SEMTECH CORP
Form 10-Q
June 07, 2013

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

FORM 10-Q

(Mark One)
x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended April 28, 2013
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 1-6395

SEMTECH CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	95-2119684
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 Flynn Road, Camarillo, California, 93012-8790
(Address of principal executive offices, Zip Code)

Registrant’s telephone number, including area code: (805) 498-2111

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes o No x
Number of shares of Common Stock, $0.01 par value per share, outstanding at May 31, 2013: 67,496,068

SEMTECH CORPORATION
INDEX TO FORM 10-Q
FOR THE QUARTER ENDED APRIL 28, 2013

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

SEMTECH CORPORATION AND SUBSIDIARIES
UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(in thousands, except per share data)

	Three Months Ended	
	April 28, 2013	April 29, 2012
Net sales	$162,407	$116,642
Cost of sales	65,120	61,305
Gross profit	97,287	55,337
Operating costs and expenses:		
Selling, general and administrative	34,794	44,818
Product development and engineering	34,559	24,083
Intangible amortization and impairments	7,856	5,578
Total operating costs and expenses	77,209	74,479
Operating income (loss)	20,078	(19,142)
Interest expense	(4,060)	(1,843)
Interest income and other (expense) income, net	(807)	214
Income (loss) before taxes	15,211	(20,771)
Provision (benefit) for taxes	434	(22,980)
Net income	$14,777	$2,209
Earnings per share:		
Basic	$0.22	$0.03
Diluted	$0.22	$0.03
Weighted average number of shares used in computing earnings per share:		
Basic	66,956	65,282
Diluted	68,579	67,233

See accompanying notes. The accompanying notes are an integral part of these statements.

SEMTECH CORPORATION AND SUBSIDIARIES
UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Three Months Ended	
	April 28, 2013	April 29, 2012
Net income	$14,777	$2,209
Other comprehensive (loss) income, before tax:		
Change in unrealized holding loss on available-for-sale investments	(1)	(24)
Less: Reclassification adjustments for gains included in net income	—	—
Change in unrealized loss on interest rate cap	(232)	—
Change in cumulative translation adjustment	—	376
Other comprehensive (loss) income , before tax	(233)	352
Benefit for taxes related to items of other comprehensive (loss) income	85	4
Other comprehensive (loss) income, net of tax	(148)	356
Total comprehensive income, net of tax	$14,629	$2,565

See accompanying notes. The accompanying notes are an integral part of these statements.

SEMTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS
(in thousands, except share data)

	April 28, 2013 (unaudited)	January 27, 2013
Assets		
Current assets:		
Cash and cash equivalents	$230,428	$223,192
Temporary investments	—	4,973
Accounts receivable, less allowances of $5,065 at April 28, 2013 and $4,917 at January 27, 2013	80,214	69,160
Inventories	76,563	74,878
Deferred tax assets	7,317	7,473
Prepaid taxes	8,134	7,794
Other current assets	17,891	18,523
Total current assets	420,547	405,993
Non-current assets:		
Property, plant and equipment, net of accumulated depreciation of $106,611 at April 28, 2013 and $101,766 at January 27, 2013	109,413	101,837
Long-term investments	5,931	7,907
Deferred tax assets	34,326	33,563
Goodwill	393,584	393,584
Other intangible assets, net	197,890	206,058
Other assets	23,423	22,071
TOTAL ASSETS	$1,185,114	$1,171,013
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$56,617	$51,991
Accrued liabilities	35,214	49,276
Deferred revenue	5,064	3,745
Current portion - long term debt	39,532	48,449
Deferred tax liabilities	3,866	4,221
Total current liabilities	140,293	157,682
Non-current liabilities:		
Deferred tax liabilities	3,017	2,042
Long term debt, less current portion	285,755	282,286
Other long-term liabilities	36,370	34,177
Stockholders' equity:		
Common stock, $0.01 par value, 250,000,000 shares authorized, 78,136,144 issued and 67,362,012 outstanding on April 28, 2013 and 78,136,144 issued and 66,607,347 outstanding on January 27, 2013	785	785
Treasury stock, at cost, 10,774,132 shares as of April 28, 2013 and 11,528,797 shares as of January 27, 2013	(187,609)	(200,604)
Additional paid-in capital	353,219	355,990
Retained earnings	553,079	538,302
Accumulated other comprehensive income	205	353
Total stockholders' equity	719,679	694,826
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,185,114	$1,171,013

See accompanying notes. The accompanying notes are an integral part of these statements.

SEMTECH CORPORATION AND SUBSIDIARIES
UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)

	Three Months Ended	
	April 28, 2013	April 29, 2012
Cash flows from operating activities:		
Net income	$14,777	$2,209
Adjustments to reconcile net income to net cash provided by operating activities, net of effects of acquisitions:		
Depreciation, amortization and impairments	13,346	6,867
Effect of acquisition fair value adjustments	2,476	14,429
Accretion of deferred financing costs and debt discount	760	328
Deferred income taxes	98	(20,152)
Stock-based compensation	8,626	5,326
Excess tax benefits on stock based compensation	—	(1,842)
(Gain) loss on disposition of property, plant and equipment	(1)	40
Changes in assets and liabilities:		
Accounts receivable, net	(11,054)	(264)
Inventories	(4,016)	1,479
Prepaid expenses and other assets	(1,184)	4,112
Accounts payable	2,308	(4,007)
Accrued liabilities	(11,287)	(17,459)
Deferred revenue	1,251	738
Income taxes payable and prepaid taxes	(1,342)	(4,401)
Other liabilities	2,392	863
Net cash provided by (used in) operating activities	17,150	(11,734)
Cash flows from investing activities:		
Purchases of available-for-sale investments	(1,050)	(10,106)
Proceeds from sales and maturities of available-for-sale investments	7,998	88,592
Proceeds from sales of property, plant and equipment	8	—
Purchase of property, plant and equipment	(10,750)	(4,630)
Purchase of intangible assets	(2,847)	—
Acquisitions, net of cash acquired	—	(491,717)
Net cash used in investing activities	(6,641)	(417,861)
Cash flows from financing activities:		
Proceeds from debt issuance, net of discount	—	347,000
Deferred financing cost	—	(8,962)
Excess tax benefits on stock based compensation	—	1,842
Proceeds from exercises of stock options	2,352	1,606
Repurchase of outstanding common stock	—	(182)
Payment of long term debt	(5,625)	—
Net cash (used in) provided by financing activities	(3,273)	341,304
Effect of exchange rate increase on cash and cash equivalents	—	170
Net increase (decrease) in cash and cash equivalents	7,236	(88,121)
Cash and cash equivalents at beginning of period	223,192	227,022
Cash and cash equivalents at end of period	$230,428	$138,901

See accompanying notes. The accompanying notes are an integral part of these statements.

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SEMTECH CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
Note 1: Organization and Basis of Presentation
Semtech Corporation (together with its subsidiaries, the “Company” or “Semtech”) is a global supplier of analog and mixed-signal semiconductor products. The end-customers for the Company’s products are primarily original equipment manufacturers (“OEM’s”) that produce and sell electronics.
The Company designs, develops and markets a wide range of products for commercial applications, the majority of which are sold into the enterprise computing, communications, high-end consumer and industrial end-markets.
Enterprise Computing: datacenters, passive optical networks, optical receiver and transceiver, desktops, notebooks, servers, graphic boards, monitors, printers and other computer peripherals.
Communications: base stations, backplane, optical networks, carrier networks, switches and routers, cable modems, signal conditioners, wireless LAN and other communication infrastructure equipment.
High-End Consumer: handheld products, set-top boxes, digital televisions, tablet computers, digital video recorders, thunderbolt and fiberless high-speed interfaces and other consumer equipment.
Industrial: broadcast studio equipment, automated meter reading, military and aerospace, medical, security systems, automotive, industrial and home automation, video security and surveillance and other industrial equipment.
Fiscal Year
The Company reports results on the basis of 52 and 53 week periods and ends its fiscal year on the last Sunday in January. The other quarters generally end on the last Sunday of April, July and October. All quarters consist of 13 weeks except for one 14-week period in 53-week years. The first quarter of fiscal years 2014 and 2013 each consisted of 13 weeks.
Principles of Consolidation
The accompanying interim unaudited consolidated condensed financial statements of Semtech Corporation and its subsidiaries have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of the Company, these unaudited statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly, in all material respects, the financial position of Semtech Corporation and its subsidiaries for the interim periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted pursuant to such rules and regulations, and the Company believes that the included disclosures are adequate to make the information presented not misleading.
These interim unaudited consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company’s latest annual report on Form 10-K. The results reported in these interim unaudited consolidated condensed financial statements should not be regarded as indicative of results that may be expected for any subsequent period or for the entire year.

Segment Information
The Company operates and accounts for its results in one reportable segment. The Company identified five operating segments which aggregate into one reportable segment. The Company designs, develops, manufactures and markets high performance analog and mixed signal integrated circuits. The Chief Executive Officer has been identified as the Chief Operating Decision Maker as defined by guidance regarding segment disclosures.
Use of Estimates
The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
Reclassification
Certain prior period immaterial amounts have been reclassified to conform with current period presentation.

Note 2: Earnings per Share

The computation of basic and diluted earnings per common share is as follows:

(in thousands, except per share amounts)	Three Months Ended April 28, 2013	April 29, 2012
Net income	$14,777	$2,209
Weighted average common shares outstanding - basic	66,956	65,282
Dilutive effect of employee equity incentive plans	1,623	1,951
Weighted average common shares outstanding - diluted	68,579	67,233
Basic earnings per common share	$0.22	$0.03
Diluted earnings per common share	$0.22	$0.03
Anti-dilutive shares not included in the above calculations	318	657

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the reporting period. Diluted earnings per common share incorporates the incremental shares issuable, calculated using the treasury stock method, upon the assumed exercise of stock options and the vesting of restricted stock.

Note 3: Revenue Recognition

The Company recognizes product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is reasonably assured. Recovery of costs associated with product design and engineering services are recognized during the period in which services are performed. The product design and engineering recovery, when recognized, will be reported as a reduction to product development and engineering expense. Historically, these recoveries have not exceeded the cost of the related development efforts.

The Company includes revenue related to granted technology licenses as part of "Net sales." Historically, revenue from these arrangements has not been significant though it is part of its recurring ordinary business.

The Company defers revenue recognition on shipment of products to certain customers, principally distributors, under agreements which provide for limited pricing credits or return privileges, until these products are sold through to end-users or the return privileges lapse. For sales subject to certain pricing credits or return privileges, the amount of future pricing credits or inventory returns cannot be reasonably estimated given the relatively long period in which a particular product may be held by the customer. Therefore, the Company has concluded that sales to customers under these agreements are not fixed and determinable at the date of the sale and revenue recognition has been deferred. The Company estimates the deferred gross margin on these sales by applying an average gross profit margin to the actual gross sales. The average gross profit margin is calculated for each category of material using standard costs which is expected to approximate actual costs at the date of sale. The estimated deferred gross margins on these sales, where there are no outstanding receivables, are recorded on the unaudited consolidated condensed balance sheets under the heading of "Deferred revenue."

The Company records a provision for estimated sales returns in the same period as the related revenues are recorded. The Company bases these estimates on historical sales returns and other known factors. Actual returns could be different from Company estimates and current provisions for sales returns and allowances, resulting in future charges to earnings. There were no significant impairments of deferred cost of sales in the first quarter of fiscal year 2014 or fiscal year 2013.

Note 4: Acquisitions

Gennum Corporation ("Gennum")

On March 20, 2012, the Company, through its wholly-owned subsidiary Semtech Canada Inc., completed the acquisition of all outstanding equity interests of Gennum (TSX: GND), a leading supplier of high speed analog and mixed-signal semiconductors for the optical communications and video broadcast markets.

Upon consummation of the business acquisition, which constituted a change in control of Gennum, Gennum's stock option awards and restricted shares became fully vested. Semtech acquired 100% of the outstanding shares and vested stock options, restricted shares, and deferred share units of Gennum for CDN $13.55 per share for a total purchase price of $506.5 million. The acquisition was financed with a combination of cash from Semtech's international cash reserves and $347 million of five-year secured term loans, net of original issuance debt discount of $3 million (see Note 10).

The Gennum assets acquired and liabilities assumed are recorded at their acquisition-date fair values. Acquisition-related transaction costs are not included as a component of consideration transferred, but are accounted for as an expense in the period in which the costs are incurred. Any excess of the acquisition consideration over the fair value of assets acquired and liabilities assumed is allocated to goodwill. The goodwill resulted from expected synergies from the transaction, including complementary products that will enhance the Company's overall product portfolio, and opportunities within new markets, and is not deductible for tax purposes. The acquired in-process research and development is recorded at fair value as an indefinite-lived intangible asset at the acquisition date until the completion or abandonment of the associated research and development efforts.

In connection with the acquisition, certain Gennum employees became entitled to payments upon a change in control and their subsequent termination. These payments, which totaled approximately $9.6 million, have been recognized as a post-acquisition compensation expense and included in the consolidated statements of income for the three months ended April 29, 2012 under "Selling, general and administrative."

The Company's allocation of the total purchase price as of March 20, 2012 is summarized below:

(in thousands)	At March 20, 2012
Cash	$19,664
Accounts receivable, less allowances	14,032
Inventories	62,941
Prepaid expenses	3,832
Income taxes receivable	1,467
Deferred tax assets - current	8,590
Other current assets	7,804
Property, plant and equipment	25,702
Amortizable intangible assets	129,863
In-process research and development	29,100
Goodwill	261,891
Deferred tax assets - non-current	31,235
Other non-current assets	8
Deferred tax liabilities	(47,077)
Accounts payable	(18,232)
Accrued liabilities	(24,274)
Total acquisition consideration	$506,546

(in thousands)	At March 20, 2012
Amortizable intangible assets:	
Developed technology	$95,100
Customer relationships	28,000

Other intangible assets	6,763
Total amortizable intangible assets	$ 129,863

The Company completed the purchase price allocation for its acquisition of Gennum in fiscal year 2013.

The Company recognized approximately $0.6 million and $18.6 million in transaction and integration related costs that were expensed in the first quarter of fiscal year 2014 and in fiscal year 2013, respectively. These costs are included in the unaudited consolidated condensed statements of income for the respective periods under “Selling, general and administrative.”

For the three months ended April 28, 2013 and April 29, 2012 (for the period after acquisition), net revenues attributable to Gennum were $40.3 million and $12.0 million, respectively, with a corresponding net loss of $0.8 million and $28.5 million, respectively.

Pro Forma Financial Information

The results of operations of Gennum have been included in the Company’s consolidated statements of income since the acquisition date of March 20, 2012. The following table reflects the unaudited consolidated pro forma information as if the acquisition had been completed on January 29, 2011, after giving effect to certain adjustments including the following for the three months ended April 29, 2012:

- decrease in cost of goods sold associated with fair value adjustment related to acquired inventory of $12.9 million for the three months ended April 29, 2012;
- increase in operating expense as a result of the settlement of two pre-acquisition contingencies related to legal matters of $4.2 million for the three months ended April 29, 2012;
- increase in amortization expense as a result of acquired intangible assets of $2.0 million for the three months ended April 29, 2012;
- decrease in tax benefit of $23.4 million associated with the releasing of prior accrued taxes on foreign earnings for the three months ended April 29, 2012;
- increase in interest expense of $2.2 million associated with the $350 million term loans entered into to finance the acquisition for the three months ended April 29, 2012; and
- the related tax effects.

Unaudited Consolidated Pro forma Information:

(in thousands)	Three months ended April 29, 2012 (unaudited)
Revenue	$ 140,882
Net loss	$ (9,383)

The unaudited pro forma information presented does not purport to be indicative of the results that would have been achieved had the acquisition been consummated on January 29, 2011 nor of the results which may occur in the future. The pro forma adjustments are based upon available information and certain assumptions that the Company believes are reasonable. The unaudited pro forma information does not include any adjustments for any restructuring activities, operating efficiencies or cost savings.

Cycleo SAS

On March 7, 2012, the Company completed the acquisition of Cycleo, a privately held company based in France that develops intellectual property (“IP”) for wireless long-range semiconductor products used in smart metering and other industrial and consumer markets. Under the terms of the agreement, Semtech paid the stockholders of Cycleo $5.0 million in cash at closing.

Total acquisition consideration is allocated to the acquired tangible and intangible assets and assumed liabilities of Cycleo based on their respective estimated fair values as of the acquisition date. Any excess of the acquisition consideration over the fair value of assets acquired and liabilities assumed is allocated to goodwill. The Company expects that all such goodwill will not be deductible for tax purposes.

The Company completed the purchase price allocation for its acquisition of Cycleo in fiscal year 2013.

Additionally, pursuant to the earn-out arrangement with Cycleo stockholders, the Company potentially may make payments totaling up to approximately $16.0 million based on the achievement of a combination of certain revenue and operating income milestones by Cycleo over the period of four years beginning on April 30, 2012. For certain of the Cycleo stockholders, payment of the earn-out liability is contingent upon employment on the payout date and is accounted for as post-acquisition compensation expense over the service period. The portion of the earn-out liability that is not dependent on continued employment is included in the purchase price allocation at March 7, 2012.

Net revenues and earnings attributable to Cycleo since the acquisition date were not material. Pro forma results of operations have not been presented as the acquisition was not material to the Company's consolidated financial statements.

Note 5: Stock-Based Compensation

Financial Statement Effects and Presentation. The following table shows total pre-tax, stock-based compensation expense included in the unaudited consolidated condensed statements of income for the three months ended April 28, 2013 and April 29, 2012.

(in thousands)	Three Months Ended April 28, 2013	April 29, 2012
Cost of sales	$328	$231
Selling, general and administrative	4,882	3,224
Product development and engineering	3,416	1,871
Stock-based compensation, pre-tax	$8,626	$5,326
Net change in stock-based compensation capitalized into inventory	$77	$66

Share-based Payment Arrangements

The Company has various equity award plans that provide for granting stock-based awards to employees and non-employee directors of the Company. The plans provide for the granting of several available forms of stock compensation. As of April 28, 2013, the Company has granted options and restricted stock under the plans and has also issued some stock-based compensation outside of the plans, including options and restricted stock issued as inducements to join the Company.

Grant Date Fair Values and Underlying Assumptions; Contractual Terms

The Company uses the Black-Scholes pricing model to value options. For awards classified as equity, stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as an expense over the employee's or director's requisite service period. For awards classified as liabilities, stock-based compensation cost is measured at fair value at the end of each reporting date until the date of settlement, and is recognized as an expense over the employee's or director's requisite service period. Expected volatilities are based on historical volatility using daily and monthly stock price observations.

The following table summarizes the assumptions used in the Black-Scholes model to determine the fair value of options granted in the three months ended April 28, 2013 and April 29, 2012:

	Three Months Ended April 28, 2013	April 29, 2012
Expected lives, in years	4.2 - 4.7	4.4
Estimated volatility	34% - 35%	41%
Dividend yield	—	—
Risk-free interest rate	0.65% - 0.69%	0.70%
Weighted average fair value on grant date	$9.04	$10.06

The estimated fair value of restricted stock awards was calculated based on the market price of the Company's common stock on the date of grant. Some of the restricted stock units awarded in the first quarter of fiscal year 2014 and prior years are classified as liabilities rather than equity. For awards classified as liabilities, the value of these awards is re-measured at the end of each quarter.

Stock Option Awards. The Company has historically granted stock option awards to both employees and non-employee directors. The grant date for these awards is equal to the measurement date. These awards were valued as of the measurement date and are amortized over the requisite vesting period (typically 3-4 years).

A summary of the activity for stock option awards during the first three months of fiscal year 2014 is presented below:

(in thousands, except for per share amounts)	Number of Shares	Weighted Average Exercise Price (per share)	Aggregate Intrinsic Value	Aggregate Unrecognized Compensation	Number of Shares Exercisable	Weighted Average Contractual Term (in years)
Balance at January 27, 2013	2,579	$18.29	$29,789	$ 3,817	1,937	
Options granted	195	31.31				
Options exercised	(418)	16.65	6,915			
Options cancelled/forfeited	(9)	24.53				
Balance at April 28, 2013	2,347	$19.64	$27,204	$ 4,802	1,692	
Exercisable at April 28, 2013	1,692	$17.08	$23,893			2.3

Restricted Stock. The Company has not granted any restricted stock to employees since fiscal year 2009. There is no outstanding and unvested restricted stock as of April 28, 2013.

Performance Units. The Company grants performance-based vesting restricted stock units to select employees. These awards have a performance condition in addition to a service condition. The performance condition generally relates to the Company's revenue and operating income measured against internal goals. Under the terms of these awards, assuming the highest performance level of 200% with no cancellations due to forfeitures, the maximum number of shares that can be earned would be 412,500 shares and 402,500 shares settled in cash. The Company would have a liability accrued in the unaudited consolidated condensed balance sheet equal to the value of 402,500 shares on the settlement date, which would be settled in cash. Only cash performance unit awards are classified as liabilities and the value of these awards is re-measured at each reporting date. At April 28, 2013, the performance metrics associated with the outstanding awards issued in fiscal years 2014, 2013 and 2012 are expected to be met at a level which would result in a grant at 100%, 80%, and 97% of target, respectively.

The following table summarizes the activity for performance units for the first three months of fiscal year 2014:

		Subject to Share Settlement	Subject to Cash Settlement		Weighted Average Grant Date	Aggregate	Period Over Which Expected
(in thousands, except for per share amounts)	Total Units	Units	Units	Recorded Liability	Fair Value (per share)	Unrecognized Compensation	to be Recognized (in years)
Balance at January 27, 2013	353	181	172	$4,422	$ 23.50	$ 4,754	1.1
Performance units granted	186	93	93		30.82		
Performance units vested	(114)	(57)	(57)		16.68		
Performance units cancelled/forfeited	(13)	(7)	(6)		25.70		
Change in liability				(2,859)			
Balance at April 28, 2013	412	210	202	$1,563	$ 28.62	$ 8,514	2.0

Stock Units, Employees. The Company issues stock unit awards to employees which are expected to be settled with stock. The grant date for these awards is equal to the measurement date. These awards are valued as of the measurement date and amortized over the requisite vesting period (typically 4 years).

The following table summarizes the stock unit award activity for the first three months of fiscal year 2014:

(in thousands, except per share amount)	Number of Units	Weighted Average Grant Date Fair Value (per unit)	Aggregate Intrinsic Value (1)	Aggregate Unrecognized Compensation	Weighted Average Period Over Which Expected to be Recognized (in years)
Balance at January 27, 2013	2,558	$ 23.41		$ 49,374	2.5
Stock units granted	206	30.82			
Stock units vested	(447)	22.57	$ 14,272		
Stock units forfeited	(54)	25.02			
Balance at April 28, 2013	2,263	$ 24.21		$ 47,856	2.5

(1) Reflects the value of Semtech stock on the date that the stock unit vested.

Stock Units, Non-Employee Directors. The Company grants stock unit awards to non-employee directors. These restricted stock units are accounted for as liabilities and accrued in the unaudited consolidated condensed balance sheets because they are cash settled. These awards are vested after 1 year of service. However, because these awards are not typically settled until a non-employee director’s separation from service, the value of these awards is re-measured at the end of each reporting period until settlement. The following table summarizes the activity for stock unit awards for the first three months of fiscal year 2014:

(in thousands, except per share amount)	Number of Units	Recorded Liability	Weighted Average Grant Date Fair Value (per unit)	Aggregate Unrecognized Compensation	Period Over Which Expected to be Recognized (in years)
Balance at January 27, 2013	20	$4,557	$ 24.46	$ 253	0.4
Stock units granted	—		—		
Stock units vested	—		—		
Stock units forfeited	—		—		
Change in liability		363			
Balance at April 28, 2013	20	$4,920	$ 24.46	$ 109	0.2

As of April 28, 2013, the total number of vested but unsettled stock units for Non-Employee Directors is 141,155 units which are included in the recorded liability.

Note 6: Investments

Investments that have original maturities of three months or less are accounted for as cash equivalents. This includes money market funds, time deposits and U.S. government obligations. Temporary and long-term investments consist of government, bank and corporate obligations, and bank time deposits with original maturity dates in excess of three months. Temporary investments have original maturities in excess of three months, but mature within twelve months of the balance sheet date. Long-term investments have original maturities in excess of twelve months. The Company determines the cost of securities sold based on the specific identification method. Realized gains or losses are reported in “Interest income and other expense, net” on the unaudited consolidated condensed statements of income.

The Company classifies its investments as “available for sale” because it may sell some securities prior to maturity. The Company’s investments are subject to market risk, primarily interest rate and credit risks. The Company’s investments are managed by a limited number of outside professional managers that operate within investment guidelines set by the Company. These guidelines include specified permissible investments, minimum credit quality ratings and maximum average duration restrictions and are intended to limit market risk by restricting the Company’s investments to high quality debt instruments with relatively short-term maturities.

The following table summarizes the Company’s available for sale investments:

	April 28, 2013			January 27, 2013		
(in thousands)	Market Value	Adjusted Cost	Gross Unrealized Gain	Market Value	Adjusted Cost	Gross Unrealized Gain
Agency securities	$5,931	$5,925	$6	$7,907	$7,900	$7
Bank time deposits	—	—	—	4,973	4,973	—
Total investments	$5,931	$5,925	$6	$12,880	$12,873	$7

Agency securities are specific securities that are issued by United States government agencies such as Ginnie Mae, Fannie Mae, Freddie Mac or the Federal Home Loan Banks. Due to the expectation of federal backing, these securities usually hold the highest credit rating possible.

The following table summarizes the maturities of the Company’s available for sale investments:

	April 28, 2013		January 27, 2013	
(in thousands)	Market Value	Adjusted Cost	Market Value	Adjusted Cost
Within 1 year	$—	$—	$4,973	$4,973
After 1 year through 5 years	5,931	5,925	7,907	7,900
Total investments	$5,931	$5,925	$12,880	$12,873

Unrealized gains and losses are the result of fluctuations in the market value of the Company’s available for sale investments and are included in “Accumulated other comprehensive income” on the unaudited consolidated condensed balance sheets. The following table summarizes net unrealized losses arising in the periods presented in addition to the tax associated with these comprehensive income items:

	Three months ended	
(in thousands)	April 28, 2013	April 29, 2012
Unrealized loss, net of tax	$(1)	$(20)
Decrease to deferred tax liability	—	(4)

The following table summarizes interest income generated from investments and cash and cash equivalents:

	Three months ended	
(in thousands)	April 28, 2013	April 29, 2012
Interest income	$100	$192

During the third quarter of fiscal year 2013, the Company acquired an investment in a privately traded company for total cash consideration of $2.5 million. The Company accounts for the investment in equity interests under the cost method of accounting since the ownership interest is less than 20% of the outstanding equity interests and it does not have the ability to exercise significant influence over the investee. The investment in equity interests is included in “Other assets” on the unaudited consolidated condensed balance sheet as of April 28, 2013.

Note 7: Fair Value Measurements

Instruments Measured at Fair Value on a Recurring Basis

Financial assets measured and recorded at fair value on a recurring basis consisted of the following types of instruments:

	Fair Value as of April 28, 2013				Fair Value as of January 27, 2013			
(in thousands)	Total	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)
Agency securities	$5,931	$—	$5,931	$—	$7,907	$—	$7,907	$—
Bank time deposits	—	—	—	—	4,973	—	4,973	—
Total available-for-sale securities	5,931	—	5,931	—	12,880	—	12,880	—
Interest rate cap	303	—	303	—	544	—	544	—
Total financial assets	$6,234	$—	$6,234	$—	$13,424	$—	$13,424	$—

Available-for-sale securities included in Level 2 are valued utilizing inputs obtained from an independent service (the “Service”), which uses quoted market prices for identical or comparable instruments rather than direct observations of quoted prices in active markets. The Service gathers observable inputs for all of our fixed income securities from a variety of industry data providers, for example, large custodial institutions and other third-party sources. Once the observable inputs are gathered by the Service, all data points are considered and an average price is determined. The Service’s providers utilize a variety of inputs to determine their quoted prices. The Company reviews and evaluates the values provided by the Service and agrees with the valuation methods and assumptions used in determining the fair value of investments. The Company believes this method provides a reasonable estimate for fair value.

The fair value of the interest rate cap at April 28, 2013 is estimated as described in Note 11 and is included in “Other assets” on the unaudited consolidated condensed balance sheet.

Financial assets measured and recorded at fair value on a recurring basis were presented on the Company's unaudited consolidated condensed balance sheets as follows:

	Fair Value as of April 28, 2013				Fair Value as of January 27, 2013			
(in thousands)	Total	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)
Temporary investments	$—	$—	$—	$—	$4,973	$—	$4,973	$—
Long-term investments	5,931	—	5,931	—	7,907	—	7,907	—
Other assets	303	—	303	—	544	—	544	—
Total financial assets	$6,234	$—	$6,234	$—	$13,424	$—	$13,424	$—

During the three months ended April 28, 2013, the Company had no transfers of financial assets or liabilities between Level 1, Level 2 or Level 3. As of April 28, 2013 and January 27, 2013, the Company had not elected the fair value option for any financial assets and liabilities for which such an election would have been permitted.

Instruments Not Recorded at Fair Value on a Recurring Basis

Some of the Company's financial instruments are not measured at fair value on a recurring basis but are recorded at amounts that approximate fair value due to their liquid or short-term nature. Such financial assets and financial liabilities include: cash and cash equivalents, receivables, net, certain other assets, accounts payable and accrued expenses, accrued personnel costs, and other current liabilities.

The Company's long-term debt is not recorded at fair value on a recurring basis, but is measured at fair value for disclosure purposes. The fair value of the Company's debt is estimated primarily based on quotes ("ask price") provided by pricing services generated in a market with insufficient volume to comprise an active market (Level 2 inputs) based on the Company's debt obligations. In addition, the Company considered the extinguishment of debt that was made on May 2, 2013 and determined that the fair value of the Company's debt was $328.0 million as of April 28, 2013.

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

The Company reduces the carrying amounts of its goodwill, intangible assets, long-lived assets and non-marketable equity security to fair value when held for sale or determined to be impaired.

For its investment in equity interests, the Company has not identified events or changes in circumstances that may have a significant adverse effect on the fair value of its cost method investment during the first three months of fiscal year 2014.

Note 8: Inventories

Inventories, consisting of material, material overhead, labor, and manufacturing overhead, are stated at the lower of cost (first-in, first-out) or market and consist of the following:

(in thousands)	April 28, 2013	January 27, 2013
Raw materials	$3,092	$1,970
Work in progress	54,940	52,669
Finished goods	18,531	20,239
Inventories	$76,563	$74,878

Note 9: Goodwill and Intangible Assets
Goodwill – There were no changes to goodwill during the first three months of fiscal year 2014.

Goodwill is not amortized, but is tested for impairment using a two-step method on an annual basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The recoverability of goodwill is measured at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair market value of the reporting unit.
The fair value of goodwill is tested for impairment on a non-recurring basis in the accompanying unaudited consolidated condensed financial statements using Level 3 inputs. The Company concluded that there were no indicators of impairment as of April 28, 2013.
Purchased Intangibles – The following table sets forth the Company's finite-lived intangible assets resulting from business acquisitions and technology licenses purchased, which continue to be amortized:

		April 28, 2013			January 27, 2013		
(in thousands)	Estimated Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core technologies	2-10 years	$178,724	$ (46,580)	$ 132,144	$173,724	$ (40,867)	$ 132,857
Customer relationships	7-10 years	40,130	(9,075)	31,055	40,130	(7,736)	32,394
Technology licenses (1)	5-10 years	8,247	(1,452)	6,795	8,164	(1,056)	7,108
Other intangibles assets	1-5 years	6,600	(5,404)	1,196	6,600	(4,601)	1,999
Total finite-lived intangible assets		$233,701	$ (62,511)	$ 171,190	$228,618	$ (54,260)	$ 174,358

(1) Technology licenses relate to licensing agreements entered into by the Company. Amortization expense related to technology licenses is reported as "Product development and engineering" in the unaudited consolidated condensed statements of income.

During the first quarter of fiscal year 2014, acquired finite-lived intangible assets increased by approximately $5.1 million primarily due to the transfer from indefinite-lived intangible assets to core technologies upon the completion of an in-process research and development project from the Gennum acquisition in March 2012.

For the three months ended April 28, 2013 and April 29, 2012, amortization expense related to finite-lived intangible assets was $7.9 million and $4.9 million, respectively. Amortization expense related to finite-lived intangible assets is reported as "Intangible amortization and impairments" in the unaudited consolidated condensed statements of income. The estimated annual amount of future amortization expense for finite-lived intangible assets will be as follows:

(in thousands)

To be recognized in:	Technology license	Sierra Monolithics	Gennum	Cycleo	Total
Remainder of fiscal year 2014	$1,194	$6,652	$14,224	$756	$22,826
Fiscal year 2015	1,465	8,870	18,965	1,007	30,307
Fiscal year 2016	1,436	8,870	18,419	1,007	29,732
Fiscal year 2017	1,186	8,870	18,332	1,007	29,395
Fiscal year 2018	776	8,160	18,332	1,007	28,275
Thereafter	738	8,490	21,345	82	30,655
Total expected amortization expense	$6,795	$49,912	$109,617	$4,866	$171,190

The following table sets forth the Company's indefinite-lived intangible assets resulting from business acquisitions:

(in thousands)	April 28, 2013 Gross Carrying Amount	April 28, 2013 Accumulated Impairment Loss	April 28, 2013 Net Carrying Amount	January 27, 2013 Gross Carrying Amount	January 27, 2013 Accumulated Impairment Loss	January 27, 2013 Net Carrying Amount
In-process research and development	$29,870	$(3,170)	$26,700	$34,870	$(3,170)	$31,700
Total indefinite-lived intangible assets	$29,870	$(3,170)	$26,700	$34,870	$(3,170)	$31,700

During the first quarter of fiscal year 2014, acquired indefinite-lived intangible assets decreased by approximately $5.0 million due to the transfer from indefinite-lived intangible assets to core technologies upon the completion of an in-process research and development project from the Gennum acquisition in March 2012.

The Company reviews indefinite-lived intangible assets for impairment annually or whenever events or changes in circumstances indicate the carrying value may not be recoverable. Recoverability of indefinite-lived intangible assets is measured by comparing the carrying amount of the asset to the future discounted cash flows the asset is expected to generate.

The fair value of indefinite-lived intangible assets is tested for impairment on a non-recurring basis in the accompanying unaudited consolidated condensed financial statements using Level 3 inputs. The Company concluded that there were no indicators of impairment as of April 28, 2013.

Note 10: Credit Facilities

On March 20, 2012, the Company entered into a credit agreement with certain lenders (the “Prior Lenders”) and Jefferies Finance LLC, as administrative and collateral agent (the “Prior Credit Agreement”). Pursuant to the Prior Credit Agreement, the Prior Lenders provided the Company with senior secured first lien credit facilities in an aggregate principal amount of $350 million (the “Prior Credit Facilities”), consisting of term A loans in an aggregate principal amount of $100 million (the “Term A Loans”) and term B loans in an aggregate principal amount of $250 million (the “Term B Loans”). The initial carrying amounts totaled $99.5 million (net of original issue discount of $0.5 million) for the Term A Loans and $247.5 million (net of original issue discount of $2.5 million) for the Term B Loans. The respective amounts of original issue discount are being amortized using the effective interest method and are included in “Interest expense” in the consolidated statements of income.

Debt issuance costs incurred in connection with the Prior Credit Agreement totaled $8.9 million and are being amortized using the effective interest method over the terms of the loans, and are included in “Interest expense” in the unaudited consolidated condensed statements of income.

Interest on the Term A Loans and Term B Loans accrued at certain reference rates plus specified applicable margins. The reference rates are equivalent to, at the Company’s option, either: (i) LIBOR for interest periods of 1, 2, 3 or 6 months or, subject to certain conditions, 9 or 12 months (“LIBOR”) or (ii) the highest of (a) the prime rate, (b) the federal funds effective rate plus 1/2% or (c) one-month LIBOR plus 1.00% (“Base Rate”). For the Term B Loans, LIBOR was subject to a floor of 1.00% and Base Rate was subject to a floor of 2.00%. For the Term A Loans, the applicable margin for LIBOR loans ranged from 2.50% to 2.75% and the applicable margin for Base Rate loans ranged from 1.50% to 1.75%, in each case depending upon the total leverage ratio. For the Term B Loans, the applicable margin for LIBOR loans was 3.25% and the applicable margin for Base Rate loans was 2.25%. Interest was payable at least quarterly. As of April 28, 2013, the interest rates payable on the Term A Loans and Term B Loans were 2.95% and 4.25%, respectively.

In accordance with the Prior Credit Agreement, and as described in Note 11, in June 2012, the Company entered into an interest rate hedging agreement protecting at least 50% of the variable interest rate exposure on the term loans. Pursuant to the Prior Credit Agreement, under certain circumstances, the Company was obligated to apply 50% of its excess cash flow (as defined in the Prior Credit Agreement) for each fiscal year, as well as net cash proceeds from specified other sources, such as asset sales, debt issuances or insurance proceeds, to prepay the Term A Loans and Term B Loans. Excess cash flow may be primarily summarized as cash provided by operating activities less capital expenditures and loan principal payments. The earliest date that any such payment may be due was 95 days after the last day of the fiscal year ending closest to January 31, 2013.

On May 2, 2013, the Company entered into new senior secured first lien credit facilities (the “New Credit Agreement”) in an aggregate principal amount of $400 million to replace its existing $350 million Prior Credit Facilities. As a result, the Company is no longer obligated to make the early excess cash flows payment for the Prior Credit Facilities discussed above. As of April 28, 2013, the current portion of the long-term debt of $13.5 million has been recorded based on payments that will be made for the New Credit Agreement in the next twelve months. In addition, the Company has classified the early prepayment of $26 million for the New Credit Agreement from “Long term debt” to “Current portion - long term debt” in the unaudited consolidated condensed balance sheets as of April 28, 2013. The prepayment of $26 million was made on June 3, 2013.

The terms of the New Credit Agreement are discussed in Note 17.

Note 11: Interest Rate Derivative Agreement

In June 2012, the Company entered into an interest rate cap agreement with a $175 million notional amount and an upfront payment of $1.1 million. The agreement matures on February 22, 2016 and caps interest rates on one-month LIBOR at 1.00%.

The interest rate cap agreement has been designated as a cash flow hedge of interest rate risk and is recorded at estimated fair value as of April 28, 2013.

The Company determined that the interest rate cap agreement is highly effective in offsetting future variable interest payments associated with the hedged portion of the Company's term loans. No ineffectiveness was recorded during the three months ended April 28, 2013. The Company did not have any active interest contracts outstanding prior to June 2012.

The amount of unrealized losses on interest rate cap recorded in other comprehensive loss at April 28, 2013 that is expected to be reclassified into interest expense in the next twelve months, if interest rates remain unchanged, is approximately $102,000.

The fair value of the interest rate cap at April 28, 2013 is determined based on assumptions that management believes market participants would use in pricing. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. Based on the inputs used in the valuation, the Company has determined that the derivative valuation is classified in Level 2 of the fair value hierarchy.

Note 12: Income Taxes

The Company's effective tax rate differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside of the U.S.

The gross unrecognized tax benefit (before federal impact of state items) was $13.1 million at April 28, 2013 and January 27, 2013. Included in the balance of unrecognized tax benefits at April 28, 2013 and January 27, 2013, is $11.1 million of net tax benefit (after federal impact of state items), respectively, that, if recognized, would impact the effective tax rate. The liability for uncertain tax positions is reflected on the unaudited consolidated condensed balance sheets as follows:

(in thousands)	April 28, 2013	January 27, 2013
Accrued liabilities	$188	$188
Other long-term liabilities		