investigations and sanctions by regulatory authorities. Any of these results could adversely affect our business and the value of our common stock.

Our products incorporate technology licensed from third parties

We incorporate technology (including software) licensed from third parties in our products. We could be subjected to claims of infringement regardless of our lack of involvement in the development of the licensed technology. Although a third-party licensor is typically obligated to indemnify us if the licensed technology infringes on another party's intellectual property rights, such indemnification is typically limited in amount and may be worthless if the licensor becomes insolvent. See *Significant litigation over intellectual property in our industry may cause us to become involved in costly and lengthy litigation which could seriously harm our business*. Furthermore, any failure of third-party technology to perform properly would adversely affect sales of our products incorporating such technology.

We are subject to risks relating to product concentration

We derive a substantial portion of our revenues from a limited number of products, and we expect these products to continue to account for a large percentage of our revenues in the near term. Continued market acceptance of these products, is therefore, critical to our future success. In addition, substantially all of our products that we have sold include technology related to one or more of our issued U.S. patents. If these patents are found to be invalid or unenforceable, our competitors could introduce competitive products that could reduce both the volume and price per unit of our products. Our business, operating results, financial condition and cash flows could therefore be adversely affected by:

- A decline in demand for any of our more significant products;
- Failure of our products to achieve continued market acceptance;
- Competitive products;
- New technological standards or changes to existing standards that we are unable to address with our products;
- A failure to release new products or enhanced versions of our existing products on a timely basis; and
- The failure of our new products to achieve market acceptance.

We are subject to credit risks related to our accounts receivable

We do not generally obtain letters of credit or other security for payment from customers, distributors or contract manufacturers. Accordingly, we are not protected against accounts receivable default or bankruptcy by these entities. Our ten largest customers or distributors represent a substantial majority of our accounts receivable. If any such customer or distributor, or a material portion of our smaller customers or distributors, were to become insolvent or otherwise not satisfy their obligations to us, we could be materially harmed.

We depend on our key personnel to manage our business effectively in a rapidly changing market, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing personnel. We believe that our future success will be dependent on retaining the services of our key personnel, developing their successors and certain internal processes to reduce our reliance on specific individuals, and on properly managing the transition of key roles when they occur. There is currently a shortage of qualified personnel with significant experience in the design, development, manufacturing, marketing and sales of analog and mixed-signal products. In particular, there is a shortage of engineers who are familiar with the intricacies of the design and manufacturability of analog elements, and competition for such personnel is intense. Our key technical personnel represent a significant asset and serve as the primary source for our technological and product innovations. We may not be successful in attracting and retaining sufficient numbers of technical personnel to support our anticipated growth. The loss of any of our key employees or the inability to attract or retain qualified personnel both in the United States and internationally, including engineers, sales, applications and marketing personnel, could delay the development and introduction of, and negatively impact our ability to sell, our products.

Any dispositions could harm our financial condition

Any disposition of a product line would entail a number of risks that could materially and adversely affect our business and operating results, including:

- Diversion of management's time and attention from our core business;
- Difficulties separating the divested business;
- Risks to relations with customers who previously purchased products from our disposed product line;
- Reduced leverage with suppliers due to reduced aggregate volume;
- Risks related to employee relations;
- Risks associated with the transfer and licensing of intellectual property;
- Security risks and other liabilities related to the transition services provided in connection with the disposition;
- Tax issues associated with dispositions; and
- Disposition-related disputes, including disputes over earn-outs and escrows.

Our stock price may be volatile

The market price of our common stock has been volatile in the past and may be volatile in the future. The market price of our common stock may be significantly affected by the following factors:

- Actual or anticipated fluctuations in our operating results;
- Changes in financial estimates by securities analysts or our failure to perform in line with such estimates;
- Changes in market valuations of other technology companies, particularly semiconductor companies;
- Announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Introduction of technologies or product enhancements that reduce the need for our products;
- The loss of, or decrease in sales to, one or more key customers;

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- A large sale of stock by a significant shareholder;
- Dilution from the issuance of our stock in connection with acquisitions;
- The addition or removal of our stock to or from a stock index fund;
- Departures of key personnel;
- The required expensing of stock awards; and
- The required changes in our reported revenue and revenue recognition accounting policy under ASC Topic 606, *Revenue from Contracts with Customers*.

The stock market has experienced extreme volatility that often has been unrelated to the performance of particular companies. These market fluctuations may cause our stock price to fall regardless of our performance.

Most of our current manufacturers, assemblers, test service providers, distributors and customers are concentrated in the same geographic region, which increases the risk that a natural disaster, epidemic, labor strike, war or political unrest could disrupt our operations or sales

Most of our foundries and several of our assembly and test subcontractors' sites are located in Taiwan and most of our other foundry, assembly and test subcontractors are located in the Pacific Rim region. In addition, many of our customers are located in the Pacific Rim region. The risk of earthquakes in Taiwan and the Pacific Rim region is significant due to the proximity of major earthquake fault lines in the area. Earthquakes, tsunamis, fire, flooding, lack of water or other natural disasters, an epidemic such as the current COVID-19 outbreak, political unrest, war, labor strikes or work stoppages in countries where our semiconductor manufacturers, assemblers and test subcontractors are located, likely would result in the disruption of our foundry, assembly or test capacity. There can be no assurance that alternate capacity could be obtained on favorable terms, if at all.

A natural disaster, epidemic, labor strike, war or political unrest where our customers' facilities are located would likely reduce our sales to such customers. North Korea's recent geopolitical maneuverings, including nuclear weapons and long-range missile testing, have created unrest. Such unrest could create economic uncertainty or instability, could escalate to war or otherwise adversely affect South Korea and our South Korean customers and reduce our sales to such customers, which would materially and adversely affect our operating results. In addition, a significant portion of the assembly and testing of our products occurs in South Korea. Any disruption resulting from these events, including the COVID-19 pandemic, could also cause significant delays in shipments of our products until we are able to shift our manufacturing, assembling or testing from the affected subcontractor to another third-party vendor. If the COVID-19 pandemic continues to progress in ways that significantly disrupt the manufacture, shipment and sales of our products or the products of our customers, this may materially negatively impact our operating results for subsequent periods. For example, if the travel restrictions or business shutdowns or slowdowns continue for an extended period of time in Taiwan, South Korea or the other countries in which our current manufacturers, assemblers, test service providers, distributors and customers are located, we may experience delays in product production, a decreased ability to support our customers, reduced design win activity, and overall lack of productivity. Our customers may also experience closures of their manufacturing facilities or inability to obtain other components, either of which could negatively impact demand for our solutions.

The semiconductor manufacturing process is highly complex and, from time to time, manufacturing yields may fall below our expectations, which could result in our inability to satisfy demand for our products in a timely manner and may decrease our gross profit due to higher unit costs

The manufacturing of our products is a highly complex and technologically demanding process. Although we work closely with our foundries and assemblers to minimize the likelihood of reduced manufacturing yields, we have from time to time experienced lower than anticipated manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials could result in lower than anticipated manufacturing yields or unacceptable performance deficiencies, which could lower our gross profit. If our foundries fail to deliver fabricated silicon wafers of satisfactory quality in a timely manner, we will be unable to meet our customers' demand for our products in a timely manner, which would adversely affect our operating results and damage our customer relationships.

We depend on our customers to support our products, and some of our customers offer competing products

We rely on our customers to provide hardware, software, intellectual property indemnification and other technical support for the products supplied by our customers. If our customers do not provide the required functionality or if our customers do not provide satisfactory support for their products, the demand for these devices that incorporate our products may diminish or we may otherwise be materially adversely affected. Any reduction in the demand for these devices would significantly reduce our revenues.

In certain products, some of our customers offer their own competitive products. These customers may find it advantageous to support their own offerings in the marketplace in lieu of promoting our products.

Our convertible senior notes could adversely affect our operating results and financial condition

Upon conversion, our convertible senior notes may be settled in cash, shares of our common stock or a combination of cash and shares, at our election. We intend to settle the principal amount of the notes in cash. If we do not have adequate cash available, we may not be able to settle the principal amount in cash. In such case, we will be required to settle the principal amount in stock, which would result in immediate, and likely material, dilution to the ownership interests of our existing stockholders. Any sales in the public market of our common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock.

Following any conclusion that we no longer have the ability to settle the convertible senior notes in cash, we will be required on a going forward basis to change our accounting policy for earnings per share from the treasury stock method to the if-converted method. Earnings per share may be lower under the if-converted method as compared to the treasury stock method.

The principal balance of the convertible senior notes was separated into liability and equity components, which were recorded initially at fair value. The excess of the principal amount of the liability component over its carrying amount represents the debt discount, which is accreted to interest expense over the term of the notes using the effective interest method. Accordingly, we will report higher interest expense because of the recognition of both the debt discount amortization and the notes' coupon interest.

Our debt could adversely affect our operations and financial condition

We believe we have the ability to service our debt, but our ability to make the required payments thereunder when due depends upon our future performance, which will be subject to general economic conditions, industry cycles and other factors affecting our operations, including risk factors described herein, such as the potential implications of the COVID-19 pandemic, many of which are beyond our control. Our credit facility also contains covenants, including financial covenants. If we breach any of the covenants under our credit facility and do not obtain appropriate waivers, then, subject to any applicable cure periods, our outstanding indebtedness thereunder could be declared immediately due and payable.

We could seek to raise additional debt or equity capital in the future, but additional capital may not be available on terms acceptable to us, or at all

We believe that our existing cash, cash equivalents, investments and credit under our credit facility will be sufficient to meet our working capital needs, capital expenditures, investment requirements and commitments for at least the next 12 months. However, our ability to borrow further under the credit facility is dependent upon our ability to satisfy various conditions, covenants and representations. It is possible that we may need to raise additional funds to finance our activities or to facilitate acquisitions of other businesses, products, intellectual property or technologies. We believe we could raise these funds, if needed, by selling equity or debt securities to the public or to selected investors. In addition, even though we may not need additional funds, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. However, we may not be able to obtain additional funds on favorable terms, or at all, particularly during financial market instability related to the COVID-19 pandemic. If we decide to raise additional funds by issuing equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced.

We have limited resources compared to some of our current and potential competitors and we may not be able to compete effectively and increase market share

Some of our current and potential competitors have longer operating histories, significantly greater resources and name recognition and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. They also may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than we can to ours. In addition, some of our current and potential competitors have already established supplier or joint development relationships with the decision makers at our current or potential customers. These competitors may be able to leverage their existing relationships to discourage their customers from purchasing products from us or persuade them to replace our products with their products. Our competitors may also offer bundled solutions offering a more complete product despite the technical merits or advantages of our products. These competitors may elect not to support our products which could complicate our sales efforts. We also face increased competition as a result of China actively promoting its domestic semiconductor industry through policy changes and investment. These actions, as well as China-U.S. trade barriers, may restrict our participation in the China market or may prevent us from competing effectively with Chinese companies or companies from other countries that China favors over the United States. Furthermore, our current or potential competitors may be acquired by third parties with greater available resources and the ability to initiate or withstand substantial price competition, which may include price concessions, delayed payment terms, financing terms, or other terms and conditions that are more enticing to potential customers. These and other competitive pressures may prevent us from competing successfully against current or future competitors, and may materially harm our business. Competition could decrease our prices, reduce our sales, lower our gross profit and/or decrease our market share.

Provisions in our charter documents and Delaware law could prevent, delay or impede a change in control of us and may reduce the market price of our common stock

Provisions of our certificate of incorporation and bylaws could have the effect of discouraging, delaying or preventing a merger or acquisition that a stockholder may consider favorable. For example, our certificate of incorporation and bylaws provide for:

- The division of our Board of Directors into three classes to be elected on a staggered basis, one class each year;
- The ability of our Board of Directors to issue shares of our preferred stock in one or more series without further authorization of our stockholders;
- A prohibition on stockholder action by written consent;
- Elimination of the right of stockholders to call a special meeting of stockholders;
- A requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders; and
- A requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation.

We also are subject to the anti-takeover laws of Delaware which may discourage, delay or prevent someone from acquiring or merging with us, which may adversely affect the market price of our common stock.

Risks related to our industry

We are subject to the cyclical nature of the semiconductor industry, which has been subject to significant fluctuations

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry has experienced significant fluctuations, often connected with, or in anticipation of, maturing product cycles and new product introductions of both semiconductor companies' and their customers' products and fluctuations in general economic conditions. Deteriorating general worldwide economic conditions, including reduced economic activity, concerns about credit and inflation, increased energy costs, decreased consumer confidence, reduced corporate profits, decreased spending and similar adverse business conditions, would make it very difficult for our customers, our vendors, and us to accurately forecast and plan future business activities and could cause U.S. and foreign businesses to slow spending on our products. We cannot predict the timing, strength, or duration of any economic slowdown or economic recovery. If the economy or markets in which we operate deteriorate, our business, financial condition, and results of operations would likely be materially and adversely affected.

Downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. We believe the semiconductor industry is currently suffering a downturn due in large part to adverse macroeconomic conditions, characterized by a slowdown in overall GDP performance and factory activity in certain regions, particularly in China, higher levels of customer inventory, the impact of tariffs on trade relations, and greater overall uncertainty regarding the economy. This downturn has had, and may continue to have, a material adverse effect on our business and operating results. In addition, the COVID-19 pandemic has caused further global economic uncertainty. The impact from the rapidly changing market and economic conditions due to the COVID-19 outbreak is uncertain, disrupting the business of our customers and suppliers, and could impact our business and operating results in the future.

Upturns have been characterized by increased product demand and production capacity constraints created by increased competition for access to third-party foundry, assembly and test capacity. We are dependent on the availability of such capacity to manufacture, assemble and test our products. None of our third-party foundry, assembly or test subcontractors have provided assurances that adequate capacity will be available to us.

The average selling prices of our products could decrease rapidly which may negatively impact our revenues and gross profit

We may experience substantial period-to-period fluctuations in future operating results due to the erosion of our average selling prices. We have reduced the average unit price of our products in anticipation of or in response to competitive pricing pressures, new product introductions by us or our competitors and other factors. If we are unable to offset any such reductions in our average selling prices by increasing our sales volumes, increasing our sales content per application or reducing production costs, our gross profit and revenues will suffer. To maintain our gross profit, we will need to develop and introduce new products and product enhancements on a timely basis and continually reduce our costs. Our failure to do so could cause our revenues and gross profit to decline.

Competition within the numerous markets we target may reduce sales of our products and reduce our market share

The markets for semiconductors in general, and for mixed-signal products in particular, are intensely competitive. We expect that the market for our products will continually evolve and will be subject to rapid technological change. In addition, as we target and supply products to numerous markets and applications, we face competition from a relatively large number of competitors. We compete with AltoBeam, Analog Devices, Aura, Broadcom, Dialog, Espressif, Infineon, Maxim Integrated Products, MaxLinear, MediaTek, Microchip, Nordic Semiconductor, NXP, Qualcomm, Rafael, Renesas, STMicroelectronics, Synaptics, Telink, Texas Instruments and others. We expect to face competition in the future from our current competitors, other manufacturers and designers of semiconductors, and start-up semiconductor design companies. As the markets for communications products grow, we also may face competition from traditional communications device companies. These companies may enter the mixed-signal semiconductor market by introducing their own products or by entering into strategic relationships with or acquiring other existing providers of semiconductor products. In addition, large companies may restructure their operations to create separate companies or may acquire new businesses that are focused on providing the types of products we produce or acquire our customers.

We may be the victim of business disruptions and security breaches, including cyber-attacks, which could lead to liability or could damage our reputation and financial results

Information technology system and/or network disruptions, regardless of the cause, but including acts of sabotage, error, or other actions, could harm the company's operations. Failure to effectively prevent, detect, and recover from security breaches, including cyber-attacks, could result in the misuse of company assets, disruption to the company, diversion of management resources, regulatory inquiries, legal claims or proceedings, reputational damage, loss of sales and other costs to the company. We routinely face attacks that attempt to breach our security protocols, gain access to or disrupt our computerized systems or steal proprietary company, customer, partner or employee information. These attacks are sometimes successful. These attacks may be due to security breaches, employee error, theft, malfeasance, phishing schemes, ransomware, faulty password or data security management, or other irregularities. The theft, loss, destruction, unavailability or misuse of personal or business data collected, used, stored or transferred by us to run our business could result in increased security costs or costs related to defending legal claims. Industrial espionage, theft or loss of our intellectual property data could lead to counterfeit products or harm the competitive position of our products and services. Costs to implement, test and maintain measures to promote compliance with applicable privacy and data security laws as well as to protect the overall security of our system could be significant. Attempted or successful attacks against our products and services could damage our reputation with customers or users and reduce demand for our products and services.

Additionally, there is an increased risk that we may experience cybersecurity-related events such as COVID-19 themed phishing attacks and other security challenges as a result of most of our employees and our service providers working remotely from non-corporate managed networks during the ongoing COVID-19 pandemic and potentially continuing working remotely even after the COVID-19 pandemic has subsided.

Changes in the Privacy and Data Security/Protection Laws Could Have an Adverse Effect on our Operations

Federal, state and international privacy-related or data protection laws and regulations could have an adverse effect on our operations. Complying with these laws and the possibility of proceedings against us by governmental entities or others in relation to these laws could increase operational costs. In May 2018, the European Union's General Data Protection Regulation ("GDPR") went into effect, replacing the EU's 1995 Data Protection Directive. The costs of compliance with the GDPR and the potential for fines and penalties in the event of a breach of the GDPR may have an adverse effect on our operations.

We may be subject to information technology failures that could damage our reputation, business operations and financial condition

We rely on information technology for the effective operation of our business. Our systems are subject to damage or interruption from a number of potential sources, including natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, computer viruses, theft, physical or electronic break-ins, cyber-attacks, sabotage, vandalism, or similar events or disruptions. Our security measures may not detect or prevent such security breaches. Any such compromise of our information security could result in the theft or unauthorized publication or use of our confidential business or proprietary information, result in the unauthorized release of customer, supplier or employee data, result in a violation of privacy or other laws, expose us to a risk of litigation or damage our reputation. In addition, our inability to use or access information systems at critical points in time could unfavorably impact the timely and efficient operation of our business, which could negatively affect our business and operating results.

Third parties with which we conduct business, such as foundries, assembly and test contractors, distributors and customers, have access to certain portions of our sensitive data. In the event that these third parties do not properly safeguard our data that they hold, security breaches could result and negatively impact our reputation, business operations and financial results. Additionally, a successful cyber-attack against one of these third-parties' information technology systems may disrupt our supply chain.

Our products must conform to industry standards and technology in order to be accepted by end users in our markets

Generally, our products comprise only a part of a device. All components of such devices must uniformly comply with industry standards in order to operate efficiently together. We depend on companies that provide other components of the devices to support prevailing industry standards. Many of these companies are significantly larger and more influential in affecting industry standards than we are. Some industry standards may not be widely adopted or implemented uniformly, and competing standards may emerge that may be preferred by our customers or end users. If larger companies do not support the same industry standards that we do, or if competing standards emerge, market acceptance of our products could be adversely affected which would harm our business.

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Products for certain applications are based on industry standards that are continually evolving. Our ability to compete in the future will depend on our ability to identify and ensure compliance with these evolving industry standards. The emergence of new industry standards could render our products incompatible with products developed by other suppliers. As a result, we could be required to invest significant time and effort and to incur significant expense to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we could miss opportunities to achieve crucial design wins. For example, the IoT market is relatively new and is continuously evolving. Furthermore, products in the IoT market frequently require interoperability across multiple standards. We may need to adjust our portfolio to meet the needs of this evolving market through acquisitions or significant new investments in research and development.

Our pursuit of necessary technological advances may require substantial time and expense. We may not be successful in developing or using new technologies or in developing new products or product enhancements that achieve market acceptance. If our products fail to achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected.

Customer demands and new regulations related to conflict-free minerals may adversely affect us

The Dodd-Frank Wall Street Reform and Consumer Protection Act imposes new disclosure requirements regarding the use of “conflict” minerals mined from the Democratic Republic of Congo and adjoining countries in products, whether or not these products are manufactured by third parties. These new requirements could affect the pricing, sourcing and availability of minerals used in the manufacture of semiconductor devices (including our products). There will be additional costs associated with complying with the disclosure requirements, such as costs related to determining the source of any conflict minerals used in our products. Our supply chain is complex and we may be unable to verify the origins for all metals used in our products. We may also encounter challenges with our customers and stockholders if we are unable to certify that our products are conflict free.

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

Our registration statement (Registration No. 333-94853) under the Securities Act of 1933, as amended, relating to our initial public offering of our common stock became effective on March 23, 2000.

In April 2020, the Board of Directors terminated our existing share repurchase program, effective immediately, which had an authorization amount of \$200 million and a termination date of December 2020. There were no repurchases of our common stock during the three months ended July 4, 2020.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

Not applicable

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Item 6. Exhibits

The following exhibits are filed as part of this report:

| <u>Exhibit Number</u> | |
|---------------------------|--|
| 2.1* | Asset Purchase Agreement, dated March 11, 2020, by and among Silicon Laboratories Inc., Silicon Laboratories International Pte. Ltd. and Redpine Signals, Inc. (filed as Exhibit 2.1 to the Form 8-K filed on March 12, 2020). |
| 3.1* | Form of Fourth Amended and Restated Certificate of Incorporation of Silicon Laboratories Inc. (filed as Exhibit 3.1 to the Registration Statement on Form S-1 (Securities and Exchange Commission File No. 333-94853) (the "IPO Registration Statement"))). |
| 3.2* | Fourth Amended and Restated Bylaws of Silicon Laboratories Inc. (filed as Exhibit 3.2 to the Form 8-K filed on January 27, 2017). |
| 4.1* | Specimen certificate for shares of common stock (filed as Exhibit 4.1 to the IPO Registration Statement). |
| 4.2* | Indenture between Silicon Laboratories Inc. and Wilmington Trust, National Association, as trustee, dated March 6, 2017 (filed as Exhibit 4.1 to the Form 8-K filed on March 6, 2017). |
| 4.3* | Form of 1.375% Convertible Senior Note due 2022 (filed as Exhibit 4.2 to the Form 8-K filed on March 6, 2017). |
| 4.4* | Indenture between Silicon Laboratories Inc. and Wilmington Trust, National Association, as trustee, dated June 1, 2020 (filed as Exhibit 4.1 to the Form 8-K filed on June 1, 2020). |
| 4.5* | Form of 0.625% Convertible Senior Note due 2025 (filed as Exhibit 4.2 to the Form 8-K filed on June 1, 2020). |
| 10.1* | Fourth Amendment to Credit Agreement, dated May 26, 2020, by and among Silicon Laboratories Inc., the subsidiaries of the borrower identified therein, Wells Fargo Bank, National Association and the lenders party thereto (filed as Exhibit 10.1 to the Form 8-K filed on May 27, 2020). |
| 31.1 | Certification of the Principal Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Principal Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification as required by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document |
| 101.SCH | Inline XBRL Taxonomy Extension Schema Document |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase Document |
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) |

* Incorporated herein by reference to the indicated filing.

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.

SILICON LABORATORIES INC.

July 29, 2020
Date

/s/ G. Tyson Tuttle
G. Tyson Tuttle
*President and
Chief Executive Officer
(Principal Executive Officer)*

July 29, 2020
Date

/s/ John C. Hollister
John C. Hollister
*Senior Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)*

Certification to the Securities and Exchange Commission
by Registrant's Chief Executive Officer, as required by Section 302
of the Sarbanes-Oxley Act of 2002

I, G. Tyson Tuttle, certify that:

1. I have reviewed this report on Form 10-Q of Silicon Laboratories Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2020

/s/ G. Tyson Tuttle

G. Tyson Tuttle
President and
Chief Executive Officer
(Principal Executive Officer)

Certification to the Securities and Exchange Commission
by Registrant's Chief Financial Officer, as required by Section 302
of the Sarbanes-Oxley Act of 2002

I, John C. Hollister, certify that:

1. I have reviewed this report on Form 10-Q of Silicon Laboratories Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2020

/s/ John C. Hollister

John C. Hollister
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

Certification of Chief Executive Officer and Chief Financial Officer

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Silicon Laboratories Inc. (the "Company") hereby certify that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the fiscal quarter ended July 4, 2020 as filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities Exchange Commission or its staff upon request.

Date: July 29, 2020

/s/ G. Tyson Tuttle

G. Tyson Tuttle
*President and
Chief Executive Officer*

/s/ John C. Hollister

John C. Hollister
*Senior Vice President and
Chief Financial Officer*
