ALEXANDERS INC
Form 10-Q
August 04, 2014

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: **June 30, 2014**

Or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from: to

Commission File Number: 001-6064

ALEXANDER'S, INC.

(Exact name of registrant as specified in its charter)

Delaware	**51-0100517**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
210 Route 4 East, Paramus, New Jersey	**07652**
(Address of principal executive offices)	(Zip Code)

(201) 587-8541

(Registrant’s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes o 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 (Section 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). x Yes o 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.

oLarge Accelerated Filer	x Accelerated Filer
o Non-Accelerated Filer (Do not check if smaller reporting company)	o Smaller Reporting Company

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

As of July 31, 2014, there were 5,106,196 shares of common stock, par value $1 per share, outstanding.

ALEXANDER'S, INC.
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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ALEXANDER'S, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(Amounts in thousands, except share and per share amounts)

ASSETS		**June 30, 2014**		**December 31, 2013**
Real estate, at cost:				
Land	$	44,971	$	44,971
Buildings and leasehold improvements		870,676		869,681
Development and construction in progress		25,057		4,924
Total		940,704		919,576
Accumulated depreciation and amortization		(197,695)		(185,375)
Real estate, net		743,009		734,201
Cash and cash equivalents		307,929		347,718
Restricted cash		85,587		90,044
Marketable securities		35,729		31,522
Tenant and other receivables, net of allowance for doubtful accounts of $1,720 and $1,993, respectively		2,283		2,925
Receivable arising from the straight-lining of rents		178,683		177,401
Deferred lease and other property costs, net, including unamortized leasing fees to Vornado of $35,009 and $36,728, respectively		48,059		50,273
Deferred debt issuance costs, net of accumulated amortization of $9,930 and $19,187, respectively		6,197		3,246
Other assets		42,380		20,394
	$	1,449,856	$	1,457,724
LIABILITIES AND EQUITY				
Mortgages payable	$	1,034,289	$	1,049,959
Amounts due to Vornado		42,489		43,307
Accounts payable and accrued expenses		32,768		27,450
Other liabilities		3,422		3,427
Total liabilities		1,112,968		1,124,143
Commitments and contingencies				
Preferred stock: $1.00 par value per share; authorized, 3,000,000 shares; issued and outstanding, none		-		-

Common stock: $1.00 par value per share; authorized, 10,000,000 shares;		
issued, 5,173,450 shares; outstanding, 5,106,196 shares	5,173	5,173
Additional capital	30,139	29,745
Retained earnings	296,374	297,515
Accumulated other comprehensive income	5,576	1,522
	337,262	333,955
Treasury stock: 67,254 shares, at cost	(374)	(374)
Total equity	336,888	333,581
	$ 1,449,856	$ 1,457,724

See notes to consolidated financial statements (unaudited).

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ALEXANDER'S, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(Amounts in thousands, except share and per share amounts)

			Three Months Ended June 30,		Six Months Ended June 30,		
			2014	2013	2014	2013	
REVENUES							70,280
Contingent consideration		37,499					
	$	127,764					

In connection with the acquisition, we issued 1,577,559 shares to the former Validity shareholders valued at $70.3 million based on the Acquisition Date closing price of our common stock of $44.55. The contingent consideration arrangement requires us to make earn-out consideration payments of up to $162.5 million, which is based primarily on sales, during certain time periods, ending on March 31, 2016, of certain products embodying Validity fingerprint sensor technology. The earn-out consideration will be payable in cash, except for the initial $16.3 million of contingent consideration, which will be satisfied by delivery of 338,427 shares of our common stock, based on the transaction reference price of $48.278. Under certain conditions, we may be required to deliver additional shares to ensure that at least 40% of the value of consideration transferred to the former Validity shareholders is paid in shares of our common stock.

The estimated fair value of the contingent consideration arrangement as of the Acquisition Date was $37.5 million. We estimated the fair value of the contingent consideration using a probability-weighted discounted cash flow model. These fair value measurements were based on significant inputs not observable in the market and thus represent a Level 3 measurement. The key assumptions in applying the probability-weighted discounted cash flow model was a 23% discount rate under three unequally weighted cash flow scenarios reviewed by senior management and our board to assess the transaction. The contingent consideration will be remeasured to fair value in future reporting periods and any adjustments will be recorded through earnings.

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The following table summarizes the estimated fair values of the assets acquired and liabilities assumed as of the Acquisition Date (in thousands):

Cash	$ 365
Accounts receivable	3,840
Inventory	2,154
Prepaid expenses and other	984
Property and equipment	326
Deferred tax assets	13,602
Acquired intangible assets	76,400
Other assets	1,283
Total identifiable assets acquired	98,954
Accounts payable	2,141
Accrued liabilities	1,497
Non-current deferred tax liabilities	5,327
Non-current taxes payable	700
Other non-current accrued liabilities	500
Net identifiable assets acquired	88,789
Goodwill	38,975
Net assets acquired	$ 127,764

Of the $76.4 million of acquired intangible assets, $57.0 million was assigned to in-process research and development and will be amortized over an estimated useful life to be determined at the date the underlying projects are determined to be substantively complete, $18.6 million was assigned to developed technology and will be amortized over an estimated useful life of 2-3 years, and $750,000 was assigned to backlog and was amortized during the quarter ended December 31, 2013. In-process research and development refers to the next generation fingerprint authentication technology designed for the mobile product and PC markets and developed technology refers to the established fingerprint authentication technology initially designed for and sold into the PC market and adapted for the mobile product market. We anticipate that all in-process research and development projects will be substantially completed within the next six to twelve months. The value of goodwill reflects the anticipated synergies of the combined operations and workforce of Validity as of the Acquisition Date.

As of December 31, 2013, our purchase price allocation is preliminary and has not been finalized. Additional information, which existed as of the Acquisition Date but is yet unknown to us, may become known to us during the remainder of the measurement period, which will not exceed 12 months from the Acquisition Date. Changes to amounts recorded as assets or liabilities will be recorded as retrospective adjustments to the provisional amounts recognized as of the Acquisition Date and may result in a corresponding adjustment to goodwill.

In connection with the acquisition, we recognized $1.2 million of indemnification assets, consisting of $700,000 for income tax and $500,000 for service tax. These amounts represent estimated tax settlement plus interest and penalties. Under the merger agreement, we are indemnified for any additional tax liability incurred (as well as other reasonable expenses) before the acquisition.

The Validity fingerprint authentication products are an extension of our existing interactive user interface solution products and are marketed to our existing customer base. We intend to report these products based on device type. Accordingly, we continue to operate in one segment and therefore the goodwill applies to a company-wide reporting unit. None of the goodwill is expected to be deductible for income tax purposes.

We recognized approximately $2.0 million of legal and consulting costs that were expensed in fiscal 2014. These costs are included in our consolidated statements of income as selling, general, and administrative expenses.

Prior to the acquisition, we did not have a preexisting relationship with Validity.

The condensed consolidated financial statements include $4.3 million revenue and approximately $2.5 million of operating loss of Validity from the date of the acquisition through December 31, 2013.

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The following unaudited pro forma financial information presents the combined results of operations for us and Validity as if the acquisition had occurred on July 1, 2012. The unaudited pro forma financial information has been prepared for comparative purposes only and does not purport to be indicative of the actual operating results that would have been recorded had the acquisition actually taken place on July 1, 2012, and should not be taken as indicative of future consolidated operating results. Additionally, the unaudited pro forma financial results do not include any anticipated synergies or other expected benefits from the acquisition.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
	(in thousands, except per share data)			
Revenue	$ 206,844	$ 146,869	$ 436,253	$ 276,924
Net income	16,354	4,732	45,785	5,807
Net income per share diluted	0.44	0.14	1.25	0.16

Pro forma adjustments used to arrive at pro forma net income for the three and six months ended December 31, 2013 and December 31, 2012, were as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Buyer transaction costs	$ 969	$	$ 2,000	$
Seller transaction costs			517	
Inventory adjustment	575		575	
Share-based compensation	140	87	280	174
Intangible amortization	(2,060)	(2,060)	(4,121)	(3,497)
Deferred compensation	49	(19)	31	(37)
Total	$ (327)	$ (1,992)	$ (718)	$ (3,360)

14. Acquired Intangibles

The following table summarizes the life, the gross carrying value of our acquired intangible assets, and the related accumulated amortization as of December 31, 2013 and June 30, 2013 (in thousands):

	Life	December 31, 2013	June 30, 2013
In-process research and development	To Be Determined	$ 57,000	$ 8,900
Finger print developed technology	2-3 years	18,650	
Thintouch developed technology	7 years	8,900	
Customer relationships	5 years	3,800	3,800
Licensed technology and other	5 years	1,335	1,335
Backlog	Less than 1 year	750	

Patents	5 years	100	100
		90,535	14,135
Accumulated amortization		(3,144)	(1,025)
Acquired intangibles, net		$ 87,391	$ 13,110

The total amortization expense for the acquired intangible assets was $1.9 million and $261,000 for the three months ended December 31, 2013, and 2012, respectively, and $2.1 million and $501,000 for the six months ended December 31, 2013, and 2012, respectively. This amortization expense was included in our condensed consolidated statements of income in cost of revenue and acquired intangibles amortization.

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The following table presents expected annual aggregate amortization expense as of December 31, 2013 (in thousands):

Remainder of 2014	$ 5,280
2015	10,560
2016	7,016
2017	3,221
2018	1,293
Thereafter	3,021
To be determined	57,000
Future amortization	$ 87,391

15. Subsequent Events

On January 2, 2014, we announced that our 0.75% convertible senior subordinated notes due 2024, or Notes, are convertible during the first calendar quarter of 2014 as a result of our common stock price exceeding the conversion trigger for 20 of the last 30 consecutive trading days ending on the last trading day of the calendar quarter ended December 31, 2013. As we previously made a principal conversion settlement election to settle the principal in cash, the principal amount of any Notes tendered for conversion will be settled in cash following the cash settlement averaging period as defined in the Indenture.

On January 21, 2014, our board authorized us to call for redemption any remaining outstanding Notes, which have not been submitted for conversion or retired. Accordingly, Notes have been classified as a short-term liability on the balance sheet as we intend to call the remaining outstanding Notes within the next 12 months.

On January 22, 2014, we purchased a 5.35 acre site, with two single story buildings totaling approximately 80,000 square feet, located adjacent to our San Jose headquarters for approximately $10.1 million in cash. We plan to retrofit one of the two buildings, or approximately 51,000 square feet, to support expansion of our San Jose-based employee population.

On February 3, 2014, we issued a Notice of Redemption setting April 2, 2014 as the redemption date upon which we will redeem 100% of the principal amount, plus accrued and unpaid interest, of any remaining outstanding Notes. Noteholders have the right to convert any of their Notes that we have called for redemption at any time prior to 5:00 p.m., New York City time, on March 31, 2014.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements and Factors That May Affect Results

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and notes in Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013.

In addition to the historical information contained in this report, this report may contain forward-looking statements, including those related to our operating model and strategies; our market penetration and market share in the mobile product applications and PC product applications markets; competitive factors in the mobile product applications and PC product applications markets; revenue from the mobile product applications and PC product applications markets; industry estimates of growth rates of these markets; average selling prices; product design mix; manufacturing costs; gross margins; new product solution introductions; customer relationships; research and development expenses; selling, general, and administrative expenses; liquidity and anticipated cash requirements; our ability to provide local sales, operational, and engineering support to customers; our assessment of the combination of the added value we bring to our OEM customers products in meeting their custom design requirements and the impact of our ongoing cost-improvement programs; our expectations regarding the timing of the conclusion of an ongoing appeal of a tax audit; and our expectations regarding tax benefits for the federal research credit. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially.

We caution that these statements are qualified by various factors that may affect future results, including the following: economic conditions; changes in the market for our products and the success of our customers products; our success in moving products from the design phase into the manufacturing phase; changes in the competitive environment; infringement claims; warranty obligations related to product failures; the failure of key technologies to deliver commercially acceptable performance; our dependence on certain key markets; penetration into new markets; the absence of both long-term purchase and supply commitments; and our lengthy development and product acceptance cycles. This report should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended June 30, 2013, including particularly Item 1A Risk Factors therein.

Overview

We are a leading worldwide developer and supplier of custom-designed human interface solutions that enable people to interact more easily and intuitively with a wide variety of mobile computing, communications, entertainment, and other electronic devices. We believe our results to date reflect the combination of our customer focus, the strength of our intellectual property, and our engineering know-how, which allow us to develop or engineer products that meet the demanding design specifications of OEMs.

Many of our customers have manufacturing operations in China, and many of our OEM customers have established design centers in that region. With our expanded global presence, including offices in China, Finland, Hong Kong, India, Japan, Korea, Switzerland, Taiwan, and the United States, we are well positioned to provide local sales, operational, and engineering support services to our existing customers, as well as potential new customers, on a global basis.

Our manufacturing operations are based on a variable cost model in which we outsource all of our production requirements and generally drop ship our products directly to our customers from our contract manufacturers facilities, reducing the need for significant capital expenditures and allowing us to minimize our investment in inventories. This approach requires us to work closely with our contract manufacturers and semiconductor foundries to ensure adequate production capacity to meet our forecasted volume requirements. We provide our contract manufacturers with six-month rolling forecasts and issue purchase orders based on our anticipated requirements for the next 90 days. However, we do not have any long-term supply contracts with any of our contract manufacturers. We use three third-party semiconductor wafer manufacturers to supply us with silicon wafers integrating our proprietary design specifications. The completed silicon wafers are forwarded to third-party package and test processors for further processing into die and packaged ASICs, as applicable, which are then utilized in our custom interface products or processed as our ASIC-based solutions. In certain cases, we rely on a single source or a limited number of suppliers to provide other key components of our products. Our cost of revenue includes all costs associated with the production of our products, including materials, logistics, amortization of intangibles related to acquired developed technology, manufacturing, assembly, and test costs paid to third-party manufacturers and related overhead costs associated with our indirect manufacturing operations personnel. Additionally, we charge losses on inventory purchase obligations and write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value (including warranty costs) to cost of revenue.

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Our gross margin generally reflects the combination of the added value we bring to our OEM customers products in meeting their custom design requirements and the impact of our ongoing cost-improvement programs. These cost-improvement programs include reducing materials and component costs and implementing design and process improvements.

Our research and development expenses include costs for supplies and materials related to product development as well as the engineering costs incurred to design ASICs and human interface solutions for OEM customers prior to and after their commitment to incorporate those solutions into their products. These expenses have generally increased, reflecting our continuing commitment to the technological and design innovation required to maintain our position in our existing markets and to adapt our existing technologies or develop new technologies for new markets.

Selling, general, and administrative expenses include expenses related to sales, marketing, and administrative personnel; internal sales and outside sales representatives commissions; market and usability research; outside legal, accounting, and consulting costs; and other marketing and sales activities. These expenses have generally increased, primarily reflecting incremental staffing and related support costs associated with our business acquisitions, increased business levels, growth in our existing markets, and penetration into new markets.

Change in contingent consideration is a cost associated with the acquisition of a business in which an earn-out arrangement was entered into between us and a selling party. We entered into earn-out arrangements in connection with our acquisitions of both Pacinian and Validity. The earn-out arrangements are designed to deliver more purchase price consideration to the selling parties, provided the acquired business delivers on the negotiated earn-out terms. Under these earn-out arrangements, upon satisfaction of certain financial metrics and other conditions, additional cash will be delivered to the former Pacinian shareholders and additional cash and shares of our common stock will be delivered to the former Validity shareholders. Accordingly, we anticipate that changes in the fair value of the contingent consideration could result in volatility in our operating results due to changes in our stock price, the degree of success of current and future projects incorporating both the developed technology and in-process technology, and changes in the discount rates used to determine the fair value of the contingent consideration over time.

Critical Accounting Policies and Estimates

There have been no significant changes in our critical accounting policies and estimates during the six months ended December 31, 2013 compared with our critical accounting policies and estimates disclosed in Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013.

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Results of Operations

Certain of our condensed consolidated statements of income data for the periods indicated, together with comparative absolute and percentage changes in these amounts, were as follows (in thousands, except percentages):

	Three Months Ended December 31,				Six Months Ended December 31,			
	2013 (1)	2012	$ Change	% Change	2013 (1)	2012	$ Change	% Change
Mobile product applications	$ 133,604	$ 81,589	$ 52,015	63.8%	$ 296,268	$ 146,205	$ 150,063	102.6%
PC product applications	72,159	61,451	10,708	17.4%	132,102	123,876	8,226	6.6%
Net revenue	205,763	143,040	62,723	43.8%	428,370	270,081	158,289	58.6%
Gross margin	94,545	69,030	25,515	37.0%	203,824	129,600	74,224	57.3%
Operating expenses:								
Research and development	45,931	34,257	11,674	34.1%	86,373	67,059	19,314	28.8%
Selling, general, and administrative	22,845	19,008	3,837	20.2%	43,969	37,916	6,053	16.0%
Acquired intangibles amortization	261	261		0.0%	523	501	22	4.4%
Change in contingent consideration	3,430	576	2,854	495.5%	3,688	863	2,825	327.3%
Operating income	22,078	14,928	7,150	47.9%	69,271	23,261	46,010	197.8%
Interest income	476	225	251	111.6%	906	443	463	104.5%
Interest expense	(5)	(5)		0.0%	(9)	(9)		0.0%
Income before provision for income taxes	22,549	15,148	7,401	48.9%	70,168	23,695	46,473	196.1%
Provision for income taxes	5,215	4,034	1,181	29.3%	17,895	6,528	11,367	174.1%
Net income	$ 17,334	$ 11,114	$ 6,220	56.0%	$ 52,273	$ 17,167	$ 35,106	204.5%

(1) Includes the results of operations from Validity, which was acquired on November 7, 2013 (see Note 13 to the condensed consolidated financial statements)

Certain of our condensed consolidated statements of income data as a percentage of net revenue for the periods indicated were as follows:

	Three Months Ended December 31,		Point Increase/ (Decrease)	Six Months Ended December 31,		Point Increase/ (Decrease)
	2013	**2012**		**2013**	**2012**	
Mobile product applications	64.9%	57.0%	7.9%	69.2%	54.1%	15.1%
PC product applications	35.1%	43.0%	(7.9%)	30.8%	45.9%	(15.1%)
Net revenue	100.0%	100.0%		100.0%	100.0%	
Gross margin	45.9%	48.3%	(2.4%)	47.6%	48.0%	(0.4%)
Operating expenses:						
Research and development	22.3%	23.9%	(1.6%)	20.2%	24.8%	(4.6%)
Selling, general, and administrative	11.1%	13.3%	(2.2%)	10.3%	14.0%	(3.7%)
Amortization of acquired intangibles	0.1%	0.2%	(0.1%)	0.1%	0.2%	(0.1%)
Change in contingent consideration	1.7%	0.4%	1.3%	0.9%	0.3%	0.6%
Operating income	10.7%	10.4%	0.3%	16.2%	8.6%	7.6%
Income before provision for income taxes	11.0%	10.6%	0.4%	16.4%	8.8%	7.6%
Provision for income taxes	2.5%	2.8%	(0.3%)	4.2%	2.4%	1.8%
Net income	8.4%	7.8%	0.6%	12.2%	6.4%	5.8%

(1) Includes the results of operations from Validity, which was acquired on November 7, 2013 (see Note 13 to the condensed consolidated financial statements)

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Net Revenue.

Net revenue was $205.8 million for the quarter ended December 31, 2013 compared with $143.0 million for the quarter ended December 31, 2012, an increase of $62.7 million, or 43.8%. Of our second quarter fiscal 2014 net revenue, $133.6 million, or 64.9%, was from mobile product applications and $72.2 million, or 35.1%, was from PC product applications. Included in our second quarter fiscal 2014 PC and mobile product applications revenue was $4.3 million of revenue from biometric fingerprint authentication products. The increase in net revenue for the quarter ended December 31, 2013 was attributable to an increase in net revenue from mobile product applications and an increase in PC product applications, as well as our new biometric fingerprint authentication products resulting from an acquisition (see Note 13 to the condensed consolidated financial statements). Net revenue from mobile product applications increased primarily as a result of higher unit sales in the quarter, reflecting an increase in our market share. Net revenue from PC product applications increased primarily as a result of higher unit sales in the quarter, reflecting a combination of increased market share and the addition of PC based biometric fingerprint authentication solutions.

Net revenue was $428.4 million for the six months ended December 31, 2013 compared with $270.1 million for the six months ended December 31, 2012, an increase of $158.3 million, or 58.6%. Of our first six months of fiscal 2014 net revenue, $296.3 million, or 69.2%, was from mobile product applications and $132.1 million, or 30.8%, was from PC product applications. Included in our first six months of fiscal 2014 PC and mobile product revenue was $4.3 million of revenue from biometric fingerprint authentication products. The increase in net revenue for the six months ended December 31, 2013 was attributable to an increase in net revenue from mobile product applications and an increase in PC product applications, as well as our new biometric fingerprint authentication products resulting from an acquisition. Net revenue from mobile product applications increased primarily as a result of higher unit sales in the six month period, reflecting an increase in our market share. Net revenue from PC product applications increased primarily as a result of higher unit sales in the six-month period, reflecting a combination of increased market share and the addition of PC-based biometric fingerprint authentication solutions.

Based on industry estimates of unit shipments, the mobile smartphone market is anticipated to increase approximately 20%, the tablet market is anticipated to increase 22%, and the notebook market is anticipated to decrease approximately 7% in calendar year 2014 compared with calendar year 2013.

Gross Margin.

Gross margin as a percentage of net revenue was 45.9%, or $94.5 million, for the quarter ended December 31, 2013 compared with 48.3%, or $69.0 million, for the quarter ended December 31, 2012. The 240 basis point decline in gross margin was primarily due to amortization of acquired intangibles incurred in the current quarter as well as an unfavorable mix of lower margin revenue.

Gross margin as a percentage of net revenue was 47.6%, or $203.8 million, for the six months ended December 31, 2013 compared with 48.0%, or $129.6 million, for the six months ended December 31, 2012. The 40 basis point decline in gross margin was primarily due to amortization of acquired intangibles incurred in the current quarter as well as an unfavorable mix of lower margin revenue.

We continuously introduce new product solutions, many of which have life cycles of less than a year. Further, as we sell our capacitive sensing technology in designs that are generally unique or specific to an OEM customer s application, gross margin varies on a product-by-product basis, making our cumulative gross margin a blend of our product specific designs. As a virtual manufacturer, our gross margin percentage is generally not impacted materially by our shipment volume. We charge losses on inventory purchase obligations and write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value (including warranty costs) to cost of revenue.

Operating Expenses.

Research and Development Expenses. Research and development expenses increased $11.7 million to $45.9 million for the quarter ended December 31, 2013 compared with the quarter ended December 31, 2012. The increase in research and development expenses primarily reflected a $5.7 million increase in employee-related costs, which included our annual merit increase, additional headcount associated with an expanded product portfolio and a recent acquisition, a $3.9 million increase in infrastructure-related costs, and a $1.2 million increase in temporary employee expenses.

Research and development expenses increased $19.3 million to $86.4 million for the six months ended December 31, 2013 compared with the six months ended December 31, 2012. The increase in research and development expenses primarily reflected a $9.6 million increase in employee-related costs, which included our annual merit increase, an increase in our incentive compensation accrual, additional headcount associated with an expanded product portfolio and a recent acquisition, a $6.7 million increase in infrastructure-related costs, $1.6 million increase in temporary employee expenses, and a $1.0 million increase in travel and entertainment expenses.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses increased $3.8 million to $22.8 million for the quarter ended December 31, 2013 compared with the quarter ended December 31, 2012. The increase in selling, general, and administrative expenses primarily reflected a $2.4 million increase in employee-related costs, which included our annual merit increase, additional headcount related to a recent acquisition, a $782,000 increase in temporary employee expenses, a $628,000 increase in travel and entertainment expenses, and a $618,000 increase in professional fees, primarily associated with acquisition-related costs, partially offset by a $809,000 decrease in share-based compensation.

Selling, general, and administrative expenses increased $6.1 million to $44.0 million for the six months ended December 31, 2013 compared with the six months ended December 31, 2012. The increase in selling, general, and administrative expenses primarily reflected a $3.9 million increase in employee-related costs, which included our annual merit increase, and additional headcount including some new employees related to a recent acquisition, a $1.8 million increase in professional fees, primarily associated with acquisition-related costs, and a $1.4 million increase in temporary employee expenses, a $1.3 million in travel and entertainment expenses, partially offset by a $2.3 million decrease in share-based compensation.

Provision for Income Taxes.

We account for income taxes under the asset and liability method. We consider the operating earnings of our foreign subsidiaries to be indefinitely invested outside the United States. Accordingly, no provision has been made for the federal, state, or foreign taxes that may result from future remittances of undistributed earnings of our foreign subsidiaries.

The provision for income taxes of $5.2 million and $4.0 million for the three months ended December 31, 2013 and 2012, respectively, represented estimated federal, foreign, and state income taxes. The effective tax rate for the three months ended December 31, 2013 was 23.1% and diverged from the combined federal and state statutory rate primarily because of foreign income taxed at lower tax rates and the federal research credit, partially offset by foreign withholding taxes, nondeductible amortization, and net unrecognized tax benefits associated with qualified stock options. The effective tax rate for the three months ended December 31, 2012 was 26.6% and diverged from the combined federal and state statutory rate primarily because of foreign income taxed at lower tax rates, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, and a slight increase in the liability for unrecognized tax benefits related to uncertain tax positions.

The provision for income taxes of $17.9 million and $6.5 million for the six months ended December 31, 2013 and 2012, respectively, represented estimated federal, foreign, and state income taxes. The effective tax rate for the six months ended December 31, 2013 was 25.5% and diverged from the combined federal and state statutory rate primarily because of foreign income taxed at lower tax rates and the federal research credit, partially offset by foreign withholding taxes, nondeductible amortization, and net unrecognized tax benefits associated with qualified stock options. The effective tax rate for the six months ended December 31, 2012 was 27.6% and diverged from the combined federal and state statutory rate primarily because of foreign income taxed at lower tax rates, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, and a slight increase in the liability for unrecognized tax benefits related to uncertain tax positions.

In May 2011, we were notified by the Internal Revenue Service, or the Service, that our fiscal 2003 through 2006 and fiscal 2008 through 2010 would be subject to examination. The early periods were being audited in connection with a mandatory review of tax refunds in excess of $2.0 million when we carried back our fiscal 2008 net operating loss. In March 2013, we received the Revenue Agent s Report resolving our examination with the Service and paid an assessment that had no material impact to our condensed consolidated financial statements. Our case is pending review by the Joint Committee on Taxation, which we anticipate to conclude in our fiscal 2014. Any prospective adjustments to our unrecognized tax benefits will be recorded as an increase or decrease to income tax expense and cause a corresponding change to our effective tax rate. Accordingly, our effective tax rate could fluctuate materially from period to period.

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On January 2, 2013, President Barack Obama signed into law The American Taxpayer Relief Act of 2013, or the Act. The Act extends the research credit for two years retroactively from January 1, 2012 through December 31, 2013. As such, we will only recognize six months of tax benefit in our current fiscal year.

Our major tax jurisdictions are the United States, California, and Hong Kong SAR, and fiscal 2003 onward remain subject to examination by one or more of these jurisdictions.

Liquidity and Capital Resources

Our cash and cash equivalents were $369.4 million as of December 31, 2013 compared with $355.3 million as of June 30, 2013, an increase of $14.1 million. The increase primarily reflected the combination of $85.8 million provided from operating cash flows and $39.2 million of proceeds from the issuance of shares, partially offset by $70.3 million used to repurchase 1,663,779 shares of our common stock, $19.6 million used for the acquisition of a business, and $17.1 million used for the purchase of property and equipment. We consider earnings of our foreign subsidiaries indefinitely invested overseas and have made no provision for income or withholding taxes that may result from a future repatriation of those earnings. As of December 31, 2013, $314.4 million of cash and cash equivalents was 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. federal, foreign, and state taxes to repatriate these funds.

Cash Flows from Operating Activities. Operating activities during the six months ended December 31, 2013 generated net cash of $85.8 million compared with $44.9 million of net cash generated during the six months ended December 31, 2012. For the six months ended December 31, 2013, net cash provided by operating activities was primarily attributable to net income of $52.3 million plus adjustments for non-cash charges of $35.9 million, and a $2.4 million net change in operating assets and liabilities. The net change in operating assets and liabilities was primarily attributable to a $13.2 million decrease in accounts payable, a $4.1 million increase in other assets, and a $3.5 million increase in prepaid expenses and other current assets, partially offset by a $19.3 million decrease in accounts receivable. From June 30, 2013 to December 30, 2013, our days sales outstanding remained at 58 days and our inventory turns declined from 9 to 8.

Cash Flows from Investing Activities. Investing activities during the six months ended December 31, 2013 used net cash of $19.6 million for the acquisition of a business and $17.1 million for purchases of property and equipment compared with $20.9 million net cash used for purchases of property and equipment and $5.0 million for the acquisition of a business during the six months ended December 31, 2012.

Cash Flows from Financing Activities. Net cash used in financing activities for the six months ended December 31, 2013 was $34.9 million compared with $33.6 million for the six months ended December 31, 2012. Net cash used in financing activities for the six months ended December 31, 2013 primarily included $70.3 million used to repurchase 1,663,779 shares of our common stock, partially offset by proceeds from issuance of shares of our common stock under our employee equity programs of $39.2 million.

Common Stock Repurchase Program. Our board has cumulatively authorized $620.0 million for our stock repurchase program, expiring in October 2015. The program authorizes us to purchase our common stock in the open market or in privately negotiated transactions, depending upon market conditions and other factors. The number of shares purchased and the timing of purchases is based on the level of our cash balances, general business and market conditions, and other factors, including alternative investment opportunities. Common stock purchased under this program is held as treasury stock. From April 2005 through December 31, 2013, we purchased 19,047,711 shares of our common stock in the open market for an aggregate cost of $530.4 million. Treasury shares purchased prior to August 28, 2008 were not subject to the stock split on that date. As of December 31, 2013, we had $89.6 million remaining under our common stock repurchase program.

Bank Credit Facility. We maintain a $75.0 million working capital line of credit with Wells Fargo Bank. The Wells Fargo Bank revolving line of credit, which expires on September 1, 2014, provides for an interest rate equal to the prime lending rate or 150 basis points above LIBOR, depending on whether we choose a variable or fixed rate, respectively. We had not borrowed any amounts under the line of credit as of December 31, 2013.

$100 Million Shelf Registration. We have registered an aggregate of $100.0 million of common stock and preferred stock for issuance in connection with acquisitions, which shares generally will be freely tradable after their issuance under Rule 145 of the Securities Act unless held by an affiliate of the acquired company, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144.

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Liquidity and Capital Resources. We believe our existing cash and cash equivalents and anticipated cash flows from operating activities will be sufficient to meet our working capital and other cash requirements for at least the next 12 months, including our obligations associated with the acquisition of Validity and the purchase of two new buildings. Our future capital requirements will depend on many factors, including our revenue, the timing and extent of spending to support product development efforts, costs related to protecting our intellectual property, the expansion of sales and marketing activities, the timing of introductions of new products and enhancements to existing products, the costs to ensure access to adequate manufacturing capacity, the costs of maintaining sufficient space or renovating recently acquired building space for our expanding workforce, the continuing market acceptance of our product solutions, our common stock repurchase program, and the amount and timing of our investments in, or acquisitions of, other technologies or companies. Further equity or debt financing may not be available to us on acceptable terms or at all. If sufficient funds are not available or are not available on acceptable terms, our ability to take advantage of business opportunities or to respond to competitive pressures could be limited or severely constrained.

Our non-current investments consist of ARS investments, which have failed to settle in auctions. These investments are not liquid, and in the event we need to access these funds, we will not be able to do so without a loss of principal, unless redeemed by the issuers or a future auction on these investments is successful.

Based on our ability to access our cash and cash equivalents, our expected operating cash flows, and our other sources of cash, we do not anticipate the lack of liquidity on these investments will affect our ability to operate our business as usual. Further, we do not anticipate the need to repatriate any undistributed earnings of our foreign subsidiaries to meet our working capital and other cash requirements.

Contractual Obligations and Commercial Commitments

Our material contractual obligations and commercial commitments as of December 31, 2013 were as follows (in millions):

	Remaining in Fiscal Year 2014	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017	Fiscal Year 2018	Thereafter	Total
Leases	$ 2	$ 4	$ 2	$ 1	$ 1	$ 2	$ 12
Purchase obligations and other commitments (1)	5	17	33				55
Total	$ 7	$ 21	$ 35	$ 1	$ 1	$ 2	$ 67

(1) Purchase obligations and other commitments include payments due for contingent consideration, a long-term services agreement and inventory purchase obligations with contract manufacturers.

In connection with the acquisition of Validity in November 2013, we entered into a contingent consideration arrangement. As of December 31, 2013, we may owe up to $162.5 million of additional consideration to the former Validity stockholders based on unit sales through March 2016. The estimated fair value of the contingent consideration liability as of December 31, 2013 was $40.7 million.

In connection with the acquisition of Pacinian in June 2012, we entered into a contingent consideration arrangement. As of December 31, 2013, we may owe up to $10.0 million of additional consideration to the former Pacinian stockholders based on unit sales of products utilizing ThinTouch technology through June 2016. The estimated fair value of the contingent consideration liability as of December 31, 2013 was $8.7 million.

The amounts in the table above exclude unrecognized tax benefits of $9.2 million. As of December 31, 2013, we were unable to make a reasonably reliable estimate of when cash settlement with a taxing authority may occur in connection with our gross unrecognized tax benefit.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk has not changed materially from the interest rate and foreign currency exchange risks disclosed in Item 7A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2013.

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ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, which included inquiries made to certain other of our employees. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have each concluded that our disclosure controls and procedures are designed and are effective to ensure that information required to be disclosed is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure and are effective and sufficient to ensure that we record, process, summarize, and report information required to be disclosed by us in our periodic reports filed under the Securities Exchange Act of 1934, as amended, within the time periods specified by the SEC s rules and forms.

During the fiscal quarter covered by this report, there have not been any changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

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

Issuer Purchases of Equity Securities

Our cumulative authorization for our common stock repurchase program is $620.0 million. The remaining amount authorized for the repurchase of our common stock through October 2015 is $89.6 million. Repurchases under our common stock repurchase program during the three-month period ended December 31, 2013 were as follows.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program (1)	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program
September 29, 2013 - October 26, 2013				$ 109,843,000
October 27, 2013 - November 23, 2013	446,875	45.35	446,875	89,578,000
November 24, 2013 - December 28, 2013				89,578,000
Total	446,875			

(1) The balance remaining under the program, as amended from time to time, is available through October 2015.

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ITEM 6. EXHIBITS

2.1	Agreement and Plan of Reorganization, dated as of October 9, 2013, by and among Synaptics Incorporated, Itsme Acquisition Corp., Itsme Acquisition II LLC, Validity Sensors, Inc., and Shareholder Representative Services LLC (1)
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference to the registrant s Form 8-K as filed with the SEC on November 12, 2013.

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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.

	SYNAPTICS INCORPORATED
Date: February 5, 2014	By: */s/ Richard A. Bergman*
	Name: Richard A. Bergman
	Title: President and Chief Executive Officer
Date: February 5, 2014	By: */s/ Kathleen A. Bayless*
	Name: Kathleen A. Bayless
	Title: Senior Vice President, Chief Financial Officer and Treasurer

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INDEX TO EXHIBITS

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101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
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(1) Incorporated by reference to the registrant s Form 8-K as filed with the SEC on November 12, 2013.