InvenSense Inc
Form 10-Q
November 08, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 29, 2013

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	**01-0789977**
(State or other jurisdiction of Incorporation or organization)	**(I.R.S. Employer Identification No.)**

1745 Technology Drive San Jose, CA 95110

(Address of principal executive offices and zip code)

(408) 988-7339

(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 x 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 x No ¨

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

Large accelerated filer ¨	Accelerated filer x
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 x

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 November 4, 2013**
Common Stock, $0.001 par value	87,455,450

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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)

	September 29, 2013	March 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 118,183	$ 100,843
Short-term investments	43,342	77,040
Accounts receivable	35,566	30,098
Inventories	38,469	23,762
Prepaid expenses and other current assets	13,728	13,302
Total current assets	249,288	245,045
Property and equipment, net	16,677	8,650
Long-term investments	56,236	22,442
Other assets	3,046	2,957
Total assets	$ 325,247	$ 279,094
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 14,418	$ 14,464
Accrued liabilities	12,387	7,753
Total current liabilities	26,805	22,217
Long-term liabilities	7,637	6,930
Total liabilities	34,442	29,147
Commitments and contingencies (Note 4)		
Stockholders equity:		
Preferred stock:		
Preferred stock, $0.001 par value 20,000 shares authorized, no shares issued and outstanding at September 29, 2013 and March 31, 2013		
Common stock:		
	175,127	158,108

Common stock, $0.001 par value 750,000 shares authorized, 87,046 shares issued and outstanding at September 29, 2013, 84,980 shares issued and outstanding at March 31, 2013				
Accumulated other comprehensive income (loss)		(41)		50
Retained earnings		115,719		91,789
Total stockholders equity		290,805		249,947
Total liabilities and stockholders equity	$	325,247	$	279,094

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

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INVENSENSE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Net revenue	$ 70,941	$ 55,294	$ 126,851	$ 94,496
Cost of revenue	34,364	24,923	60,955	42,562
Gross profit	36,577	30,371	65,896	51,934
Operating expenses:				
Research and development	9,810	5,918	17,924	11,574
Selling, general and administrative	11,424	7,202	20,580	13,459
Total operating expenses	21,234	13,120	38,504	25,033
Income from operations	15,343	17,251	27,392	26,901
Other income, net	210	54	291	90
Income before income taxes	15,553	17,305	27,683	26,991
Income tax provision	1,945	3,641	3,753	5,676
Net income	$ 13,608	$ 13,664	$ 23,930	$ 21,315
Net income per share:				
Basic	$ 0.16	$ 0.17	$ 0.28	$ 0.26
Diluted	$ 0.15	$ 0.16	$ 0.27	$ 0.24
Weighted average shares outstanding used in computing net income per share:				
Basic	86,289	82,429	85,658	81,806
Diluted	89,778	87,257	88,841	87,168

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

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INVENSENSE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended		Six Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Net income	$ 13,608	$ 13,664	$ 23,930	$ 21,315
Other comprehensive income:				
Unrealized gain on available-for-sale investments, net of tax	26	157	91	83
Total comprehensive income	$ 13,634	$ 13,821	$ 24,021	$ 21,398

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

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INVENSENSE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended	
	September 29, 2013	**September 30, 2012**
Cash flows from operating activities:		
Net income	$ 23,930	$ 21,315
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,524	1,158
Stock-based compensation expense	6,177	3,692
Deferred income tax assets	(5)	(4)
Tax effect of employee benefit plans	3,231	2,707
Excess tax benefit from stock-based compensation	(3,231)	(2,707)
Changes in operating assets and liabilities:		
Accounts receivable	(5,468)	(18,181)
Inventories	(14,707)	(8,968)
Prepaid expenses and other current assets	(485)	259
Other assets	(63)	696
Accounts payable	765	3,375
Accrued liabilities	4,789	1,839
Net cash provided by operating activities	16,457	5,181
Cash flows from investing activities:		
Purchase of property and equipment	(9,805)	(2,249)
Sale and maturities of available-for-sale investments	46,197	7,926
Purchase of available-for-sale investments	(46,345)	(103,765)
Net cash used in investing activities	(9,953)	(98,088)
Cash flows from financing activities:		
Proceeds from exercise of warrants		81
Proceeds from exercise of common stock	7,611	3,321
Offering costs		(465)
Payments of long-term debt and capital lease obligations	(6)	(14)
Excess tax benefit from stock-based compensation	3,231	2,707
Net cash provided by financing activities	10,836	5,630
Net increase (decrease) in cash and cash equivalents	17,340	(87,277)

Cash and cash equivalents:		
Beginning of period	100,843	153,643
End of period	$ 118,183	$ 66,366
Supplemental disclosures of cash flow information:		
Net cash received (paid) for income taxes	$ 3,329	$ (20)
Noncash investing and financing activities:		
Unpaid purchases of property and equipment purchased	$ 1,591	$ 236
Unrealized gain from available-for-sale investments	$ 109	$ 83
Non-cash warrant exercises		$ 70
Unpaid accrued liabilities for offering costs incurred		$ 6

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 MEMS gyroscopes for MotionTracking devices in consumer electronics and is dedicated to bringing the best-in-class size, performance and cost solutions to market. Targeting applications in smartphones and tablets, console and portable video gaming devices, digital still and video cameras, smart TVs (including digital set-top boxes, televisions and multi-media HDDs), navigation devices, toys, and health and fitness accessories, the Company delivers leading generation of motion interface solutions based on its advanced multi-axis gyroscope technology.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the fiscal year ended March 31, 2013 included in the Company s Annual Report on Form 10-K filed on June 14, 2013 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 March 31, 2013.

Certain Significant Business Risks and Uncertainties

The Company participates in the high-technology industry and believes that adverse changes in any of the following areas 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; advances and trends in new technologies and industry standards; market acceptance of the Company s products; development of sales channels; 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.

Fiscal Year

The Company s fiscal year is a 52 or 53 week period ending on the Sunday closest to March 31. The Company s most recent fiscal year (Fiscal 2013) ended on March 31, 2013 (March 2013). The second fiscal quarter in each of the two most recent fiscal years ended on September 29, 2013 (three months ended September 29, 2013 or September 2013) and September 30, 2012 (three months ended September 30, 2012 or September 2012), respectively, and each quarter period included 13 weeks.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (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 March 31, 2013, 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 all normal recurring adjustments necessary to present fairly the Company s financial position, results of operations, comprehensive income and cash flows for the interim periods. The results of operations for the period ended September 29, 2013 is not necessarily indicative of the results to be expected for the fiscal year ending March 30, 2014 or for any future year or interim period.

Basis of Consolidation

All intercompany transactions and balances have been eliminated upon 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, net in the condensed consolidated statements of income.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Use of Estimates

The preparation of the Company s condensed consolidated financial statements 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 financial statements 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 and warranty reserves. These estimates are based upon information available as of the date of the consolidated financial statements, and actual results could differ from those estimates.

Concentration of Credit Risk

At September 29, 2013, four customers each accounted for 22%, 21%, 12% and 10% of total accounts receivable. At September 30, 2012, five customers each accounted for 23%, 19%, 15%, 12%, and 11% of total accounts receivable.

For the three months ended September 29, 2013, two customers each accounted for 36% and 14% of total net revenue. For the six months ended September 29, 2013, one customer accounted for 31% of total net revenue. For the three months ended September 30, 2012, three customers each accounted for 29%, 19% and 17% of total net revenue. For the six months ended September 30, 2012, three customers each accounted for 22%, 19% and 15% of total net revenue.

Warranty

The Company s warranty agreements are contract and component specific and can be up to three years for selected components. The Company s accrual for anticipated warranty costs has declined primarily due to a decline in the historical volume of product returned under the warranty program. The accrual also includes management s judgment regarding anticipated rates of warranty claims and associated repair costs. The following table summarizes the activity related to the product warranty liability during the six months ended September 29, 2013 and September 30, 2012:

	Six Months Ended	
	September 29, 2013	**September 30, 2012**
	(in thousands)	
Beginning balance	$ 123	$ 361
(Decrease) increase in provision for warranty	(6)	102
Less: actual warranty costs	(16)	(27)
Ending balance	$ 101	$ 436

Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of shares outstanding during the period, which excludes dilutive unvested restricted stock.

Diluted net income per share is computed by dividing net income 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.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

	Three Months Ended		Six Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
	(in thousands, except per share data)			
Numerator:				
Basic and Diluted:				
Net income	$ 13,608	$ 13,664	$ 23,930	$ 21,315
Denominator:				
Basic shares:				
Weighted average shares used in computing basic net income per share	86,289	82,429	85,658	81,806
Diluted shares:				
Weighted average shares used in computing basic net income per share	86,289	82,429	85,658	81,806
Effect of potentially dilutive securities:				
Stock options and unvested restricted stock	3,405	4,657	3,101	5,166
Common stock warrants	84	171	82	196
Weighted average shares used in computing diluted net income per share	89,778	87,257	88,841	87,168
Net income per share:				
Basic	$ 0.16	$ 0.17	$ 0.28	$ 0.26
Diluted	$ 0.15	$ 0.16	$ 0.27	$ 0.24

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

	Three Months Ended		Six Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012

		(in thousands)		
Employee stock options	1,644	2,304	4,418	2,304
Unvested restricted stock units	250	152	589	152
Total antidilutive securities	1,894	2,456	5,007	2,456

Recent Accounting Pronouncements

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. ASU No. 2011-02 became effective for fiscal years, and interim periods within those years, beginning after December 15, 2012, which is the Company s fiscal interim period ended June 30, 2013 of fiscal year ending March 30, 2014, and the adoption did not impact the Company s financial condition or results of operations.

INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Cash Equivalents and Available-for-sale Investments

At September 29, 2013, of the $118.2 million of the Company s cash and cash equivalents, $94.9 million was cash and $23.3 million was cash equivalents invested in money market funds and commercial paper. At September 29, 2013, $64.4 million of the $118.2 million of cash and cash equivalents were held by our foreign subsidiaries. Additionally, as of September 29, 2013, the Company had short-term available-for-sale investments of $43.3 million and long-term available-for-sale investments of $56.2 million totaling $99.5 million. Long-term investments as of September 29, 2013 of $56.2 million had scheduled maturities between one and five years from the balance sheet date.

At March 2013, of the $100.8 million of the Company s cash and cash equivalents, $77.9 million was cash and $22.9 million was cash equivalents invested in money market funds. At March 2013, $60.7 million of the $100.8 million of cash and cash equivalents were held by our foreign subsidiaries. Additionally, as of March 2013, the Company had short-term available-for-sale investments of $77.0 million and long-term available-for-sale investments of $22.4 million totaling $99.4 million. Long-term investments as of March 2013 of $22.4 million had scheduled maturities between one and five years from the balance sheet date.

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.

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 our 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 still reported at their carrying values.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Fair value measurements at each reporting date were as follows:

September 2013:

Assets measured at fair value on a recurring basis were presented in the Company s condensed consolidated balance sheet as of September 29, 2013.

	September 2013 Balance	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Other Unobservable Inputs Level 3
		(in thousands)		
Investment Class				
Money Market Funds	$ 23,252	$ 23,252	$	$
Corporate Notes and Bonds	93,608		93,608	
Municipal Notes and Bonds	3,970		3,970	
U.S. Agency Securities	2,000		2,000	
Total	$ 122,830	$ 23,252	$ 99,578	$
Financial Statement Classification				
Cash equivalents	$ 23,252	$ 23,252	$	$
Short-term investments	43,342		43,342	
Long-term investments	56,236		56,236	
Total	$ 122,830	$ 23,252	$ 99,578	$

	September 2013 Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	September 2013 Estimated FMV
Investment Class				
Corporate Notes and Bonds and Municipal Notes and Bonds	$ 93,499	$ 109	$	$ 93,608
Municipal Notes and Bonds	3,970			3,970
U.S. Agency Securities	2,000			2,000

Total Available-for-sale investments	$	99,469	$	109	$		$	99,578
Cash equivalents								23,252
Total Aggregate Fair Value							$	122,830

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, municipal notes and bonds 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 the three months ended September 29, 2013.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

March 2013:

Assets measured at fair value on a recurring basis were presented in the Company s consolidated balance sheet as of March 31, 2013.

	March 2013 Balance	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Other Unobservable Inputs Level 3
		(in thousands)		
Investment Class				
Money Market Funds	$ 22,860	$ 22,860	$	$
Corporate Notes and Bonds	94,485		94,485	
Commercial Paper	2,998		2,998	
U.S. Agency Securities	1,999		1,999	
Total	$ 122,342	$ 22,860	$ 99,482	$
Financial Statement Classification				
Cash equivalents	$ 22,860	$ 22,860	$	$
Short-term investments	77,040		77,040	
Long-term investments	22,442		22,442	
Total	$ 122,342	$ 22,860	$ 99,482	$

	March 2013 Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	March 2013 Estimated FMV
Investment Class				
Corporate Notes and Bonds	$ 94,407	$ 78	$	$ 94,485
Commercial Paper	2,997	1		2,998
U.S. Agency Securities	2,001		(2)	1,999
Total Available-for-sale investments	$ 99,405	$ 79	$ (2)	$ 99,482

Cash equivalents		22,860
Total Aggregate Fair Value	$	122,342

There were no transfers of assets measured at fair value between Level 1 and Level 2 during Fiscal 2013.

3. Balance Sheet Details

Inventories

Inventories at September 29, 2013 and March 31, 2013 consist of the following:

	September 2013	March 2013
	(in thousands)	
Work in progress	$ 26,449	$ 18,803
Finished goods	12,020	4,959
Total inventories	$ 38,469	$ 23,762

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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 September 29, 2013 and March 31, 2013 consist of the following:

	September 2013	March 2013
	(in thousands)	
Tax receivable	$ 4,361	$ 6,374
Advance to and receivable from vendors	2,873	2,824
Prepaid expenses	2,505	2,209
Deferred tax assets	949	951
Other current assets	3,040	944
Total prepaid expenses and other current assets	$ 13,728	$ 13,302

The Company has agreements with foundry vendors to facilitate and expand production and development capacity for the Company s products. Certain of these agreements require advance payments to these foundry vendors, which are applied at agreed upon rates to subsequent wafer purchases from these vendors. The Company classifies advances expected to be applied towards purchases within 12 months as Prepaid expenses and other current assets and the remaining balances as Other assets on the Company s condensed consolidated balance sheets. The Company believes that the advances to these vendors will be fully applied towards future purchases from these vendors. The Company made $0.8 million of advance payments to foundry vendors during the three and six months ended September 29, 2013. The Company made no payments to foundry vendors during the three and six months ended September 30, 2012.

Property and Equipment

Property and equipment at September 29, 2013 and March 31, 2013 consist of the following:

	September 2013	March 2013
	(in thousands)	
Production and lab equipment	$ 15,897	$ 11,654
Computer equipment and software	2,984	1,124
Equipment under construction	4,170	1,851
Leasehold improvements and furniture and fixtures	2,041	923
Subtotal	$ 25,092	$ 15,552

Accumulated depreciation and amortization	(8,415)	(6,902)
Property and equipment net	$ 16,677	$ 8,650

Depreciation and amortization expense for the three and six months ended September 29, 2013 was $0.8 million and $1.5 million, respectively. Depreciation and amortization expense for the three and six months ended September 30, 2012 was $0.6 million and $1.2 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 2014. Capitalized leases consist of office equipment. For the three and six months ended September 29, 2013 and September 30, 2012, there were no new capitalized leases.

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Accrued Liabilities

Accrued liabilities at September 29, 2013 and March 31, 2013 consist of the following:

	September 2013	March 2013
	(in thousands)	
Payroll-related expenses	$ 2,774	$ 2,777
Legal fees	3,646	884
Other accrued liabilities	3,975	819
Former CEO separation costs (1)	278	828
Bonuses	1,390	2,120
Engineering services	178	106
Warranty reserves	101	123
Income tax payable	45	96
Total accrued liabilities	$ 12,387	$ 7,753

(1) During the third quarter of fiscal year 2013, the Company s founder and CEO resigned. Under the terms of his employment agreement, he will receive severance payments totaling $828,000 through the end of fiscal year 2014.

4. Commitments and Contingencies

Operating Lease Obligations

The Company has non-cancelable operating leases for its facilities through fiscal year 2020.

Future minimum lease payments under operating leases as of September 29, 2013 are as follows:

Fiscal Years Ending:	Amount (in thousands)
2014 (remainder)	$ 722
2015	2,756
2016	3,468
2017	3,647

2018		3,732
Beyond		6,756
Total	$	21,081

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 was approximately $1.2 million and $1.8 million for the three and six months ended September 29, 2013, respectively. The Company s rental expense under operating leases was approximately $0.5 million and $1.0 million for the three and six months ended September 30, 2012, respectively.

INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

401(k) Savings Plan

In November 2004, the Company established a defined contribution savings plan under Section 401(k) of the Internal Revenue Code. This plan covers substantially all employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pretax basis. The Company contributions to the plan may be made at the discretion of the Board of Directors. To date, no contributions have been made to the plan by the Company.

Legal Proceedings

On May 16, 2012, STMicroelectronics, Inc. (STI) filed a patent infringement complaint (ST Microelectronics Patent Litigation I) in the Northern District of California against the Company, alleging infringement of certain of their patents (collectively, the Asserted Patents). STI alleges that certain lnvenSense Micro-Electro-Mechanical Systems (MEMS) products and services, including but not limited to InvenSense s ISZ, IXZ, IDG, IMU, ITG, and MPU product lines, infringe one or more claims of the Asserted Patents. The Company intends to contest the case vigorously. On July 9, 2012, the Company filed counterclaims against STI for alleged infringement of certain of the Company s patents. Of the nine Asserted Patents, all patents are now being reexamined by the U.S. Patent & Trademark Office (PTO) at the Company s request. In view of the reexamination proceedings, the Company requested that the Court stay the litigation pending the final outcome of those reexamination proceedings. On February 27, 2013, the Court granted the Company s request and stayed the litigation until final exhaustion of all patent reexamination proceedings, including appeals. As this litigation is still in its early stages and is currently stayed, the Company believes it is not yet possible to assess the merits of the plaintiff s claim and or the amount of damages, if any, that could be awarded in the event of an unfavorable outcome.

On March 11, 2013, STI filed a request with the United States International Trade Commission (ITC) that the ITC institute an investigation under Section 337 of the Tariff Act of 1930 against the Company, Roku, Inc., and Black & Decker (U.S.) Inc., concerning the alleged infringement of five patents (collectively, the ITC Patents), three of which were previously asserted in ST Microelectronics Patent Litigation I and two of which are newly asserted patents. STI alleges that certain InvenSense MEMS products and services, including but not limited to InvenSense s ISZ, IMU, ITG, and MPU product lines, infringe one or more claims of the ITC Patents. STI additionally alleges that certain Roku devices that incorporate certain InvenSense MEMS products, including but not limited to the Roku 2 XS, infringe one or more claims of a subset of the ITC Patents. STI additionally alleges that certain Black & Decker devices that incorporate certain InvenSense MEMS products, including but not limited to the Black & Decker 4v Max Gyro Rechargeable Screwdriver, infringe one or more claims of a subset of the ITC Patents. On April 10, 2013, the ITC instituted this investigation. All five of the ITC patents are in reexamination or subject to inter partes review by the PTO, at the request of the Company, and the PTO has rejected many of the asserted claims in the currently-pending reexaminations and inter partes reviews. The Company has contested this investigation vigorously and will continue to do so. On April 30, 2013, the Company filed a request with the ITC to stay proceedings pending final reexamination and inter partes review of the ITC patents. The request to stay was denied without prejudice on May 21, 2013. On July 17, 2013, the ITC issued an order ordering a Markman hearing and amending the procedural schedule for the investigation, in which it set the Markman hearing for September 13, 2013. On September 13, 2013, the ITC held a Markman hearing, but no Markman order has been issued. On June 11, 2013, August 14, 2013, and October 14, 2013, the parties met for settlement conferences ordered by the ITC, but the parties were unable to agree to a settlement of the claims in this investigation. On September 30, 2013, the ITC announced that in the event of a government shutdown the schedules and deadlines for all investigations would be tolled, all hearings and conferences would be postponed, and that the ITC may reconsider schedules after resuming operations. From October 1-16, 2013, the ITC shut down as part of the government shutdown. On November 5, 2013, the ITC issued an order further amending the procedural schedule for the investigation, in which is set the expert discovery cutoff date for December 20, 2013, the hearing to take place from February 7 to 20, 2014, and the target date to be September 23, 2014. The Company believes it is not yet possible to assess the merits of the Complainant s claim.

INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

On March 12, 2013, STI filed a patent infringement complaint in the Northern District of California against the Company, alleging infringement of the two patents that were newly asserted in the ITC Investigation (collectively, the Newly Asserted Patents) that were not previously asserted in ST Microelectronics Patent Litigation I. STI alleges that certain lnvenSense MEMS products and services, including but not limited to InvenSense s ISZ, IMU, ITG, and MPU product lines, infringe one or more claims of the Newly Asserted Patents. The Company intends to contest the case vigorously. On April 11, 2013, before the Company was required to respond to the Complaint, the Company requested that the Court stay the litigation, as required by statute, in view of the co pending investigation in the ITC of the Newly Asserted Patents. On April 16, 2013, the Court granted the Company s request, staying the litigation until the determination of the ITC becomes final. As this litigation is still in its early stages and is currently stayed, the Company believes it is not yet possible to assess the merits of the plaintiff s claim and or the amount of damages, if any, that could be awarded in the event of an unfavorable outcome.

On May 14, 2013, the Company brought a lawsuit against STI in federal court in the Eastern District of Texas, alleging that STI infringes three of the Company s patents. The Company has asserted three patents against STI in this case: U.S. Patent Nos. 8,347,717, 8,351,773, 8,250,921. The Company seeks to prevent STI s unauthorized use of the Company s patents and to be awarded monetary damages. STI has filed motions to dismiss, transfer, and stay, all of which are fully briefed and are pending before the court. The case will continue to move forward pending resolution of the outstanding motions. The court conducted a scheduling conference in September, and discovery is underway in the case. Parties have exchanged their respective infringement and invalidity contentions. Also, the Company has amended its compliant to add STI s parent STNV to the lawsuit. STNV has filed a motion to dismiss and the Company has filed its opposition brief to it.

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.

5. 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 there under on the first business day of each fiscal year, beginning with the Company s fiscal year following the year of this offering, 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 3.4 million shares for fiscal year 2014.

Under the Company s 2004 Stock Incentive Plan and 2011 Stock Incentive Plan (the Plans), 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. As of September 29, 2013, the Company has reserved for issuance under the Plans a total of 18.6 million shares (plus additional shares subject to automatic increase provisions under the 2011 Plan).

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 100% of 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.

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(Unaudited)

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

	Options Available for Grant	Options Issued and Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value
Balance March 31, 2013	10,198	10,495	$ 7.65	7.49	38,135
Increase to stock option pool	3,399				
Options granted (weighted-average fair value of $5.64 per share)	(1,303)	1,303	$ 15.35		
Options exercised		(2,050)	$ 3.71		
Options canceled	377	(377)	$ 9.71		
Balance September 29, 2013	12,671	9,371	$ 9.50	8.11	79,600
September 29, 2013					
Vested and expected to vest		8,339	$ 9.23	8.01	73,122
Exercisable September 29, 2013		2,736	$ 6.47	5.21	34,938

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 income 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. Variables to be determined include expected volatility, estimated term and risk-free interest rate.

The aggregate intrinsic value of the stock options exercised during the three and six months ended September 29, 2013 was $11.3 million and $22.8 million respectively. The aggregate intrinsic value of the stock options exercised during the three and six months ended September 30, 2012 was $13.7 million and $19.7 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.

The number of options expected to vest takes into account an estimate of expected forfeitures. The remaining unamortized stock-based compensation expense, reduced for estimated forfeitures and related to non-vested options, was $20.7 million, and $18.7 million at September 29, 2013 and March 31, 2013 respectively, and, for both periods will be amortized over a weighted-average remaining period of approximately 3.1 years. Total unrecognized expense will be adjusted for future changes in estimated forfeitures.

Weighted-Average Assumptions

Expected Term

Prior to the third quarter of fiscal year 2013, the Company use the simplified method described in Staff Accounting Bulletin Topic 14, *Share-Based Payment*, to estimate expected term. Beginning the third quarter of fiscal year 2013, the Company used historical experience to estimate expected term as it believes it had accumulated enough historical data on which to base this estimate. The change to historical data did not result in a significant change in the expected term used in the Black-Sholes computation.

Expected Volatility

The Company estimates volatility for option grants by evaluating the average historical volatility of peer group companies for the period immediately preceding the option grant for a term that is approximately equal to the option s expected term and by evaluating the average historical volatility of the Company s common stock since the Company s initial public offering in November 2011.

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INVENSENSE, INC.

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Risk-Free Interest Rate

The Company bases the risk-free interest rate that it uses in the Black-Scholes option pricing model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Expected Dividend

The Company does not anticipate paying any cash dividends in the foreseeable future and, therefore, uses an expected dividend yield of zero in the Black-Scholes option pricing model.

The Company used the following weighted-average assumptions in determining stock-based compensation expense for the three and six months ended September 29, 2013 and September 30, 2012.

	Three Months Ended		Six Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Expected Term	4.7 years	6.6 years	4.7 years	6.3 years
Volatility	41.9%	48.0%	41.7%	48.3%
Risk-free interest rate	1.5%	1.0%	1.2%	1.0%
Dividend yield	0%	0%	0%	0%

Restricted Stock Units and Restricted Stock

Restricted stock unit and restricted stock activity of the Company under the Plans are as follows (in thousands, except per share amounts):

Restricted stock unit and restricted stock activity	Shares (in thousands)	Weighted average grant date fair value per share
Nonvested at March 31, 2013	806	$ 12.05
Granted	1,348	14.69
Vested	(19)	13.65
Forfeited	(85)	12.77
Nonvested at September 29, 2013	2,050	$ 13.74

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INVENSENSE, INC.

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Restricted stock units and restricted stock granted to employees are generally subject to the employee s continued service to the Company over that 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. At September 29, 2013, there was approximately $20.7 million of total unrecognized compensation cost related to restricted stock units and restricted stock, which the Company expects to recognize over a weighted-average period of 3.4 years. The weighted-average grant-date fair value per share of restricted stock units and restricted stock awarded in the three months ended September 29, 2013 was $14.69. The weighted-average grant-date fair value per share of restricted stock units and restricted stock awarded in the three months ended September 30, 2012 was $13.13.

Stock-Based Compensation Expense

Total stock-based compensation cost for the Company s stock plans for the three and six months ended September 29, 2013 and September 30, 2012 is as follows:

	Three Months Ended		Six Months Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
	(in thousands)			
Cost of revenue	$ 259	$ 179	$ 495	$ 331
Research and development	1,204	705	2,277	1,323
Selling, general and administrative	1,897	1,135	3,405	2,038
Total stock-based compensation expense	$ 3,360	$ 2,019	$ 6,177	$ 3,692

Common Stock

As of September 29, 2013 and March 31, 2013, common stock reserved for future issuance was as follows (in thousands):

	Number of Shares	
Common stock reserved for issuance	**September 2013**	**March 2013**
Stock Plans:		
Outstanding stock options	9,371	10,495
Outstanding restricted stock units and restricted stock	2,050	806

Reserved for future equity incentive grants	10,500	9,383
	21,921	20,684
Warrants to purchase common stock	94	94
Total common stock reserved for future issuances	22,015	20,778

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INVENSENSE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

6. Income Taxes

In the three and six months ended September 29, 2013, the Company recorded an income tax provision of $1.9 million and $3.8 million respectively. In the three and six months ended September 30, 2012, the Company recorded an income tax provision of $3.6 million and $5.7 million respectively. The Company s estimated 2014 effective tax rate differs from the U.S. statutory rate primarily due to profits earned in jurisdictions where the tax rate is lower than the U.S. tax rate partially offset by the unfavorable effects of non-deductible stock-based compensation expense.

The Company files U.S. federal income tax returns as well as income tax returns in California and various foreign jurisdictions. The Company has not provided for U.S. federal income and foreign withholding taxes on undistributed earnings from non-U.S. operations as of September 29, 2013 because such earnings are to be reinvested indefinitely.

The Company s tax years from 2003 and onwards could be subject to examinations by tax authorities in one or more tax jurisdictions. The Company has recorded $8.8 million of uncertain tax positions within Long-term liabilities on the condensed consolidated balance sheet as at September 29, 2013. The Company does not expect any significant increases or decreases to its unrecognized tax benefits within the next twelve months. While management believes that the Company has adequately provided for all tax positions, amounts asserted by tax authorities could be greater or less than the recorded position. Accordingly, the Company s provisions on federal, state and foreign tax-related matters to be recorded in the future may change as revised estimates are made or the underlying matters are settled or otherwise resolved.

7. Subsequent Events

On October 14, 2013, the Company entered into a definitive Master Asset Purchase and Sale Agreement with Analog Devices, Inc. (ADI). The transaction closed on October 31, 2013. The Company acquired certain assets relating to ADI s MEMS microphone business for a purchase price of $100 million in cash. The Company also agreed to a contingent cash payment of up to $70 million payable upon the achievement of certain revenue performance targets. ADI licensed certain technology related to the MEMS microphone business to the Company on a royalty-free, worldwide basis, and provides certain transition services to the Company following the closing. As permitted by ASU 805-10-50, the Company was not able to include certain required disclosures in its quarterly report on Form 10-Q for the three months ended September 29, 2013 because the information necessary to complete the preliminary purchase price allocation related to the acquisition was not yet available. The Company incurred $0.1 million of acquisition-related costs in the three months ended September 29, 2013.

On November 6, 2013, the Company announced its pricing of $150 million aggregate principal amount of 1.75% Convertible Senior Notes due 2018 (the Notes), in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act. The Company also announced that it granted the initial purchaser of the Notes an option to purchase up to an additional $25.0 million aggregate principal amount of the Notes, which the initial purchaser subsequently exercised. The Notes offered 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.

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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 March 31, 2013, and with management s discussion and analysis of our financial condition and results of operations included in our Annual Report on Form 10-K with the Securities and Exchange Commission (SEC) on June 14, 2013.

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 our expectations as to future sales of consumer electronics devices that could potentially integrate motion processors, our expectation that our products will remain a component of customers products throughout any such product s life cycle, our belief that users of our products are likely to introduce these products into other devices as well as to adopt our more advanced devices, our belief that certain end-markets pose large growth opportunities for motion processing functionality, our ability to protect our intellectual property in the United States and abroad, our belief in the sufficiency of our cash flows to meet our needs and our future financial and operating results. 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 June 14, 2013 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 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 the pioneer and a global market leader in devices for the motion interface market that detect and track an object s motion in three-dimensional space. Our MotionTracking devices combine micro-electro-mechanical system, or (MEMS) motion sensors, such as accelerometers, gyroscopes and compasses, with mixed-signal integrated circuits (ICs) and proprietary algorithms and firmware that intelligently process, synthesize and calibrate the output of sensors for use by software applications via an application programming interface (API). Our MotionTracking devices are differentiated by small form factor, high level of integration, performance, reliability and cost effectiveness. While our solutions have broad applicability, we currently target consumer electronics applications such as smartphones and tablets, console and portable video gaming devices, digital still and video cameras, smart TVs (including digital set-top boxes, televisions and multi-media HDDs), navigation devices, industrial sensors, toys, and health and fitness accessories. We utilize a fabless model, leveraging current CMOS and MEMS foundries and semiconductor packaging supply chains.

Our current strategy is to continue targeting the consumer electronics market with integrated MotionTracking devices that meet or exceed the performance and cost requirements of consumer electronics manufacturers, are easy to integrate and set industry performance benchmarks. Our ability to secure new customers depends on winning competitive processes, known as design wins. These selection processes are typically lengthy, and, as a result, our sales cycles will vary based on the market served, whether the design win is with an existing or a new customer and whether our product being designed into our customer s device is a first generation or subsequent generation product. Because the sales cycle for our products is long, we can incur design and development support expenditures in circumstances where we do not ultimately recognize any net revenue. We do not receive long-term purchase commitments from any of our customers, all of whom purchase our products on a purchase order basis. While product life cycles in our target market vary by application, once one of our solutions is incorporated into a customer s design, we believe that it will likely remain a component of the customer s product for its life cycle because of the time and expense associated with redesigning the product or substituting an alternative solution. The trend is also supported by the increased likelihood that once a customer introduces one of our products into one of their devices, we believe they are likely to introduce it into others. Additionally, once a customer introduces one of our lower functionality sensors into their platforms, we believe they are more likely to adopt our more advanced integrated MotionTracking devices.

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The history of our product development and sales and marketing efforts is, on a calendar year basis, as follows:

From our inception in 2003 through 2005, we were primarily engaged in the design and development of our analog gyroscopes. In this period, we also developed and refined our fabrication process, which we refer to as our patented fabrication platform.

In 2006, we began volume shipments of our IDG family of integrated X-Y dual-axis analog gyroscopes for the compact digital camera market, the first commercially available sensors of that type. Subsequently, through 2008, we developed and shipped successive generations of these gyroscopes with enhanced performance and reduced die sizes. We began high-volume shipments of our IDG-600 to Nintendo beginning in May 2008.

In 2009, we began shipping enhanced and alternative versions of our single- and dual-axis analog gyroscopes as well as our ITG family of X-Y-Z three-axis digital output gyroscopes. We also significantly accelerated shipments of our products due to the broad market adoption of the Nintendo Wii MotionPlus accessory. In addition, we migrated our manufacturing processes to larger wafer sizes enabling significant cost efficiencies.

In 2010, we began volume shipments of our MPU-3000 family of Motion-Processors consisting of three-axis gyroscopes digital outputs and software development kits, designed to enable faster motion interface application development. In addition, we started shipping our ITG- and IMU-3000 family of products, which address a broader array of consumer applications than our analog products. We also started sampling our MPU-6000 family of integrated six-axis Motion-Processors that integrate a three-axis gyroscope and three-axis accelerometer on one chip used with our MotionApps software platform.

In 2011, we began high-volume shipments of our ITG/IMU/MPU-3000 family of Motion-Processors for the portable gaming, smart TV, smartphone and tablet markets. In addition, we began volume shipments of our MPU-6000 family of six-axis motion processors for the smartphone and tablet markets. We also introduced our IDG-2020 and IXZ-2020 families of dual-axis gyroscopes, which address the need for optical image stabilization (OIS) technology in camera phones and digital still cameras.

In 2012, we introduced our nine-axis MPU-9150 Motion-Processor to selected customers, targeted for the smartphone, tablet, gaming controller and wearable sensor markets.

In 2012, we also introduced our MPU-3300, a single-chip, high performance integrated 3-axis gyroscope for industrial applications.

In 2012, we also introduced the MPU- 6500, the Company s next-generation 6-axis MotionTracking device for smartphones, tablets, wearable sensors, and other consumer markets.

In January 2013, we introduced the MPU-9250, an integrated accelerometer, gyroscope, compass in a 3x3x1mm package with 9.2mW power consumption, ideal for mobile devices, wearable sensors for sports and remote health monitoring, and emerging applications.

In February 2013, we introduced the MPU-9350, an integrated accelerometer, gyroscope, and electronic compass in a 3x3x1mm package that has a 28% lower power consumption than its predecessor.

In February 2013, we also introduced the ITG-3501, with an industry first 0.75mm height and lowest power consumption of only 5.9mW (3.3mA at 1.8V).

In May 2013, we announced the IDG-2030 and IXZ-2030 dual-axis OIS gyroscopes. OIS eliminates the effects of hand jitter to achieve blur free images and jitter free HD video.

In May 2013, we announced the MPU-6521 MEMS SoC, which is the world s smallest, lowest profile, and lowest power 6-axis solution. The slim profile MPU-6521 is targeted for the next-generation of smartphones, tablets, gaming devices, motion-based remote controls, and wearable sensors.

In June 2013, we announced a family of 6 Industrial MotionTracking solutions including 3-axis gyroscopes and integrated 6-axis gyroscopes plus accelerometers.

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Net Revenue

We derive our net revenue from sales of our MotionTracking devices. We primarily sell our products through our worldwide sales organization to manufacturers of consumer electronics devices from whom we have secured a design win. The sale may be executed directly with the manufacturer or via the manufacturer s supply chain to their designated contract manufacturer. We also sell our products through an indirect channel of distributors that fulfill orders for our products from manufacturers of consumer electronics devices, original design manufacturers and contract manufacturers.

(in thousands)	Three Months Ended September 29, 2013	Three Months Ended September 30, 2012	Six Months Ended September 29, 2013	Six Months Ended September 30, 2012
Net revenue	$ 70,941	$ 55,294	$ 126,851	$ 94,496

Net revenue for the three and six months ended September 29, 2013 increased by $15.6 million and $32.4 million, or 28 % and 34%, respectively, compared to the same periods of the prior fiscal year, primarily due to higher volume shipments to an expanded customer base, including manufacturers of smartphones, tablet devices and digital television and set-top box remote controls, partially offset by lower volume shipments to gaming manufacturers and by per unit sold average selling price erosion. Total unit shipments for the three and six months ended September 29, 2013 increased 81% and 81%, respectively, compared to the same periods of the prior fiscal year. Our overall average unit selling price for the three and six months ended September 29, 2013 decreased 29% and 25%, respectively, compared to the same periods of the prior fiscal year, as a result of the change in our product mix and declines in average selling prices associated with products primarily introduced in prior years. We expect a continued trend of declining unit average selling prices for our products during their life cycles.

For the three months ended September 29, 2013, two customers each accounted for 36% (Samsung) and 14% (Nintendo) of total net revenue. For the six months ended September 29, 2013, one customer accounted for 31% (Samsung) of total net revenue. For the three months ended September 30, 2012, three customers each accounted for 29% (Nintendo), 19% (Samsung) and 17% (Quanta) of total net revenue. For the six months ended September 30, 2012, three customers each accounted for 22% (Nintendo), 19% (Samsung) and 15% (Quanta) of total net revenue.

No other customers accounted for more than 10% of total net revenue for the three and six months ended September 29, 2013 or September 30, 2012.

Net Revenue by End Market

	Three Months Ended September 29, 2013	Three Months Ended September 30, 2012	Six Months Ended September 29, 2013	Six Months Ended September 30, 2012
	(in thousands)			
Smartphone and tablet devices	$ 50,950	$ 34,563	$ 93,921	$ 63,966
% of net revenue	72%	63%	74%	68%
Gaming	$ 9,647	$ 15,935	$ 11,607	$ 21,173
% of net revenue	13%	29%	9%	22%
	$ 10,344	$ 4,796	$ 21,323	$ 9,357

Optical image stabilization and other				
% of net revenue	15%	9%	17%	10%

Net revenue growth and contribution to total net revenue for the smartphone/tablet end market for the three and six months ended September 29, 2013, compared to the same periods of the prior fiscal year, reflects significant expansion of the smartphone portion of the handset market, growth in the market for tablet computing devices and increased adoption of our technologies in those devices. Net revenue growth and contribution to total net revenue for the optimal image stabilization and other end market for the three and six months ended September 29, 2013, compared to the same periods of the prior fiscal year, reflects significantly increased adoption of our technology for optical image stabilization in smartphone camera modules. The net revenue decline and contribution to total net revenue for the gaming end market for the three and six months ended September 29, 2013, compared to the same periods of the prior fiscal year, reflects a declining consumer market for console gaming and a shift to mobile devices and online gaming.

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Net Revenue by Geographic Region

Region	Three Months Ended September 29, 2013	Three Months Ended September 30, 2012	Six Months Ended September 29, 2013	Six Months Ended September 30, 2012
	(in thousands)			
Korea	$ 30,503	$ 15,321	$ 50,365	$ 27,585
Japan	15,533	21,442	31,077	30,597
Taiwan	8,871	11,859	13,059	23,005
United States	8,755	3,229	14,974	4,567
China	6,366	3,087	12,218	8,082
Rest of world	913	356	5,158	660
	$ 70,941	$ 55,294	$ 126,851	$ 94,496

The net revenue increase in Korea reflects growing demand primarily by mobile device customers. The net revenue decrease in Japan reflects a declining consumer market for console gaming due to a shift to mobile device and online gaming. We primarily sell our products directly to customers and distributors in Asia which consists mainly of Korea, Japan, Taiwan and China. We believe that a substantial majority of our net revenue will continue to come from sales to customers located in Asia, where most of the manufacturers of consumer electronics devices that use and may in the future use our products are located. As a result of this 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 June 14, 2013 with the SEC.

Cost of Revenue

Cost of revenue primarily consists of manufacturing, packaging, assembly and testing costs for our products, shipping costs, costs of personnel, including stock-based compensation, warranty costs and write-downs or benefits related to excess and obsolete inventory.

(in thousands)	Three Months Ended September 29, 2013	Three Months Ended September 30, 2012	Six Months Ended September 29, 2013	Six Months Ended September 30, 2012
Cost of revenue	$ 34,364	$ 24,923	$ 60,955	$ 42,562
% of net revenue	48%	45%	48%	45%

Cost of revenue for the three and six months ended September 29, 2013 increased by $9.4 million and $18.4 million, or 38% and 43%, respectively, compared to the same periods of the prior fiscal year, due to an increase in unit sales of our products, partially offset by improvements in unit cost driven by transition to smaller footprint products, and continued improvements in our production yields and efficiency.

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 sales.

We price our products based on market and competitive conditions and periodically reduce the price of our products as market and competitive conditions change. Typically we experience price decreases over the life cycle of our products, which may vary by market and customer. As a result, if we are not able to decrease the cost of our products in line with the price decreases of our products, we may experience a reduction in our gross profit and gross margin. Gross margin has been and will continue to be affected by a variety of factors, including:

- demand for our products and services;
- our ability to add new product features to our existing products;
- the rate of adoption of our products by new markets;
- product manufacturing cost and yields;
- write-downs of inventory for excess quantity and technological obsolescence;

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benefit from sale of previously written down inventories;

product mix;

erosion of average selling prices, as required by agreements entered into with our customers and in anticipation of competitive pricing pressures, new product introductions by us and our competitors, product end of life programs, and for other reasons;

the proportion of our products that are sold through direct versus indirect channels;

our ability to attain volume manufacturing pricing from our foundry partners and suppliers; and

growth in our headcount and other related costs incurred in our organization.

	Three Months Ended		Six Months Ended	
(in thousands)	**September 29, 2013**	**September 30, 2012**	**September 29, 2013**	**September 30, 2012**
Gross profit	$ 36,577	$ 30,371	$ 65,896	$ 51,934
% of net revenue	52%	55%	52%	55%

Gross profit for the three and six months ended September 29, 2013 increased by $6.2 million and $14.0 million, or 20% and 27%, respectively, compared to the same periods of the prior fiscal year, due to an increase in unit sales of our products, partially off-set by decreases in average selling price per unit sold for comparable products. For the three and six months ended September 29, 2013, gross profit as a percentage of sales, or gross margin, decreased, compared to the same periods of the prior fiscal year, due to the effect of reductions in average selling price per unit sold for comparable products and changes in product mix sold. For the three and six months ended September 29, 2013, gross margin benefit of previously written down inventories was nil and $0.3 million, or approximately nil% and 0.2% of net revenue, respectively. For the three and six months ended September 30, 2012, gross margin benefit of previously written down inventories was $0.9 million and $2.5 million, or approximately 1.6% and 2.7% of net revenue, respectively. We expect gross margins to fluctuate during future periods due to changes in product mix, average unit selling prices, manufacturing costs, manufacturing yields 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), intellectual property license costs, reference design development costs, development testing and evaluation costs, depreciation expense 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 on an absolute basis as we continue to expand our product offerings and enhance existing products.

	Three Months Ended		Six Months Ended	
(in thousands)	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Research and development	$ 9,810	$ 5,918	$ 17,924	$ 11,574
% of net revenue	14%	11%	14%	12%

Research and development expense for the three and six months ended September 29, 2013 increased by $3.9 million and $6.4 million, or 66% and 55%, respectively, compared to the same periods of the prior fiscal year. The increase for the three and six months ended September 29, 2013, respectively, was primarily attributable to increases of $1.3 million and $2.5 million in employee cash compensation and benefit costs due to an increase in the number of employees, increases of $0.6 million and $0.8 million in supplies expense due to an increase in technology development activities, increases of $0.5 million and $1.0 million in stock-based compensation expense due to an increase in the number of employees and increases of $0.4 million and $0.6 million in outside services related to the increase in technology development activities. Research and development headcount was 132 at the end of September 29, 2013 and 104 at the end of September 30, 2012. Additions to headcount primarily supported expansion of new product and future technology development activities.

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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. We expect selling, general and administrative expenses to increase on an absolute basis in the future as we expand our sales, marketing, finance and administrative personnel, and we incur additional expenses associated with operating as a public company.

	Three Months Ended		Six Months Ended	
(in thousands)	**September 29, 2013**	**September 30, 2012**	**September 29, 2013**	**September 30, 2012**
Selling, general and administrative	$ 11,424	$ 7,202	$ 20,580	$ 13,459
% of net revenue	16%	13%	16%	14%

Selling, general and administrative expense for the three and six months ended September 29, 2013 increased by $4.2 million and $7.1 million, or 59 % and 53%, respectively, compared to the same periods of the prior fiscal year. The increase for the three and six months ended September 29, 2013, respectively, was primarily attributable to increases of $ 2.6 million and $4.2 million in legal costs due mainly to patent litigation activities and increases of $0.8 million and $1.4 million in stock-based compensation driven by an increase in the number of employees. Selling, general and administrative headcount increased to 111 at September 29, 2013 from 99 at September 30, 2012. Additions to headcount primarily supported expanded geographic, customer and market opportunities for our products.

Income From Operations

	Three Months Ended		Six Months Ended	
(in thousands)	**September 29, 2013**	**September 30, 2012**	**September 29, 2013**	**September 30, 2012**
Income from operations	$ 15,343	$ 17,251	$ 27,392	$ 26,901
% of net revenue	22%	31%	22%	29%

Income from operations for the three and six months ended September 29, 2013 decreased by $1.9 million and increased by $0.5 million, or (11)% and 2%, respectively, compared to the same periods of the prior fiscal year, primarily due to increased gross profit of $6.2 million and $14.0 million, offset by higher operating expenses of $8.1 million and $13.5 million, respectively.

Other Income, Net

	Three Months Ended		Six Months Ended	
(in thousands)	**September 29, 2013**	**September 30, 2012**	**September 29, 2013**	**September 30, 2012**
Other income, net	$ 210	$ 54	$ 291	$ 90
% of net revenue	%	%	%	%

Other income, net for the three and six months ended September 29, 2013 increased by $0.2 million and $0.2 million, or 289% and 223%, respectively, compared to the same periods of the prior fiscal year. The increase for the respective periods was primarily due to increased interest income of $0.1 million and $0.1 million on higher investment balances and increases of $0.1 million and $0.1 million in foreign exchange gain.

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Income Tax Provision

(in thousands)	Three Months Ended September 29, 2013	Three Months Ended September 30, 2012	Six Months Ended September 29, 2013	Six Months Ended September 30, 2012
Income tax provision	$ 1,945	$ 3,641	$ 3,753	$ 5,676
% of income before income taxes	13%	21%	14%	21%

In the three and six months ended September 29, 2013, the Company recorded an income tax provision of $1.9 million and $3.8 million respectively. In the three and six months ended September 30, 2012, the Company recorded an income tax provision of $3.6 million and $5.7 million respectively. The decrease in the provision for income taxes for the three and six months ended September 29, 2013, compared to the same periods of the prior fiscal year, was primarily due to income attributable to foreign jurisdictions where the tax rate is lower than the U.S. tax rate and also due to a two year extension of the R&D Tax Credit. The American Taxpayer Relief Act of 2012 , signed into law by the President on January 2, 2013, extends the credit retroactively and is now set to expire at the end of calendar year 2013. The Company s estimated fiscal year 2014 effective tax rate differs from the U.S. statutory rate primarily due to profits earned in jurisdictions where the tax rate is lower than the U.S. tax rate.

Net Income

(in thousands)	Three Months Ended September 29, 2013	Three Months Ended September 30, 2012	Six Months Ended September 29, 2013	Six Months Ended September 30, 2012
Net income	$ 13,608	$ 13,664	$ 23,930	$ 21,315
% of net revenue	19%	24%	19%	23%

Net income for the three and six months ended September 29, 2013 decreased by $0.1 million and increased $2.6 million, or 0.4% and 12%, respectively, compared to the same periods of the prior fiscal year, primarily due to increased unit shipments, increased gross profit and a lower effective tax rate, offset by increased operating expenses in the current periods.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, net revenue, costs, and expenses, and any related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Changes in accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. We evaluate our estimates and assumptions on an ongoing basis. To the extent that there are material differences between these estimates and our actual results, our future financial statement presentation, financial condition results of operations and cash flows will be affected.

We believe that the assumptions and estimates associated with income taxes, inventory valuation, and stock-based compensation have the greatest potential impact on our condensed consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

There have been no material changes to the our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K filed with the SEC on June 14, 2013.

Liquidity and Capital Resources

Since our inception, our operations have been financed primarily by net proceeds of $50.2 million from the issuance of shares of our preferred stock, net proceeds of $75.2 million from the issuance of shares of common stock in public offerings and $35.3 million, $44.4 million and $7.9 million in cash generated from operations in fiscal years 2013, 2012 and 2011, respectively. As of September 29, 2013, we had $217.8 million of cash, cash equivalents and investments. Although the majority of our sales are generated from a limited number of customers, we expect the aggregate number of customers and the volume of sales to those customers to increase as the number of applications for our products continue to increase.

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We believe our current cash, along with net cash provided by operating activities, will be sufficient to satisfy our liquidity requirements for the next 12 months. We also believe our current cash, along with net cash provided by operating activities and the Convertible Senior Notes described in Note 7 of this Quarterly Report on Form 10-Q, position us to pursue value-creating acquisitions if opportunities arise. Our liquidity may be negatively impacted as a result of a decline in sales of our products due to a decline in our end markets, decrease in sales of our customers products in the market, or adoption of competitors products. Additionally, at September 29, 2013, $64.4 million of $118.2 million of cash and cash equivalents were held by our foreign subsidiaries. If these funds are needed for our operations in the United States, we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to indefinitely reinvest these funds outside of the United States, and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Our primary uses of cash are to fund operating expenses, purchases of inventory, acquisition of property and equipment and business acquisition related activities. Cash used to fund operating expenses excludes the impact of non-cash items such as depreciation and stock-based compensation and is impacted by the timing of when we pay these expenses as reflected in the change in our outstanding accounts payable and accrued expenses.

Our primary sources of cash are cash receipts on accounts receivable from our shipment of products to customers and distributors and convertible debt. Aside from the growth in amounts billed to our customers, net cash collections of accounts receivable are impacted by the efficiency of our cash collections process, which can vary from period to period depending on the payment cycles of our major customers and distributors.

Below is a summary of our cash flows (used in) provided by operating activities, investing activities and financing activities for the following periods:

	Six Months Ended	
(in thousands)	**September 29, 2013**	**September 30, 2012**
Net cash provided by operating activities	$ 16,458	$ 5,181
Net cash used in investing activities	(9,954)	(98,088)
Net cash provided by financing activities	10,836	5,630
Net increase (decrease) in cash and cash equivalents	$ 17,340	$ (87,277)

Net Cash Provided by (Used in) Operating Activities

Net cash provided by operating activities for the six months ended September 29, 2013 of $16.5 million primarily reflected net income of $23.9 million and non-cash expenses of $7.7 million, partially off-set by a net change in operating assets and liabilities of $15.2 million consisting primarily of an increase in Inventories of $14.7 million, and Accounts receivable of $5.5 million, partially off-set by an increase in Accrued liabilities of $4.8 million. Non-cash expenses of $7.7 million consisted primarily of stock-based compensation of $6.2 million and depreciation and amortization of $1.5 million. The $14.7 million increase in Inventories was attributable to increased production to meet future demand. The $5.5 million increase in Accounts receivable principally relates to increased sales associated with an upward trend in demand in September 29, 2013 compared with March 2013. The $4.8 million increase in Accrued liabilities is due primarily to higher accrued legal and payroll related expenses.

Net cash provided by operating activities for the six months ended September 30, 2012 of $5.2 million, primarily reflected net income of $21.3 million, non-cash expenses of $4.8 million and a net decrease in operating assets and liabilities of $21.0 million consisting primarily of an increase in accounts receivable of $18.2 million and inventories of $9.0 million, and an increase in accounts payable of $3.4 million. Each of these increases resulted primarily from our increase in sales volume weighted towards the end of the second quarter of fiscal year 2013, and correspondingly, the increase in inventory to support future sales. Non-cash expenses of $4.8 million consisted primarily of depreciation and amortization of $1.2 million and stock-based compensation of $3.7 million.

Net Cash Used in Investing Activities

Net cash used in investing activities in the six months ended September 29, 2013 of $10.0 million primarily reflected the purchase of available-for-sale investments of $46.3 million and the purchase of property and equipment of $9.8 million, partially off-set by the sale and maturity of available-for-sale investments of $46.2 million.

Net cash used in investing activities in the six months ended September 30, 2012 of $98.1 million primarily reflected the purchase of available-for-sale investments of $103.8 million and the purchase of property and equipment of $2.2 million, partially offset by the sale of available-for-sale investments of $7.9 million.

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Net Cash Provided by Financing Activities

Net cash provided by financing activities in the six months ended September 29, 2013 of $10.8 million resulted primarily from proceeds from the issuance of common stock of $7.6 million and excess tax benefit from stock-based compensation of $3.2 million.

Net cash provided by financing activities in the six months ended September 30, 2012 of $5.6 million resulted primarily from proceeds from the issuance of common stock of $3.3 million and excess tax benefit from stock based compensation of 2.7 million.

Off Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 29, 2013, we were not involved in any unconsolidated SPE transactions

Warranties and Indemnification

In connection with the sale of products in the ordinary course of business, we often make representations affirming, among other things, that our products do not infringe on the intellectual property rights of others, and agree to indemnify customers against third-party claims for such infringement. Further, our bylaws require us to indemnify our officers and directors against any action that may arise out of their services in that capacity. We have not been subject to any material liabilities under such provisions and therefore believe that our exposure for these indemnification obligations is minimal. Accordingly, we have no liabilities recorded for these indemnity agreements as of September 29, 2013.

Contractual Obligations

The following table summarizes our outstanding contractual obligations as of September 29, 2013:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
			(in thousands)		
Operating lease obligations	$ 21,081	$ 722	$ 9,872	$ 7,576	$ 2,911
Purchase obligations	62,957	62,957			
Total contractual obligations	$ 84,038	$ 63,679	$ 9,872	$ 7,576	$ 2,911

Operating leases consist of contractual obligations from agreements for non-cancelable office space. Purchase obligations consist of the minimum purchase commitments made to contract manufacturers.

Included in our gross unrecognized tax benefits balance of $9.9 million at September 29, 2013 are $8.8 million of tax positions which would affect income tax expense if recognized. As of September 29, 2013, approximately $1.1 million of unrecognized tax benefits would be offset by a change in valuation allowance. Due to the high degree of uncertainty regarding the settlement of these liabilities, we are unable to estimate the year in which the future cash flows may occur. As a result, these amounts are not included in the tables above.

Recent Accounting Pronouncements

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. ASU No. 2011-02 became effective for fiscal years, and interim periods within those years, beginning after December 15, 2012, which is the Company s fiscal interim period ended June 30, 2013 of fiscal year ending March 30, 2014, and the adoption did not impact the Company s financial condition or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

We had cash, cash equivalents and investments of $217.8 million at September 29, 2013, which was held for liquidity purposes. We do not enter into investments for trading or speculative purposes. A 10% change in interest rates will not have a material impact on our future interest income or investment fair value. As of September 29, 2013, our cash, cash equivalents and investments were in money market funds, corporate notes and bonds, commercial paper and U.S. agency securities.

Foreign Currency Risk

Our sales contracts are primarily denominated in U.S. dollars and therefore substantially all of our net revenue is not subject to foreign currency risk. However, a portion of our operating expenses are incurred outside the U.S., are denominated in foreign currencies and are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the New Taiwan Dollar, Japanese Yen and Korean Won. Additionally, fluctuations in foreign currency exchange rates may cause us to recognize transaction gains and losses in our statement of income.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control

During the first quarter of fiscal 2014, we completed the initial conversion from our former Enterprise Resource Planning (ERP) system to a new Oracle ERP system including modules for global customer order-to-cash settlement, procurement to payment processing, inventory production management, and general ledger and consolidations. The next phase of this conversion effort primarily includes our Customer Relationship Management (CRM) system which is expected to be completed with the 2013 calendar year. While we expect this new ERP system to strengthen our internal financial controls by automating manual processes and standardizing business processes across our organization, management will continue to evaluate and monitor our internal controls and processes and procedures in each of the affected areas. There were no other changes in our internal control over financial reporting identified in management s evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On May 16, 2012, STMicroelectronics, Inc. (STI) filed a patent infringement complaint (ST Microelectronics Patent Litigation I) in the Northern District of California against the Company, alleging infringement of certain of their patents (collectively, the Asserted Patents). STI alleges that certain lnvenSense Micro-Electro-Mechanical Systems (MEMS) products and services, including but not limited to InvenSense s ISZ, IXZ, IDG, IMU, ITG, and MPU product lines, infringe one or more claims of the Asserted Patents. The Company intends to contest the case vigorously. On July 9, 2012, the Company filed counterclaims against STI for alleged infringement of certain of the Company s patents. Of the nine Asserted Patents, all patents are now being reexamined by the U.S. Patent & Trademark Office (PTO) at the Company s request. In view of the reexamination proceedings, the Company requested that the Court stay the litigation pending the final outcome of those reexamination proceedings. On February 27, 2013, the Court granted the Company s request and stayed the litigation until final exhaustion of all patent reexamination proceedings, including appeals. As this litigation is still in its early stages and is currently stayed, the Company believes it is not yet possible to assess the merits of the plaintiff s claim and or the amount of damages, if any, that could be awarded in the event of an unfavorable outcome.

On March 11, 2013, STI filed a request with the United States International Trade Commission (ITC) that the ITC institute an investigation under Section 337 of the Tariff Act of 1930 against the Company, Roku, Inc., and Black & Decker (U.S.) Inc., concerning the alleged infringement of five patents (collectively, the ITC Patents), three of which were previously asserted in ST Microelectronics Patent Litigation I and two of which are newly asserted patents. STI alleges that certain InvenSense MEMS products and services, including but not limited to InvenSense s ISZ, IMU, ITG, and MPU product lines, infringe one or more claims of the ITC Patents. STI additionally alleges that certain Roku devices that incorporate certain InvenSense MEMS products, including but not limited to the Roku 2 XS, infringe one or more claims of a subset of the ITC Patents. STI additionally alleges that certain Black & Decker devices that incorporate certain InvenSense MEMS products, including but not limited to the Black & Decker 4v Max Gyro Rechargeable Screwdriver, infringe one or more claims of a subset of the ITC Patents. On April 10, 2013, the ITC instituted this investigation. All five of the ITC patents are in reexamination or subject to inter partes review by the PTO, at the request of the Company, and the PTO has rejected many of the asserted claims in the currently-pending reexaminations and inter partes reviews. The Company has contested this investigation vigorously and will continue to do so. On April 30, 2013, the Company filed a request with the ITC to stay proceedings pending final reexamination and inter partes review of the ITC patents. The request to stay was denied without prejudice on May 21, 2013. On July 17, 2013, the ITC issued an order ordering a Markman hearing and amending the procedural schedule for the investigation, in which it set the Markman hearing for September 13, 2013. On September 13, 2013, the ITC held a Markman hearing, but no Markman order has been issued. On June 11, 2013, August 14, 2013, and October 14, 2013, the parties met for settlement conferences ordered by the ITC, but the parties were unable to agree to a settlement of the claims in this investigation. On September 30, 2013, the ITC announced that in the event of a government shutdown the schedules and deadlines for all investigations would be tolled, all hearings and conferences would be postponed, and that the ITC may reconsider schedules after resuming operations. From October 1-16, 2013, the ITC shut down as part of the government shutdown. On November 5, 2013, the ITC issued an order further amending the procedural schedule for the investigation, in which is set the expert discovery cutoff date for December 20, 2013, the hearing to take place from February 7 to 20, 2014, and the target date to be September 23, 2014. The Company believes it is not yet possible to assess the merits of the Complainant s claim.

On March 12, 2013, STI filed a patent infringement complaint in the Northern District of California against the Company, alleging infringement of the two patents that were newly asserted in the ITC Investigation (collectively, the Newly Asserted Patents) that were not previously asserted in ST Microelectronics Patent Litigation I. STI alleges that certain lnvenSense MEMS products and services, including but not limited to InvenSense s ISZ, IMU, ITG, and MPU product lines, infringe one or more claims of the Newly Asserted Patents. The Company intends to contest the case vigorously. On April 11, 2013, before the Company was required to respond to the Complaint, the Company requested that the Court stay the litigation, as required by statute, in view of the co pending investigation in the ITC of the Newly Asserted Patents. On April 16, 2013, the Court granted the Company s request, staying the litigation until the determination of the ITC becomes final. As this litigation is still in its early stages and is currently stayed, the Company believes it is not yet possible to assess the merits of the plaintiff s claim and or the amount of damages, if any, that could be awarded in the event of an unfavorable outcome.

On May 14, 2013, the Company brought a lawsuit against STI in federal court in the Eastern District of Texas, alleging that STI infringes three of the Company s patents. The Company has asserted three patents against STI in this case: U.S. Patent Nos. 8,347,717, 8,351,773, 8,250,921. The Company seeks to prevent STI s unauthorized use of the Company s patents and to be awarded monetary damages. STI has filed motions to dismiss, transfer, and stay, all of which are fully briefed and are pending before the court. The case will continue to move forward pending resolution of the outstanding motions. The court conducted a scheduling conference in September, and discovery is underway in the case. Parties have exchanged their respective infringement and invalidity contentions. Also, the Company has amended its compliant to add STI s parent STNV to the lawsuit. STNV has filed a motion to dismiss and the Company has filed its opposition brief to it.

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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.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock. The risks facing our business have not changed substantively from those discussed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013 except as noted below:

Acquisitions or strategic investments may not generate the results expected and could be difficult to integrate, divert the attention of key personnel, disrupt our business, dilute stockholder value and impair our financial results.

We recently concluded the acquisition of the assets of Analog Devices, Inc. s MEMS microphone business line, including carrying over approximately 37 employees and support operations located in Wilmington, Massachusetts, Bratislava, Slovakia and Shanghai, China, for $100 million in cash, with potential additional payments of up to $70 million upon achievement of certain revenue targets over the 12 months following closing of the transaction. We expect to continue to pursue acquisitions of, or strategic investments into, companies, technologies and products that we believe could accelerate our ability to compete in our core markets or allow us to enter new markets. This and other strategic transactions may involve numerous risks, any of which could harm our business, including:

- difficulties in integrating the manufacturing, operations, technologies, products, offices, systems, existing contracts, accounting, personnel and culture of acquired business or company and realizing the anticipated synergies of the combined businesses;

- difficulties in supporting and transitioning customers, if any, of the acquired business or company;

- diversion of financial and management resources from our existing operations;

- the price we pay or other resources that we devote may exceed the value we actually realize, or the value we could have realized if we had allocated the purchase price or other resources to another opportunity or for our existing operations;

- risks associated with entering new markets in which we have limited or no experience, including risks related to technology, customers, competitors, product cycles, customer demand, terms and conditions and other industry specific issues;

- potential loss of key employees;

customers, potential customers or strategic partners from either our current business or the acquired business may terminate or scale back their business relationships with us for many reasons, including to reduce reliance on a single company or because they view the combined businesses as potentially competitive;

assumption of unanticipated problems or latent liabilities, such as problems with the quality of the acquired company s products;

inability to generate sufficient revenue and profitability to offset acquisition costs;

equity-based acquisitions may have a dilutive effect on our stock; and

inability to successfully consummate transactions with identified acquisition or investment candidates.
Further, there can be no assurance that any acquisition we consummate, including the MEMS microphone business, will generate the expected returns and other projected results we anticipate. For example, we may incur costs in excess of what we anticipate, the acquisitions of product lines with lower operating margins than our existing business may reduce our overall lower operating margins, and acquisitions frequently result in the recording of goodwill and other intangible assets that are subject to potential impairments in the future that could harm our financial results. In addition, we could use substantial portions of our available cash or, subject to provisions of any existing indebtedness we have, incur additional debt, or issue additional equity securities in order to finance acquisitions, the result of which may be to constrain our access to cash for other purposes or result in dilution to our existing stockholders. As a result of these and other risks, if we fail to manage the pursuit, consummation and integration of acquisitions effectively, our business could suffer.

Our debt obligations may be a burden on our future cash flows and cash resources.

On November 6, 2013, we agreed to issue $150 million aggregate principal amount of 1.75% Convertible Senior Notes due 2018, (the Notes), and also granted the initial purchaser of the Notes an option to purchase up to an additional $25 million aggregate principal amount of the Notes. Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not generate cash flow from operations in the future sufficient to satisfy our obligations under the Notes and any future indebtedness we may incur and to make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance the Notes or future indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on the Notes or future indebtedness.

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We may issue additional shares of our common stock in connection with the conversion of the Notes, and thereby dilute our existing stockholders and potentially adversely affect the market price of our common stock.

In the event that some or all of the Notes are converted into common stock, the ownership interests of existing stockholders will be diluted, and any sales in the public market of any shares of our common stock issuable upon such conversion of the Notes could adversely affect the prevailing market price of our common stock. In addition, the anticipated conversion of the Notes could depress the market price of our common stock.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.

Under Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer s economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders equity on our consolidated balance sheet at the issuance date and the value of the equity component would be treated as debt discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to record a greater amount of non-cash interest expense as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. We will report larger net losses in our financial results because ASC 470-20 will require interest to include both the amortization of the debt discount and the instrument s coupon interest, which could adversely affect our future financial results, the trading price of our common stock and the trading price of the Notes.

The make-whole fundamental change provisions of the Notes may delay or prevent an otherwise beneficial takeover attempt of us.

If a make-whole fundamental change such as an acquisition of our company occurs prior to the maturity of the Notes, under certain circumstances, the conversion rate for the Notes will increase such that additional shares of our common stock will be issued upon conversion of the Notes in connection with such make-whole fundamental change. The increase in the conversion rate will be determined based on the date on which the make-whole fundamental change occurs or becomes effective and the price paid (or deemed paid) per share of our common stock in such transaction. This increase will be dilutive to our existing stockholders. Our obligation to increase the conversion rate upon the occurrence of a make-whole fundamental change may, in certain circumstances, delay or prevent a takeover of us that might otherwise be beneficial to our stockholders.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Sales of Unregistered Securities

None

ITEM 6. EXHIBITS

See the Exhibit Index immediately following the signature page to this Quarterly Report on Form 10-Q, which is incorporated by reference here.

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SIGNATURES

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

Dated: November 8, 2013

INVENSENSE, INC.

By: /s/ Alan Krock
Alan Krock
Chief Financial Officer (Principal Financial Officer and Accounting Officer)

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INDEX TO EXHIBITS

Exhibit Number	Description
31.1	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350.
101*	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of September 29, 2013 and March 31, 2013, (ii) Condensed Consolidated Statements of Income for the three months ended September 29, 2013 and September 30, 2012, (iii) Condensed Consolidated Statements of Comprehensive Income for three months ended September 29, 2013 and September 30, 2012, (iv) Condensed Consolidated Statements of Cash Flows for the three months ended September 29, 2013 and September 30, 2012 and (v) Notes to Condensed Consolidated Financial Statements.

* In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections.