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

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes that appear elsewhere in this Annual Report on Form 10-K. In addition to historical information, the following discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results may differ substantially and adversely from those referred to herein due to a number of factors, including but not limited to those described below and in Item 1A "Risk Factors" and elsewhere in this Annual Report on Form 10-K.*

### OVERVIEW

We, together with our consolidated subsidiaries, are empowering the wireless networking revolution. Our highly innovative analog semiconductors are connecting people, places, and things spanning a number of new and previously unimagined applications within the automotive, broadband, cellular infrastructure, connected home, industrial, medical, military, smartphone, tablet and wearable markets. Our key customers include Arris, Bose, Cisco, Dell, Ericsson, Foxconn, Fujitsu, General Electric, Google, Honeywell, HTC, Huawei, Landis & Gyr, Lenovo, LG Electronics, Microsoft, Nest, Netgear, Northrop Grumman, Rockwell Collins, Samsung, Sonos, and ZTE. Our competitors include Analog Devices, Avago Technologies, Linear Technology, Maxim Integrated Products, Murata Manufacturing, NXP, QUALCOMM, and Qorvo.

### RESULTS OF OPERATIONS

### FISCAL YEARS ENDED OCTOBER 2, 2015, OCTOBER 3, 2014, AND SEPTEMBER 27, 2013.

The following table sets forth the results of our operations expressed as a percentage of net revenue:

| | October 2, 2015 | October 3, 2014 | September 27, 2013 |
|---|---|---|---|
| Net revenue | 100.0% | 100.0% | 100.0 % |
| Cost of goods sold | 52.3 | 55.4 | 57.2 |
| Gross profit | 47.7 | 44.6 | 42.8 |
| Operating expenses: | | | |
| Research and development | 9.3 | 11.0 | 12.6 |
| Selling, general and administrative | 5.9 | 7.8 | 8.9 |
| Amortization of intangibles | 1.0 | 1.1 | 1.6 |
| Restructuring and other charges | 0.1 | — | 0.4 |
| Total operating expenses | 16.3 | 19.9 | 23.5 |
| Operating income | 31.4 | 24.7 | 19.3 |
| Other income (expense), net | — | — | — |
| Income before income taxes | 31.4 | 24.7 | 19.3 |
| Provision for income taxes | 6.9 | 4.7 | 3.7 |
| Net income | 24.5% | 20.0% | 15.6 % |

### GENERAL

During the fiscal year ended October 2, 2015, the following key factors contributed to our overall results of operations, financial position and cash flows:

- Net revenue increased to approximately $3.3 billion, an increase of 42% as compared to the prior fiscal year. This increase in revenue was primarily related to our continued growth as smartphones displace traditional cellular phones, increased strength in emerging markets due to the adoption of 3G and 4G technologies, increases in tablet computing and the expansion of our analog product portfolio to address additional content within the handset and tablet markets as well as new vertical markets including medical, automotive, military and industrial.

- Operating margin increased by 670 basis points to 31.4% for fiscal 2015 from 24.7% in fiscal 2014. The increase in operating margin was primarily related to higher revenue and the leveraging impact on our gross margin and operating expenses partially offset by higher employee compensation expenses.

- As a result of the aforementioned factors, overall profitability increased significantly from fiscal 2014 with year-over-year increases in net income and diluted earnings per share of 74% and 72%, respectively.

- Our ending cash and cash equivalents balance increased 30% to $1,044 million in fiscal 2015 from $806 million in fiscal 2014. This was the result of a 29% increase in cash from operations to $993 million in fiscal 2015 from $772 million in fiscal 2014 due to higher net income partially offset by changes in working capital. In addition, we invested $430 million on capital expenditures associated with plant expansions in Mexico and Japan, $237 million to repurchase over 2.9 million shares of our common stock, and $123 million in cash dividend payments.

**NET REVENUE**

| | Fiscal Years Ended | | | | |
|---|---|---|---|---|---|
| | October 2, 2015 | Change | October 3, 2014 | Change | September 27, 2013 |
| (dollars in millions) | | | | | |
| Net revenue | $ 3,258.4 | 42.2% | $ 2,291.5 | 27.9% | $ 1,792.0 |

We market and sell our products directly to original equipment manufacturers of communications and electronics products, third-party original design manufacturers and contract manufacturers, and indirectly through electronic components distributors. We generally experience seasonal peaks during the second half of the calendar year, primarily as a result of increased worldwide production of consumer electronics in anticipation of increased holiday sales, whereas our second fiscal quarter is typically lower and in line with seasonal industry trends.

The $966.9 million increase in revenue in fiscal 2015 as compared to fiscal 2014 was primarily driven by our ability to capture a higher share of the increasing RF and analog content per device due to more complex smartphones continuing to displace traditional cellular phones, increased strength in emerging markets due to the adoption of 3G and 4G technologies, the increasing popularity of tablet computing and wearables, and our expanding analog product portfolio supporting new vertical markets including medical, automotive, military and industrial.

The $499.5 million increase in revenue in fiscal 2014 as compared to fiscal 2013 was primarily driven by our ability to capture a higher share of the increasing RF and analog content per device due to more complex smartphones continuing to displace traditional cellular phones, increased strength in emerging markets due to the adoption of 3G and 4G technologies, the increasing popularity of tablet computing, and our expanding analog product portfolio supporting new vertical markets including medical, automotive, military and industrial.

For information regarding net revenue by geographic region and customer concentration, see Note 16 of Item 8 of this Annual Report on Form 10-K.

**GROSS PROFIT**

| | Fiscal Years Ended | | | | |
|---|---|---|---|---|---|
| | October 2, 2015 | Change | October 3, 2014 | Change | September 27, 2013 |
| (dollars in millions) | | | | | |
| Gross profit | $ 1,554.5 | 52.0% | $ 1,022.7 | 33.4% | $ 766.6 |
| % of net revenue | 47.7% | | 44.6% | | 42.8% |

Gross profit represents net revenue less cost of goods sold. Our cost of goods sold consists primarily of purchased materials, labor and overhead (including depreciation and share-based compensation expense) associated with product manufacturing. Erosion of average selling prices of established products is typical of the semiconductor industry. Consistent with trends in the industry, we anticipate that average selling prices for our established products will continue to decline at a normalized rate of five to ten percent per year. As part of our normal course of business, we mitigate the gross margin impact of declining average selling prices with efforts to increase unit volumes, reduce material costs, improve manufacturing efficiencies, lower manufacturing costs of existing products and by introducing new and higher value-added products.

Gross profit was $531.8 million greater in fiscal 2015 as compared to fiscal 2014. The increase in gross profit was primarily the result of higher unit volumes, lower overall per unit material and manufacturing costs with an aggregate gross profit benefit of $687.8 million. These benefits were partially offset by the erosion of average selling price, unfavorable changes in product mix and other costs that combined to negatively impact gross profit by $156.0 million. As a result of these impacts, gross profit margin increased to 47.7% of net revenue for fiscal 2015.

Gross profit was $256.1 million greater in fiscal 2014 as compared to fiscal 2013. The increase in gross profit was primarily the result of higher unit volumes, lower overall per unit material and manufacturing costs with an aggregate gross profit benefit of $273.5 million. These benefits were partially offset by the erosion of average selling price, unfavorable changes in product mix and other costs which combined to negatively impact gross profit by $17.4 million. As a result of these impacts, gross profit margin increased to 44.6% of net revenue for fiscal 2014.

**RESEARCH AND DEVELOPMENT**

| | Fiscal Years Ended | | | | |
|---|---|---|---|---|---|
| (dollars in millions) | October 2, 2015 | Change | October 3, 2014 | Change | September 27, 2013 |
| Research and development | $ 303.2 | 20.2% | $ 252.2 | 11.4% | $ 226.3 |
| % of net revenue | 9.3% | | 11.0% | | 12.6% |

Research and development expenses consist primarily of direct personnel costs including share-based compensation expense, costs for pre-production evaluation and testing of new devices, masks, engineering prototypes and design tool costs.

The increase in research and development expense in fiscal 2015 as compared to fiscal 2014 is primarily related to increased employee compensation expense, including share-based compensation, of approximately $26.7 million and increased product development and other related expenses of approximately $24.3 million. Research and development expense decreased as a percentage of net revenue due to the aforementioned increase in net revenue.

The increase in research and development expense in fiscal 2014 as compared to fiscal 2013 is primarily related to increased compensation expense, including share-based compensation of $19.1 million, enhanced development activity, related services and other costs of $6.8 million. Research and development expense decreased as a percentage of net revenue due to the aforementioned increase in net revenue.

**SELLING, GENERAL AND ADMINISTRATIVE**

| | Fiscal Years Ended | | | | |
|---|---|---|---|---|---|
| (dollars in millions) | October 2, 2015 | Change | October 3, 2014 | Change | September 27, 2013 |
| Selling, general and administrative | $ 191.3 | 6.8% | $ 179.1 | 12.1% | $ 159.7 |
| % of net revenue | 5.9% | | 7.8% | | 8.9% |

Selling, general and administrative expenses include legal and related costs, accounting, treasury, human resources, information systems, customer service, bad debt expense, sales commissions, share-based compensation expense, advertising, marketing, costs associated with business combinations completed or contemplated during the period or prior periods and other costs.

The increase in selling, general and administrative expenses in fiscal 2015 as compared to fiscal 2014 was primarily related to increased compensation expense including share-based compensation, and legal expenses related to acquisitions completed and contemplated during the period. Selling, general and administrative expenses decreased as a percentage of net revenue due to the aforementioned increase in net revenue.

The increase in selling, general and administrative expenses in fiscal 2014 as compared to fiscal 2013 was primarily related to increased compensation expense including share-based compensation of $8.1 million, legal expenses related to ongoing litigation of $3.9 million and acquisition related expenses of $3.4 million. Selling, general and administrative expenses decreased as a percentage of net revenue due to the aforementioned increase in net revenue.

**AMORTIZATION OF INTANGIBLES**

| | Fiscal Years Ended | | | | |
|---|---|---|---|---|---|
| (dollars in millions) | October 2, 2015 | Change | October 3, 2014 | Change | September 27, 2013 |
| Amortization of intangibles | $ 33.5 | 29.3% | $ 25.9 | (11.0)% | $ 29.1 |
| % of net revenue | 1.0% | | 1.1% | | 1.6% |

The increase in amortization expense for fiscal 2015 as compared to fiscal 2014 was primarily due to the intangible assets that were acquired in fiscal 2015 and fiscal 2014, partially offset by the end of the estimated useful lives of certain fully amortized intangible assets that were acquired in prior fiscal years.

Amortization expense decreased in fiscal 2014 when compared to the prior fiscal year due to the end of the estimated useful lives of certain fully amortized intangible assets acquired in prior fiscal years. This decrease was partially offset by the amortization of intangibles acquired in the Panasonic transaction.

**PROVISION FOR INCOME TAXES**

| | Fiscal Years Ended | | | | |
|---|---|---|---|---|---|
| (dollars in millions) | October 2, 2015 | Change | October 3, 2014 | Change | September 27, 2013 |
| Provision for income taxes | $ 225.3 | 109.6% | $ 107.5 | 61.9% | $ 66.4 |
| % of net revenue | 6.9% | | 4.7% | | 3.7% |

The annual effective tax rate for fiscal 2015 of 22.0% was less than the United States federal statutory rate of 35% primarily due to benefits of 11.8% related to foreign earnings taxed at a rate less than the United States federal rate, benefits of 1.9% related to a domestic production activities deduction, and benefits of 1.5% related to the recognition of federal research and development tax credits, partially offset by income tax rate expense impact of 2.5% related to a change in our tax reserves.

As a result of the enactment of the Tax Increase Prevention Act of 2014, which retroactively reinstated and extended the research and development tax credit, $11.0 million of tax credits that were earned in fiscal 2014, our tax rate was reduced during fiscal 2015.

We operate under a tax holiday in Singapore, which is effective through September 30, 2020. This tax holiday is conditioned upon our compliance with certain employment and investment thresholds in Singapore. The impact of the tax holiday decreased the taxes we owe in Singapore by $26.6 million and $12.6 million for fiscal 2015 and fiscal 2014, respectively. This resulted in tax benefits of $0.14 and $0.07 of diluted earnings per share for fiscal 2015 and fiscal 2014, respectively.

As of October 2, 2015, the Company's federal income tax returns for the fiscal year ended September 28, 2012 ("fiscal 2012") and fiscal 2013 were under examination by the Internal Revenue Service ("IRS"). The Company expects the IRS examination to close in the first quarter of the fiscal year ending September 30, 2016 ("fiscal 2016") and does not expect the results of this audit to have an adverse impact on its tax expense. In addition, various state and international returns are under examination by their respective taxing authorities. The Company does not expect the results of these audits to have a material impact on its financial position, results of operations, or cash flows.

The annual effective tax rate for fiscal 2014 of 19.0% was less than the United States federal statutory rate of 35% primarily due to benefits of 13.7% related to foreign earnings taxed at a rate less than the United States federal rate, benefits of 1.9% related to a domestic production activities deduction, and benefits of 3.5% from the settlement of the IRS audit of our fiscal 2011 income tax return, partially offset by income tax rate expense impact of 2.0% related to a change in our tax reserves.

## LIQUIDITY AND CAPITAL RESOURCES

| (dollars in millions) | Fiscal Years Ended October 2, 2015 | Fiscal Years Ended October 3, 2014 | Fiscal Years Ended September 27, 2013 |
|---|---|---|---|
| Cash and cash equivalents at beginning of period | $ 805.8 | $ 511.1 | $ 307.1 |
| Net cash provided by operating activities | 992.8 | 772.4 | 499.7 |
| Net cash used in investing activities | (454.7) | (357.1) | (123.0) |
| Net cash used in financing activities | (300.3) | (120.6) | (172.7) |
| Cash and cash equivalents at end of period | $ 1,043.6 | $ 805.8 | $ 511.1 |

***Cash Flow from Operating Activities:***
Cash provided by operating activities is net income adjusted for certain non-cash items and changes in certain operating assets and liabilities. For fiscal 2015, we generated $992.8 million in cash flow from operations, an increase of $220.4 million when compared to $772.4 million generated in fiscal 2014. The increase in cash flow from operating activities during the fiscal year ended October 2, 2015 was related to higher net income combined with a net cash inflow from changes in operating assets and liabilities and the effects of non-cash depreciation and share-based compensation. Specifically, the changes in operating assets and liabilities that were sources of cash were: $106.0 million related to tax liabilities, payroll related accruals and other accrued expenses, $90.5 million in accounts payable related to the timing of vendor payments, and $3.6 million in changes in inventory. These sources of cash were offset by uses of cash of $222.2 million in accounts receivable due to the timing of customer collections and $39.2 million primarily related to pre-paid manufacturing costs.

***Cash Flow from Investing Activities:***
Cash flow from investing activities consists of capital expenditures, cash paid for acquisitions, net of cash acquired and the sale and maturity of investments. Cash flow used in investing activities was $454.7 million during fiscal 2015, compared to $357.1 million during fiscal 2014. The increase in capital expenditures was primarily due to the expansion of our assembly and test facility in Mexicali, Mexico, the construction of a new filter fabrication facility in Osaka, Japan, the purchase of manufacturing equipment to support increased production for the operations in Japan and Singapore of the joint venture with Panasonic, referred to as FilterCo, and to a lesser extent, our wafer fabrication facilities in the United States. Cash flows from investing activities for the twelve months ended October 2, 2015 also include the final working capital payment associated with the FilterCo acquisition as well as cash paid for an immaterial business combination net of cash, during the period.

***Cash Flow from Financing Activities:***
Cash flows from financing activities consist primarily of cash transactions related to debt and equity. During fiscal 2015, we had net cash outflows of $300.3 million, compared to $120.6 million in fiscal 2014. During fiscal 2015 we had the following significant uses of cash:

- $237.3 million related to our repurchase of approximately 2.9 million shares of our common stock pursuant to the share repurchase program approved by our Board of Directors on November 11, 2014;
- $123.1 million related to the payment of cash dividends on our common stock; and
- $54.2 million related to the minimum statutory payroll tax withholdings upon vesting of employee performance and restricted stock awards.

These uses of cash were partially offset by the excess tax benefit from stock option exercises of $57.3 million and net proceeds from employee stock option exercises of $57.0 million during fiscal 2015.

***Liquidity:***

Cash and cash equivalent balances were $1,043.6 million at October 2, 2015, representing an increase of $237.8 million from October 3, 2014. The increase resulted from $992.8 million in cash generated from operations which was partially offset by $430.1 million in capital expenditures primarily for increased production capacity in Mexico and Japan, $237.3 million used to repurchase 2.9 million shares of stock, and $123.1 million in cash dividend payments during fiscal 2015. Based on our historical results of operations, we expect that our cash and cash equivalents on hand and the cash we expect to generate from operations will be sufficient to fund our research and development, capital expenditures, potential acquisitions, working capital, quarterly cash dividend payments (if such dividends are declared by the Board of Directors), outstanding commitments and other liquidity requirements associated with existing operations for at least the next 12 months. However, we cannot be certain that our cash on hand and cash generated from operations will be available in the future to fund all of our capital and operating requirements. In addition, any future strategic investments and acquisitions may require additional cash and capital resources. If we are unable to obtain sufficient cash or capital to meet our needs on a timely basis and on favorable terms, our business and operations could be materially and adversely affected.

Our invested cash balances primarily consist of highly liquid term deposits with original maturities of 90 days or less and money market funds where the underlying securities primarily consist of United States treasury obligations, United States agency obligations and repurchase agreements collateralized by United States government and agency obligations.

Our cash and cash equivalent balance of $1,043.6 million at October 2, 2015 consisted of $657.2 million held domestically and $386.4 million held by foreign subsidiaries. Of the cash and cash equivalents held by our foreign subsidiaries at October 2, 2015, $340.8 million is considered by us to be indefinitely reinvested and would be subject to material tax effects if repatriated. The remaining $45.6 million of foreign cash and cash equivalents can be repatriated without any tax consequences.

## OFF-BALANCE SHEET ARRANGEMENTS

All significant contractual obligations are recorded on our consolidated balance sheet or fully disclosed in the notes to our consolidated financial statements. We have no material off-balance sheet arrangements as defined in SEC Regulation S-K-303(a)(4)(ii).

## CONTRACTUAL CASH FLOWS

Set forth below is a summary of our contractual payment obligations related to our operating leases, other commitments and long-term liabilities at October 2, 2015 (in millions):

| | Payments Due By Period | | | | |
|---|---|---|---|---|---|
| **Obligation** | **Total** | **Less Than 1 Year** | **1-3 Years** | **3-5 Years** | **Thereafter** |
| Other long-term liabilities (1) | $ 78.7 | $ 5.4 | $ 2.6 | $ — | $ 70.7 |
| Operating lease obligations | 66.2 | 15.1 | 22.9 | 14.0 | 14.2 |
| Other commitments (2) | 94.4 | 94.2 | 0.2 | — | — |
| Total | $ 239.3 | $ 114.7 | $ 25.7 | $ 14.0 | $ 84.9 |

(1) Other long-term liabilities include our gross unrecognized tax benefits, as well as executive deferred compensation, which are both classified as beyond five years due to the uncertain nature of the liabilities.

(2) Other commitments consist of liabilities related to business combinations, contractual license and royalty payments, and other purchase obligations. See Note 11 of Item 8 of this Annual Report on Form 10-K.

## CRITICAL ACCOUNTING ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles, or GAAP. 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 assets and liabilities. The Securities and Exchange Commission has defined critical accounting policies as those that are both most important to the portrayal of our financial condition and results and which require our most difficult, complex or subjective judgments or estimates. Based on this definition, we believe our critical accounting policies include revenue recognition, inventory valuation, impairment of long-lived assets, goodwill and intangibles, business combinations, share-based compensation, loss contingencies and income taxes. Note 2 of Item 8 on this Annual Report on Form 10-K describes the significant accounting policies and methods used in the preparation of our consolidated financial statements.

On an ongoing basis, we evaluate the judgments and estimates underlying all of our accounting policies. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures, and reported amounts of revenues and expenses. These estimates and assumptions are based on our best judgments using historical experience and other factors, including the current economic environment, which we believe to be reasonable under the circumstances. We adjust such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, factors may arise over time that lead us to change our methods, estimates and judgments that could materially and adversely affect our results of operations.

*Revenue Recognition.* We recognize revenue in accordance with the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") 605 *Revenue Recognition* net of estimated reserves. Our revenue reserves contain uncertainties because they require management to make assumptions and to apply judgment to estimate the value of future credits to customers for price protection and product returns (stock rotation) for products sold to certain electronic component distributors. Our estimates of the amount and timing of the reserves is based primarily on historical experience and specific contractual arrangements. Historically, we have not experienced material differences between our estimated sales reserves and actual results.

*Inventory Valuation.* We value our inventory at the lower of cost or fair market value. Reserves for excess and obsolete inventory are established on a quarterly basis and are based on a detailed analysis of forecasted demand in relation to on-hand inventory, saleability of our inventory, general market conditions, and product life cycles. Once reserves are established, write-downs of inventory are considered permanent adjustments to the cost basis of inventory. Our reserves contain uncertainties because the calculation requires management to make assumptions and to apply judgment regarding historical experience, forecasted demand and technological obsolescence. Changes in actual demand or market conditions could adversely impact our reserve calculations. Historically, we have not experienced material differences between our estimated inventory reserves and actual results.

*Goodwill and Purchased Intangible Assets.* We evaluate goodwill and other purchased intangible assets for impairment annually on the first day of the fourth fiscal quarter and whenever events or circumstances arise that may indicate that the carrying value of the goodwill or other intangibles may not be recoverable.

The impairment evaluation of goodwill involves comparing the fair value to the carrying value of the reporting unit. We use the market price of the Company's stock adjusted for a market premium to calculate the fair value of the reporting unit. If the fair value exceeds the carrying value, then it is concluded that no goodwill impairment has occurred. If the carrying value of the reporting unit exceeds its fair value, a second step is required to measure the possible goodwill impairment loss.

In the second step, if required, we would use a discounted cash flow methodology to determine the implied fair value of our goodwill. The implied fair value of the reporting unit's goodwill would then be compared to the carrying value of the goodwill. If the carrying value of the goodwill exceeds the implied fair value of the goodwill, we would recognize a loss equal to the excess.

Our impairment analysis contains uncertainties because it requires management to make assumptions and to apply judgment to items such as: estimated control premiums, discount rate, future cash flows, the profitability of future business strategies and useful lives. Historically, we have not experienced material differences between our impairment calculations and actual results.

*Business Combinations.* We apply significant estimates and judgments in order to determine the fair value of the identified tangible and intangible assets acquired, liabilities assumed and goodwill recognized in business combinations. The value of all assets and liabilities are recognized at fair value as of the acquisition date using a market participant approach.

In measuring the fair value, we utilize a number of valuation techniques consistent with the market approach, income approach and/ or cost approach. The valuation of the identifiable assets and liabilities includes assumptions such as projected revenue, royalty rates, weighted average cost of capital, discount rates and estimated useful lives. These assessments can be significantly affected by our judgments. Historically, we have not experienced material differences in our assigned values and actual results.

*Share-Based Compensation*. We have a share-based compensation plan which includes non-qualified stock options, restricted and performance share awards and units, employee stock purchase plan and other special share-based awards. Note 9 of Item 8 of this Annual Report on Form 10-K details our current share-based compensation programs.

We determine the fair value of our non-qualified stock options at the date of grant using the Black-Scholes options-pricing model. For restricted and performance based awards and units, we determine the fair value based on the grant date fair value of the Company's stock based on the most probable outcome of the underlying performance metric, as applicable. For more complex performance awards with market-based conditions we employ a Monte Carlo simulation and determine the fair value based on the most probable outcome of the performance metric. Our determination of fair value of share-based items on the date of grant contains assumptions regarding a number of highly complex and subjective variables including, but not limited to: our expected stock price volatility over the term of the award, correlation coefficients, risk-free rate, the expected life of the award, forfeiture rates, and a dividend yield with compensation expense recognized over the requisite service period of the underlying award. Management periodically evaluates these assumptions and updates share-based compensation expense accordingly. Historically, we have not experienced material differences in our estimates and actual results.

*Loss Contingencies.* We record an estimate for loss contingencies such as a legal proceeding or claims if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. We disclose material loss contingencies if there is at least a reasonable possibility that a loss has been incurred.

Our loss contingency analysis contains uncertainties because it requires management to assess the degree of probability of an unfavorable outcome and to make a reasonable estimate of the amount of potential loss. Historically, we have not experienced material differences between our estimates and actual results.

*Income Taxes.* We account for income taxes using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between tax and financial reporting. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. We record a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized. Significant management judgment is required in developing our provision for income taxes, including the determination of deferred tax assets and liabilities and any valuation allowances that might be required against the deferred tax assets. ASC 740 *Income Taxes* ("ASC 740") clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with GAAP. ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This statement also provides guidance on derecognition, classification, interest and penalties, accounting in the interim periods and disclosure.

The application of tax laws and regulations to calculate our tax liabilities is subject to legal and factual interpretation, judgment, and uncertainty in a multitude of jurisdictions. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations, and court rulings. We recognize potential liabilities for anticipated tax audit issues in the United States and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes and interest will be due. We record an amount as an estimate of probable additional income tax liability at the largest amount that we feel is more likely than not, based upon the technical merits of the position, to be sustained upon audit by the relevant tax authority. We record a valuation allowance against deferred tax assets that we feel are more likely than not to not be realized. Historically, we have not experienced material differences between our estimates and actual results.

**OTHER MATTERS**

Inflation did not have a material impact on our results of operations during the three-year period endedOctober 2, 2015.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

We are subject to overall financial market risks, such as changes in market liquidity, credit quality investment risk, interest rate risk and exchange rate risk as described below.

*Investment and Interest Rate Risk*

Our exposure to interest rate and general market risks related principally to our investment portfolio and consisted of the following (in millions):

| | October 2, 2015 |
|---|---|
| Cash and cash equivalents (time deposits, certificate of deposits and money market funds) | $ 1,043.6 |
| Available for sale securities (auction rate securities) at carrying value | 2.3 |
| Total | $ 1,045.9 |

The main objectives of our investment activities are the liquidity and preservation of capital. Our cash equivalent investments have short-term maturity periods that dampen the impact of market or interest rate risk. Credit risk associated with our investments is not material as our money market and deposits are diversified across several financial institutions with high credit ratings that reduces the amount of credit exposure to any one counterparty.

Based on our results of operations for the fiscal year endedOctober 2, 2015, a hypothetical reduction in the interest rates on our cash and cash equivalents to zero would result in an immaterial reduction of interest income with a de minimis impact to income before taxes.

We own $3.2 million of par value auction rate securities that are currently valued at $2.3 million as ofOctober 2, 2015. In the event that the market conditions change in the future and our auction rate security becomes fully and permanently impaired, the impact to income before income taxes would be the par value of the auction rate security of approximately $3.2 million as of October 2, 2015.