SEMTECH CORP
Form 10-Q
August 29, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended July 29, 2018
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 1-6395

SEMTECH CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	95-2119684
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 Flynn Road, Camarillo, California, 93012-8790
(Address of principal executive offices, Zip Code)

Registrant’s telephone number, including area code: (805) 498-2111

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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x		Accelerated filer	¨
Non-accelerated filer	¨	(Do not check if a smaller reporting company)	Smaller reporting company	¨
Emerging growth company	¨			

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

Number of shares of Common Stock, $0.01 par value per share, outstanding at August 24, 2018: 66,222,077

SEMTECH CORPORATION
INDEX TO FORM 10-Q
FOR THE QUARTER ENDED JULY 29, 2018

Unless the context otherwise requires, the use of the terms "Semtech," "the Company," "we," "us" and "our" in this Quarterly Report on Form 10-Q refers to Semtech Corporation and its consolidated subsidiaries. This Quarterly Report on Form 10-Q may contain references to the Company’s trademarks and to trademarks belonging to other entities. Solely for convenience, trademarks and trade names referred to in this Quarterly Report on Form 10-Q, including logos, artwork and other visual displays, may appear without the ® or ™ symbols, but such references are not intended to indicate, in any way, that we will not assert, to the fullest extent under applicable law, our rights or the rights of the applicable licensor to these trademarks and trade names. We do not intend our use or display of other companies' trade names or trademarks to imply a relationship with, or endorsement or sponsorship of us by, any other company.

Special Note Regarding Forward-Looking and Cautionary Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, as amended, based on our current expectations, estimates and projections about our operations, industry, financial condition, performance, results of operations, and liquidity. Forward-looking statements are statements other than historical information or statements of current condition and relate to matters such as future financial performance, future operational performance, the anticipated impact of specific items on future earnings, and our plans, objectives and expectations. Statements containing words such as "may," "believe," "anticipate," "expect," "intend," "plan," "project," "estimate," "should," "will," "designed to," "projections," or "business outlook," or other similar expressions constitute forward-looking statements. Forward-looking statements involve known and unknown risks and uncertainties that could cause actual results and events to differ materially from those projected.

Potential factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to:

- fluctuation in the Company’s future results;
- downturns in the business cycle;
- rapid decline in the average selling price;
- reduced demand for the Company’s products, including due to global economic conditions and potential changes in economic policy;
- business interruptions;
- the Company’s reliance on a limited number of suppliers and subcontractors for components and materials;
- potentially insufficient liability insurance if the Company’s products are found to be defective;
- obsolete inventories as a result of changes in demand and change in life cycles for the Company’s products;
- the Company’s inability to successfully develop and sell new products;
- lengthy and expensive product qualification processes without any assurance of product sales;
- the Company’s products failing to meet industry standards;
- the Company’s inability to protect intellectual property rights;
- the Company suffering losses if its products infringe the intellectual property rights of others;
- the Company’s need to commit resources to product production prior to receipt of purchase commitments;
- increased business risk resulting from significant business with foreign customers;
- the Company’s foreign currency exposures;
- potential increased tax liabilities and effective tax rate if the Company needs to repatriate funds held by foreign subsidiaries;
- export restrictions and laws affecting the Company’s trade and investments including the adoption and expansion of trade restrictions or the occurrence of trade wars;
- the impact of tariffs on the Company's expenses and on the pricing and demand for the Company's customer's products;
- the Company's inability to adequately compete against larger, more established entities;
- increased competition due to industry consolidation;
- the loss of any one of the Company’s significant customers;
- volatility of customer demand;

- termination of a contract by a distributor;
- sales of our products on the gray market;

- the Company’s failure to maintain effective internal control over financial reporting and disclosure controls and procedures;
- government regulations and other standards, including those that impose operational and reporting requirements;
- the Company’s failure to comply with applicable environmental regulations;
- compliance with conflict minerals regulations;
- increase in the Company’s cost of doing business as a result of having to comply with the codes of conduct of certain of the Company’s customers and suppliers;
- changes in tax law, including effective tax rates, and review by taxing authorities;
- taxation of Company sales in non-U.S. jurisdictions;
- the Company’s limited experience with government contracting;
- potential government investigations and inquiries;
- loss of the Company’s key personnel;
- risks associated with companies the Company has acquired in the past and may acquire in the future and the Company’s ability to successfully integrate acquired businesses and benefit from expected synergies;
- the Company may be required to recognize additional impairment charges;
- loss of value of investments in entities not under our control;
- the Company may not receive accurate, complete or timely financial information from entities for which the Company is required to consolidate such information;
- the Company may be adversely affected by new accounting pronouncements;
- the Company’s ability to generate cash to service its debt obligations;
- restrictive covenants in the Company’s credit agreement which may restrict its ability to pursue its business strategies;
- the Company’s reliance on certain critical information systems for the operation of its business;
- costs associated with the Company’s indemnification of certain customers, distributors and other parties;
- the Company’s share price could be subject to extreme price fluctuations;
- the impact on the Company’s common stock price if securities or industry analysts do not publish reports about the Company’s business or adversely change their recommendations regarding the Company’s common stock;
- anti-takeover provisions in the Company’s organizational documents could make an acquisition of the Company more difficult; and
- the Company is subject to litigation risks which may be costly to defend

Additionally, forward-looking statements should be considered in conjunction with the cautionary statements contained in this Quarterly Report on Form 10-Q, including, without limitation, information under the captions "Management’s Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" and additional factors that accompany the related forward-looking statements in this Quarterly Report on Form 10-Q, in our Annual Report on Form 10-K for the fiscal year ended January 28, 2018 including, without limitation information under the caption "Risk Factors", in other filings with the Securities and Exchange Commission ("SEC"), and in material incorporated herein and therein by reference. In light of the significant risks and uncertainties inherent in the forward-looking information included herein that may cause actual performance and results to differ materially from those predicted, any such forward-looking information should not be regarded as representations or guarantees by the Company of future performance or results, or that its objectives or plans will be achieved, or that any of its operating expectations or financial forecasts will be realized. Reported results should not be considered an indication of future performance. Investors are cautioned not to place undue reliance on any forward-looking information contained herein, which reflect management’s analysis only as of the date hereof. Except as required by law, the Company assumes no obligation to publicly release the results of any update or revision to any forward-looking statement that may be made to reflect new information, events or circumstances after the date hereof or to reflect the occurrence of unanticipated or future events, or otherwise.

In addition to regarding forward-looking statements with caution, you should consider that the preparation of the consolidated financial statements requires us to draw conclusions and make interpretations, judgments, assumptions and estimates with respect to certain factual, legal, and accounting matters. Our financial statements might have been materially impacted if we had reached different conclusions or made different interpretations, judgments, assumptions or estimates.

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	Three Months Ended		Six Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Net sales	$163,211	$153,127	$293,640	$296,929
Cost of sales	63,087	60,891	122,047	119,778
Gross profit	100,124	92,236	171,593	177,151
Operating costs and expenses:				
Selling, general and administrative	33,529	39,237	74,935	73,252
Product development and engineering	28,079	27,432	54,278	53,415
Intangible amortization	6,480	6,675	13,441	12,961
Loss on disposition of business operations	—	—	—	375
Changes in the fair value of contingent earn-out obligations	(900)	—	(900)	—
Total operating costs and expenses	67,188	73,344	141,754	140,003
Operating income	32,936	18,892	29,839	37,148
Interest expense, net	(2,200)	(2,029)	(4,390)	(4,075)
Non-operating income (expense), net	542	(204)	732	(836)
Income before taxes and equity in net losses of equity method investments	31,278	16,659	26,181	32,237
Provision for taxes	6,082	4,095	(11,428)	7,852
Net income before equity in net losses of equity method investments	25,196	12,564	37,609	24,385
Equity in net losses of equity method investments	(27)	—	(58)	—
Net income	$25,169	$12,564	$37,551	$24,385
Earnings per share:				
Basic	$0.38	$0.19	$0.57	$0.37
Diluted	$0.37	$0.19	$0.55	$0.36
Weighted average number of shares used in computing earnings per share:				
Basic	66,063	65,763	66,194	65,801
Diluted	68,880	67,470	68,428	67,421

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

SEMTECH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three Months Ended		Six Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Net income	$25,169	$12,564	$37,551	$24,385
Other comprehensive income, net:				
Unrealized (loss) gain on foreign currency cash flow hedges	(164)	810	(117)	993
Realized gain (loss) on foreign currency cash flow hedges	25	(203)	25	(256)
Unrealized gain on convertible debt	—	—	—	750
Release of realized gain on convertible debt	—	(750)	—	(750)
Change in employee benefit plans	(16)	22	(32)	43
Other comprehensive (loss) income, net	(155)	(121)	(124)	780
Comprehensive income	$25,014	$12,443	$37,427	$25,165

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

SEMTECH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	July 29, 2018	January 28, 2018
Assets		
Current assets:		
Cash and cash equivalents	$311,334	$307,923
Accounts receivable, less allowances of $2,849 and $9,089, respectively	78,376	53,183
Inventories	58,893	71,067
Prepaid taxes	9,347	11,809
Other current assets	20,346	17,250
Total current assets	478,296	461,232
Non-current assets:		
Property, plant and equipment, net of accumulated depreciation of $190,149 and $179,604, respectively	122,608	124,586
Deferred tax assets	24,244	4,236
Goodwill	346,731	341,897
Other intangible assets, net	46,766	60,207
Other assets	90,125	93,618
TOTAL ASSETS	$1,108,770	$1,085,776
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$37,717	$37,208
Accrued liabilities	55,791	60,832
Deferred revenue	5,100	12,758
Current portion - long-term debt	17,307	15,410
Total current liabilities	115,915	126,208
Non-current liabilities:		
Deferred tax liabilities	15,762	14,682
Long term debt, less current portion	201,986	211,114
Other long-term liabilities	71,819	68,759
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Common stock, $0.01 par value, 250,000,000 shares authorized, 78,136,144 issued and 65,931,409 outstanding and 78,136,144 issued and 66,280,129 outstanding, respectively	785	785
Treasury stock, at cost, 12,204,735 shares and 11,856,015 shares, respectively	(288,541)	(251,974)
Additional paid-in capital	442,964	415,056
Retained earnings	549,404	502,346
Accumulated other comprehensive loss	(1,324)	(1,200)
Total stockholders' equity	703,288	665,013
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,108,770	$1,085,776

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

7

SEMTECH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended					
	July 29, 2018			July 30, 2017		
Cash flows from operating activities:						
Net income	$	37,551		$	24,385	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	24,540			23,093		
Accretion of deferred financing costs and debt discount	269			289		
Deferred income taxes	(14,870		)	380		
Share-based compensation and warrant costs	49,481			28,810		
Loss on disposition of business operations and assets	11			424		
Earn-out liabilities	(900		)	—		
Equity in net losses of equity method investments	58			—		
Contingencies	—			45		
Corporate owned life insurance, net	645			554		
Changes in assets and liabilities:						
Accounts receivable, net	(20,653		)	(9,490		)
Inventories	13,020			(9,423		)
Other assets	4,190			(1,099		)
Accounts payable	2,626			(9,132		)
Accrued liabilities	(6,414		)	(6,541		)
Deferred revenue	(53		)	196		
Income taxes payable	(1,697		)	1,328		
Other liabilities	(3,437		)	2,177		
Net cash provided by operating activities	84,367			45,996		
Cash flows from investing activities:						
Proceeds from sales of property, plant and	10			6		

equipment						
Purchase of property, plant and equipment	(9,821		)	(18,952		)
Purchase of investments	(5,595		)	(7,462		)
Acquisition, net of cash acquired	(7,321		)	(17,619		)
Proceeds from sale of investments	1,601			—		
Net cash used in investing activities	(21,126		)	(44,027		)
Cash flows from financing activities:						
Payments of term loans	(7,500		)	(7,500		)
Payment for employee share-based compensation payroll taxes	(10,640		)	(5,687		)
Proceeds from exercise of stock options	8,048			2,332		
Repurchase of outstanding common stock	(49,738		)	(10,394		)
Net cash used in financing activities	(59,830		)	(21,249		)
Net increase (decrease) in cash and cash equivalents	3,411			(19,280		)
Cash and cash equivalents at beginning of period	307,923			297,134		
Cash and cash equivalents at end of period	$	311,334		$	277,854	
Supplemental disclosure of cash flow information						
Income taxes paid	$	2,939		$	3,078	
Interest paid	$	3,900		$	3,490	
Non-cash items						
Capital expenditures in accounts payable	$	2,314		$	1,902	

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

8

SEMTECH CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: Organization and Basis of Presentation

Nature of Business

Semtech Corporation (together with its consolidated subsidiaries, the "Company" or "Semtech") is a global supplier of analog and mixed-signal semiconductors and advanced algorithms. The end customers for the Company's products are primarily original equipment manufacturers ("OEMs") that produce and sell electronics.

The Company designs, develops and markets a wide range of products for commercial applications, the majority of which are sold into the enterprise computing, communications, high-end consumer and industrial end-markets.

Enterprise Computing: datacenters, passive optical networks, desktops, notebooks, servers, monitors, printers and other computer peripherals.

Communications: base stations, optical networks, carrier networks, switches and routers, cable modems, wireless LAN and other communication infrastructure equipment.

High-End Consumer: handheld products, smartphones, wireless charging, set-top boxes, digital televisions, monitors and displays, tablets, wearables, digital video recorders and other consumer equipment.

Industrial: analog and digital video broadcast equipment, Video-over-IP solutions, automated meter reading, Internet of Things ("IoT"), smart grid, wireless charging, military and aerospace, medical, security systems, automotive, industrial and home automation and other industrial equipment.

Fiscal Year

The Company reports results on the basis of 52 and 53 week periods and ends its fiscal year on the last Sunday in January. The other quarters generally end on the last Sunday of April, July and October. All quarters consist of 13 weeks except for one 14-week period in the fourth quarter of 53-week years. The second quarter of fiscal years 2019 and 2018 each consisted of 13 weeks.

Principles of Consolidation

The accompanying interim unaudited condensed consolidated financial statements have been prepared by the Company, in accordance with accounting principles generally accepted in the United States ("GAAP") and on the same basis as the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended January 28, 2018. In the opinion of the Company, these interim unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly, in all material respects, the financial position of the Company for the interim periods presented. All intercompany balances have been eliminated. Certain information and footnote disclosures normally included in annual consolidated financial statements have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Because the interim unaudited condensed consolidated financial statements do not include all of the information and notes required by GAAP for a complete set of consolidated financial statements, they should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended January 28, 2018. The results reported in these interim unaudited condensed consolidated financial statements should not be regarded as indicative of results that may be expected for any subsequent period or for the entire year.

The Company's interim unaudited condensed consolidated statements of income are referred to herein as the "Statements of Income." The Company's interim unaudited condensed consolidated balance sheets are referred to herein as the "Balance Sheets" and interim unaudited condensed consolidated statements of cash flows as the "Statements of Cash Flows."

Segment Information

The Company's Chief Executive Officer ("CEO") has been identified as the Chief Operating Decision Maker ("CODM") as defined by guidance regarding segment disclosures (see Note 12 for further discussion). Prior to the first quarter of fiscal year 2019, the Company had four operating segments. Beginning with the first quarter of fiscal year 2019, the Company identified three operating segments that aggregate into one reportable segment, the Semiconductor Products Group.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Acquisitions

On May 2, 2018, the Company acquired substantially all the assets of IC Interconnect, Inc. (“ICI”) for a cash payment of approximately $7.3 million. The addition of ICI is aimed at further enhancing the Company’s U.S. research and development capabilities for its next-generation Z-Pak platform. $4.8 million was attributed to goodwill and $2.5 million was attributed to the estimated fair values of the tangible net assets acquired. The goodwill is deductible for tax purposes. The transaction was accounted for as a business combination and we are still assessing the purchase price allocation.

Net revenues, earnings and pro forma results of operations have not been presented because they are not material to the Company’s consolidated financial statements.

Settlements

On August 1, 2018, the Company announced the settlement of a lawsuit filed against HiLight Semiconductor Limited and related individual Defendants in accordance with which Semtech is to be paid approximately $9.0 million to cover damages for claims, costs and attorneys' fees. The $6.6 million received during the second quarter of fiscal year 2019 is presented within selling, general and administrative ("SG&A").

Recent Accounting Standards Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Accounting Standards Codification ("ASC") 606), which requires an entity to recognize revenue from the transfer of control of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance addresses, in particular, contracts with more than one performance obligation, as well as the accounting for some costs to obtain or fulfill a contract with a customer, and provides for additional disclosures with respect to revenues and cash flows arising from contracts with customers.

The Company adopted the standard, effective January 29, 2018, using the modified retrospective transition method which resulted in an adjustment to retained earnings for the cumulative effect of applying the standard to all contracts not completed as of the adoption date. The primary change associated with the adoption relates to the Company’s sales to distributors with return or price adjustment rights where the Company will no longer defer revenue until the resale by the distributor to the end customer, but rather, will record revenue at the time control transfers to the distributor. The Company estimated the effects of returns and allowances provided to these distributors. Upon adoption, including the effect of income taxes, opening retained earnings as of January 29, 2018 increased by $11.1 million net, as a result of these changes. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Asset Transfers Other Than Inventory (Topic 740). This accounting standard update is aimed at recognizing the income tax consequences of intra-entity transfers of assets other than inventory when they occur. This removes the exception to postpone the recognition of income tax consequences of intra-entity transfers until the asset has been sold to an outside party. In the first quarter of 2019, the Company adopted ASU 2016-16 using a modified retrospective transition method, resulting in a $1.8 million decrease in retained earnings, a $3.7 million net increase in deferred income tax assets, and a $5.5 million decrease in pre-paid taxes.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (Topic 230). The primary purpose of this ASU is to reduce the diversity in practice that has resulted from the lack of consistent principles on this topic.

Accounting Guidance Issued but Not Adopted as of July 29, 2018

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which will require that substantially all leases be recognized by lessees on their balance sheets as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. Public entities are required to apply the amendments for annual periods beginning after December 15, 2018 and for interim periods within those annual periods. The Company will adopt this update beginning in the first quarter of fiscal year 2020 utilizing the modified retrospective transition method by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company expects to elect certain practical expedients permitted under the transition guidance within the standard.

The Company expects the valuation of right of use assets and lease liabilities, previously described as operating leases, to be the present value of the Company’s forecasted future lease commitments. The Company is continuing to assess the overall impacts of the new standard, including the discount rate to be applied in these valuations, and expects the amendments will have a material impact on our consolidated financial statements, primarily to the consolidated balance sheets and related disclosures.

Note 2: Revenue

The Company derives its revenue primarily from the sale of semiconductor products into various end markets. Revenue is recognized when control of these products is transferred to the Company's customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for these products. Control is generally transferred when products are shipped and, to a lesser extent, when the products are delivered. Recovery of costs associated with product design and engineering services are recognized during the period in which services are performed and are reported as a reduction to product development and engineering expense. Historically, these recoveries have not exceeded the cost of the related development efforts. The Company includes revenue related to granted technology licenses as part of "Net sales." Historically, revenue from these arrangements has not been significant though it is part of its recurring ordinary business.

The Company determines revenue recognition through the following five steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, performance obligations are satisfied

The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

The Company's revenue contracts generally represent a single performance obligation to sell its products to trade customers. Net sales reflect the transaction prices for contracts, which include units shipped at selling prices reduced by variable consideration. Determination of variable consideration requires judgment by the Company. Variable consideration includes expected sales returns and other price adjustments. Variable consideration is estimated using the expected value method considering all reasonably available information, including the Company's historical experience and its current expectations, and is reflected in the transaction price when sales are recorded. Sales returns are generally accepted at the Company's discretion or from distributors with such rights. The Company's contracts with trade customers do not have significant financing components or non-cash consideration. The Company records net sales excluding taxes collected on its sales to its trade customers.

The Company provides an assurance type warranty which is typically not sold separately and does not represent a separate performance obligation. The Company's payment terms are generally aligned with shipping terms.

The following presents the amounts by which financial statement line items were affected in the current periods due to the adoption of ASC 606 as compared with the guidance that was in effect before the change:

	Three Months Ended	Six Months Ended
Statements of Income	July 29, 2018	July 29, 2018
(in thousands, except per share amounts)	Increase/(decrease)	Increase/(decrease)
Net sales	$ 1,884	$ 6,346
Cost of sales	$ 428	$ 1,444
Provision for taxes	$ 306	$ 1,030
Net income	$ 1,150	$ 3,873
Earnings per share:		
Basic	0.02	0.06
Diluted	0.02	0.06

Balance Sheets	July 29, 2018
(in thousands)	Increase/(decrease)
Deferred revenue	(17,306)

Excludes line items that were not materially affected by the Company's adoption of ASC 606. The adoption had no impact to total net cash provided by or used in operating, investing or financing activities in the Statements of Cash Flows.

Contract Modifications:
If a contract is modified, which does not normally occur, changes in contract specifications and requirements must be accounted for. The Company considers contract modifications to exist when the modification either creates new or changes the existing enforceable rights and obligations. Most of the Company's contract modifications are to distributor agreements for adding new goods or services that are considered distinct from the existing contract and the change in contract price reflects the standalone selling price of the distinct service.
Disaggregated Revenue:
The Company disaggregates revenue from contracts with customers by types of products and geography, as it believes it best depicts how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Refer to "Note 12: Segment Information" for further information on revenues by product line and geographic region.
Contract Balances:
Accounts receivable represents the Company's unconditional right to receive consideration from its customers. Contract assets consist of the Company's right to consideration in exchange for goods or services that the Company has transferred to a customer when that right is conditioned on something other than the passage of time. ASC 606 also requires an entity to present a revenue contract as a contract liability in instances when a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (e.g. receivable), before the entity transfers a good or service to the customer. The opening and closing contract asset and contract liability balances are not material.
There were no impairment losses recognized on the Company's accounts receivable or contract assets during the three and six months ended July 29, 2018. There were no significant changes in the contract assets or the contract liabilities for the three and six months ended July 29, 2018.
Practical Expedients:
Unsatisfied Performance Obligations: Because all of the Company's performance obligations relate to contracts with a duration of less than one year, the Company elected to apply the optional exemption provided in ASC 606 and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period.
Contract Costs: All incremental customer contract acquisition costs are expensed as they are incurred as the amortization period of the asset that the Company otherwise would have recognized is one year or less in duration.
Significant Financing Component: The Company does not adjust the promised amount of consideration for the effects of a significant financing component as the Company expects, at contract inception, that the period between when the Company transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.
Sales Tax Exclusion from the Transaction Price: The Company excludes from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the Company from the customer.
Shipping and Handling Activities: The Company accounts for shipping and handling activities performed after a customer obtains control of the good as activities to fulfill the promise to transfer the good.

Note 3: Earnings per Share

The computation of basic and diluted earnings per common share was as follows:

(in thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Net income	$25,169	$12,564	$37,551	$24,385
Weighted average common shares outstanding - basic	66,063	65,763	66,194	65,801
Dilutive effect of stock options and restricted stock units	2,817	1,707	2,234	1,620
Weighted average common shares outstanding - diluted	68,880	67,470	68,428	67,421
Basic earnings per common share	$0.38	$0.19	$0.57	$0.37
Diluted earnings per common share	$0.37	$0.19	$0.55	$0.36
Anti-dilutive shares not included in the above calculations	202	254	364	385

Basic earnings per common share is computed by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding during the reporting period. Diluted earnings per common share incorporates the incremental shares issuable, calculated using the treasury stock method, upon the assumed exercise of non-qualified stock options, the vesting of restricted stock units and performance unit awards if the conditions have been met.

12

Note 4: Share-Based Compensation

Financial Statement Effects and Presentation. The following table summarizes pre-tax share-based compensation included in the Statements of Income for the three and six months ended July 29, 2018 and July 30, 2017.

(in thousands)	Three Months Ended		Six Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Revenue offset	$—	$3,197	$21,501	$8,477
Cost of sales	306	281	633	845
Selling, general and administrative	11,170	10,855		