Fiscal 2010 Special Charges

Patent Licenses

During the first quarter of fiscal 2010, we agreed to the terms of a patent license with an unrelated third party and signed an agreement on July 9, 2009. The patent license settled alleged infringement claims. The total payment made to the third-party in July 2009 was $1.4 million, $1.2 million of which was expensed in the first quarter of fiscal 2010 and the remaining $0.2 million was recorded as a prepaid royalty that was amortized over the remaining life of the patents, which expired in June 2010.

Fiscal 2009 Special Charges

Patent Licenses

We entered into a patent portfolio license effective March 31, 2009 with an unrelated third-party that covers both issued patents and patent applications and settled alleged infringement claims. The total payment made to the third-party was $8.25 million, $4.0 million of which was expensed in the fourth quarter of fiscal 2009 and the remaining $4.25 million was recorded as a prepaid royalty that will be amortized over the estimated 20-year remaining life of the patents. We entered into another patent portfolio license with the same unrelated third party in March 2011 and $2.75 million was paid covering patent applications and was recorded as a prepaid royalty that will be amortized over the life of the patents.

In-Process Research and Development

During the third quarter of fiscal 2009, we completed our acquisition of Hampshire Company, a leader in the large format touch screen controller market. As a result of the acquisition, we incurred a $0.5 million in-process research and development charge in the third quarter of fiscal 2009.

During the fourth quarter of fiscal 2009, we completed the acquisition of HI-TECH Software, a provider of software development tools and compilers. As a result of the acquisition, we incurred a $0.2 million in-process research and development charge in the fourth quarter of fiscal 2009.

During the fourth quarter of fiscal 2009, we completed our acquisition of R&E International, a leader in developing innovative integrated circuits for smoke and carbon monoxide detectors and other life-safety systems. As a result of the acquisition, we incurred a $0.2 million in-process research and development charge in the fourth quarter of fiscal 2009.

Abandoned Acquisition Expenses

During the third quarter of fiscal 2009, we pursued a potential acquisition and such efforts were subsequently terminated during the fourth quarter of fiscal 2009. As such, during the fourth quarter of fiscal 2009, we expensed $1.6 million of various costs associated with the terminated acquisition.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Note Regarding Forward-looking Statements

This report, including "Item 1 – Business," "Item 1A – Risk Factors," and "Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations," contains certain forward-looking statements that involve risks and uncertainties, including statements regarding our strategy, financial performance and revenue sources. We use words such as "anticipate," "believe," "plan," "expect," "estimate," "future," "continue," "intend" and similar expressions to identify forward-looking statements. These forward-looking statements include, without limitation, statements regarding the following:

- The effects that adverse global economic conditions and fluctuations in the global credit and equity markets may have on our financial condition and results of operations;
- The effects and amount of competitive pricing pressure on our product lines;
- Our ability to moderate future average selling price declines;
- The effect of product mix, capacity utilization, yields, fixed cost absorption, competition and economic conditions on gross margin;
- The amount of, and changes in, demand for our products and those of our customers;

- Our expectation that the overall percentage of revenue from our top ten customers will increase due to our acquisition of SMSC;
- The level of orders that will be received and shipped within a quarter;
- Our expectation that our inventory levels will increase modestly in the June 2013 quarter compared to the March 2013 quarter and that it will allow us to maintain competitive lead times and keep our capital expenditures low;
- Our expectation that research and development expenses will be relatively flat with the March 2013 quarter and for such expenses to decrease as a percentage of net sales due to operational efficiencies and continued synergies of the SMSC integration;
- The effect that distributor and customer inventory holding patterns will have on us;
- Our belief that customers recognize our products and brand name and use distributors as an effective supply channel;
- Our belief that deferred cost of sales are recorded at their approximate carrying value and will have low risk of material impairment;
- Our belief that our direct sales personnel combined with our distributors provide an effective means of reaching our customer base;
- Our ability to increase the proprietary portion of our analog, interface and mixed signal product lines and the effect of such an increase;
- Our belief that our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs;
- The impact of any supply disruption we may experience;
- Our ability to effectively utilize our facilities at appropriate capacity levels and anticipated costs;
- That we adjust capacity utilization to respond to actual and anticipated business and industry-related conditions;
- That our existing facilities will provide sufficient capacity to respond to increases in demand with modest incremental capital expenditures;
- That manufacturing costs will be reduced by transition to advanced process technologies;
- Our ability to maintain manufacturing yields;
- Continuing our investments in new and enhanced products;
- The cost effectiveness of using our own assembly and test operations;
- Our anticipated level of capital expenditures;
- Continuation and amount of quarterly cash dividends;
- The sufficiency of our existing sources of liquidity to finance anticipated capital expenditures and otherwise meet our anticipated cash requirements, and the effects that our contractual obligations are expected to have on them;
- The impact of seasonality on our business;
- The accuracy of our estimates used in valuing employee equity awards;
- That the resolution of legal actions will not have a material effect on our business, and the accuracy of our assessment of the probability of loss and range of potential loss;
- The recoverability of our deferred tax assets;
- The adequacy of our tax reserves to offset any potential tax liabilities, having the appropriate support for our income tax positions and the accuracy of our estimated tax rate;
- Our belief that the expiration of any tax holidays will not have a material impact on our overall tax expense or effective tax rate;
- Our belief that the estimates used in preparing our consolidated financial statements are reasonable;
- Our belief that recently issued accounting pronouncements listed in this document will not have a significant impact on our consolidated financial statements;
- The accuracy of our estimates of the useful life and values of our property, assets and other liabilities;
- The adequacy of our patent strategy, and our belief that the impact of the expiration of any particular patent will not have a material effect on our business;
- Our actions to vigorously and aggressively defend and protect our intellectual property on a worldwide basis;
- Our ability to obtain patents and intellectual property licenses and minimize the effects of litigation;
- The level of risk we are exposed to for product liability or indemnification claims;
- The effect of fluctuations in market interest rates on our income and/or cash flows;
- The effect of fluctuations in currency rates;
- The accuracy of our estimates of market information that determines the value of our Auction Rate Securities (ARS), and that the lack of markets for the ARS will not have a material impact on our liquidity, cash flow, or ability to fund operations;
- That a significant portion of our future cash generation will be in our foreign subsidiaries;
- Our intention to satisfy the lesser of the principal amount or the conversion value of our debenture in cash;
- Our intention to indefinitely reinvest undistributed earnings of certain non-US subsidiaries in those subsidiaries;

- Our intent to maintain a high-quality investment portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield; and
- Our ability to collect accounts receivable.

Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth in "Item 1A – Risk Factors," and elsewhere in this Form 10-K. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. We disclaim any obligation to update information contained in any forward-looking statement.

Introduction

The following discussion should be read in conjunction with the consolidated financial statements and the related notes that appear elsewhere in this document, as well as with other sections of this Annual Report on Form 10-K, including "Item 1 – Business;" "Item 6 – Selected Financial Data;" and "Item 8 – Financial Statements and Supplementary Data."

We begin our Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) with a summary of our overall business strategy to give the reader an overview of the goals of our business and the overall direction of our business and products. This is followed by a discussion of the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. In the next section, beginning at page 34, we discuss our Results of Continuing Operations for fiscal 2013 compared to fiscal 2012, and for fiscal 2012 compared to fiscal 2011. We then provide an analysis of changes in our balance sheet and cash flows, and discuss our financial commitments in sections titled "Liquidity and Capital Resources," "Contractual Obligations" and "Off-Balance Sheet Arrangements."

Acquisition of SMSC

On August 2, 2012, we closed our acquisition of SMSC and SMSC became a wholly owned subsidiary of Microchip. We financed the transaction using approximately $312.7 million of our existing balance of cash, cash equivalents and short-term investments and borrowings of approximately $600.0 million under our existing credit agreement. At August 2, 2012, SMSC had approximately $205.2 million of cash and investments on its balance sheet. SMSC is a leading developer of Smart Mixed-Signal Connectivity™ solutions. SMSC is focused on delivering connectivity solutions that enable the proliferation of data in automobiles, consumer devices, PCs and other applications.

Strategy

Our goal is to be a worldwide leader in providing specialized semiconductor products for a wide variety of embedded control applications. Our strategic focus is on the embedded control market, which includes microcontrollers, high-performance linear and mixed signal devices, power management and thermal management devices, connectivity devices, interface devices, Serial EEPROMs, SuperFlash memory products, our patented KeeLoq® security devices and Flash IP solutions. We provide highly cost-effective embedded control products that also offer the advantages of small size, high performance, low voltage/power operation and ease of development, enabling timely and cost-effective embedded control product integration by our customers. We license SuperFlash technology to foundries, integrated device manufacturers and design partners throughout the world for use in the manufacture of their advanced microcontroller products.

We sell our products to a broad base of domestic and international customers across a variety of industries. The principal markets that we serve include consumer, automotive, industrial, office automation and telecommunications. Our business is subject to fluctuations based on economic conditions within these markets.

Our manufacturing operations include wafer fabrication, wafer probe and assembly and test. The ownership of a substantial portion of our manufacturing resources is an important component of our business strategy, enabling us to maintain a high level of manufacturing control resulting in us being one of the lowest cost producers in the embedded control industry. By owning wafer fabrication facilities and our assembly and test operations, and by employing statistical process control techniques, we have been able to achieve and maintain high production yields. Direct control over manufacturing resources allows us to shorten our design and production cycles. This control also allows us to capture a portion of the wafer manufacturing and the assembly and test profit margin. We do outsource a significant portion of our manufacturing requirements to third parties and the amount of our outsourced manufacturing increased due to our acquisition of SMSC which outsourced all of its manufacturing.

We employ proprietary design and manufacturing processes in developing our embedded control products. We believe our processes afford us both cost-effective designs in existing and derivative products and greater functionality in new product designs. While many of our competitors develop and optimize separate processes for their logic and memory product lines, we use a common process technology for both microcontroller and non-volatile memory products. This allows us to more fully leverage our process research and development costs and to deliver new products to market more rapidly. Our engineers utilize advanced computer-aided design (CAD) tools and software to perform circuit design, simulation and layout, and our in-house photomask and wafer fabrication facilities enable us to rapidly verify design techniques by processing test wafers quickly and efficiently.

We are committed to continuing our investment in new and enhanced products, including development systems, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. Our current research and development activities focus on the design of new microcontrollers, digital signal controllers, memory and mixed-signal products, Flash-IP systems, new development systems, software and application-specific software libraries. We are also developing new design and process technologies to achieve further cost reductions and performance improvements in our products.

We market our products worldwide primarily through a network of direct sales personnel and distributors. Our distributors focus primarily on servicing the product and technical support requirements of a broad base of diverse customers. We believe that our direct sales personnel combined with our distributors provide an effective means of reaching this broad and diverse customer base. Our direct sales force focuses primarily on major strategic accounts in three geographical markets: the Americas, Europe and Asia. We currently maintain sales and support centers in major metropolitan areas in North America, Europe and Asia. We believe that a strong technical service presence is essential to the continued development of the embedded control market. Many of our field sales engineers (FSEs), field application engineers (FAEs), and sales management have technical degrees and have been previously employed in an engineering environment. We believe that the technical knowledge of our sales force is a key competitive advantage in the sale of our products. The primary mission of our FAE team is to provide technical assistance to strategic accounts and to conduct periodic training sessions for FSEs and distributor sales teams. FAEs also frequently conduct technical seminars for our customers in major cities around the world, and work closely with our distributors to provide technical assistance and end-user support.

Critical Accounting Policies and Estimates

General

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. We review the accounting policies we use in reporting our financial results on a regular basis. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, business combinations, share-based compensation, inventories, income taxes, junior subordinated convertible debentures and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Our results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. We review these estimates and judgments on an ongoing basis. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. We also have other policies that we consider key accounting policies, such as our policy regarding revenue recognition to OEMs; however, we do not believe these policies require us to make estimates or judgments that are as difficult or subjective as our policies described below.

Revenue Recognition – Distributors

Our distributors worldwide generally have broad price protection and product return rights, so we defer revenue recognition until the distributor sells the product to their customer. Revenue is recognized when the distributor sells the product to an end-user, at which time the sales price becomes fixed or determinable. Revenue is not recognized upon shipment to our distributors since, due to discounts from list price as well as price protection rights, the sales price is not substantially fixed or determinable at that time. At the time of shipment to these distributors, we record a trade receivable for the selling price as there is a legally enforceable right to payment, relieve inventory for the carrying value of goods shipped since legal title has passed to the distributor, and record the gross margin in deferred income on shipments to distributors on our consolidated balance sheets.

Deferred income on shipments to distributors effectively represents the gross margin on the sale to the distributor; however, the amount of gross margin that we recognize in future periods could be less than the deferred margin as a result of credits granted to distributors on specifically identified products and customers to allow the distributors to earn a competitive gross margin on the sale of our products to their end customers and price protection concessions related to market pricing conditions.

We sell the majority of the items in our product catalog to our distributors worldwide at a uniform list price. However, distributors resell our products to end customers at a very broad range of individually negotiated price points. The majority of our distributors' resales require a reduction from the original list price paid. Often, under these circumstances, we remit back to the distributor a portion of their original purchase price after the resale transaction is completed in the form of a credit against the distributors' outstanding accounts receivable balance. The credits are on a per unit basis and are not given to the distributor until they provide information to us regarding the sale to their end customer. The price reductions vary significantly based on the customer, product, quantity ordered, geographic location and other factors and discounts to a price less than our cost have historically been rare. The effect of granting these credits establishes the net selling price to our distributors for the product and results in the net revenue recognized by us when the product is sold by the distributors to their end customers. Thus, a portion of the "deferred income on shipments to distributors" balance represents the amount of distributors' original purchase price that will be credited back to the distributor in the future. The wide range and variability of negotiated price concessions granted to distributors does not allow us to accurately estimate the portion of the balance in the deferred income on shipments to distributors account that will be credited back to the distributors. Therefore, we do not reduce deferred income on shipments to distributors or accounts receivable by anticipated future concessions; rather, price concessions are typically recorded against deferred income on shipments to distributors and accounts receivable when incurred, which is generally at the time the distributor sells the product. At March 31, 2013, we had approximately $201.8 million of deferred revenue and $62.8 million in deferred cost of sales recognized as $139.0 million of deferred income on shipments to distributors. At March 31, 2012, we had approximately $159.1 million of deferred revenue and $50.4 million in deferred cost of sales recognized as $108.7 million of deferred income on shipments to distributors. The deferred income on shipments to distributors that will ultimately be recognized in our income statement will be lower than the amount reflected on the balance sheet due to additional price credits to be granted to the distributors when the product is sold to their customers. These additional price credits historically have resulted in the deferred income approximating the overall gross margins that we recognize in the distribution channel of our business.

Distributor advances, reflected as a reduction of deferred income on shipments to distributors on our consolidated balance sheets, totaled $70.1 million at March 31, 2013 and $51.7 million at March 31, 2012. On sales to distributors, our payment terms generally require the distributor to settle amounts owed to us for an amount in excess of their ultimate cost. The sales price to our distributors may be higher than the amount that the distributors will ultimately owe us because distributors often negotiate price reductions after purchasing products from us and such reductions are often significant. It is our practice to apply these negotiated price discounts to future purchases, requiring the distributor to settle receivable balances, on a current basis, generally within 30 days, for amounts originally invoiced. This practice has an adverse impact on the working capital of our distributors. As such, we have entered into agreements with certain distributors whereby we advance cash to the distributors to reduce the distributor's working capital requirements. These advances are reconciled at least on a quarterly basis and are estimated based on the amount of ending inventory as reported by the distributor multiplied by a negotiated percentage. Such advances have no impact on our revenue recognition or our consolidated statements of income. We process discounts taken by distributors against our deferred income on shipments to distributors' balance and true-up the advanced amounts generally after the end of each completed fiscal quarter. The terms of these advances are set forth in binding legal agreements and are unsecured, bear no interest on unsettled balances and are due upon demand. The agreements governing these advances can be canceled by us at any time.

We reduce product pricing through price protection based on market conditions, competitive considerations and other factors. Price protection is granted to distributors on the inventory they have on hand at the date the price protection is offered. When we reduce the price of our products, it allows the distributor to claim a credit against its outstanding accounts receivable balances based on the new price of the inventory it has on hand as of the date of the price reduction. There is no immediate revenue impact from the price protection, as it is reflected as a reduction of the deferred income on shipments to distributors' balance.

Products returned by distributors and subsequently scrapped have historically been immaterial to our consolidated results of operations. We routinely evaluate the risk of impairment of the deferred cost of sales component of the deferred income on shipments to distributors account. Because of the historically immaterial amounts of inventory that have been scrapped, and historically rare instances where discounts given to a distributor result in a price less than our cost, we believe the deferred costs are recorded at their approximate carrying value.

Business Combinations

All of our business combinations are accounted for at fair value under the acquisition method of accounting. Under the acquisition method of accounting, (i) acquisition-related costs, except for those costs incurred to issue debt or equity securities, will be expensed in the period incurred; (ii) non-controlling interests will be valued at fair value at the acquisition date; (iii) in-process research and development will be recorded at fair value as an intangible asset at the acquisition date and amortized once the technology reaches technological feasibility; (iv) restructuring costs associated with a business combination will be expensed subsequent to the acquisition date; and (v) changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date will be recognized through income tax expense or directly in contributed capital. The measurement of fair value of assets acquired and liabilities assumed requires significant judgment. The valuation of intangible assets and acquired investments, in particular, requires that we use valuation techniques such as the income approach. The income approach includes the use of a discounted cash flow model, which includes discounted cash flow scenarios and requires the following significant estimates: revenue, expenses, capital spending and other costs, and discount rates based on the respective risks of the cash flows. The valuation of non-marketable equity investments acquired also takes into account variables such as conditions reflected in the capital markets, recent financing activity by the investees, the investees' capital structure and the terms of the investees' issued interests.

Share-based Compensation

We measure at fair value and recognize compensation expense for all share-based payment awards, including grants of employee stock options, restricted stock units (RSUs) and employee stock purchase rights, to be recognized in our financial statements based on their respective grant date fair values. Total share-based compensation in fiscal 2013 was $58.0 million, of which $49.8 million was reflected in operating expenses. Total share-based compensation included in cost of sales in fiscal 2013 was $8.2 million. Total share-based compensation included in our inventory balance was $4.6 million at March 31, 2013.

Determining the appropriate fair-value model and calculating the fair value of share-based awards at the date of grant requires judgment. The fair value of our RSUs is based on the fair market value of our common stock on the date of grant discounted for expected future dividends. We use the Black-Scholes option pricing model to estimate the fair value of employee stock options and rights to purchase shares under our employee stock purchase plans. Option pricing models, including the Black-Scholes model, require the use of input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. We use a blend of historical and implied volatility based on options freely traded in the open market as we believe this is most reflective of market conditions and a better indicator of expected volatility than using purely historical volatility. The expected life of the awards is based on historical and other economic data trended into the future. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our awards. The dividend yield assumption is based on our history and expectation of future dividend payouts. We estimate the number of share-based awards that will be forfeited due to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant effect on reported share-based compensation, as the effect of adjusting the rate for all expense amortization after April 1, 2006 is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate is higher or lower than the estimated forfeiture rate, then an adjustment is made to increase or decrease the estimated forfeiture rate, which will result in a decrease or increase to the expense recognized in our financial statements. If forfeiture adjustments are made, they would affect our gross margin, research and development expenses, and selling, general, and administrative expenses. The effect of forfeiture adjustments in fiscal 2013 was immaterial.

We evaluate the assumptions used to value our awards on a quarterly basis. If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees or we assume unvested equity awards in connection with acquisitions.

Inventories

Inventories are valued at the lower of cost or market using the first-in, first-out method. We write down our inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we projected, additional inventory write-downs may be required. Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable. In estimating our inventory obsolescence, we primarily evaluate estimates of demand over a 12-month period and record impairment charges for inventory on hand in excess of the estimated

12-month demand. Estimates for projected 12-month demand are generally based on the average shipments of the prior three-month period, which are then annualized to adjust for any potential seasonality in our business. The estimated 12-month demand is compared to our most recently developed sales forecast to further reconcile the 12-month demand estimate. Management reviews and adjusts the estimates as appropriate based on specific situations. For example, demand can be adjusted up for new products for which historic sales are not representative of future demand. Alternatively, demand can be adjusted down to the extent any existing products are being replaced or discontinued.

In periods where our production levels are substantially below our normal operating capacity, the reduced production levels of our manufacturing facilities are charged directly to cost of sales. As a result of decreased production in our wafer fabs, approximately $31.7 million and $6.7 million was charged directly to cost of sales in fiscal 2013 and fiscal 2012, respectively. There were no such charges in fiscal 2011.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income within the relevant jurisdiction and to the extent we believe that recovery is not likely, we must establish a valuation allowance. We have provided valuation allowances for certain of our deferred tax assets where it is more likely than not that some portion, or all of such assets, will not be realized. At March 31, 2013, the valuation allowances totaled $88.6 million and relate to foreign and state net operating loss carryforwards, capital losses, foreign tax credits and state tax credits. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. At March 31, 2013, our deferred tax asset was $80.7 million.

Various taxing authorities in the U.S. and other countries in which we do business scrutinize the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. We are currently under audit by the U.S. Internal Revenue Service (IRS) for our fiscal years 2009 and 2010 and SMSC is currently under IRS audit for fiscal years 2011 and 2012. We recognize liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. We believe that we maintain appropriate tax reserves to offset any potential tax liabilities that may arise upon these and other pending audits in the U.S. and other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than an ultimate assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

Junior Subordinated Convertible Debentures

We separately account for the liability and equity components of our junior subordinated convertible debentures in a manner that reflects our nonconvertible debt (unsecured debt) borrowing rate when interest cost is recognized. This results in a bifurcation of a component of the debt, classification of that component in equity and the accretion of the resulting discount on the debt to be recognized as part of interest expense in our consolidated statements of income. Lastly, we include the dilutive effect of the shares of our common stock issuable upon conversion of the outstanding junior subordinated convertible debentures in our diluted income per share calculation regardless of whether the market price trigger or other contingent conversion feature has been met. We apply the treasury stock method as we have the intent and have adopted an accounting policy to settle the principal amount of the junior subordinated convertible debentures in cash. This method results in incremental dilutive shares when the average fair value of our common stock for a reporting period exceeds the conversion price per share, which was $26.78 at March 31, 2013, and adjusts as dividends are recorded in the future.

Contingencies

In the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. We also periodically receive notifications from various third parties alleging infringement of patents, intellectual property rights or other matters. With respect to pending legal actions to which we are a party, although the outcomes of these actions are not generally determinable, we believe that the ultimate resolution of these matters will not have a material adverse effect on our financial position, cash flows or results of operations. Litigation relating to the semiconductor industry is not uncommon, and we are, and from time to time have been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

Results of Continuing Operations

The following table sets forth certain operational data as a percentage of net sales for the years indicated:

	Year Ended March 31,		
	2013	2012	2011
Net sales	100.0%	100.0%	100.0%
Cost of sales	47.0	42.2	40.7
Gross profit	53.0	57.8	59.3
Research and development	16.1	13.2	11.5
Selling, general and administrative	16.5	15.0	15.0
Amortization of acquired intangible assets	7.1	0.8	0.8
Special charges	2.0	0.1	0.1
Operating income	11.3%	28.7%	31.9%

Net Sales

We operate in two industry segments and engage primarily in the design, development, manufacture and marketing of semiconductor products as well as the licensing of Flash intellectual property. We sell our products to distributors and original equipment manufacturers, referred to as OEMs, in a broad range of markets, perform ongoing credit evaluations of our customers and generally require no collateral. In certain circumstances, a customer's financial condition may require collateral, and, in such cases, the collateral would be typically provided by letters of credit.

Our net sales of $1,581.6 million in fiscal 2013 increased by $198.4 million, or 14.4%, over fiscal 2012, and our net sales of $1,383.2 million in fiscal 2012 decreased by $104.0 million, or 7.0%, from fiscal 2011. The increase in net sales in fiscal 2013 over fiscal 2012 was due primarily to our acquisition of SMSC on August 2, 2012, offset in part by adverse general economic and semiconductor industry conditions. The decrease in net sales in fiscal 2012 from fiscal 2011 was due primarily to weak general economic and semiconductor industry conditions. Average selling prices for our semiconductor products were up approximately 5% in fiscal 2013 over fiscal 2012 and were essentially flat in fiscal 2012 over fiscal 2011. The number of units of our semiconductor products sold was up approximately 10% in fiscal 2013 over fiscal 2012 and down approximately 8% in fiscal 2012 over fiscal 2011. The increase in the number of units of our semiconductor products sold and our average selling prices in fiscal 2013 was a result of our acquisition of SMSC. The average selling prices and the unit volumes of our sales are impacted by the mix of our products sold and overall semiconductor market conditions. Key factors impacting the amount of net sales during the last three fiscal years include:

- our acquisition of SMSC whose net sales included in our consolidated statements of income was approximately $234.3 million in fiscal 2013;
- global economic conditions in the markets we serve;
- semiconductor industry conditions;
- inventory holding patterns of our customers;
- increasing semiconductor content in our customers' products;
- customers' increasing needs for the flexibility offered by our programmable solutions;
- our new product offerings that have increased our served available market; and
- continued market share gains in the segments of the markets we address.

Sales by product line for the fiscal years ended March 31, 2013, 2012 and 2011 were as follows (dollars in thousands):

	Year Ended March 31,					
	2013	%	2012	%	2011	%
Microcontrollers	$ 1,035,514	65.5	$ 928,509	67.1	$ 1,013,937	68.2
Analog, interface and mixed signal products	307,723	19.4	171,165	12.4	177,994	12.0
Memory products	142,557	9.0	179,217	13.0	221,219	14.9
Technology licensing	83,803	5.3	87,001	6.3	72,068	4.8
Other	12,026	0.8	17,284	1.2	1,987	0.1
Total Sales	$ 1,581,623	100.0	$ 1,383,176	100.0	$ 1,487,205	100.0

Microcontrollers

Our microcontroller product line represents the largest component of our total net sales. Microcontrollers and associated application development systems accounted for approximately 65.5% of our total net sales in fiscal 2013, approximately 67.1% of our total net sales in fiscal 2012 and 68.2% of our total net sales in fiscal 2011.

Net sales of our microcontroller products increased approximately 11.5% in fiscal 2013 compared to fiscal 2012, and decreased approximately 8.4% in fiscal 2012 compared to fiscal 2011. The increase in net sales in fiscal 2013 compared to fiscal 2012 resulted primarily from our acquisition of SMSC and market share gains which offset weak general economic and semiconductor industry conditions in the end markets that we serve including the consumer, automotive, industrial control, communications and computing markets. The decrease in net sales in fiscal 2012 compared to fiscal 2011 resulted primarily from changes in general economic and semiconductor industry conditions in the end markets that we serve.

Historically, average selling prices in the semiconductor industry decrease over the life of any particular product. The overall average selling prices of our microcontroller products have remained relatively constant over time due to the proprietary nature of these products. We have experienced, and expect to continue to experience, moderate pricing pressure in certain microcontroller product lines, primarily due to competitive conditions. We have in the past been able to, and expect in the future to be able to, moderate average selling price declines in our microcontroller product lines by introducing new products with more features and higher prices. We may be unable to maintain average selling prices for our microcontroller products as a result of increased pricing pressure in the future, which could adversely affect our operating results.

Analog, Interface and Mixed Signal Products

Sales of our analog, interface and mixed signal products accounted for approximately 19.4% of our total net sales in fiscal 2013, approximately 12.4% of our total net sales in fiscal 2012 and approximately 12.0% of our total net sales in fiscal 2011.

Net sales of our analog, interface and mixed signal products increased approximately 79.8% in fiscal 2013 compared to fiscal 2012 and decreased approximately 3.8% in fiscal 2012 compared to fiscal 2011. The increase in net sales in fiscal 2013 compared to fiscal 2012 was driven primarily by our acquisition of SMSC and market share gains achieved within the analog, interface and mixed signal market. The decrease in net sales in fiscal 2012 compared to fiscal 2011 was driven primarily by weak general economic and semiconductor industry conditions which offset market share gains achieved within the analog, interface and mixed signal market.

Analog, interface and mixed signal products can be proprietary or non-proprietary in nature. Currently, we consider more than 80% of our analog, interface and mixed signal product mix to be proprietary in nature, where prices are relatively stable, similar to the pricing stability experienced in our microcontroller products. The non-proprietary portion of our analog, interface and mixed signal business will experience price fluctuations, driven primarily by the current supply and demand for those products. We may be unable to maintain the average selling prices of our analog, interface and mixed signal products as a result of increased pricing pressure in the future, which could adversely affect our operating results. We anticipate the proprietary portion of our analog, interface and mixed signal products will increase over time.

Memory Products

Sales of our memory products accounted for approximately 9.0% of our total net sales in fiscal 2013, approximately 13.0% of our total net sales in fiscal 2012 and approximately 14.9% of our total net sales in fiscal 2011.

Net sales of our memory products decreased approximately 20.5% in fiscal 2013 compared to fiscal 2012, and decreased approximately 19.0% in fiscal 2012 compared to fiscal 2011. The decreases in memory product net sales in fiscal 2013 compared to fiscal 2012 and fiscal 2012 compared to fiscal 2011 were driven primarily by adverse customer demand conditions within the Serial EEPROM and Flash memory markets and weak general economic and semiconductor industry conditions.

Memory product pricing has historically been cyclical in nature, with steep price declines followed by periods of relative price stability, driven by changes in industry capacity at different stages of the business cycle. We have experienced, and expect to continue to experience, varying degrees of competitive pricing pressures in our memory products. We may be unable to maintain the average selling prices of our memory products as a result of increased pricing pressure in the future, which could adversely affect our operating results.

Technology Licensing

Technology licensing revenue includes a combination of royalties associated with technology licensed for the use of our SuperFlash technology and fees for engineering services. Technology licensing accounted for approximately 5.3% of our total net sales in fiscal 2013, approximately 6.3% of our total net sales in fiscal 2012 and approximately 4.8% of our total net sales in fiscal 2011.

Net sales related to our technology licensing decreased approximately 3.7% in fiscal 2013 compared to fiscal 2012 and increased approximately 20.7% in fiscal 2012 compared to fiscal 2011. The decrease in technology licensing net sales in fiscal 2013 compared to fiscal 2012 was due primarily to adverse semiconductor industry and global economic conditions. The increase in technology licensing net sales in fiscal 2012 compared to fiscal 2011 was driven primarily by the adoption of our technology by more manufacturers of semiconductors.

Other

Revenue from assembly and test subcontracting services accounted for approximately 0.8% of our total net sales in fiscal 2013, approximately 1.2% of our total net sales in fiscal 2012 and approximately 0.1% of our total net sales in fiscal 2011.

Distribution

Distributors accounted for approximately 53% of our net sales in fiscal 2013, approximately 59% of our net sales in fiscal 2012 and approximately 58% of our net sales in fiscal 2011. The decrease in distributor net sales in fiscal 2013 compared to prior periods was driven primarily by our acquisition of SMSC which makes a larger percentage of its net sales to OEM customers rather than through distributors.

Our largest distributor, Future Electronics, accounted for approximately 10% of our net sales in each of fiscal 2012 and fiscal 2011. Our two largest distributors together accounted for approximately 13% of our net sales in fiscal 2013 and approximately 14% of our net sales in each of fiscal 2012 and fiscal 2011. No other distributor accounted for more than 10% of our net sales in fiscal 2013, fiscal 2012 or fiscal 2011.

Generally, we do not have long-term agreements with our distributors and we, or our distributors, may terminate our relationship with each other with little or no advanced notice. The loss of, or the disruption in the operations of, one or more of our distributors could reduce our future net sales in a given quarter and could result in an increase in inventory returns.

At March 31, 2013, our distributors maintained 30 days of inventory of our products compared to 31 days at March 31, 2012 and 40 days at March 31, 2011. Over the past three fiscal years, the days of inventory maintained by our distributors have fluctuated between approximately 27 days and 47 days. We do not believe that inventory holding patterns at our distributors will materially impact our net sales, due to the fact that we recognize revenue based on sell-through for all of our distributors.

Net Sales by Geography

Net sales by geography for the fiscal years ended March 31, 2013, 2012 and 2011 were as follows (dollars in thousands):

	Year Ended March 31,					
	2013	%	2012	%	2011	%
Americas	$ 313,574	19.8	$ 290,392	21.0	$ 310,735	20.9
Europe	344,398	21.8	319,881	23.1	334,911	22.5
Asia	923,651	58.4	772,903	55.9	841,559	56.6
Total Net Sales	$ 1,581,623	100.0	$ 1,383,176	100.0	$ 1,487,205	100.0

Our sales to foreign customers have been predominately in Asia and Europe, which we attribute to the manufacturing strength in those areas for automotive, communications, computing, consumer and industrial control products. Americas sales include sales to customers in the U.S., Canada, Central America and South America.

Sales to foreign customers accounted for approximately 83% of our net sales in fiscal 2013, approximately 82% of our net sales in fiscal 2012 and approximately 80% of our net sales in fiscal 2011. Substantially all of our foreign sales are U.S. dollar denominated. Sales to customers in Asia have generally increased over time due to many of our customers transitioning their manufacturing operations to Asia and growth in demand from the emerging Asian market as well as acquisitions such as SMSC which had a significant concentration of sales in Asia. Our sales force in the Americas and Europe supports a significant portion of the design activity for products which are ultimately shipped to Asia.

Sales to customers in China, including Hong Kong, accounted for approximately 27% of our net sales in fiscal 2013 and approximately 24% of our net sales in fiscal 2012 and approximately 25% in fiscal 2011. Sales to customers in Taiwan accounted for approximately 13% of our net sales in fiscal 2013, approximately 15% of our net sales in fiscal 2012 and approximately 13% of our net sales in fiscal 2011. We did not have sales into any other countries that exceeded 10% of our net sales during the last three fiscal years.

Gross Profit

Our gross profit was $838.5 million in fiscal 2013, $799.3 million in fiscal 2012 and $881.3 million in fiscal 2011. Gross profit as a percent of sales was 53.0% in fiscal 2013, 57.8% in fiscal 2012 and 59.3% in fiscal 2011.

The most significant factors affecting our gross profit percentage in the periods covered by this report were:

- charges of approximately $53.6 million in fiscal 2013 related to the recognition of acquired inventory at fair value as a result of our acquisitions which reduced our gross margins;
- production levels being below the range of our normal capacity, resulting in under absorption of fixed costs, in fiscal 2013 and the second half of fiscal 2012 compared to production levels being at or above the range of our normal capacity levels in the first half of fiscal 2012 and all of fiscal 2011;
- for each of fiscal 2013 and fiscal 2012, inventory write-downs being higher than the gross margin impact of sales of inventory that was previously written down; and
- fluctuations in the product mix of microcontrollers, analog products, memory products and technology licensing.

Other factors that impacted our gross profit percentage in the periods covered by this report include:

- continual cost reductions in wafer fabrication and assembly and test manufacturing, such as new manufacturing technologies and more efficient manufacturing techniques; and
- lower depreciation as a percentage of cost of sales.

We adjust our wafer fabrication and assembly and test capacity utilization as required to respond to actual and anticipated business and industry-related conditions. When production levels are below normal capacity, we charge cost of sales for the unabsorbed capacity. Our wafer fabrication facilities operated below normal capacity levels, which we typically consider to be 90% to 95% of the actual capacity of the installed equipment, during fiscal 2013 and the second half of fiscal 2012 in response to weak economic conditions. During fiscal 2011 and the first half of fiscal 2012, we operated at or above normal capacity levels in our wafer fabrication facilities. As a result of decreased production in our wafer fabs, approximately $31.7 million was charged to cost of sales in fiscal 2013 and approximately $6.7 million was charged to cost of sales in fiscal 2012. In the future, if production levels are below normal capacity, we will charge cost of sales for the unabsorbed capacity. Similar to our wafer fabs, during fiscal 2013 and the second half of fiscal 2012, we operated at levels below the total operating capacity of our Thailand assembly and test facility due to adverse business conditions and these actions had a negative impact on our gross margins. During the first half of fiscal 2012 and all of fiscal 2011, we operated at normal levels of capacity at our Thailand assembly and test facility, and we selectively increased our assembly and test capacity at such facility during such time.

The process technologies utilized in our wafer fabs impact our gross margins. Fab 2 currently utilizes various manufacturing process technologies, but predominantly utilizes our 0.5 to 1.0 micron processes. Fab 4 predominantly utilizes our 0.22 to 0.5 micron processes. We continue to transition products to more advanced process technologies to reduce future manufacturing costs. All of our production has been on 8-inch wafers during the periods covered by this report.

Our overall inventory levels were $242.3 million at March 31, 2013, compared to $217.3 million at March 31, 2012 and $180.8 million at March 31, 2011. We maintained 116 days of inventory on our balance sheet at March 31, 2013 compared to 138 days of inventory at March 31, 2012 and 108 days at March 31, 2011. We expect our inventory levels in the June 2013 quarter to increase modestly from the March 2013 levels due to projected higher wafer purchases from third-party foundries. We believe our existing level of inventory will allow us to maintain competitive lead times and provide strong delivery performance to our customers and allow us to keep our fiscal 2014 capital expenditures at relatively low levels.

We anticipate that our gross margins will fluctuate over time, driven primarily by capacity utilization levels, the overall product mix of microcontroller, analog, interface and mixed signal products, memory products and technology licensing revenue and the percentage of net sales of each of these products in a particular quarter, as well as manufacturing yields, fixed cost absorption, and competitive and economic conditions in the markets we serve.

During the fourth quarter of fiscal 2013, approximately 56% of our assembly requirements were performed in our Thailand facilities, compared to approximately 67% during the fourth quarter of fiscal 2012 and approximately 61% during the fourth quarter of fiscal 2011. The percentage of our assembly work that is performed internally fluctuates over time based on supply and demand conditions in the semiconductor industry and our internal capacity capabilities. Third-party contractors located in Asia perform the balance of our assembly operations. During the fourth quarter of fiscal 2013, approximately 84% of our test requirements were performed in our Thailand facilities compared to approximately 95% during the fourth quarter of fiscal 2012 and approximately 88% during the fourth quarter of fiscal 2011. We believe that the assembly and test operations performed at our Thailand facility provide us with significant cost savings compared to contractor assembly and test costs, as well as increased control over these portions of the manufacturing process. SMSC had historically outsourced the majority of its assembly and test activities. We plan to bring some of SMSC's assembly and test activities into our Thailand facilities over time.

We have, in recent years, outsourced a larger portion of our wafer production requirements to third-party wafer foundries to augment our internal manufacturing capabilities. As a result of our acquisitions of SMSC in August 2012 and Silicon Storage Technology (SST) in April 2010, we have become more reliant on outside wafer foundries for our wafer fabrication requirements. In fiscal 2013 and the fourth quarter of fiscal 2013, approximately 33% and 38% of our sales came from products that were produced at outside wafer foundries.

Our use of third parties involves some reduction in our level of control over the portions of our business that we subcontract. While we review the quality, delivery and cost performance of our third-party contractors, our future operating results could suffer if any third-party contractor is unable to maintain manufacturing yields, assembly and test yields and costs at approximately their current levels.

Research and Development (R&D)

R&D expenses for fiscal 2013 were $254.7 million, or 16.1% of sales, compared to $182.7 million, or 13.2% of sales, for fiscal 2012 and $170.6 million, or 11.5% of sales, for fiscal 2011. We are committed to investing in new and enhanced products, including development systems software, and in our design and manufacturing process technologies. We believe these investments are significant factors in maintaining our competitive position. R&D costs are expensed as incurred. Assets purchased to support our ongoing research and development activities are capitalized when related to products which have achieved technological feasibility or that have alternative future uses and are amortized over their expected useful lives. R&D expenses include labor, depreciation, masks, prototype wafers, and expenses for the development of process technologies, new packages, and software to support new products and design environments.

R&D expenses increased $72.1 million, or 39.5%, for fiscal 2013 over fiscal 2012. The primary reasons for the dollar increase in R&D costs in fiscal 2013 compared to fiscal 2012 were additional costs from our acquisition of SMSC and higher headcount costs. R&D expenses increased $12.1 million, or 7.1%, for fiscal 2012 over fiscal 2011. The primary reasons for the dollar increase in R&D costs in fiscal 2012 compared to fiscal 2011 were an increased number of employees driving higher employee costs and higher discretionary expenses offset by lower bonus costs.

In the June 2013 quarter, we expect R&D expenses to be relatively flat with the March 2013 quarter and for such expenses to decrease as a percentage of net sales due to operational efficiencies and continued synergies of integrating our acquisition of SMSC.

Selling, General and Administrative

Selling, general and administrative expenses for fiscal 2013 were $261.5million, or 16.5% of sales, compared to $208.3 million, or 15.1% of sales, for fiscal 2012, and $222.2 million, or 14.9% of sales, for fiscal 2011. Selling, general and administrative expenses include salary expenses related to field sales, marketing and administrative personnel, advertising and promotional expenditures and legal expenses. Selling, general and administrative expenses also include costs related to our direct sales force and field applications engineers who work in sales offices worldwide to stimulate demand by assisting customers in the selection and use of our products.

Selling, general and administrative expenses increased $53.2 million, or 25.5%, for fiscal 2013 over fiscal 2012. The primary reason for the dollar increase in selling, general and administrative expenses in fiscal 2013 over fiscal 2012 were additional costs from our acquisition of SMSC. Selling, general and administrative expenses decreased $13.9 million, or 6.2%, for fiscal 2012 over fiscal 2011. The primary reasons for the dollar decrease in selling, general and administrative expenses in fiscal 2012 over fiscal 2011 were lower bonus costs.

Selling, general and administrative expenses fluctuate over time, primarily due to revenue and operating expense investment levels.

Special Charges

Acquisition Related Expenses

During fiscal 2013, we incurred special charges of $32.2 million comprised of a $4.4 million net increase in the fair value of contingent consideration related to one of our acquisitions, $16.3 million of primarily severance-related costs in addition to office closing, and other costs associated with the acquisition of SMSC and legal settlement costs of approximately $11.5 million for certain legal matters related to SST (which we acquired in April 2010) in excess of previously accrued amounts. During fiscal 2012, special charges included a benefit of $0.7 million comprised of a $1.0 million favorable adjustment to contingent consideration offset by $0.3 million of severance-related charges related to a prior year acquisition. During fiscal 2011, we incurred $1.9 million of severance-related and office closure costs associated with our acquisition of SST.

Patent Licenses

During the fourth quarter of fiscal 2012, we agreed to the terms of a patent license with an unrelated third party and signed an agreement on March 20, 2012. The patent license settled alleged infringement claims. The total payment made to the third-party in March 2012 was $2.8 million, $1.5 million of which was expensed in the fourth quarter of fiscal 2012 and the remaining $1.3 million was recorded as a prepaid royalty which will be amortized over the remaining life of the patents, which expire in December 2018.

Other Income (Expense)

Interest income in fiscal 2013 decreased to $15.6 million from $18.0 million in fiscal 2012 and from $16.0 million in fiscal 2011. The primary reasons for the decrease in interest income for fiscal 2013 over fiscal 2012 relates to lower yields on short-term cash investments and lower invested cash balances. The primary reasons for the increase in interest income in fiscal 2012 over fiscal 2011 relates to the redemption of a previously written down auction rate security at par value and higher invested cash balances. Interest expense in fiscal 2013 was $40.9 million compared to $34.3 million in fiscal 2012 and $31.5 million in fiscal 2011. The primary reasons for the increase in interest expense in fiscal 2013 over fiscal 2012 relates to increased borrowings under our credit facility to partially finance our acquisition of SMSC. Other expense, net in fiscal 2013 was $0.4 million compared to other expense, net of $0.4 million in fiscal 2012 and other income, net of $1.9 million in fiscal 2011. The change in other (expense) income, net during fiscal 2012 compared to fiscal 2011 primarily relates to $1.3 million of losses on equity securities during fiscal 2012 compared to $2.4 million of gains on equity securities during fiscal 2011. These losses and gains were a result of impairment charges due to market fluctuations in the value of certain investments in publicly traded companies, as well as dividends received and losses and gains recognized on the sale of these equity securities.

Provision for Income Taxes

Provisions for income taxes reflect tax on our foreign earnings and federal and state tax on our U.S. earnings. Our effective tax rate on income from continuing operations was 16.3% in fiscal 2013, 11.3% in fiscal 2012 and 6.8% in fiscal 2011. Excluding one-time tax events described below, our effective tax rates were lower than statutory rates in the U.S. primarily due to our mix of earnings in foreign jurisdictions with lower tax rates, changes in tax regulations and the R&D tax credit. During fiscal 2013, our effective tax rate was higher due to $27.2 million of one-time foreign and domestic tax implications from our acquisition of SMSC, which offset an $8.1 million benefit received from the reinstatement of the R&D credit and $9.7 million of other non-recurring tax events including releases of previously established tax reserves related to audit closures and expirations of statutes of limitations and the revaluation of deferred tax assets and liabilities. These items increased our effective tax rate from continuing operations by 6.2% to an effective tax rate of 16.3%. During fiscal 2012, we completed a project that led to additional R&D tax credit claims in the amount of $4.1 million which reduced our effective tax rate by 1.1% to 11.3%. Our effective tax rate in fiscal 2011 includes a $24.4 million benefit related to various items including a settlement with the IRS for our fiscal 2006 through fiscal 2008 tax audits, the expiration of the statute of limitations on various tax reserves, and a charge related to a corporate restructuring. This benefit reduced our effective tax rate from continuing operations by 5.4 percentage points to an effective tax rate of 6.8%.

Various taxing authorities in the U.S. and other countries in which we do business are increasing their scrutiny of the tax structures employed by businesses. Companies of our size and complexity are regularly audited by the taxing authorities in the jurisdictions in which they conduct significant operations. We are currently under audit by the IRS for our fiscal years 2009 and 2010, and SMSC is under audit for fiscal years 2011 and 2012. We recognize liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. We believe that we maintain adequate tax reserves to offset any potential tax liabilities that may arise upon these and other pending audits in the U.S. and other countries in which we do business. If such amounts ultimately prove to be unnecessary, the resulting reversal of such reserves would result in tax benefits being recorded in the period the reserves are no longer deemed necessary. If such amounts ultimately prove to be less than any final assessment, a future charge to expense would be recorded in the period in which the assessment is determined.

Our Thailand manufacturing operations currently benefit from numerous tax holidays that have been granted to us by the Thailand government based on our investments in property, plant and equipment in Thailand. Our tax holiday periods in Thailand expire at various times in the future and any expiration of our tax holidays in Thailand are expected to have a minimal impact on our overall tax expense due to other tax holidays and increases in income in other taxing jurisdictions with lower statutory rates.

Results of Discontinued Operations

As a result of our acquisition of SST, certain of SST's product lines were marketed for sale based on management's decision regarding them not being a strategic fit into our product portfolio. The discontinued businesses include various memory product lines. For financial statement purposes, the net assets and results of operations for these discontinued businesses have been segregated from those of the continuing operations and are presented in our consolidated financial statements as discontinued operations and assets held for sale. On May 21, 2010, we completed a transaction to sell one of the businesses acquired from SST to Greenliant Systems, Ltd. The sale price in this transaction was determined by management to represent fair value, and accordingly, no gain or loss was recognized on the sale of the net assets. In this sale, we disposed of approximately $23.6 million of assets held for sale, primarily comprised of inventory, property, plant and equipment, intangible assets and non-marketable securities. Consideration in the transaction was in the form of cash and notes receivable from Greenliant Systems, Ltd. On July 8, 2010, we granted an exclusive limited license for certain Serial NOR-Flash products to Professional Computer Technology, Ltd. (PCT). The license is limited to certain industry segments and geographic regions and excludes certain multinational customers. PCT has no license to sell these products to any other industry segment or geographic region other than as set forth in our agreement with them.

The net loss from discontinued operations in fiscal 2011 was $10.2 million, or $0.05 per diluted share. Contributing to the net loss from discontinued operations in fiscal 2011 was $9.4 million of inventory write-downs related to discontinued operations. There were no assets held for sale on our consolidated balance sheet for the fiscal years ended March 31, 2013 or March 31, 2012.

Liquidity and Capital Resources

We had $1,836.0 million in cash, cash equivalents and short-term and long-term investments at March 31, 2013, an increase of $48.5 million from the March 31, 2012 balance. The increase in cash, cash equivalents and short-term and long-term investments over this time period is primarily attributable to cash generated by operating activities being offset by dividend payments of $273.8 million and cash used for our acquisitions, net of proceeds received from our line of credit, of $132.3 million.

Net cash provided from operating activities was $446.2 million for fiscal 2013, $396.5 million for fiscal 2012 and $582.7 million for fiscal 2011. The increase in cash flow from operations in fiscal 2013 compared to fiscal 2012 was primarily due to changes in our operating assets and liabilities. The decrease in cash flow from operations in fiscal 2012 compared to fiscal 2011 was primarily due to changes in our operating assets and liabilities and lower net income in fiscal 2012.

Net cash used in investing activities was $936.8 million for fiscal 2013, $256.5 million for fiscal 2012 and $187.9 million in fiscal 2011. The increase in net cash used in investing activities in fiscal 2013 compared to fiscal 2012 was primarily due to $731.7 million of cash consideration, net of $180.9 million of cash and cash equivalents acquired, used for our acquisition of SMSC. The increase in net cash used in investing activities in fiscal 2012 compared to fiscal 2011 was primarily due to a decrease in cash related to changes in our net purchases, sales and maturities of short-term and long-term investments which offset lower capital expenditures in fiscal 2012.

Our level of capital expenditures varies from time to time as a result of actual and anticipated business conditions. Capital expenditures were $50.8 million in fiscal 2013, $62.4 million in fiscal 2012 and $124.5 million in fiscal 2011. The lower capital expenditure activity in fiscal 2013 compared to fiscal 2012 was primarily driven by decreased production requirements as a result of uncertain economic conditions. Capital expenditures are primarily for the expansion of production capacity and the addition of research and development equipment. We currently intend to spend approximately $80 million during the next twelve months to invest in equipment and facilities to maintain, and selectively increase, capacity to meet our currently anticipated needs.

We expect to finance our capital expenditures through our existing cash balances and cash flows from operations. We believe that the capital expenditures anticipated to be incurred over the next twelve months will provide sufficient manufacturing capacity to meet our currently anticipated needs.

Net cash provided by financing activities was $382.2 million for fiscal 2013. Net cash used in financing activities was $208.1 million for fiscal 2012 and $183.0 million for fiscal 2011. We received cash proceeds from borrowings under our credit agreement of $620.0 million during fiscal 2013 which was used to partially finance our acquisition of SMSC. We paid cash dividends to our shareholders of $273.8 million in fiscal 2013, $266.2 million in fiscal 2012, and $256.8 million in fiscal 2011. Proceeds from the exercise of stock options and employee purchases under our employee stock purchase plans were $35.7 million for fiscal 2013, $57.5 million for fiscal 2012 and $71.9 million for fiscal 2011.

On August 12, 2011, we entered into a credit agreement with certain lenders. The credit agreement provides for a $750 million revolving credit facility, with a $100 million foreign currency sublimit, a $25 million letter of credit sublimit and a $15 million swingline loan sublimit, terminating on August 12, 2016. The credit agreement also contains an increase option permitting us, subject to certain requirements, to arrange with existing lenders and/or new lenders for them to provide up to an aggregate of $250 million in additional commitments, which may be for revolving loans or term loans. Proceeds of loans made under the credit agreement may be used for working capital and general corporate purposes. At March 31, 2013, $620.0 million of borrowings were outstanding under the credit agreement. See Note 16 of the notes to consolidated financial statements for more information regarding the credit agreement.

On August 2, 2012, we closed our acquisition of SMSC, and SMSC became a wholly owned subsidiary of Microchip. Upon the closing of the acquisition, each share of common stock of SMSC was cancelled and automatically converted into the right to receive $37.00 in cash, without interest and less any applicable withholding taxes. We financed the transaction using approximately $312.7 million of our existing balance of cash, cash equivalents and short-term investments and borrowings of approximately $600.0 million under our existing credit agreement. At August 2, 2012, SMSC had approximately $205.2 million of cash, cash equivalents and long-term investments on its balance sheet.

Our total cash, cash equivalents, short-term investments and long-term investments held by our foreign subsidiaries was $1,782.0 million at March 31, 2013 and $1,381.1 million at March 31, 2012. Under current tax laws and regulations, if accumulated earnings and profits held by our foreign subsidiaries that U.S. taxes had not previously been provided for were to be distributed to the U.S. in the form of dividends or otherwise, we would be subject to additional U.S. income taxes and foreign withholding taxes. The balance of cash, cash equivalents, short-term investments and long-term investments available for our U.S. operations as of March 31, 2013 and March 31, 2012 was approximately $100.0 million and $406.5 million, respectively. We utilize a variety of tax planning and financing strategies with the objective of having our worldwide cash available in the locations in which it is needed. We believe our offshore earnings are permanently reinvested offshore. However, there can be no assurance that we will not determine to repatriate some of our offshore earnings in future periods to fund stockholder dividends, share repurchases, acquisitions or other corporate activities in the future. We expect that a significant portion of our future cash generation will be in our foreign subsidiaries.

We enter into derivative transactions from time to time in an attempt to reduce our exposure to currency rate fluctuations. Although none of the countries in which we conduct significant foreign operations have had a highly inflationary economy in the last five years, there is no assurance that inflation rates or fluctuations in foreign currency rates in countries where we conduct operations will not adversely affect our operating results in the future. At March 31, 2013, we had $6.0 million in notional amount of foreign currency-forward contracts outstanding.

On December 11, 2007, we announced that our Board of Directors had authorized the repurchase of up to 10 million shares of our common stock in the open market or in privately negotiated transactions. As of March 31, 2013, we had repurchased 7.5 million shares under this 10 million share authorization for a total of $234.7 million. There is no expiration date associated with this program. The timing and amount of future repurchases will depend upon market conditions, interest rates, and corporate considerations.

As of March 31, 2013, we held approximately 22.3 million shares as treasury shares.

On October 28, 2002, we announced that our Board of Directors had approved and instituted a quarterly cash dividend on our common stock. The initial quarterly dividend of $0.02 per share was paid on December 6, 2003 in the amount of $4.1 million. To date, our cumulative dividend payments have totaled approximately $1.95 billion. During fiscal 2013, we paid dividends in the amount of $1.406 per share for a total dividend payment of $273.8 million. During fiscal 2012, we paid dividends in the amount of $1.390 per share for a total dividend payment of $266.2 million. During fiscal 2011, we paid dividends in the amount of $1.374 per share for a total dividend payment of $256.8 million. On May 2, 2013, we declared a quarterly cash dividend of $0.3535 per share, which will be paid on June 4, 2013, to stockholders of record on May 21, 2013 and the total amount of such dividend is expected to be approximately $69.6 million. Our Board is free to change our dividend practices at any time and to increase or decrease the dividend paid, or not to pay a dividend, on our common stock on the basis of our results of operations, financial condition, cash requirements and future prospects, and other factors deemed relevant by our Board. Our current intent is to provide for ongoing quarterly cash dividends depending upon market conditions and our results of operations.

We believe that our existing sources of liquidity combined with cash generated from operations will be sufficient to meet our currently anticipated cash requirements for at least the next 12 months. However, the semiconductor industry is capital intensive. In order to remain competitive, we must constantly evaluate the need to make significant investments in capital equipment for both production and research and development. We may further borrow under our credit agreement, expand our credit agreement or seek additional equity or debt financing from time to time to increase our level of domestic cash to fund dividends, share repurchases or acquisitions, or to maintain or expand our wafer fabrication and product assembly and test facilities, or for other purposes. The timing and amount of any such financing requirements will depend on a number of factors, including our level of dividend payments, changes in tax laws and regulations regarding the repatriation of offshore cash, demand for our products, changes in industry conditions, product mix, competitive factors and our ability to identify suitable acquisition candidates. There can be no assurance that such financing will be available on acceptable terms, and any additional equity financing would result in incremental ownership dilution to our existing stockholders.

Contractual Obligations

The following table summarizes our significant contractual obligations at March 31, 2013, and the effect such obligations are expected to have on our liquidity and cash flows in future periods. This table excludes amounts already recorded on our balance sheet as current liabilities at March 31, 2013 (dollars in thousands):

	Payments Due by Period				
	Total	Less than 1 year	1 – 3 years	3 – 5 years	More than 5 years
Operating lease obligations	$ 71,071	$ 13,344	$ 21,451	$ 16,591	$ 19,685
Capital purchase obligations (1)	28,011	28,011	—	—	—
Other purchase obligations and commitments (2)	57,719	56,413	1,306	—	—
Borrowings under credit agreement outstanding as of March 31, 2013 - principal and interest (3)	662,026	12,152	24,304	625,570	—
2.125% junior convertible debentures – principal and interest(4)	1,753,810	24,438	48,875	48,875	1,631,622
Total contractual obligations (5)	$ 2,572,637	$ 134,358	$ 95,936	$ 691,036	$ 1,651,307

(1) Capital purchase obligations represent commitments for construction or purchases of property, plant and equipment. These obligations were not recorded as liabilities on our balance sheet as of March 31, 2013, as we have not yet received the related goods or taken title to the property.

(2) Other purchase obligations and commitments include payments due under various types of licenses and outstanding purchase commitments with our wafer foundries of approximately $55.3 million for delivery of wafers in fiscal 2014.

(3) For purposes of this table we have assumed that the principal of our credit agreement borrowings outstanding at March 31, 2013 will be paid on August 12, 2016, which is the maturity date of such borrowings.

(4) For purposes of this table we have assumed that the principal of our convertible debentures will be paid on December 31, 2037.

(5) Total contractual obligations do not include contractual obligations recorded on the balance sheet as current liabilities, or certain purchase obligations as discussed below. The contractual obligations also do not include amounts related to uncertain tax positions because reasonable estimates cannot be made.

Purchase orders or contracts for the purchase of raw materials and other goods and services, with the exception of commitments to our wafer foundries, are not included in the table above. We are not able to determine the aggregate amount of such purchase orders that represent contractual obligations, as purchase orders may represent authorizations to purchase rather than binding agreements. For the purpose of this table, contractual obligations for the purchase of goods or services are defined as agreements that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Our purchase orders are based on our current manufacturing needs and are fulfilled by our vendors with short time horizons. We do not have significant agreements for the purchase of raw materials or other goods specifying minimum quantities or set prices that exceed our expected requirements for three months. We also enter into contracts for outsourced services; however, the obligations under these contracts were not significant and the contracts generally contain clauses allowing for cancellation without significant penalty.

The expected timing of payment of the obligations discussed above is estimated based on current information. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services or changes to agreed-upon amounts for some obligations.

Off-Balance Sheet Arrangements

As of March 31, 2013, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Recently Issued Accounting Pronouncements

In February 2013, the FASB issued an amendment to the existing guidance to clarify the reclassification requirements from accumulated other comprehensive income to net income. This amendment requires disclosure of amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present either on the face of the financial statements or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount is reclassified in its entirety to net income in the same reporting period. For amounts not reclassified in their entirety to net income, an entity is required to cross-reference to the related note on the face of the financial statements for additional information. These amendments are effective for interim and annual periods beginning after December 15, 2012, which for us is the first quarter of fiscal year 2014. These changes are required to be applied prospectively. We do not anticipate that the adoption of this amendment will have a material impact on our consolidated financial statements and related disclosures.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations, and delivers an appropriate yield in relationship to our investment guidelines and market conditions. Our investment portfolio, consisting of fixed income securities, money market funds, cash deposits, and marketable securities that we hold on an available-for-sale basis, was $1,836.0 million as of March 31, 2013 compared to $1,787.6 million as of March 31, 2012. The available-for-sale debt securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. We have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize any material adverse impact in income or cash flows if market interest rates increase. The following table provides information about our available-for-sale securities that are sensitive to changes in interest rates. We have aggregated our available-for-sale securities for presentation purposes since they are all very similar in nature (dollars in thousands):

	Financial instruments maturing during the fiscal year ended March 31,					
	2014	2015	2016	2017	2018	Thereafter
Available-for-sale securities	$ 352,279	$ 290,359	$ 462,073	$ 36,958	$ 10,016	$ 144,328
Weighted-average yield rate	1.48%	1.37%	0.57%	0.81%	0.45%	0.86%

At March 31, 2013, $33.8 million of the fair value of our investment portfolio was invested in ARS. With the continuing liquidity issues in the global credit and capital markets, our ARS have experienced multiple failed auctions and are not liquid. While we continue to earn interest on these investments based on a pre-determined formula with spreads tied to particular interest rate indices, the estimated market value for a portion of these ARS no longer approximates the original purchase value.

The fair value of the failed ARS of $33.8 million has been estimated based on market information and estimates determined by management and could change significantly based on market conditions. We evaluated the impairments in the value of these ARS, determining our intent to sell these securities prior to the recovery of our amortized cost basis, which resulted in some of the securities being other-than-temporarily impaired and recognized impairment charges on these investments of $0.4 million in fiscal 2013. In fiscal 2012, we recognized a $0.3 million gain on our ARS positions as a gain on redemption at par value of one ARS position offset impairment charges recognized during the year. If the issuers are unable to successfully close future auctions or if their credit ratings deteriorate further, we may be required to further adjust the carrying value of the investments through an additional impairment charge to earnings.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements listed in the index appearing under Item 15(a)(1) hereof are filed as part of this Form 10-K. See also Index to Financial Statements below.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Annual Report on Form 10-K, as required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), we evaluated under the supervision of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Exchange Act. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we