

SEMTECH CORP
Form 10-Q
November 28, 2018

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

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended October 28, 2018

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 1-6395

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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Exchange Act. "

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

Number of shares of Common Stock, \$0.01 par value per share, outstanding at November 23, 2018: 65,808,898

SEMTECH CORPORATION
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Unless the context otherwise requires, the use of the terms "Semtech," "the Company," "we," "us" and "our" in this Quarterly Report on Form 10-Q refers to Semtech Corporation and its consolidated subsidiaries. This Quarterly Report on Form 10-Q may contain references to the Company's trademarks and to trademarks belonging to other entities. Solely for convenience, trademarks and trade names referred to in this Quarterly Report on Form 10-Q, including logos, artwork and other visual displays, may appear without the ® or ™ symbols, but such references are not intended to indicate, in any way, that we will not assert, to the fullest extent under applicable law, our rights or the rights of the applicable licensor to these trademarks and trade names. We do not intend our use or display of other companies' trade names or trademarks to imply a relationship with, or endorsement or sponsorship of us by, any other company.

Special Note Regarding Forward-Looking and Cautionary Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, as amended, based on our current expectations, estimates and projections about our operations, industry, financial condition, performance, results of operations, and liquidity. Forward-looking statements are statements other than historical information or statements of current condition and relate to matters such as future financial performance, future operational performance, the anticipated impact of specific items on future earnings, and our plans, objectives and expectations. Statements containing words such as "may," "believe," "anticipate," "expect," "intend," "plan," "project," "estimate," "should," "will," "designed to," "projections," or "business outlook," or other similar expressions constitute forward-looking statements. Forward-looking statements involve known and unknown risks and uncertainties that could cause actual results and events to differ materially from those projected.

Potential factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to:

- fluctuation in the Company's future results;
- downturns in the business cycle;
- rapid decline in the average selling price;
- reduced demand for the Company's products, including due to global economic conditions and potential changes in economic policy;
- business interruptions;
- the Company's reliance on a limited number of suppliers and subcontractors for components and materials;
- potentially insufficient liability insurance if the Company's products are found to be defective;
- obsolete inventories as a result of changes in demand and change in life cycles for the Company's products;
- the Company's inability to successfully develop and sell new products;
- lengthy and expensive product qualification processes without any assurance of product sales;
- the Company's products failing to meet industry standards;
- the Company's inability to protect intellectual property rights;
- the Company suffering losses if its products infringe the intellectual property rights of others;
- the Company's need to commit resources to product production prior to receipt of purchase commitments;
- increased business risk resulting from significant business with foreign customers;
- the Company's foreign currency exposures;
- potential increased tax liabilities and effective tax rate if the Company needs to repatriate funds held by foreign subsidiaries;
- export restrictions and laws affecting the Company's trade and investments including the adoption and expansion of trade restrictions or the occurrence of trade wars;
- the impact of tariffs on the Company's expenses and on the pricing and demand for the Company's customer's products;
- the Company's inability to adequately compete against larger, more established entities;
- increased competition due to industry consolidation;
- the loss of any one of the Company's significant customers;
- volatility of customer demand;

termination of a contract by a distributor;
sales of our products on the gray market;

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- the Company's failure to maintain effective internal control over financial reporting and disclosure controls and procedures;
- government regulations and other standards, including those that impose operational and reporting requirements;
- the Company's failure to comply with applicable environmental regulations;
- compliance with conflict minerals regulations;
- increase in the Company's cost of doing business as a result of having to comply with the codes of conduct of certain of the Company's customers and suppliers;
- changes in tax law, including effective tax rates, and review by taxing authorities;
- taxation of Company sales in non-U.S. jurisdictions;
- the Company's limited experience with government contracting;
- potential government investigations and inquiries;
- loss of the Company's key personnel;
- risks associated with companies the Company has acquired in the past and may acquire in the future and the Company's ability to successfully integrate acquired businesses and benefit from expected synergies;
- the Company may be required to recognize additional impairment charges;
- loss of value of investments in entities not under our control;
- the Company may not receive accurate, complete or timely financial information from entities for which the Company is required to consolidate such information;
- the Company may be adversely affected by new accounting pronouncements;
- the Company's ability to generate cash to service its debt obligations;
- restrictive covenants in the Company's credit agreement which may restrict its ability to pursue its business strategies;
- the Company's reliance on certain critical information systems for the operation of its business;
- costs associated with the Company's indemnification of certain customers, distributors and other parties;
- the Company's share price could be subject to extreme price fluctuations;
- the impact on the Company's common stock price if securities or industry analysts do not publish reports about the Company's business or adversely change their recommendations regarding the Company's common stock;
- anti-takeover provisions in the Company's organizational documents could make an acquisition of the Company more difficult; and
- the Company is subject to litigation risks which may be costly to defend

Additionally, forward-looking statements should be considered in conjunction with the cautionary statements contained in this Quarterly Report on Form 10-Q, including, without limitation, information under the captions "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" and additional factors that accompany the related forward-looking statements in this Quarterly Report on Form 10-Q, in our Annual Report on Form 10-K for the fiscal year ended January 28, 2018 including, without limitation information under the caption "Risk Factors", in other filings with the U.S. Securities and Exchange Commission, and in material incorporated herein and therein by reference. In light of the significant risks and uncertainties inherent in the forward-looking information included herein that may cause actual performance and results to differ materially from those predicted, any such forward-looking information should not be regarded as representations or guarantees by the Company of future performance or results, or that its objectives or plans will be achieved, or that any of its operating expectations or financial forecasts will be realized. Reported results should not be considered an indication of future performance. Investors are cautioned not to place undue reliance on any forward-looking information contained herein, which reflect management's analysis only as of the date hereof. Except as required by law, the Company assumes no obligation to publicly release the results of any update or revision to any forward-looking statement that may be made to reflect new information, events or circumstances after the date hereof or to reflect the occurrence of unanticipated or future events, or otherwise.

In addition to regarding forward-looking statements with caution, you should consider that the preparation of the consolidated financial statements requires us to draw conclusions and make interpretations, judgments, assumptions and estimates with respect to certain factual, legal, and accounting matters. Our financial statements might have been

materially impacted if we had reached different conclusions or made different interpretations, judgments, assumptions or estimates.

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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

SEMTECH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Net sales	\$ 173,550	\$ 150,304	\$ 467,190	\$ 447,233
Cost of sales	66,988	60,885	189,035	180,663
Gross profit	106,562	89,419	278,155	266,570
Operating costs and expenses:				
Selling, general and administrative	39,587	36,568	114,522	109,820
Product development and engineering	27,147	27,631	81,425	81,046
Intangible amortization	6,480	7,453	19,921	20,414
Loss on disposition of business operations	—	—	—	375
Changes in the fair value of contingent earn-out obligations	(8,519)	188	(9,419)	188
Total operating costs and expenses	64,695	71,840	206,449	211,843
Operating income	41,867	17,579	71,706	54,727
Interest expense, net	(2,355)	(2,032)	(6,745)	(6,107)
Non-operating income, net	1,182	5,517	1,914	4,681
Investment impairments	(30,000)	(4,250)	(30,000)	(4,250)
Income before taxes and equity in net losses of equity method investments	10,694	16,814	36,875	49,051
Provision for taxes	(1,454)	3,272	(12,882)	11,124
Net income before equity in net losses of equity method investments	12,148	13,542	49,757	37,927
Equity in net gain (losses) of equity method investments	17	(204)	(41)	(204)
Net income	\$ 12,165	\$ 13,338	\$ 49,716	\$ 37,723
Earnings per share:				
Basic	\$ 0.18	\$ 0.20	\$ 0.75	\$ 0.57
Diluted	\$ 0.18	\$ 0.20	\$ 0.73	\$ 0.56
Weighted average number of shares used in computing earnings per share:				
Basic	66,014	66,194	66,134	65,932
Diluted	68,731	67,817	68,549	67,555

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

SEMTECH CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October 28,	October 29,	October 28,	October 29,
	2018	2017	2018	2017
Net income	\$12,165	\$ 13,338	\$49,716	\$ 37,723
Other comprehensive income, net:				
Unrealized gain (loss) on foreign currency cash flow hedges	8	(144)	(109)	865
Realized gain (loss) on foreign currency cash flow hedges	11	(509)	36	(772)
Unrealized gain on convertible debt	—	—	—	750
Release of realized gain on convertible debt	—	—	—	(750)
Change in employee benefit plans	(16)	22	(48)	65
Other comprehensive income (loss), net	3	(631)	(121)	158
Comprehensive income	\$12,168	\$ 12,707	\$49,595	\$ 37,881

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

SEMTECH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	October 28, 2018	January 28, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$312,236	\$307,923
Accounts receivable, less allowances of \$841 and \$9,089, respectively	83,820	53,183
Inventories	61,159	71,067
Prepaid taxes	11,093	11,809
Other current assets	18,126	17,250
Total current assets	486,434	461,232
Non-current assets:		
Property, plant and equipment, net of accumulated depreciation of \$193,453 and \$179,604, respectively	119,481	124,586
Deferred tax assets	27,485	4,236
Goodwill	355,175	341,897
Other intangible assets, net	40,286	60,207
Other assets	55,523	93,618
TOTAL ASSETS	\$1,084,384	\$1,085,776
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$40,556	\$37,208
Accrued liabilities	60,856	60,832
Deferred revenue	965	12,758
Current portion - long-term debt	18,256	15,410
Total current liabilities	120,633	126,208
Non-current liabilities:		
Deferred tax liabilities	13,814	14,682
Long term debt, less current portion	197,417	211,114
Other long-term liabilities	59,583	68,759
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Common stock, \$0.01 par value, 250,000,000 shares authorized, 78,136,144 issued and 65,779,522 outstanding and 78,136,144 issued and 66,280,129 outstanding, respectively	785	785
Treasury stock, at cost, 12,356,622 shares and 11,856,015 shares, respectively	(313,019)	(251,974)
Additional paid-in capital	444,903	415,056
Retained earnings	561,589	502,346
Accumulated other comprehensive loss	(1,321)	(1,200)
Total stockholders' equity	692,937	665,013
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,084,384	\$1,085,776

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

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

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	Nine Months Ended	
	October 28, 2018	October 29, 2017
Cash flows from operating activities:		
Net income	\$49,716	\$ 37,723
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	37,332	35,794
Impairment of investments	30,000	4,250
Accretion of deferred financing costs and debt discount	399	430
Deferred income taxes	(19,001)	5,508
Share-based compensation and warrant costs	60,947	44,166
Loss on disposition of business operations and assets	(68)	283
Earn-out liabilities	(9,419)	188
Equity in net losses of equity method investments	41	204
Gain from convertible debt settlement	—	(4,275)
Corporate owned life insurance, net	41	843
Changes in assets and liabilities:		
Accounts receivable, net	(26,096)	(14,726)
Inventories	10,754	(5,697)
Other assets	1,377	(2,618)
Accounts payable	5,329	