SYNAPTICS INC
Form 10-Q
February 07, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended December 30, 2006

Commission file number 000-49602

SYNAPTICS INCORPORATED
(Exact name of Registrant as specified in its charter)

Delaware	**77-0118518**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3120 Scott Blvd., Suite 130
Santa Clara, California 95054
(Address of principal executive offices) (Zip code)
(408) 454-5100
(Registrant s telephone number, including area code)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Number of shares of Common Stock outstanding at February 5, 2007: 26,056,456

SYNAPTICS INCORPORATED
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED DECEMBER 31, 2006
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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)
(unaudited)

	December 31, 2006	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 47,129	$ 38,724
Short-term investments	206,517	206,452
Accounts receivable, net of allowances of $289 and $189, respectively	52,787	34,034
Inventories	8,204	10,010
Prepaid expenses and other current assets	4,699	3,407
Total current assets	319,336	292,627
Property and equipment, net	17,789	16,038
Goodwill	1,927	1,927
Other assets	18,841	20,829
	$ 357,893	$ 331,421
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 17,941	$ 16,542
Accrued compensation	4,430	4,842
Income taxes payable		8,078
Other accrued liabilities	8,313	5,377
Note payable to a related party	1,500	
Total current liabilities	32,184	34,839
Note payable to a related party		1,500
Other liabilities	2,052	3,040
Convertible senior subordinated notes	125,000	125,000
Stockholders equity:		
Common stock:		
$0.001 par value; 60,000,000 shares authorized; 28,493,662 and 27,462,125 shares issued, respectively	28	27
Additional paid-in capital	156,678	134,217
Less: 2,521,100 and 2,306,100 common treasury shares, respectively, at cost	(44,611)	(39,999)
Accumulated other comprehensive loss	(167)	(464)
Retained earnings	86,729	73,261
Total stockholders equity	198,657	167,042

	$ 357,893	$ 331,421

See notes to condensed consolidated financial statements.

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SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2006	**2005**	**2006**	**2005**
Net revenue	$ 76,087	$ 48,555	$ 130,902	$ 100,280
Cost of revenue (1)	45,696	26,384	78,116	54,437
Gross margin	30,391	22,171	52,786	45,843
Operating expenses:				
Research and development (1)	9,958	8,345	19,146	16,634
Selling, general, and administrative (1)	8,927	6,913	16,728	13,641
Restructuring	915		915	
Total operating expenses	19,800	15,258	36,789	30,275
Income from operations	10,591	6,913	15,997	15,568
Interest income	2,978	1,901	5,517	3,452
Interest expense	(488)	(485)	(975)	(969)
Income before provision for income taxes	13,081	8,329	20,539	18,051
Provision for income taxes	3,740	3,526	7,071	7,736
Net income	$ 9,341	$ 4,803	$ 13,468	$ 10,315
Net income per share:				
Basic	$ 0.37	$ 0.20	$ 0.53	$ 0.42
Diluted	$ 0.32	$ 0.18	$ 0.48	$ 0.38
Shares used in computing net income per share:				
Basic	25,568	24,299	25,359	24,534
Diluted	29,692	28,781	29,468	28,911

(1) Amounts include share-based compensation costs as follows:

Cost of revenue	$ 185	$ 188	$ 332	$ 380
Research and development	$ 1,439	$ 1,243	$ 2,474	$ 2,535
Selling, general, and administrative	$ 2,284	$ 1,959	$ 4,203	$ 3,785

See notes to condensed consolidated financial statements.

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SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

	Six Months Ended December 31, 2006	Six Months Ended December 31, 2005
Cash flows from operating activities		
Net income	$ 13,468	$ 10,315
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation costs	7,009	6,700
Deferred taxes from share-based compensation	(855)	(1,390)
Tax benefit realized from share-based compensation	6,075	1,083
Excess tax benefit from share-based compensation	(5,535)	(880)
Depreciation of property and equipment	971	781
Write-down of property and equipment	102	
Amortization of debt issuance costs	430	430
Changes in operating assets and liabilities:		
Accounts receivable, net	(18,753)	1,925
Inventories	1,806	824
Prepaid expenses and other current assets	(1,292)	(370)
Other assets	2,413	(2,919)
Accounts payable	1,399	262
Accrued compensation	(412)	(1,991)
Income taxes payable	(8,078)	2,680
Other accrued liabilities	2,936	1,597
Other liabilities	(988)	79
Net cash provided by operating activities	696	19,126
Cash flows from investing activities		
Purchases of short-term investments	(133,261)	(131,239)
Proceeds from sales and maturities of short-term investments	133,493	87,520
Purchases of property and equipment	(2,824)	(2,054)
Net cash used in investing activities	(2,592)	(45,773)
Cash flows from financing activities		
Purchase of treasury stock	(4,612)	(18,819)
Proceeds from issuance of common stock upon exercise of options and stock purchase plan	9,378	2,345
Excess tax benefit from share-based compensation	5,535	880
Net cash provided by (used in) financing activities	10,301	(15,594)
Net increase (decrease) in cash and cash equivalents	8,405	(42,241)

Cash and cash equivalents at beginning of period	38,724	72,232
Cash and cash equivalents at end of period	$ 47,129	$ 29,991
Supplemental disclosures of cash flow information		
Cash paid for interest	$ 469	$ 469
Cash paid for income taxes	$ 8,259	$ 7,787

See notes to condensed consolidated financial statements.

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SYNAPTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) and U.S. generally accepted accounting principles. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. In our opinion, the financial statements include all adjustments, which are of a normal and recurring nature, necessary for the fair presentation of the results of the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future period. These financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our annual report on Form 10-K for the fiscal year ended June 30, 2006.

The consolidated financial statements include our financial statements and those of our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. Fiscal 2007 will be a 53-week period, and fiscal 2006 was a 52-week period. The quarter ended December 31, 2006 was a 14-week quarter, and the quarter ended December 31, 2005 was a 13-week quarter. For ease of presentation, the accompanying consolidated financial statements have been shown as ending on June 30 and calendar quarter end dates for all annual, interim, and quarterly financial statement captions, unless otherwise indicated.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, product warranty, share-based compensation costs, provision for income taxes, income taxes payable, and contingencies. We base our estimates on historical experience, applicable laws and regulations, and various other assumptions that we believe 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. Actual results may differ from these estimates under different assumptions or conditions.

2. Revenue Recognition

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred and title has transferred, the price is fixed or determinable, and collection is reasonably assured. We accrue for estimated sales returns and other allowances, based on historical experience, at the time we recognize revenue. We record contract revenue for research and development as the services are provided under the terms of the contract. We recognize non-refundable contract fees for which no further performance obligations exist and for which there is no continuing involvement by us on the earlier of when the payments are received or when collection is reasonably assured.

3. Net Income Per Share

Basic net income per share amounts for each period presented were computed using the weighted average number of shares of common stock outstanding. Diluted net income per share amounts for each period presented were computed (1) using the weighted average number of potentially dilutive shares issuable in connection with stock options under the treasury stock method, and (2) using the weighted average number of shares issuable in connection with convertible debt under the if-converted method, when dilutive.

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The following table presents the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2006	2005	2006	2005
Numerator:				
Basic net income	$ 9,341	$ 4,803	$ 13,468	$ 10,315
Interest expense and amortization of debt issuance costs on convertible notes (net of tax)	266	266	532	532
Diluted net income	$ 9,607	$ 5,069	$ 14,000	$ 10,847
Denominator:				
Shares, basic	25,568	24,299	25,359	24,534
Effect of dilutive share-based awards	1,650	2,008	1,635	1,903
Effect of convertible notes	2,474	2,474	2,474	2,474
Shares, diluted	29,692	28,781	29,468	28,911
Net income per share:				
Basic	$ 0.37	$ 0.20	$ 0.53	$ 0.42
Diluted	$ 0.32	$ 0.18	$ 0.48	$ 0.38

Dilutive net income per share does not include the effect of 2,342,737, 2,079,016, 2,557,243, and 2,414,224 share-based awards that were outstanding during the three months ended December 31, 2006 and 2005 and the six months ended December 31, 2006 and 2005, respectively. These share-based awards were not included in the computation of diluted net income per share because the proceeds received, if any, from such share-based awards combined with the average unamortized compensation costs adjusted for the hypothetical tax benefit or deficiency creditable or chargeable, respectively, to additional paid-in capital, were greater than the average market price of our common stock, and therefore, their effect would have been antidilutive.

4. Cash Equivalents and Short-Term Investments

Cash equivalents consist of highly liquid investments with original maturities of three months or less. Short-term investments consist of marketable securities and are classified as securities available for sale under Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. Such securities are reported at fair value, with unrealized gains and losses, net of taxes, excluded from earnings and shown separately as a component of accumulated other comprehensive loss within stockholders equity. Interest earned on marketable securities is included in interest income. We determine realized gains and losses on the sale of marketable securities using the specific identification method.

5. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (estimated net realizable value) and consisted of the following (in thousands):

	December 31, 2006	June 30, 2006

Raw materials	$ 7,198	$ 9,743
Finished goods	1,006	267
	$ 8,204	$ 10,010

Periodically, we purchase inventory from our subcontractors when a customer s delivery schedule is delayed or a customer s order is cancelled. In those circumstances in which our customer has cancelled its order and we purchase inventory from our subcontractors, we consider a write-down to reduce the carrying value of the inventory purchased to its net realizable value. We charge write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value to cost of revenue.

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6. Product Warranties, Indemnifications, and Legal Proceedings

Product Warranties

We generally warrant our products for a period of 12 months or more from the date of sale and estimate probable product warranty costs at the time we recognize revenue. Factors that affect our warranty liability include historical and anticipated rates of warranty claims, materials usage, and service delivery costs. Warranty costs incurred have not been material in recent years. However, we assess the adequacy of our warranty obligations periodically and adjust the accrued warranty liability on the basis of our estimates.

Changes in our accrued warranty liability (included in other accrued liabilities) for the six-month periods ended December 31, 2006 and 2005 were as follows (in thousands):

	Six Months Ended December 31,	
	2006	2005
Beginning accrued warranty	$ 357	$ 369
Provision for product warranties	479	298
Cost of warranty claims and settlements	(355)	(473)
Ending accrued warranty	$ 481	$ 194

Indemnifications

In connection with certain third-party agreements, we are obligated to indemnify the third party in connection with any technology infringement by us. We have also entered into indemnification agreements with our officers and directors. Maximum potential future payments cannot be estimated because these agreements do not have a maximum stated liability. However, historical costs related to these indemnification provisions have not been significant. We have not recorded any liability in our consolidated financial statements for such indemnification obligations.

Legal Proceedings

In March 2006, Elantech Devices Corporation (Elantech) filed a Complaint for Patent Infringement against us claiming that we infringed one of its patents and seeking damages, attorneys fees, and a permanent injunction against us infringing or inducing others to infringe the patent. In April 2006, we filed our Answer to the Complaint and Counterclaims against Elantech claiming that Elantech has infringed and induced infringement of four of our patents and seeking damages, attorneys fees, and a permanent injunction against infringing or inducing others to infringe.

Elantech responded to our counterclaim denying liability and counterclaimed seeking an injunction and damages for alleged violations of California law. We subsequently filed a motion to dismiss the Elantech counterclaims, which was granted in July 2006 with leave to amend the counterclaims after the adjudication of the patent infringement claims. We intend to vigorously defend our patents and pursue our counterclaims. We have not recorded any liability associated with Elantech s claims and have expensed as incurred all legal fees associated with the legal proceedings.

7. Convertible Senior Subordinated Notes

During December 2004, we issued an aggregate of $125 million of 0.75% Convertible Senior Subordinated Notes maturing December 1, 2024 (the Notes) in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. In connection with issuing the Notes, we incurred debt issuance costs of $4.3 million, consisting primarily of the initial purchasers discount and costs related to legal, accounting, and printing, which are being amortized over five years. We expect to use the net proceeds for working capital and general corporate purposes and potentially for future acquisitions.

The Notes bear interest at a rate of 0.75% per annum payable on December 1 and June 1 of each year. However, we will pay additional contingent interest on the Notes if the average trading price of the Notes is at or above 120% of the principal amount of the Notes for a specified period beginning with the six-month period commencing December 1, 2009. The amount of contingent interest payable on the Notes with respect to a six-month period, for which contingent interest applies, will equal 0.375% per annum of the average trading price of the Notes for a specified five trading day period preceding such six-month period. We are also obligated to file and maintain a shelf registration

statement with the SEC covering resales by the holders of the Notes and the common stock issuable upon conversion of the Notes. In the event of a registration default, we will be obligated to pay additional interest of up to 0.5% per annum until such registration default is cured. On June 1, 2005, our Registration Statement for these securities was declared effective by the SEC.

The Notes are convertible into shares of our common stock, initially at a conversion rate of 19.7918 shares per $1,000 principal amount of Notes, or a total of 2,473,975 shares of common stock, which is equivalent to an initial conversion price of approximately $50.53 per share of common stock, subject to adjustment in certain events. The denominator of the diluted net income per share calculation includes the weighted average effect of the 2,473,975 shares of common stock issuable upon conversion of the Notes in accordance with Emerging Issues Task Force (EITF) Issue No. 04-08. Through November 30, 2009, upon the occurrence of a fundamental change as defined in the indenture governing the Notes, we could potentially be obligated to issue up to 27.7085 shares per $1,000 of principal amount of Notes, or a total of 3,463,562 shares of common stock, which is equivalent to a conversion price of $36.09 per share of common stock. The additional 989,587 shares, contingently issuable upon a fundamental change, are not included in the calculation of diluted net income per share.

The Notes may be converted (1) if, during any calendar quarter commencing after December 31, 2004, the last reported sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than or equal to 120% of the applicable conversion price on such last trading day; (2) on or after January 1, 2020; (3) if we have called the Notes for redemption; or (4) during prescribed periods, upon the occurrence of specified corporate transactions or fundamental changes. On or after December 1, 2009, we may redeem for cash all or a portion of the notes at a redemption price of 100% of the principal amount of the notes plus accrued and unpaid interest, including contingent interest and additional interest, if any. Noteholders have the right to require us to repurchase all or a portion of their notes for cash on December 1, 2009, December 1, 2014, and December 1, 2019 at a price equal to 100% of the principal amount of the notes to be purchased plus accrued and unpaid interest, including contingent interest and additional interest, if any. Upon conversion of the Notes, in lieu of delivering common stock, we may, at our discretion, deliver cash or a combination of cash and common stock. As of December 31, 2006, none of the conditions for conversion of the Notes had occurred.

The Notes are unsecured senior subordinated obligations and rank junior in right of payment to all of our existing and future senior indebtedness, equal in right of payment with all of our existing and future indebtedness or other obligations that are not, by their terms, either senior or subordinated to the Notes, including trade debt and other general unsecured obligations that do not constitute senior or subordinated indebtedness, and senior in right of payment to all of our future indebtedness that, by its terms, is subordinated to the Notes. There are no financial covenants in the Notes.

Interest expense includes the amortization of debt issuance costs. We recorded $449,000 of interest expense on the Notes during each of the three month periods ended December 31, 2006 and 2005 and $898,000 during each of the six month periods ended December 31, 2006 and 2005.

8. Share-Based Compensation

The purpose of our various share-based compensation plans is to attract, motivate, retain, and reward high-quality employees, directors, and consultants by enabling such persons to acquire or increase their proprietary interest in our common stock in order to strengthen the mutuality of interests between such persons and our stockholders and to provide such persons with annual and long-term performance incentives to focus their best efforts in the creation of stockholder value. Consequently, share-based compensatory awards issued subsequent to the initial award to our employees and consultants are determined primarily on individual performance. Our share-based compensation plans with outstanding awards consist of our 1996 Stock Option Plan, our 2000 Nonstatutory Stock Option Plan, our 2001 Incentive Compensation Plan, and our 2001 Employee Stock Purchase Plan.

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Share-based compensation awards available for grant or issuance for each plan as of the beginning of the fiscal year, including changes in the balance of awards available for grant during the six months ended December 31, 2006, were as follows:

	Awards Available Under All Share-Based Award Plans	1996 Stock Option Plan	2000 Nonstatutory Stock Option Plan	2001 Incentive Compensation Plan	2001 Employee Stock Purchase Plan
Balance at June 30, 2006	3,292,246	226,465	37,584	2,414,826	613,371
Additional shares authorized	754,093			754,093	
Stock options granted	(684,885)			(684,885)	
Deferred stock units granted	(87,683)			(87,683)	
Purchases under employee stock purchase plan	(52,469)				(52,469)
Forfeited and expired	131,527	2,814		128,713	
Plan shares expired	(229,279)	(229,279)			
Balance at December 31, 2006	3,123,550		37,584	2,525,064	560,902

The 1996 Stock Option Plan (1996 Plan) expired in December 2006. Accordingly, plan shares available under the 1996 Plan that had not been granted prior to the expiration of the plan have expired and no new grants can be issued under the 1996 Plan. Option awards that are currently outstanding under the 1996 Plan will remain outstanding unless exercised, forfeited, or cancelled under the terms of the option grant agreements.

We adopted SFAS No. 123R, Share-Based Payment (SFAS 123R), in fiscal 2006 and applied the provisions of Staff Accounting Bulletin No. 107, Share-Based Payment, to our existing share-based compensation plans in accordance with the modified prospective transition method. Previously, we followed Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for employee share-based compensation, as permitted by SFAS No. 123, Accounting for Stock-Based Compensation, (SFAS 123), and we did not recognize compensation expense for stock option grants to employees and directors with an exercise price equal to the fair market value of the shares at the date of grant. Accordingly, no share-based compensation costs based on grant date fair value were included in our consolidated statements of income for any period prior to fiscal 2006.

Share-based compensation and the related tax benefit recognized in our consolidated statements of income for the three and six months ended December 31, 2006 and 2005 were as follows (in thousands):

	Three Months Ended December 31,	Six Months Ended December 31,