

InvenSense Inc
Form 10-Q
November 04, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 October 2, 2016**

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 001-35269

INVENSENSE, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of	01-0789977 (I.R.S. Employer
Incorporation or organization)	Identification No.)
1745 Technology Drive, Suite 200, San Jose, CA 95110	
(Address of principal executive offices and zip code)	
(408) 501-2200	
(Registrant's telephone number, including area code)	

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

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

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:

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Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding at October 21, 2016
Common Stock, \$0.001 par value	93,973,000

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INVENSENSE, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INVENSENSE, INC.**CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except par value)**

	October 2, 2016	April 3, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 37,047	\$ 41,105
Short-term investments	239,121	243,755
Accounts receivable	36,599	41,447
Inventories	46,101	62,297
Prepaid expenses and other current assets	9,187	9,250
Total current assets	368,055	397,854
Property and equipment, net	33,140	36,271
Intangible assets, net	43,988	43,169
Goodwill	143,320	139,175
Other assets	5,778	5,992
Total assets	\$ 594,281	\$ 622,461
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 16,507	\$ 35,200
Accrued liabilities	31,123	30,248
Total current liabilities	47,630	65,448
Long-term debt	155,310	151,038
Other long-term liabilities	26,703	27,230
Total liabilities	229,643	243,716

Commitments and contingencies (Note 4)

Stockholders' equity:

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Preferred stock:

Preferred stock, \$0.001 par value 20,000 shares authorized, no shares issued and outstanding at October 2, 2016 and April 3, 2016

Common stock:

Common stock, \$0.001 par value 750,000 shares authorized, 93,855 shares issued and outstanding at October 2, 2016; 93,010 shares issued and outstanding at April 3, 2016;

Common stock, \$0.001 par value 750,000 shares authorized, 93,855 shares issued and outstanding at October 2, 2016; 93,010 shares issued and outstanding at April 3, 2016;	321,956	303,153
Accumulated other comprehensive (loss)	(241)	(26)
Retained earnings	42,923	75,618
Total stockholders' equity	364,638	378,745
Total liabilities and stockholders' equity	\$ 594,281	\$ 622,461

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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INVENSENSE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Net revenue	\$ 79,831	\$ 112,545	\$ 140,467	\$ 218,841
Costs of revenue	46,299	65,974	82,190	127,439
Gross profit	33,532	46,571	58,277	91,402
Operating expenses:				
Research and development	28,144	24,991	54,685	45,246
Selling, general and administrative	14,869	15,186	28,731	31,010
Legal settlement				11,708
Total operating expenses	43,013	40,177	83,416	87,964
Income (loss) from operations	(9,481)	6,394	(25,139)	3,438
Interest expense	(2,925)	(2,765)	(5,806)	(5,489)
Other income (expense), net	138	104	364	165
Income (loss) before income taxes	(12,268)	3,733	(30,581)	(1,886)
Income tax provision (benefit)	242	(1,960)	2,114	(1,732)
Net income (loss)	\$ (12,510)	\$ 5,693	\$ (32,695)	\$ (154)
Net income (loss) per share of common stock:				
Basic	\$ (0.13)	\$ 0.06	\$ (0.35)	\$ (0.00)
Diluted	\$ (0.13)	\$ 0.06	\$ (0.35)	\$ (0.00)
Weighted average shares outstanding used in computing net income (loss) per share:				
Basic	93,657	91,574	93,447	91,325
Diluted	93,657	92,569	93,447	91,325

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents**INVENSENSE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(Unaudited)****(In thousands)**

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Net income (loss)	\$ (12,510)	\$ 5,693	\$ (32,695)	\$ (154)
Other comprehensive loss:				
Unrealized loss on available-for-sale securities, net of tax	(212)	(59)	(215)	(98)
Comprehensive income (loss)	\$ (12,722)	\$ 5,634	\$ (32,910)	\$ (252)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents**INVENSENSE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

	Six Months Ended	
	October 2, 2016	September 27, 2015
Cash flows from operating activities:		
Net loss	\$ (32,695)	\$ (154)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	6,781	6,245
Amortization of intangible assets	4,882	4,503
Non cash interest expense	4,271	3,958
Loss on other investments	325	
Stock-based compensation expense	17,221	17,683
Contingent consideration adjustment		(5,307)
Deferred income tax assets	75	(3,498)
Tax effect of employee benefit plan		(758)
Changes in operating assets and liabilities:		
Accounts receivable	4,847	(5,912)
Inventories	16,196	13,421
Prepaid expenses and other assets	6	2,113
Other assets	398	(1,833)
Accounts payable	(18,623)	12,444
Accrued liabilities	506	15,872
Net cash provided by operating activities	\$ 4,190	\$ 58,777
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(9,845)	
Purchase of property and equipment	(3,784)	(3,953)
Sales and maturities of available-for-sale investments	143,011	71,843
Purchase of available-for-sale investments	(138,731)	(145,732)
Operating lease deposit	(207)	
Other non-marketable investments	(300)	
Net cash used in investing activities	(9,856)	(77,842)
Cash flows from financing activities:		
Proceeds from the issuance of common stock	1,702	3,590
Repayment of loan	(94)	

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Net cash provided by financing activities	1,608	3,590
Net decrease in cash and cash equivalents	(4,058)	(15,475)
Cash and cash equivalents:		
Beginning of period	41,105	85,637
End of period	\$ 37,047	\$ 70,162
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 1,531	\$ 1,531
Cash paid for income taxes	\$ 455	\$ 294
Noncash investing and financing activities:		
Unpaid purchases of property and equipment	\$ 356	\$ 604
Unrealized loss from available-for-sale investments	\$ (241)	\$ (157)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization and summary of significant accounting policies

Business

InvenSense, Inc. (the Company) was incorporated in California in June 2003 and reincorporated in Delaware in January 2004. The Company designs, develops, markets and sells sensor systems on a chip, including accelerometers, gyroscopes and microphones for the mobile, wearable, smart home, gaming, industrial, and automotive market segments. The Company delivers leading solutions based on its advanced motion and sound technology and is dedicated to bringing the best-in-class size, performance and cost solutions to market. The Company targets solutions such as: smartphones, tablets, wearables, console and portable video gaming devices, digital television and set-top box remote controls, fitness accessories, sports equipment, digital still cameras, automobiles, ultra-books, laptops, hearing aids, stabilization systems, tools, navigation devices, remote controlled toys and other household consumer and industrial devices.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the fiscal year ended April 3, 2016 included in the Company's Annual Report on Form 10-K filed on May 25, 2016 with the Securities and Exchange Commission (SEC). No material changes have been made to the Company's significant accounting policies since the Company's Annual Report on Form 10-K for the fiscal year ended April 3, 2016.

Certain significant business risks and uncertainties

The Company participates in the high-technology industry and believes that a number of factors including, but not limited to the following could have a material effect on the Company's future financial position, results of operations, or cash flows: reliance on a limited number of primary customers to support the Company's revenue generating activities; changes in end-user demand for the products manufactured and sold by the Company and its customers; the receipt, reduction, cancellation or delay of significant orders by customers; advances and trends in new technologies and industry standards; new product announcements and introductions by the Company's competitors; the general cyclicality and seasonality of the semiconductor and consumer electronics industries and the resulting effect on the Company's business; market acceptance of the Company's and its customers' products; the Company's development and introduction of new products on a timely basis; developing new sales channels and attracting new customers; significant warranty claims, including those not covered by the Company's suppliers; delays in the Company's customers' ability to manufacture and ship products that incorporate the Company's products caused by internal and external factors unrelated to the Company's business and that are out of its control; shortages of key third party components; the effects of competitive pricing pressures, including decreases in average selling prices of the Company's products; write-downs of inventory for excess quantity, changes in business priorities, technological obsolescence and erosion in net realizable value; strategic relationships, including key component suppliers; litigation or claims against the Company based on intellectual property, patent, product, regulatory, or other factors; and the Company's ability to attract and retain employees necessary to support its growth. Further information on potential risks that could affect the Company's business and financial results is included in the Company's Annual Report on Form 10-K for the year ended April 3, 2016 filed with SEC on May 25, 2016.

Basis of consolidation

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles, or GAAP, and include the Company's accounts and the accounts of its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The functional currency of each of the Company's subsidiaries is the U.S. dollar. Foreign currency gains or losses are recorded as other income (expense), net, in the condensed consolidated statements of operations.

Fiscal year

The Company's fiscal year is a 52 or 53 week period ending on the Sunday closest to March 31. Fiscal year 2016 was a 53-week fiscal year ended April 3, 2016 (Fiscal year 2016). The extra week was included in the Company's fourth fiscal quarter ended April 3, 2016. The Company's fiscal year ended March 29, 2015 (fiscal year 2015) was comprised of 52 weeks.

The first and second fiscal quarters in each of the two most recent fiscal years included 13 weeks.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP and applicable rules and regulations of the SEC regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations.

The condensed consolidated balance sheet as of April 3, 2016, included herein was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP. The unaudited interim condensed consolidated financial statements, in the opinion of management, reflect adjustments, consisting of all normal recurring adjustments, necessary to present fairly the Company's financial position, results of operations, comprehensive loss and cash flows for the interim periods. The results of operations for the period ended October 2, 2016 is not necessarily indicative of the results to be expected for the fiscal year ending April 2, 2017 or for any future year or interim period.

Use of estimates

The preparation of the Company's condensed consolidated financial statements and related notes in conformity with 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 condensed consolidated financial statements and related notes and the reported amounts of income and expenses during the reporting period. Significant estimates included in the condensed consolidated financial statements and related notes include income taxes, inventory valuation, stock-based compensation, loss contingencies, warranty reserves, goodwill, valuation of acquired assets, and valuation of convertible senior note, including the related convertible notes hedges and warrants. These estimates are based upon information available as of the date of the condensed consolidated financial statements, and actual results could differ from those estimates.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. In accordance with Accounting Standard Codification (ASC) 350, the Company reviews goodwill for impairment at the reporting unit level on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. As the Company uses the market approach to assess impairment, its common stock price is an important component of the fair value calculation. The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. The Company monitors the recoverability of goodwill recorded in connection with acquisitions annually, or whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company performs the annual goodwill impairment analysis in the third quarter of each fiscal year. As of October 2, 2016, no events or changes in circumstances indicate the carrying value may not be recoverable.

Concentration of credit risk

The majority of the Company's products are shipped to distributors, original design manufacturers and contract manufacturers (collectively referred to as intermediaries), who are the legal counter-parties to the Company's sales. When the Company references customers, sales and revenue in this report, the Company is referring to the manufacturers of consumer electronics devices who are the end customers for our products. However, any disclosure about the composition of the Company's accounts receivable refers to the intermediaries. Some of the Company's intermediaries may serve more than one of the Company's customers. As a result, attempting to compare or correlate disclosures about the Company's accounts receivable composition as of a particular date with the disclosures regarding revenues generated by the Company's customers for the period ending on the same date can be difficult or misleading.

One distributor accounted for 66% of accounts receivable and one customer accounted for 14% of accounts receivable at October 2, 2016. One distributor accounted for 49% of accounts receivable and one customer accounted for 20% of accounts receivable at September 27, 2015.

For the three months ended October 2, 2016, Apple Inc. (Apple) and GH Development Holdings Limited (GHIC) accounted for 58% and 11% of total net revenue, respectively. For the three months ended September 27, 2015, Apple and Samsung Electronics Co., Ltd. (Samsung) accounted for 34% and 19% of total net revenue, respectively. For the six months ended October 2, 2016, Apple accounted for 53% of net revenue. For the six months ended September 27, 2015, Apple and Samsung accounted for 36% and 21% of total net revenue, respectively.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Warranty**

The Company offers one year standard warranty on its products. In selective cases, the warranty period can be extended to multiple years. The Company's accrual for anticipated warranty costs includes management's judgment regarding anticipated rates of warranty claims and associated repair costs. The following table summarizes the activity related to product warranty liability during the six months ended October 2, 2016 and September 27, 2015:

	Six Months Ended	
	October 2, 2016	September 27, 2015
	(in thousands)	
Beginning balance	\$ 625	\$ 341
Provision for warranty	682	421
Adjustments related to changes in estimate	(519)	(204)
Less: actual warranty costs	(18)	(82)
Ending balance	\$ 770	\$ 476

Net income (loss) per share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding during the period, which excludes dilutive unvested restricted stock. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding, including unvested restricted stock, certain warrants to purchase common stock and potential dilutive shares from the dilutive effect of outstanding stock options using the treasury stock method. In periods in which the Company has reported a net loss, the common stock equivalents are excluded from the calculation of diluted net loss per share of common stock as their effect is antidilutive under the treasury stock method.

The following table presents the calculation of basic and diluted net income (loss) per share:

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands, except per share data)			
Numerator:				
Basic and diluted				

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Net income (loss)	\$ (12,510)	\$ 5,693	\$ (32,695)	\$ (154)
Denominator:				
Basic shares:				
Weighted-average shares used in computing basic net income (loss) per share	93,657	91,574	93,447	91,325
Diluted shares:				
Weighted-average shares used in computing basic net income (loss) per share	93,657	91,574	93,447	91,325
Effect of potentially dilutive securities:				
Stock options and unvested restricted stock		995		
Weighted-average shares used in computing diluted net income (loss) per share	93,657	92,569	93,447	91,325
Net income (loss) per share				
Basic	\$ (0.13)	\$ 0.06	\$ (0.35)	\$ (0.00)
Diluted	\$ (0.13)	\$ 0.06	\$ (0.35)	\$ (0.00)

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following summarizes the potentially dilutive securities outstanding at the end of each period that were excluded from the computation of diluted net income (loss) per share for the periods presented as their effect would have been antidilutive:

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Employee stock options	12,033	7,382	11,609	9,059
Unvested restricted stock units	5,212	2,989	5,112	4,204
Total antidilutive securities	17,245	10,371	16,721	13,263

In November 2013, the Company issued \$175.0 million aggregate principal amount of 1.75% Convertible Senior Notes due on November 1, 2018 (the Notes). On or after August 1, 2018 until the maturity date, the Notes may be converted at the option of the holders under certain circumstances. The conversion rate is initially 45.683 shares per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$21.89 per share of common stock), subject to certain adjustments (see Note 5).

Segment information

The Company operates in one operating segment, the design, development, manufacture and marketing of sensor systems on a chip. The Chief Executive Officer has been identified as the Chief Operating Decision Maker as defined by Financial Accounting Standards Board (FASB) ASC 280 Segment Reporting. Enterprise-wide information is provided in accordance with ASC 280. Geographical revenue information is based on the location of the head offices of the Company's customers. Property and equipment information is based on the physical location of the assets at the end of each fiscal period.

Property and equipment, net by country was as follows:

Country	October 2, 2016	April 3, 2016
	(in thousands)	
Taiwan	\$ 22,325	\$ 25,183
United States	8,861	9,207

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Other	1,954	1,881
	\$ 33,140	\$ 36,271

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Net revenue from unaffiliated customers by location of the Company's customers' headquarters offices was as follows:

Region	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
United States	\$ 50,193	\$ 42,913	\$ 80,298	\$ 86,716
China	14,844	26,010	27,290	50,616
Korea	5,074	24,469	10,868	53,192
Japan	4,873	8,028	10,153	12,164
Taiwan	3,583	7,576	9,008	10,762
Rest of world	1,264	3,549	2,850	5,391
	\$ 79,831	\$ 112,545	\$ 140,467	\$ 218,841

A majority of sales to U.S. headquartered companies are sold to their distributors or contract manufacturers located overseas.

Recent accounting pronouncements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses. Under the new guidance, credit losses for certain types of financial instruments will be estimated based on expected losses. The new guidance also modifies the impairment models for available-for-sale debt securities and for purchased financial assets with credit deterioration since their origination. The new guidance will be effective for the Company starting in the first quarter of fiscal 2021. Early adoption is permitted starting in the first quarter of fiscal 2020. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

In March, 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends ASC Topic 718, Compensation – Stock Compensation. The new guidance simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance will be effective for the Company starting in the first quarter of fiscal 2018. Early adoption is permitted in any annual or interim period. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

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In February 2016, the FASB issued new guidance related to leases that outlines a comprehensive lease accounting model and supersedes the current lease guidance. The new guidance requires lessees to recognize lease liabilities and corresponding right-of-use assets for all leases with lease terms of greater than 12 months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. The new guidance must be adopted using the modified retrospective approach and will be effective for the Company starting in the first quarter of fiscal 2020. Early adoption is permitted. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 provides guidance that companies will recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the payment to which a company expects to be entitled in exchange for those goods or services. The standard requires public entities to apply the amendments in ASU 2014-09 for annual reporting periods beginning after December 15, 2016, including interim reporting periods therein. On April 1, 2015, the FASB proposed for a one-year deferral of the effective date for this pronouncement. The Company will be required to implement the new revenue recognition standard for the first quarter of fiscal year 2019. The Company is currently evaluating the impact on its consolidated financial statements.

2. Cash equivalents and available-for-sale investments

At October 2, 2016, cash and cash equivalents totaled \$37.0 million, of which \$7.1 million was cash and \$29.9 million was cash equivalents invested in money market funds. At October 2, 2016, \$23.9 million of the cash and cash equivalents were held by the Company's foreign subsidiaries. Additionally, as of October 2, 2016, the Company had short-term available-for-sale investments of \$239.1 million.

At April 3, 2016, cash and cash equivalents totaled \$41.1 million, of which \$25.4 million was cash and \$15.7 million was cash equivalents invested in money market funds. At April 3, 2016, \$21.0 million of the cash and cash equivalents were held by the Company's foreign subsidiaries. Additionally, as of April 3, 2016, the Company had short-term available-for-sale investments of \$243.8 million.

The Company applies the provisions of ASC 820-10, *Fair Value Measurements*. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. ASC 820-10 requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The standard describes a fair value hierarchy based on three levels of inputs that may be used to measure fair value. The inputs for the first two levels are considered observable and the last is unobservable and include the following:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; or

Level 3 Unobservable inputs in which there is little or no market data, and as a result, prices or valuation techniques are employed that require inputs that are significant to the fair value measurement.

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This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value. The fair values of the Company's money market funds were derived from quoted market prices as active markets for these instruments exist. The Company chose not to elect the fair value option as prescribed by ASC 825-10-05 Fair Value Option for its financial assets and liabilities that had not been previously carried at fair value. Therefore, financial assets and liabilities not carried at fair value, such as accounts payable, are reported at their carrying values.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Fair value measurements at each reporting date were as follows:

October 2, 2016:

Assets and liabilities measured at fair value on a recurring basis were presented in the Company's condensed consolidated balance sheet as of October 2, 2016.

		Quoted prices		
	October 2, 2016 balance	in active markets for identical assets or liabilities Level 1	Significant other observable inputs Level 2	Significant other unobservable inputs Level 3
		(in thousands)		
Assets				
Money market funds	\$ 29,891	\$ 29,891	\$	\$
Corporate notes and bonds	91,672		91,672	
Commercial paper	116,604		116,604	
U.S. agency securities	30,845		30,845	
Total investments	\$ 269,012	\$ 29,891	\$ 239,121	\$
Liabilities				
Contingent consideration	\$ 1,909	\$	\$	\$ 1,909
Assets				
Cash equivalents	\$ 29,891	\$ 29,891	\$	\$
Short-term investments	239,121		239,121	
Total investments	\$ 269,012	\$ 29,891	\$ 239,121	\$
Liabilities				
Accrued liabilities	\$ 1,909	\$	\$	\$ 1,909
Total contingent consideration	\$ 1,909	\$	\$	\$ 1,909

	October 2, 2016 amortized cost	Gross unrealized gain	Gross unrealized loss	October 2, 2016 estimated FMV
	(in thousands)			
Corporate notes and bonds	\$ 91,763	\$ 1	\$ (92)	\$ 91,672
Commercial paper	116,770	1	(167)	116,604
U.S. agency securities	30,829	16		30,845
Total available-for-sale investments	\$ 239,362	\$ 18	\$ (259)	239,121
Money market funds				29,891
Total aggregate fair value				\$ 269,012

The fair values of money market funds were derived from quoted market prices as active markets for these instruments exist. The fair values of corporate notes and bonds, commercial paper and U.S. agency securities were derived from non-binding market consensus prices that are corroborated by observable market data.

None of the gross unrealized losses as of October 2, 2016 were considered to be other-than-temporary impairments.

There were no transfers of assets measured at fair value between Level 1 and Level 2 during the six months ended October 2, 2016.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****April 3, 2016:**

Assets and liabilities measured at fair value on a recurring basis were presented in the Company's condensed consolidated balance sheet as of April 3, 2016.

	April 3, 2016 balance	Quoted prices in active markets for identical assets or liabilities Level 1	Significant other observable inputs Level 2	Significant other unobservable inputs Level 3
(in thousands)				
Assets				
Money market funds	\$ 15,697	\$ 15,697	\$	\$
Corporate notes and bonds	163,675		163,675	
Commercial paper	45,473		45,473	
U.S. agency securities	34,607		34,607	
Total investments	\$ 259,452	\$ 15,697	\$ 243,755	\$
Liabilities				
Contingent consideration	\$ 1,909	\$	\$	\$ 1,909
Assets				
Cash equivalents	\$ 15,697	\$ 15,697	\$	\$
Short-term investments	243,755		243,755	
Total investments	\$ 259,452	\$ 15,697	\$ 243,755	\$
Liabilities				
Accrued liabilities	\$ 1,909	\$	\$	\$ 1,909
Total contingent consideration	\$ 1,909	\$	\$	\$ 1,909

April 3, 2016	Gross unrealized	Gross unrealized	April 3, 2016
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	amortized cost	gain	loss	estimated FMV
	(in thousands)			
Corporate notes and bonds	\$ 163,712	\$ 19	\$ (56)	\$ 163,675
Commercial paper	45,480	3	(10)	45,473
U.S. agency securities	34,589	25	(7)	34,607
Total available-for-sale investments	\$ 243,781	\$ 47	\$ (73)	243,755
Money market funds				15,697
Total aggregate fair value				\$ 259,452

The fair values of money market funds were derived from quoted market prices as active markets for these instruments exist. The fair values of corporate notes and bonds, commercial paper and U.S. agency securities were derived from non-binding market consensus prices that are corroborated by observable market data.

There were no transfers of assets measured at fair value between Level 1 and Level 2 during fiscal year 2016.

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(Unaudited)

Level 3 financial liabilities:

The following table provides a summary of changes in fair value of the Company's contingent consideration categorized as Level 3 for the three and six months ended October 2, 2016 and September 27, 2015:

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Beginning balance	\$ 1,909	\$ 3,817	\$ 1,909	\$ 9,124
Change in fair value and other				(5,307)
Ending balance	\$ 1,909	\$ 3,817	\$ 1,909	\$ 3,817

Contingent consideration on acquired businesses was measured at fair value using Level 3 inputs as defined in the fair value hierarchy. The following table presents certain information about the significant unobservable inputs used in the fair value measurement for the contingent consideration measured at fair value on a recurring basis using significant unobservable inputs:

Description	Valuation Techniques	Significant Unobservable Inputs
Liabilities: Contingent consideration	Present value of a Probability Weighted Earn-out model using an appropriate discount rate.	Estimate of achieving the milestones.

An increase in the estimate of probability of meeting the milestones could result in a significantly higher estimated fair value of the contingent consideration liability. Alternatively, a decrease in the estimate of probability of meeting the milestones could result in a significantly lower estimated fair value of contingent consideration liability. The fair value of contingent consideration was derived from a probability weighted earn-out model of future contingent payments. The cash payments are expected to be made upon meeting the milestones. The initial valuation of the contingent consideration was based on a collaborative effort of the Company's engineering and finance departments, and third party valuation experts. The estimate of meeting the milestones and discount rates is reviewed quarterly and updated as and when necessary. Potential valuation adjustments will be made to adjust the contingent consideration payments. These adjustments will be recorded in the statements of operations.

In fiscal year 2016, the fair value of contingent consideration, net declined by \$5.3 million. The decline in fair value was the result of a reduction in the probability of a design win milestone associated with the Movea, S.A. (Movea) acquisition from 50% to 0% and a reduction in the probability of a design win associated with the Trusted Positioning,

Inc. (TPI) acquisition from 50% to 0%. The gross declines in fair value of the design win milestones for Movea and TPI were \$4.0 million and \$2.4 million, respectively, were recorded as a credit to research and development expense. The earn-out payments for the Movea and TPI design win milestones were not made as these milestones were not met and expired during fiscal year 2016. Offsetting the gross declines was an increase in the fair value of two TPI cloud application milestones as a result of an increase in the estimated probability of achievement of those milestones. The increase in the fair value of the cloud application milestones was \$1.1 million, which was recorded as a debit to research and development expense in fiscal year 2016. A design milestone for TPI was achieved and the payment of \$1.9 million was made in fiscal year 2016. The last milestone of \$1.9 million for TPI is expected to be paid in fiscal year 2017.

3. Balance sheet details

Inventories

Inventories at October 2, 2016 and April 3, 2016 consist of the following:

	October 2, 2016	April 3, 2016
	(in thousands)	
Work in process	\$ 30,381	\$ 40,329
Finished goods	15,720	21,968
Total inventories	\$ 46,101	\$ 62,297

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Prepaid expenses and other current assets

Prepaid expenses and other current assets at October 2, 2016 and April 3, 2016 consist of the following:

	October 2, 2016	April 3, 2016
	(in thousands)	
Prepaid expenses	\$ 5,647	\$ 5,256
Income tax receivable	42	156
Other receivables	1,031	1,676
Other current assets	2,467	2,162
Total prepaid expenses and other current assets	\$ 9,187	\$ 9,250

Property and equipment

Property and equipment at October 2, 2016 and April 3, 2016 consists of the following:

	October 2, 2016	April 3, 2016
	(in thousands)	
Production and lab equipment	\$ 55,083	\$ 52,821
Computer equipment and software	10,410	9,074
Equipment under construction	678	607
Leasehold improvements and furniture and fixtures	8,400	8,396
Subtotal	74,571	70,898
Accumulated depreciation and amortization	(41,431)	(34,627)
Property and equipment net	\$ 33,140	\$ 36,271

Depreciation expense for the three and six months ended October 2, 2016 was \$3.5 million and \$6.8 million, respectively. Depreciation expense for the three and six months ended September 27, 2015 was \$3.2 million and \$6.2 million, respectively. Equipment under construction consists primarily of production and lab equipment. Equipment under construction is not subject to depreciation until it is available for its intended use. All of the equipment under construction is expected to be completed and placed in service by the end of fiscal 2017.

Accrued liabilities

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Accrued liabilities at October 2, 2016 and April 3, 2016 consist of the following:

	October 2, 2016	April 3, 2016
	(in thousands)	
Payroll-related expenses	\$ 8,569	\$ 8,030
Bonuses	3,686	5,040
Contingent consideration, current portion	1,909	1,909
Deferred revenue	1,618	1,949
Legal fees	694	197
Accrued contractual coupon interest payable on convertible senior notes	1,316	1,313
Income tax payable	1,150	553
Other tax payable	768	768
Customer deposits	2,582	4,008
Other accrued liabilities	8,831	6,481
Total accrued liabilities	\$ 31,123	\$ 30,248

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Other long-term liabilities

Other long-term liabilities at October 2, 2016 and April 3, 2016 consists of the following:

	October 2, 2016	April 3, 2016
	(in thousands)	
Long-term tax payable	\$ 14,943	\$ 13,928
Deferred rent	3,001	3,436
Deferred tax liabilities	2,554	3,026
Deferred revenue	3,700	4,100
Long-term debt	2,412	2,465
Other long-term liabilities	93	275
Total other long-term liabilities	\$ 26,703	\$ 27,230

4. Commitments and contingencies**Operating lease obligations**

The Company has non-cancelable operating leases for its facilities through fiscal year 2022.

Future minimum lease payments, net of future minimum lease income, under operating leases as of October 2, 2016 are as follows:

Fiscal Years Ending:	Amount
	(in thousands)
2017 (remainder)	\$ 2,949
2018	6,524
2019	6,691
2020	5,339
2021	1,406
Beyond	514
Total	\$ 23,423

The Company's lease agreements provide for rental payments which have certain lease incentives and graduated rental payments. As a result, the rent expense is recognized on a straight-line basis over the term of the lease. The Company's rental expense under operating leases, net of the rent income from subleases of \$0.4 million and \$0.8 million, was approximately \$1.2 million and \$2.3 million for the three and six months ended October 2, 2016, respectively. The Company's rental expense under operating leases, net of the rent income from subleases of \$0.4 million and \$0.7 million, was approximately \$1.2 million and \$2.6 million for the three and six months ended September 27, 2015, respectively.

Purchase Commitments

The Company has non-cancelable purchase commitments with its foundry vendors. Future minimum payments of \$21.8 million under the purchase commitments as of October 2, 2016 are due in less than twelve months.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Legal proceedings and contingencies

From time to time the Company is involved in various disputes and litigation matters that arise in the ordinary course of our business, including disputes and lawsuits related to intellectual property and employment issues. In addition, the Company is a party to class action lawsuits.

In January and March 2015, purported shareholders filed five substantially similar class action complaints in the U.S. District Court, Northern District of California against the Company and two of the Company's current and former executives (Class Action Defendants) (Jim McMillan v. InvenSense, Inc., et al. Case No. 3:15-cv-00084-JD, filed January 7, 2015; William Lendales v. InvenSense, Inc. et al., Case No. 3:15-cv-00142-VC, filed on January 12, 2015; Plumber & Steamfitters Local 21 Pension Fund v. InvenSense, Inc., et al., Case No. 5:15-cv-00249-BLF, filed on January 16, 2015; William B. Davis vs. InvenSense, Inc., et al., Case No. 5:15-cv-00425-RMW, filed on January 29, 2015; and Saratoga Advantage Trust Technology & Communications Portfolio v. InvenSense et al., Case No. 3:15-cv-01134, filed on March 11, 2015). On April 23, 2015, three of those cases were consolidated into a single proceeding which is currently pending in the U.S. District Court, Northern District of California and captioned In re InvenSense, Inc. Securities Litigation, Case No. 3:15-cv-00084-JD (the Securities Case), and the Vossen Group was designated as lead plaintiff; the other two cases (Lendales and Saratoga Advantage Trust) were voluntarily dismissed in March and June 2015, respectively. On May 26, 2015, the lead plaintiffs filed a consolidated amended class action complaint, which alleges that the defendants violated the federal securities laws by making materially false and misleading statements regarding our business results between July 29, 2014 and October 28, 2014, and seeks unspecified damages along with plaintiff's costs and expenses, including attorneys' fees. On June 25, 2015, the Class Action Defendants filed a motion seeking dismissal of the case. A ruling granting the motion in part and denying it in part, and giving the lead plaintiffs leave to file an amended complaint, issued on March 28, 2016. The lead plaintiffs filed an amended complaint on April 18, 2016. On May 5, 2016, the Class Action Defendants filed a motion seeking dismissal of the amended complaint. The motion was argued and submitted on June 29, 2016; the court has not yet filed an order ruling on the motion. In light of the unresolved legal issues, the amount of any potential loss cannot be estimated. At this stage, the Company is unable to predict the outcome of this matter and, accordingly, cannot estimate the potential financial impact on the Company's business, operating results, cash flows or financial position.

In addition, in January and March 2015, other purported shareholders filed three substantially similar shareholder derivative complaints against two of our current and former officers and several of our current and former directors, two in the U.S. District Court, Northern District of California and a third in Santa Clara Superior Court (George E Rollins v. Behrooz Abdi et al., Case No. 5:15-cv-00184-PSG, filed on January 13, 2015; Linda Karr v. Behrooz Abdi et al., Case No. 5:15-cv-00200-NC, filed on January 14, 2015; and Robert Bilbrey v. Behrooz Abdi et al., Case No. 1-15-CV-278742 was filed on March 20, 2015). The two federal court derivative actions have been consolidated into In re InvenSense, Inc. Derivative Litigation, Case No. 5:15-cv-00184-PSG. In June 2016, other purported shareholders filed a substantially similar shareholder derivative complaint against three of our current and former officers and several of our current and former directors in the Superior Court of the Commonwealth of Massachusetts, Suffolk County (Valerie Caveglia v. Jon Olson, et al., Civil Action No. 16-1971-BLS-1) (collectively, the Derivative Cases). In the Derivative Cases complaints, the plaintiffs make allegations similar to those presented in the Securities

Case, but the plaintiff asserts various state law causes of action, including claims of breach of fiduciary duty and unjust enrichment. The Company has undertaken an evaluation of these complaints. Plaintiffs in all four of the Derivative Cases have agreed to, and the courts have entered, indefinite stays pending developments in the Securities Case.

The semiconductor and MEMS industries are characterized by companies that hold large numbers of patents and other intellectual property rights and that vigorously pursue, protect and enforce intellectual property rights.

Robert Bosch GmbH (Bosch), one of the Company's competitors, and the Company have each previously made generalized assertions of potential patent infringement by the other. On October 28, 2015, the Company and Bosch resolved all assertions of potential infringement between them and entered into a multi-year, worldwide patent cross license agreement for MEMS and sensor technologies, excluding patents covering InvenSense's CMOS-MEMS eutectic bonding production process and Bosch's two-layer porous silicon production process, and an upfront payment of \$11.5 million to Bosch. The other terms of the settlement and the patent cross license agreement remain confidential and are not expected to have a material impact on the Company's future results. Based on the status of the negotiations, the Company recognized a pre-tax charge of \$11.7 million during the quarter ended June 28, 2015. On October 28, 2015, Bosch and the Company resolved all assertions of potential infringement made by the other. There were no significant changes to the final terms which required any additional charge in the fiscal year 2016. In the future, other third parties may assert against the Company and its customers and distributors, their patent and other intellectual property rights to technologies that are important to the Company's business.

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(Unaudited)

The Company is not aware of any other pending legal matters or claims, individually or in the aggregate, that are expected to have a material adverse impact on its condensed consolidated financial position, results of operations, or cash flows. However, the Company's analysis of whether a claim may proceed to litigation cannot be predicted with certainty, nor can the results of litigation be predicted with certainty. Nevertheless, defending any of these actions, regardless of the outcome, may be costly, time consuming, distract management personnel, and have a negative effect on the Company's business. An adverse outcome in any of these actions, including a judgment or settlement, may have a material adverse effect on the Company's future business, operating results, and/or financial condition.

The Company indemnifies certain customers, distributors, suppliers and subcontractors for attorney fees and damages and costs awarded against such parties in certain circumstances in which the Company's products are alleged to infringe third-party intellectual property rights, including patents, registered trademarks or copyrights. Indemnification costs are charged to operations as incurred.

The Company's Third Amended and Restated Bylaws require the Company to indemnify its directors and officers and employees to the fullest extent permitted by the Delaware General Corporation Law ("DGCL"). In addition, the Company's directors, the Company's chief executive officer and certain executive officers have entered into separate indemnification agreements with the Company. The Company's Second Amended and Restated Certificate of Incorporation, as amended, limits the liability of directors to the Company or its stockholders to the fullest extent permitted by the DGCL. The obligation to indemnify generally means that the Company is required to pay or reimburse the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters.

5. Convertible senior notes

In November 2013, the Company issued \$175.0 million aggregate principal amount of 1.75% Convertible Senior Notes due on November 1, 2018 (the "Notes"), in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933 (the "Securities Act"). The Notes have not been registered under the Securities Act, or applicable state securities laws or blue sky laws, and may not be offered or sold in the United States absent registration under the Securities Act and applicable state securities laws or available exemptions from the registration requirements.

The Notes are senior unsecured obligations of the Company and rank equally in right of payment with all of the Company's existing and future senior unsecured indebtedness and are junior to any of the Company's existing and future secured indebtedness. The Notes pay interest in cash semi-annually (May and November) at a rate of 1.75% per annum. Net proceeds received by the Company, after issuance costs, were approximately \$169.3 million.

On or after August 1, 2018 until the maturity date, the Notes may be converted at the option of the holders. Holders may convert the Notes at their option prior to August 1, 2018 only under the following circumstances:

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- 1) During any calendar quarter and only during such calendar quarter, if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price of \$21.89 on each applicable trading day;
- 2) During the five business day period after any five consecutive trading day period in which the trading price per \$1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or
- 3) Upon the occurrence of specified corporate events, including if there is a fundamental change.

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(Unaudited)

Upon conversion, the Company will pay cash up to the aggregate principal amount of the Notes to be converted and pay or deliver cash, shares of its own common stock or a combination of cash and shares of its own common stock, at the Company's election, in respect of the remainder, if any, of its conversion obligation in excess of the aggregate principal amount of the Notes being converted.

The conversion rate is initially 45.683 shares per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$21.89 per share of common stock), subject to certain adjustments.

The Notes are not redeemable by the Company prior to the maturity date. At an event of default or fundamental change, the principal amount of the Notes plus accrued and unpaid interest may become due immediately at the Note holders' option.

The Company separately accounts for the liability and equity components of the Notes. The initial debt component of the Notes was valued at \$135.7 million based on the contractual cash flows discounted at an appropriate comparable market non-convertible debt borrowing rate at the date of issuance of 7.3%, with the equity component representing the residual amount of the proceeds of \$39.3 million which was recorded as a debt discount. The issuance costs were allocated pro-rata based on the relative initial carrying amounts of the debt and equity components, including the Note hedges and warrants transactions described below. As a result, \$2.5 million of the issuance costs were allocated to the equity component of the Notes, \$3.0 million of issuance costs paid to the initial purchaser were accounted for as a debt discount and \$0.25 million of the issuance costs were classified as other non-current assets. Debt issuance costs were reclassified and presented in the balance sheet as a direct deduction from the carrying value of the debt liability, consistent with the presentation of a debt discount in the first quarter of the Company's fiscal year 2016 pertaining to the requirement of ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. The debt discount and the issuance costs allocated to the debt component are amortized as additional interest expense over the term of the Notes using the effective interest method. As of October 2, 2016, the remaining amortization period of the debt discount and the issuance costs is 2.1 years. The effective interest rate of the Notes is 7.84% per annum (1.75% coupon rate plus 6.09% of non-cash accretion expense).

Convertible notes hedges and warrants

Concurrent with the issuance of the Notes on November 6 and 7, 2013, the Company purchased call options for its own common stock to hedge the Notes (the Note Hedge) and sold call options for its own common stock (the Warrants). The Note Hedges and Warrants transactions are structured to reduce the potential future economic dilution associated with the conversion of the Notes and are excluded from the computation of diluted earnings per share for each period presented, as the Company's average stock price during each period is less than the conversion price.

The Note Hedges On November 6 and 7, 2013, the Company purchased call options from a counterparty for an aggregate price of approximately \$39.1 million, which gives the Company the right to buy from the counterparty up to approximately 8.0 million shares of the Company's common stock at a price of \$21.89 per share, subject to adjustments. The Note Hedge is exercisable upon conversion of the Notes for a number of shares equal to the product

of 0.045683 and amount of the converted Note. Upon exercise of the Note Hedge, the Company will receive from the counterparty cash, shares of the Company's common stock, or a combination thereof, equal to the amount by which the market price per share of the Company's common stock exceeds \$21.89 during the applicable valuation period. By the Note Hedge terms, the Company will receive cash and shares in a combination that offsets share dilution caused by conversion of the Notes.

Warrants On November 6 and 7, 2013, the Company sold call options to the same counterparty for approximately \$25.6 million, which gives the counterparty the right to buy from the Company up to approximately 8.0 million shares of the Company's common stock at an exercise price of \$28.66 per share, subject to adjustments, on a series of days commencing on February 1, 2019 and ending May 13, 2019. Upon exercise of the Warrants, the Company has the option to deliver cash or shares of its common stock equal to the difference between the market price on the exercise date and the strike price of the Warrants. Upon exercise of the Warrants, the Company will pay to the initial purchaser cash, shares of the Company's common stock, or a combination thereof (at the Company's choice), equal to the amount by which the market price per share of the Company's common stock exceeds \$28.66 during the applicable valuation period.

The Note Hedges and Warrants are classified in stockholders' equity in the Company's condensed consolidated balance sheets.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table summarizes the principal amounts and related unamortized discount on the Notes:

	October 2, 2016	April 3, 2016
	(in thousands)	
Principal amount of the Notes	\$ 175,000	\$ 175,000
Unamortized discount on the Notes	19,565	23,809
Unamortized debt issuance costs	125	153
Net carrying value	\$ 155,310	\$ 151,038

The following table presents the amount of interest expense recognized related to the Notes:

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Contractual coupon interest expense	\$ 764	\$ 764	\$ 1,528	\$ 1,528
Accretion of debt discount	2,144	1,986	4,243	3,931
Amortization of debt issuance costs	14	13	28	26
Total interest expense related to the Notes	\$ 2,922	\$ 2,763	\$ 5,799	\$ 5,485

As of October 2, 2016, the Company's aggregate future principal debt maturities are as follows:

Fiscal Year	October 2, 2016 (in thousands)
2019	\$ 175,000
Total	\$ 175,000

The Notes are shown in the accompanying condensed consolidated balance sheets at their original issuance value, net of unamortized discount, and are not marked to market each period. The approximate fair value of the Notes as of October 2, 2016 was \$169.6 million. The fair value of the Notes was determined using quoted market prices for similar securities, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

6. Stockholders equity

Stock plans

In July 2011, the Company's Board of Directors and its stockholders approved the establishment of the 2011 Stock Incentive Plan (the 2011 Plan). The 2011 Plan provides for annual increases in the number of shares available for issuance thereunder on the first business day of each fiscal year, equal to four percent (4%) of the number of shares of the Company's common stock outstanding as of such date, which resulted in an annual increase of 3.7 million shares for fiscal year 2017.

Under the 2011 Plan, the Board of Directors may grant either incentive stock options, nonqualified stock options, or stock awards to eligible persons, including employees, nonemployees, members of the Board of Directors, consultants and other independent advisors who provide services to the Company.

The Company's 2004 Stock Incentive Plan (the 2004 Plan), was adopted by the Company's board of directors and approved by the Company's stockholders on April 13, 2004, and was last amended on August 31, 2011. The 2004 Plan provides for the grant of incentive stock options, within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, to employees and any parent and subsidiary corporation's employees, and for the grant of non-qualified stock options and restricted stock to employees, directors and consultants and any parent and subsidiary corporation's employees. The Company has not granted any additional awards under the 2004 Plan following the completion of the Company's initial public offering in November 2011. However, the 2004 Plan continues to govern the terms and conditions of outstanding awards granted thereunder.

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Incentive stock options may only be granted to employees and at an exercise price of no less than fair value on the date of grant. Nonqualified stock options may be granted at an exercise price of no less than fair value on the date of grant. For owners of more than 10% of the Company's common stock, options may only be granted for an exercise price of not less than 110% of fair value, and these options generally expire 10 years from the date of grant. Stock options may be exercisable immediately but subject to repurchase. Stock options vest over the period determined by the Board of Directors, generally four years.

Stock option activities of the Company under the 2011 Plan and 2004 Plan (the Plans) are as follows (in thousands, except per share amounts):

	Options issued and outstanding	Weighted- average exercise price	Weighted- average remaining contractual term (in years)	Aggregate intrinsic value
Balance April 3, 2016	10,126	\$ 12.76	7.53	\$ 5,016
Options granted	2,860	5.95		
Exercised options	(33)	6.40		
Cancelled options	(981)	14.98		
Balance October 2, 2016	11,972	\$ 10.97	7.67	\$ 6,622
Vested and expected to vest October 2, 2016	10,636	\$ 11.22	7.49	\$ 5,461
Exercisable October 2, 2016	5,462	\$ 11.83	6.25	\$ 2,349

Valuation of stock-based awards

The Company applies the provisions of ASC 718-10 Compensation Stock Compensation which establishes the accounting for stock-based awards based on the fair value of the award measured at grant date. Accordingly, stock-based compensation cost is recognized in the condensed consolidated statements of operations as a component of both cost of revenues and operating expenses over the requisite service period. ASC 718-10 requires tax benefits in excess of compensation cost to be reported as a financing cash flow rather than as a reduction of taxes paid. The determination of the fair value of stock-based payment awards on the date of grant using the Black-Scholes option pricing model is affected by the volatilities of a peer group of companies based on industry, stage of life cycle, size and financial leverage, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The Company uses historical experience to estimate expected term. The expected volatility was based on the historical stock volatilities of the Company's historical data with that of a peer group of publicly listed

companies over a period equal to the expected terms. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term. The Company does not anticipate paying any cash dividends in the foreseeable future and, therefore, uses an expected dividend yield of zero.

The aggregate intrinsic value of the stock options exercised during the three and six months ended October 2, 2016 was \$9,000 and \$32,000, respectively. The aggregate intrinsic value of the stock options exercised during the three and six months ended September 27, 2015 was \$0.4 million and \$2.6 million respectively. The aggregate intrinsic value was calculated as the difference between the exercise price of the stock options and the estimated fair market value of the underlying common stock at the date of exercise.

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The number of options expected to vest takes into account an estimate of expected forfeitures. As of October 2, 2016, the remaining unamortized stock-based compensation expense, reduced for estimated forfeitures related to non-vested options, was \$17.4 million to be amortized over a weighted-average remaining period of 3.3 years. Total unrecognized expense will be adjusted for future changes in estimated forfeitures.

The Company used the following weighted-average assumptions in determining stock-based compensation expense for options granted in the three and six months ended October 2, 2016 and September 27, 2015

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Expected term (in years)	5.5	5.1	5.5	5.1
Volatility	51.2%	44.4%	49.2%	45.1%
Risk-free interest rate	1.2%	1.5%	1.4%	1.5%
Dividend rate	0%	0%	0%	0%

The weighted-average grant date fair value of the Company's stock options granted in the three and six month ended October 2, 2016 was \$3.60 and \$2.72 per share, respectively. The weighted-average grant date fair value of the Company's stock options granted in the three and six month ended September 27, 2015 was \$5.33 and \$6.06 per share, respectively.

Restricted stock units and restricted stock

Restricted stock unit and restricted stock activity of the Company under the Plans are as follows:

	Shares (in thousands, except per share amount)	Weighted Average	
		Grant	
		Date Fair	
		Value Per	
		Share	
Restricted stock units and restricted stock activities			
Unvested at April 3, 2016	4,972	\$	13.47
Granted	1,320		6.54
Released	(604)		15.76

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Forfeited	(446)		14.02
Unvested at October 2, 2016	5,242	\$	11.41

Restricted stock units and restricted stock granted to employees are generally subject to the employee's continued service to the Company over the vesting period. The fair value of restricted stock units and restricted stock is determined using the fair value of the Company's common stock on the date of the grant. Compensation expense is generally recognized on a straight-line basis over the requisite service period of each grant adjusted for estimated forfeitures. As of October 2, 2016, the remaining unamortized stock-based compensation expense, reduced for estimated forfeitures related to non-vested restricted stock units and restricted stock, was \$38.1 million to be amortized over a weighted-average remaining period of 2.6 years.

The weighted-average grant-date fair value per share of restricted stock units and restricted stock awarded in the three and six months ended October 2, 2016 was \$7.46 and \$6.54 per share, respectively. The weighted-average grant-date fair value per share of restricted stock units and restricted stock awarded in the three and six months ended September 27, 2015 was \$11.77 and \$14.20 per share, respectively.

Table of Contents**INVENSENSE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****2013 Employee stock purchase plan**

Under the 2013 Employee Stock Purchase Plan, as amended (the "ESPP"), eligible employees may apply accumulated payroll deductions, which may not exceed 10% of an employee's compensation, to the purchase of shares of the Company's common stock at periodic intervals. The purchase price of stock under the ESPP is equal to 85% of the lower of (i) the fair market value of the Company's common stock on the first day of each offering period, or (ii) the fair market value of the Company's common stock on the purchase date (as defined in the ESPP). Each offering period consists of one purchase period of approximately six months duration.

At the 2016 and 2015 annual meetings of stockholders, stockholders of the Company approved amendments to the ESPP to increase the number of shares of common stock reserved for future issuance by 2,000,000 shares and 1,000,000 shares, respectively, which brought the total amount of common stock reserved for issuance pursuant to the ESPP to an aggregate of 3,400,000 shares. As of October 2, 2016, 722,000 shares had been purchased pursuant to the ESPP.

Compensation expense recognized in connection with the ESPP was \$0.3 million and \$0.5 million for the three and six months ended October 2, 2016. Compensation expense recognized in connection with the ESPP was \$0.2 million and \$0.5 million for the three and six months ended September 27, 2015.

Common stock

As of October 2, 2016 and April 3, 2016, common stock reserved for future issuance was as follows:

	October 2, 2016	April 3, 2016
	(in thousands)	
Common stock reserved for issuance		
Stock plans		
Outstanding stock options	11,972	10,126
Outstanding restricted stock units and restricted stock	5,242	4,972
Reserved for future equity incentive grants	10,281	9,295
	27,495	24,393
ESPP	2,678	1,000
Shares issuable upon exercise of warrants to purchase common stock	7,995	7,995
Total common stock reserved for future issuance	38,168	33,388

Stock-based compensation expense

Total employee stock-based compensation cost for the Company's stock plans for the three and six months ended October 2, 2016 and September 27, 2015 is as follows:

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Cost of revenue	\$ 571	\$ 584	\$ 1,187	\$ 1,184
Research and development	4,217	4,002	8,291	7,838
Selling, general and administrative	4,257	4,462	7,743	8,661
Total stock-based compensation expense	\$ 9,045	\$ 9,048	\$ 17,221	\$ 17,683

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

7. Income taxes

In the three and six months ended October 2, 2016, the Company recorded an income tax provision of \$0.2 million and \$2.1 million, respectively. In the three and six months ended September 27, 2015, the Company recorded an income tax provision (benefit) of (\$2.0) million and (\$1.7) million, respectively. The primary difference between the 2016 effective tax rate and the federal statutory tax rate relates to the valuation allowances on certain of the Company's net operating losses and tax credits, foreign tax rate differences, integration of acquired technologies, and non-deductible stock-based compensation expense.

On July 27, 2015, the Tax Court issued an opinion (Altera Corp. et al. v. Commissioner) regarding the treatment of stock-based compensation expense in intercompany cost-sharing arrangements. However, U.S. Treasury has not withdrawn the requirement to include stock-based compensation from its regulations. Also, there is uncertainty related to the Internal Revenue Service (IRS) response to the Tax Court opinion, the final resolution of this issue, and the potential favorable benefits to the Company. As such, no impact will be recorded at this time. The Company will continue to monitor developments related to this opinion and the potential impact of those developments on the Company's current and prior fiscal years.

The Company does not provide for federal income taxes on undistributed earnings of its foreign subsidiaries because it is the Company's intent to reinvest earnings indefinitely offshore.

As of October 2, 2016, the total amount of gross unrecognized tax benefits was \$34.2 million. If the gross unrecognized tax benefits as of October 2, 2016 were realized in a subsequent period, this would result in a tax benefit of \$18.5 million within the provision of income taxes at such time.

The Company is currently under examination by the IRS for the 2011 through 2014 tax years. The Company may be subject to examination by California for tax years 2010 and forward. The Company is subject to routine examination for tax years 2008 and forward in various foreign tax jurisdictions in which it operates.

The Company is engaged in discussions and negotiations with the IRS regarding tax matters in the tax years 2011 through 2014. The balance of the gross unrecognized tax benefits may decrease within the next twelve months due to lapses of applicable statutes of limitations and the completion of tax review cycles in various tax jurisdictions.

The Company is pursuing all available administrative remedies relative to these matters. Management believes that the Company has adequately provided for any reasonably foreseeable outcomes related to these proposed adjustments and the ultimate resolution of these matters is unlikely to have a material effect on the Company's consolidated financial condition or results of operations; however there is still a possibility that an adverse outcome of these matters could have a material effect on its consolidated financial condition and results of operations.

8. Acquisition

The Company completed one acquisition in fiscal year 2017 and one acquisition in fiscal year 2016. The acquisitions have been accounted for under ASC 805. Under ASC 805, the total purchase consideration of the acquisition is allocated to the tangible assets and identifiable intangible assets and liabilities assumed based on their relative fair values. The excess of the purchase consideration over the net tangible and identifiable intangible assets is recorded as goodwill, and was derived from expected benefits from future technology development, synergies and the knowledgeable and experienced workforce who joined the Company after the acquisition.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Fiscal year 2017

In August 2016, the Company acquired the pressure sensor business from Sensirion Holding AG and its affiliates used in the development of capacitive-type monolithic digital pressure-sensor technology platform. The preliminary purchase price allocation reflected that the purchase price associated with the acquisition was approximately \$9.8 million, of which \$5.7 million was allocated to developed technology with an estimated useful life of six years and \$4.1 million was allocated to goodwill. This acquisition is not significant to the Company's results of operations.

Fiscal year 2016

In December 2015, the Company acquired certain assets of Spirit Corp LLC and its affiliates used in the development of navigation solutions. The total cash consideration associated with the acquisition was approximately \$7 million for which the purchase price was attributable to the acquired in-process research and development. The fair value of in-process research and development was determined using a cost approach, which includes an estimate of time and expenses required to recreate the intangible asset. The Company also will record approximately \$1 million post-acquisition expense that may be payable in the future should certain specified milestones be met. This acquisition is not significant to the Company's results of operations.

9. Goodwill and intangible assets

The Company monitors the recoverability of goodwill recorded in connection with acquisitions annually, or whenever events or changes in circumstances indicate the carrying value may not be recoverable. There were no changes in the carrying amount of goodwill since April 3, 2016. The Company performs the annual goodwill impairment analysis during the third quarter of each fiscal year. As of and for the six months ended October 2, 2016, the Company concluded that the \$143.3 million of goodwill was not impaired.

Purchased intangible assets subject to amortization consist primarily of developed technology, customer relationships and patents and are reported net of accumulated amortization. Developed technology, customer relationships and patents are amortized on a straight line basis over the estimated useful life of the assets. In-process research and development (IPR&D) is assessed for impairment until the development is completed and products are available for sale.

During the six months ended October 2, 2016, one IPR&D project was released to production. The IPR&D value allocated to this project of \$1.6 million was transferred to developed technology. The estimated useful life for this technology was five years. In fiscal year 2016, two IPR&D projects were released to production. The IPR&D value allocated to the projects of \$3.3 million and \$1.7 million, respectively, were transferred to developed technology. The estimated useful life for each technology is five years.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Amortization for acquired intangible assets for the three and six months ended October 2, 2016 was approximately \$2.5 million and \$4.9 million, respectively. Amortization for acquired intangible assets for the three and six months ended September 27, 2015 was approximately \$2.4 million and \$4.5 million, respectively. The following table represents intangible assets and accumulated amortization:

	Gross	October 2, 2016 Accumulated amortization (in thousands)	Net
Developed technology	\$ 56,580	\$ 21,746	\$ 34,834
Customer relationships	1,560	650	910
Patents	2,120	626	1,494
Total intangible assets subject to amortization	60,260	23,022	37,238
IPR&D	6,750		6,750
Total intangible assets, net	\$ 67,010	\$ 23,022	\$ 43,988

	Gross	April 3, 2016 Accumulated amortization (in thousands)	Net
Developed technology	\$ 49,310	\$ 17,159	\$ 32,151
Customer relationships	1,560	539	1,021
Patents	2,120	443	1,677
Total intangible assets subject to amortization	52,990	18,141	34,849
IPR&D	8,320		8,320
Total intangible assets, net	\$ 61,310	\$ 18,141	\$ 43,169

The estimated future amortization expense related to intangible assets at October 2, 2016, is as follows:

Estimated

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Fiscal Year	amortization (in thousands)
2017 (remainder)	\$ 5,382
2018	10,764
2019	10,764
2020	6,820
2021	2,057
Thereafter	1,451
Total	\$ 37,238

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the notes to those statements included elsewhere in this Quarterly Report on Form 10-Q, the Consolidated Financial Statements and Notes thereto for the year ended April 3, 2016, and with management's discussion and analysis of our financial condition and results of operations included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on May 25, 2016.

This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, includes a number of forward-looking statements that involve many risks and uncertainties. Forward-looking statements are identified by the use of the words would, could, will, may, expect, believe, should, anticipate, outlook, if, future, intend, plan, estimate, predict, potential, targets, seek or continue and similar words and phrases, including the negatives of these terms, or other variations of these terms, that denote future events. These forward-looking statements include, but are not limited to, our expectations as to when cash payments and milestone payments are to be made; our expectations as to when equipment under construction is to be completed and placed in service; our ability to protect our intellectual property and defend against infringement claims; our expectations as to the outcome of current and future legal proceedings, including the potential impact thereof; our estimated useful life of certain technologies; our belief that a substantial majority of our net revenue will continue to come from sales to customers in Asia and from sales to customers who are headquartered in the United States, but who use contract manufacturers in Asia; the outcome of current and future tax examinations by the IRS, California and various foreign tax jurisdictions; our belief that the proposed tax adjustments and the ultimate resolution thereof is unlikely to have a material effect on our consolidated financial condition or results of operations; our belief in the sufficiency of our current cash, cash equivalents and investments to satisfy our liquidity requirements for the next 12 months; our plans to reinvest earnings from our foreign subsidiaries outside of the United States; and our belief that exposure for indemnification obligations is minimal. These statements reflect our current views with respect to future events and our potential financial performance and are subject to risks and uncertainties that could cause our actual results and financial position to differ materially and adversely from what is projected or implied in any forward-looking statements included in this Form 10-Q. These factors include, but are not limited to, the risks referred to under Item 1A. of Part I Risk Factors, included in the Company's Annual Report on Form 10-K filed on May 25, 2016 with the SEC and Item 2 of Part I Management's Discussion and Analysis of Financial Condition and Results of Operations, and discussed elsewhere in this Quarterly Report on Form 10-Q including in Note 1 to the Condensed Consolidated Financial Statements and those discussed in other documents we file with the SEC. We make these forward-looking statements based upon information available on the date of this Form 10-Q, and we have no obligation (and expressly disclaim any such obligation) to update or alter any forward-looking statements, whether as a result of new information or otherwise except as otherwise required by securities regulations.

Overview**Business overview**

We are a leader in sensor solutions, particularly sensors that combine microelectromechanical systems (MEMS) transducers, such as accelerometers, gyroscopes, barometers, compasses, and microphones, with proprietary algorithms, processors and firmware that synthesize and calibrate sensor output data. We utilize a fabless model, leveraging generally available complementary metal oxide semiconductor (CMOS) and MEMS foundries to whom we have granted licenses to use our proprietary enhancements and improvements for our benefit, as well as

semiconductor packaging and services vendors. We perform critical test and calibration functions in our wholly owned subsidiary located in Hsinchu, Taiwan. We design our products and solutions in California, Massachusetts, China, Taiwan, Korea, Japan, France, Canada, Slovakia, and Italy.

Net revenue

We derive our net revenue from sales of our Motion and Audio sensor solutions. We primarily sell our products through our worldwide sales organization. We also sell our products through an indirect channel of distributors that fulfill orders from manufacturers of consumer electronics devices, original design manufacturers and contract manufacturers (collectively referred to as intermediaries). When we reference customers, we are referring to the manufacturers of consumer electronics devices to whom these intermediaries sell our products.

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	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Net revenue	\$ 79,831	\$ 112,545	\$ 140,467	\$ 218,841

Net revenue decreased by \$32.7 million, or 29%, in the second quarter of fiscal year 2017 and decreased by \$78.4 million, or 36%, in the first half of fiscal year 2017 compared to the corresponding periods of fiscal year 2016. The decreases in net revenue were primarily due to lower volume shipments to manufacturers of smartphones, tablet devices and camera modules incorporating optimal image stabilization, combined with lower per unit average selling prices. Total unit shipments decreased by 23% and 31% in the three and six months ended October 2, 2016, respectively. Our overall average unit selling price for the three and six months ended October 2, 2016 decreased 9% and 7%, respectively, as a result of the change in our product mix and declines in average selling prices.

For the three months ended October 2, 2016, Apple Inc. (Apple) and GH Development Holdings Limited accounted for 58% and 11% of total net revenue, respectively. For the three months ended September 27, 2015, Apple and Samsung Electronics Co., Ltd. (Samsung) accounted for 34% and 19% of total net revenue, respectively. For the six months ended October 2, 2016, Apple accounted for 53% of net revenue. For the six months ended September 27, 2015, Apple and Samsung accounted for 36% and 21% of total net revenue, respectively.

Net revenue by target end market

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Smartphone and tablet devices	\$ 57,482	\$ 69,856	\$ 95,718	\$ 146,876
% of net revenue	72%	62%	68%	67%
Optical image stabilization	\$ 4,917	\$ 20,775	\$ 12,260	\$ 37,525
% of net revenue	6%	18%	9%	17%
IoT and other	\$ 17,432	\$ 21,914	\$ 32,489	\$ 34,440
% of net revenue	22%	20%	23%	16%

The net revenue decrease for the smartphone and tablet end market and IoT and other end market in the three and six months ended October 2, 2016 compared to the corresponding periods last year reflects the weak high-end smartphone market combined with increased competition for market share across this market segment. The net revenue decrease for the optimal image stabilization end market in the three months ended October 2, 2016 primarily reflects a loss of market share at a major customer in Korea.

Net revenue by geographic region

Region	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
United States	\$ 50,193	\$ 42,913	\$ 80,298	\$ 86,716

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China	14,844	26,010	27,290	50,616
Korea	5,074	24,469	10,868	53,192
Japan	4,873	8,028	10,153	12,164
Taiwan	3,583	7,576	9,008	10,762
Rest of world	1,264	3,549	2,850	5,391
	\$ 79,831	\$ 112,545	\$ 140,467	\$ 218,841

We report revenue by geographic region based upon the location of the headquarters of our customers. We primarily sell our products directly to customers and distributors in Asia and North America. Sales into companies headquartered in Asian countries constituted 36% and 41% of our net revenue in the three and six months ended October 2, 2016, respectively, compared with 59% and 58% of our net revenue in the three and six months ended September 27, 2015, respectively. For the three months ended October 2, 2016, net revenue increased in United States and decreased in the rest of the geographic regions. For the six months ended October 2,

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2016, net revenue decreased in all geographic regions. The net revenue increase in the United States for the three months ended October 2, 2016 reflected higher demand for our products by mobile device manufacturers. The net revenue decreases in the rest of the geographic regions for the three months ended October 2, 2016 and in all geographic regions for the six months ended October 2, 2016, reflected the weak high-end smartphone market combined with increased competition for market share for mobile device manufacturers. The net revenue decrease in Korea in the three and six months ended October 2, 2016 compared to the corresponding period last year resulted from a loss of market share at a major customer.

As a result of our regional customer concentration, we may be subject to economic and political events and other developments that impact our customers in Asia. For more information, see the section titled **Risk Factors** Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business, referred to under Item 1A. of Part I in our Annual Report on Form 10-K filed on May 25, 2016 with the SEC.

Gross profit and gross margin

Gross profit is the difference between net revenue and cost of revenue and gross margin is gross profit as a percentage of net revenue.

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Gross profit	\$ 33,532	\$ 46,571	\$ 58,277	\$ 91,402
% of net revenue	42%	41%	41%	42%

Gross profit decreased by \$13.0 million in the second quarter of fiscal year 2017 and decreased by \$33.1 million in the first half of fiscal year 2017 as compared to the corresponding periods of fiscal 2016. In the second quarter and the first half of fiscal year 2017, gross profit decreased primarily due to a decrease in unit sales of our products combined with decreases in average selling prices per unit.

Gross profit as a percentage of net revenue, or gross margin, increased in the second quarter of fiscal year 2017 compared to the same period last year due to:

a net benefit of the sale of previously written down inventories of \$2.4 million in the second quarter of fiscal year 2017 compared to an excess and obsolete inventory charge of \$1.2 million in the same period last year;

offset partially by manufacturing yield losses attributable to production ramp of a new product and a decrease in average selling prices per unit in the second quarter of fiscal year 2017 compared to the same period last year.

Gross profit as a percentage of net revenue, or gross margin, decreased in the first six months of fiscal year 2017 compared to the same period last year due to:

manufacturing yield losses attributable to production ramp of a new product and a decrease in average selling prices per unit in the first six months of fiscal year 2017 compared to the same period last year;

offset partially by a net benefit of the sale of previously written down inventories of \$2.3 million in the first six months of fiscal year 2017 compared to an excess and obsolete inventory charge of \$2.0 million in the same period last year.

We expect gross margins to fluctuate during future periods due to changes in product mix, average unit selling prices, manufacturing costs, manufacturing yields, amortization of acquired intangible assets, levels of inventory valuation and excess reserves recorded, if any, and levels of product demand.

Research and development

Research and development expense primarily consists of personnel related expenses (including employee cash compensation and benefits, and stock-based compensation), contract engineering services, reference design development costs, development testing and evaluation costs, depreciation expense, amortization of certain acquisition intangibles and allocated occupancy costs. Research and development activities include the design of new products, refinement of existing products and processes and design of test methodologies, including hardware and software to ensure compliance with required specifications. All research and development costs are expensed as incurred. We expect our research and development expenses to increase slightly on an absolute basis in the near future as we continue to expand our product offerings and enhance existing products.

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	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Research and development	\$ 28,144	\$ 24,991	\$ 54,685	\$ 45,246
% of net revenue	35%	22%	39%	21%

Research and development expense for three months ended October 2, 2016 increased by \$3.2 million, or 13%, compared to the corresponding period last year. The increase was primarily attributable to a \$1.1 million increase in employee compensation and benefits costs primarily due to an increase in headcount, a \$1.0 million increase in outside services costs associated with new product development and a \$0.9 million increase in engineering equipment costs. Research and development headcount increased to 337 at October 2, 2016 from 310 at September 27, 2015.

Research and development expense for the six months ended October 2, 2016 increased by \$9.4 million, or 21%, primarily attributable to a contingent consideration credit adjustment in the six months ended September 27, 2015 that resulted in reduced research and development expenses by \$5.3 million for the six months ended September 27, 2015. Excluding this credit, research and development expense for the six months ended October 2, 2016 increased by \$4.1 million compared to the corresponding period last year. The increase was primarily due to a \$2.5 million increase in employee compensation and benefits costs largely from higher headcount, a \$2.1 million increase in outside services costs associated with new product development, a \$0.3 million increase in depreciation costs related to increased capital equipment and a \$0.2 million increase in allocated infrastructure costs to support higher headcount during the six months ended October 2, 2016. These increases were partially offset by a \$1.1 million decrease in engineering supplies related to manufacturing activities.

Selling, general and administrative

Selling, general and administrative expense primarily consists of personnel related expenses (including employee cash compensation and benefits, and stock-based compensation), sales commissions, field application engineering support, travel costs, professional and consulting fees, legal fees, depreciation expense and allocated occupancy costs.

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Selling, general and administrative	\$ 14,869	\$ 15,186	\$ 28,731	\$ 31,010
% of net revenue	19%	13%	20%	14%

Selling, general and administrative expense decreased by \$0.3 million, or 2%, in the three months ended October 2, 2016 compared to the corresponding period last year. The decrease was primarily attributable to a \$0.3 million decrease in outside services costs primarily resulting from decreased legal costs.

Selling, general and administrative expense decreased by \$2.3 million, or 7%, in the six months ended October 2, 2016 compared to the corresponding period last year. The decrease was primarily attributable to a \$1.4 million decrease in employee compensation and benefits costs primarily due to a decrease in headcount and a decrease of \$1.1 million in outside services costs due primarily to decreased legal costs.

Legal settlement accrual

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			

Legal settlement accrual	\$	\$	\$	\$ 11,708
% of net revenue	%	%	%	5%

During the six months ended September 27, 2015, we recorded a charge of \$11.7 million related to the settlement with Bosch.

Table of Contents**Interest expense**

	Three Months Ended		Six Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
	(in thousands)			
Interest expense	\$ (2,925)	\$ (2,765)	\$ (5,806)	\$ (5,489)
% of net revenue	4%	2%	4%	3%