

Avago Technologies LTD
Form 10-Q
June 07, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q
(MARK ONE)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended May 5, 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: 001-34428

| | |
|--|---------------------|
| Avago Technologies Limited | |
| (Exact Name of Registrant as Specified in Its Charter) | |
| Singapore | 98-0682363 |
| (State or Other Jurisdiction of | (I.R.S. Employer |
| Incorporation or Organization) | Identification No.) |
| 1 Yishun Avenue 7 | N/A |
| Singapore 768923 | |
| (Address of Principal Executive Offices) | (Zip Code) |

(65) 6755-7888

(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 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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES ☐ NO ☒

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

| | | | |
|---|---|---|---|
| Large accelerated filer <input type="radio"/> | Accelerated filer <input type="radio"/> | Non-accelerated filer <input type="radio"/> | Smaller reporting company <input type="radio"/> |
| (Do not check if a 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 ☒

As of May 31, 2013 there were 246,911,684 shares of our ordinary shares, no par value per share, outstanding.

Table of Contents

AVAGO TECHNOLOGIES LIMITED
 Quarterly Report on Form 10-Q
 For the Quarterly Period Ended May 5, 2013

TABLE OF CONTENTS

| | |
|--|-----------|
| | Page |
| <u>PART I — FINANCIAL INFORMATION</u> | <u>3</u> |
| <u>Item 1. Condensed Consolidated Financial Statements — Unaudited</u> | <u>3</u> |
| <u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>18</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | <u>28</u> |
| <u>Item 4. Controls and Procedures</u> | <u>29</u> |
| <u>PART II. OTHER INFORMATION</u> | <u>30</u> |
| <u>Item 1. Legal Proceedings</u> | <u>30</u> |
| <u>Item 1A. Risk Factors</u> | <u>30</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>49</u> |
| <u>Item 3. Defaults Upon Senior Securities</u> | <u>49</u> |
| <u>Item 4. Mine Safety Disclosures</u> | <u>49</u> |
| <u>Item 5. Other Information</u> | <u>49</u> |
| <u>Item 6. Exhibits</u> | <u>51</u> |
| <u>SIGNATURES</u> | <u>53</u> |
| EX-10.1 | |
| EX-31.1 | |
| EX-31.2 | |
| EX-32.1 | |
| EX-32.2 | |
| EX-101 INSTANCE DOCUMENT | |
| EX-101 SCHEMA DOCUMENT | |
| EX-101 CALCULATION LINKBASE DOCUMENT | |
| EX-101 DEFINITION LINKBASE DOCUMENT | |
| EX-101 LABELS LINKBASE DOCUMENT | |
| EX-101 PRESENTATION LINKBASE DOCUMENT | |

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements — Unaudited

AVAGO TECHNOLOGIES LIMITED

CONDENSED CONSOLIDATED BALANCE SHEETS — UNAUDITED

(in millions, except share amounts)

| | May 5, 2013 | October 28, 2012 (1) |
|---|----------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,219 | \$ 1,084 |
| Trade accounts receivable, net | 271 | 341 |
| Inventory | 229 | 194 |
| Other current assets | 99 | 72 |
| Total current assets | 1,818 | 1,691 |
| Property, plant and equipment, net | 561 | 503 |
| Goodwill | 201 | 180 |
| Intangible assets, net | 393 | 422 |
| Other long-term assets | 66 | 66 |
| Total assets | \$ 3,039 | \$ 2,862 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 240 | \$ 248 |
| Employee compensation and benefits | 59 | 61 |
| Capital lease obligations — current | 1 | 1 |
| Other current liabilities | 30 | 36 |
| Total current liabilities | 330 | 346 |
| Long-term liabilities: | | |
| Capital lease obligations — non-current | 2 | 2 |
| Other long-term liabilities | 96 | 95 |
| Total liabilities | 428 | 443 |
| Commitments and contingencies (Note 11) | | |
| Shareholders' equity: | | |
| Ordinary shares, no par value; 246,852,295 shares and 245,477,491 shares issued and outstanding on May 5, 2013 and October 28, 2012, respectively | 1,518 | 1,479 |
| Retained earnings | 1,100 | 951 |
| Accumulated other comprehensive loss | (7 |) (11 |
| Total shareholders' equity | 2,611 | 2,419 |
| Total liabilities and shareholders' equity | \$ 3,039 | \$ 2,862 |

(1) Amounts as of October 28, 2012 have been derived from audited consolidated financial statements as of that date.

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

Table of Contents

AVAGO TECHNOLOGIES LIMITED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS — UNAUDITED

(in millions, except per share data)

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|----------------------|-------------------|---------------------------|-------------------|
| | May 5, 2013 | April 29, 2012 | May 5, 2013 | April 29, 2012 |
| Net revenue | \$562 | \$577 | \$1,138 | \$1,140 |
| Cost of products sold: | | | | |
| Cost of products sold | 276 | 284 | 562 | 563 |
| Amortization of intangible assets | 14 | 14 | 28 | 28 |
| Restructuring charges | — | 1 | — | 1 |
| Total cost of products sold | 290 | 299 | 590 | 592 |
| Gross margin | 272 | 278 | 548 | 548 |
| Research and development | 95 | 84 | 188 | 166 |
| Selling, general and administrative | 52 | 51 | 105 | 101 |
| Amortization of intangible assets | 6 | 5 | 11 | 10 |
| Restructuring charges | 1 | 1 | 2 | 2 |
| Total operating expenses | 154 | 141 | 306 | 279 |
| Income from operations | 118 | 137 | 242 | 269 |
| Interest expense | (1 |) — | (1 |) (1 |
| Other income, net | 1 | 3 | 3 | 2 |
| Income before income taxes | 118 | 140 | 244 | 270 |
| Provision for income taxes | 5 | 6 | 6 | 11 |
| Net income | \$113 | \$134 | \$238 | \$259 |
| Net income per share: | | | | |
| Basic | \$0.46 | \$0.55 | \$0.97 | \$1.05 |
| Diluted | \$0.45 | \$0.54 | \$0.95 | \$1.03 |
| Weighted average shares : | | | | |
| Basic | 246 | 244 | 246 | 246 |
| Diluted | 251 | 250 | 251 | 251 |
| Cash dividends declared and paid per share | \$0.19 | \$0.13 | \$0.36 | \$0.25 |

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

Table of Contents

AVAGO TECHNOLOGIES LIMITED

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME — UNAUDITED

(in millions)

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|----------------------|-------------------|---------------------------|-------------------|
| | May 5, 2013 | April 29, 2012 | May 5, 2013 | April 29, 2012 |
| Net income | \$ 113 | \$ 134 | \$ 238 | \$ 259 |
| Tax effect on defined benefit pension plans | — | — | 2 | — |
| Change in net unrealized gains on available-for-sale investments | 2 | — | 2 | — |
| Net unrealized loss on derivative instruments, net of tax effects of \$0 | — | (1 |) — | — |
| Other comprehensive income (loss) | 2 | (1 |) 4 | — |
| Total comprehensive income | \$ 115 | \$ 133 | \$ 242 | \$ 259 |

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

Table of Contents

AVAGO TECHNOLOGIES LIMITED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS — UNAUDITED

(in millions)

| | Two Fiscal Quarters Ended | | |
|---|---------------------------|-------------------|---|
| | May 5, 2013 | April 29, 2012 | |
| Cash flows from operating activities: | | | |
| Net income | \$238 | \$259 | |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 83 | 75 | |
| Loss on disposal of property, plant and equipment | 1 | 1 | |
| Other | (1 |) 2 | |
| Share-based compensation | 35 | 24 | |
| Tax benefits from share-based compensation | — | 2 | |
| Excess tax benefits from share-based compensation | — | (1 |) |
| Changes in assets and liabilities, net of acquisition: | | | |
| Trade accounts receivable, net | 70 | 54 | |
| Inventory | (34 |) (24 |) |
| Accounts payable | 2 | 13 | |
| Employee compensation and benefits | (2 |) (32 |) |
| Other current assets and current liabilities | (18 |) (18 |) |
| Other long-term assets and long-term liabilities | 2 | (5 |) |
| Net cash provided by operating activities | 376 | 350 | |
| Cash flows from investing activities: | | | |
| Purchase of property, plant and equipment | (114 |) (103 |) |
| Acquisition and investment, net of cash acquired | (46 |) — | |
| Net cash used in investing activities | (160 |) (103 |) |
| Cash flows from financing activities: | | | |
| Proceeds from government grants | 5 | 2 | |
| Payments on capital lease obligations | (1 |) (1 |) |
| Issuance of ordinary shares | 28 | 22 | |
| Repurchase of ordinary shares | (24 |) (85 |) |
| Excess tax benefits from share-based compensation | — | 1 | |
| Dividend payments to shareholders | (89 |) (61 |) |
| Net cash used in financing activities | (81 |) (122 |) |
| Net increase in cash and cash equivalents | 135 | 125 | |
| Cash and cash equivalents at the beginning of period | 1,084 | 829 | |
| Cash and cash equivalents at end of period | \$1,219 | \$954 | |

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

Table of Contents

AVAGO TECHNOLOGIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Overview, Basis of Presentation and Significant Accounting Policies

Overview

Avago Technologies Limited, or the “Company”, was organized under the laws of the Republic of Singapore in August 2005.

We are a designer, developer and global supplier of analog semiconductor devices with a focus on III-V based products. We offer products in three primary target markets: wireless communications, wired infrastructure and industrial & other. Applications for our products in these target markets include cellular phones, consumer appliances, data networking and telecommunications equipment, enterprise storage and servers, factory automation and displays. References herein to “we”, “our”, “us” and “Avago” are to Avago Technologies Limited and its consolidated subsidiaries, unless otherwise specified or the context otherwise requires.

Basis of Presentation

Fiscal Periods. We operate on a 52- or 53-week fiscal year ending on the Sunday closest to October 31. Our fiscal year ending November 3, 2013, or fiscal year 2013, is a 53-week fiscal year, with our first fiscal quarter containing 14 weeks. The first quarter of our fiscal year 2013 ended on February 3, 2013, the second quarter ended on May 5, 2013, the third quarter will end on August 4, 2013 and the fourth quarter will end on November 3, 2013.

Information. The unaudited condensed consolidated financial statements include the accounts of Avago Technologies Limited and all of its wholly-owned subsidiaries, and are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. Intercompany transactions and balances have been eliminated in consolidation.

Interim information presented in the unaudited condensed consolidated financial statements has been prepared by management and, in the opinion of management, includes all adjustments of a normal recurring nature that are necessary for the fair statement of the financial position, results of operations, comprehensive income and cash flows for the periods shown, and is in accordance with GAAP. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the fiscal year ended October 28, 2012, or fiscal year 2012, included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on December 17, 2012.

The operating results for the fiscal quarter and two fiscal quarters ended May 5, 2013 are not necessarily indicative of the results that may be expected for fiscal year 2013, or for any other future period. The balance sheet data as of October 28, 2012 presented is derived from the audited financial statements as of that date.

Significant Accounting Policies

Use of estimates. The preparation of 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 revenues and expenses during the reporting period. Actual results could differ from those estimates, and such differences could affect the results of operations reported in future periods.

Concentrations of credit risk and significant customers. Our cash, cash equivalents and accounts receivable are subject to concentration of credit risk. Cash and cash equivalents may be redeemable upon demand and are maintained with several financial institutions that management believes are of high credit quality and therefore bear minimal credit risk. We seek to mitigate our credit risks by spreading such risks across multiple counterparties and monitoring the risk profile of these counterparties. Our accounts receivable are derived from revenue earned from customers located in the U.S. and internationally. Credit risk with respect to accounts receivable is largely diversified, due to the large number of entities comprising our customer base and their dispersion across many different industries and geographies. We also mitigate collection risks from our customers by performing regular credit evaluations of our customers' financial conditions, and require collateral, such as letters of credit and bank guarantees, in certain circumstances.

We sell our products through our direct sales force, distributors and manufacturers' representatives. One customer accounted for 20% of our net accounts receivable balance at May 5, 2013. One customer accounted for 32% of our net accounts receivable balance at October 28, 2012. For the fiscal quarter ended May 5, 2013, two customers represented 16% and 10% of our net revenue, respectively, and for the two fiscal quarters ended May 5, 2013, one customer represented 18% of our net revenue. For the fiscal quarter and two fiscal quarters ended April 29, 2012, one customer represented 16% and 17% of our net revenue, respectively.

Warranty. We accrue for the estimated costs of product warranties at the time revenue is recognized. Product warranty costs are estimated based upon our historical experience and specific identification of product requirements, which may

Table of Contents

fluctuate based on product mix. Additionally, we accrue for warranty costs associated with occasional or unanticipated product quality issues if a loss is probable and can be reasonably estimated.

The following table summarizes the changes in accrued warranty (in millions):

| | | |
|--|-----|---|
| Balance as of October 28, 2012 — included in other current liabilities | \$2 | |
| Utilized | (1 |) |
| Balance as of May 5, 2013 — included in other current liabilities | \$1 | |

Net income per share. Basic net income per share is computed using the weighted-average number of ordinary shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of ordinary shares and potentially dilutive share equivalents outstanding during the period. Diluted shares outstanding includes the dilutive effect of in-the-money options, restricted share units, or RSUs, and employee share purchase rights under the Avago Technologies Limited Employee Share Purchase Plan, or ESPP. The dilutive effect of such equity awards is calculated based on the average share price for each fiscal period, using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising share options and to purchase shares under the ESPP, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when equity awards become deductible for income tax purposes are collectively assumed to be used to repurchase ordinary shares.

Diluted net income per share for the fiscal quarter and two fiscal quarters ended May 5, 2013 and the fiscal quarter and two fiscal quarters ended April 29, 2012 excluded the potentially dilutive effect of weighted-average outstanding equity awards (options, RSUs, and ESPP rights) to acquire 2 million, 2 million, 1 million and 1 million ordinary shares, respectively, as their effect was antidilutive.

The following is a reconciliation of the denominators of the basic and diluted net income per share computations for the periods presented (in millions, except per share data):

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|-------------------------|----------------------|----------------|---------------------------|----------------|
| | May 5, 2013 | April 29, 2012 | May 5, 2013 | April 29, 2012 |
| Net income (Numerator): | | | | |
| Net income | \$113 | \$134 | | |