ILLUMINA INC
Form 10-Q
August 10, 2011

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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 July 3, 2011

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _________to__________

Commission file number 000-30361

Illumina, Inc.

(Exact name of registrant as specified in its charter)

Delaware	33-0804655
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
9885 Towne Centre Drive, San Diego, CA	92121
(Address of Principal Executive Offices)	(Zip Code)

(858) 202-4500
(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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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

As of July 15, 2011, there were 124,339,763 shares of the Registrant s Common Stock outstanding.

ILLUMINA, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ILLUMINA, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	July 3, 2011 (Unaudited)	January 2, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 261,084	$ 248,947
Short-term investments	972,830	645,342
Accounts receivable, net	193,431	165,598
Inventory, net	142,583	142,211
Deferred tax assets, current portion	22,450	19,378
Prepaid expenses and other current assets	30,937	36,922
Total current assets	1,623,315	1,258,398
Property and equipment, net	129,762	129,874
Goodwill	321,853	278,206
Intangible assets, net	112,708	91,462
Deferred tax assets, long-term portion	16,990	39,497
Other assets	52,358	41,676
Total assets	$ 2,256,986	$ 1,839,113
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 58,270	$ 66,744
Accrued liabilities	185,536	156,164
Long-term debt, current portion	40,649	311,609
Total current liabilities	284,455	534,517
Long-term debt	757,274	
Other long-term liabilities	38,512	28,531
Conversion option subject to cash settlement	8,441	78,390
Stockholders equity:		
Preferred stock		
Common stock	1,651	1,516
Additional paid-in capital	2,170,564	1,891,288
Accumulated other comprehensive income	2,347	1,765
Accumulated deficit	(100,584)	(155,335)
Treasury stock, at cost	(905,674)	(541,559)
Total stockholders equity	1,168,304	1,197,675
Total liabilities and stockholders equity	$ 2,256,986	$ 1,839,113

See accompanying notes to the condensed consolidated financial statements.

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ILLUMINA, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	July 3, 2011	July 4, 2010	July 3, 2011	July 4, 2010
Revenue:				
Product revenue	$ 269,871	$ 198,538	$ 536,588	$ 372,217
Service and other revenue	17,579	13,465	33,377	31,917
Total revenue	287,450	212,003	569,965	404,134
Cost of revenue:				
Cost of product revenue	84,518	59,627	169,955	112,566
Cost of service and other revenue	6,541	4,690	12,593	10,084
Amortization of acquired intangible assets	3,035	1,595	6,020	3,215
Total cost of revenue	94,094	65,912	188,568	125,865
Gross profit	193,356	146,091	381,397	278,269
Operating expense:				
Research and development	50,801	43,667	101,001	87,343
Selling, general and administrative	69,233	53,135	134,894	103,414
Acquisition related expense, net	4,770	1,861	5,040	1,861
Headquarter relocation expense	2,542		5,064	
Total operating expense	127,346	98,663	245,999	192,618
Income from operations	66,010	47,428	135,398	85,651
Other income (expense):				
Interest income	1,981	1,751	3,521	3,955
Interest expense	(9,418)	(6,134)	(16,809)	(12,089)
Other (expense) income, net	(9,549)	3,481	(37,078)	2,369
Total other expense, net	(16,986)	(902)	(50,366)	(5,765)
Income before income taxes	49,024	46,526	85,032	79,886
Provision for income taxes	18,404	16,730	30,275	28,882
Net income	$ 30,620	$ 29,796	$ 54,757	$ 51,004
Net income per basic share	$ 0.25	$ 0.24	$ 0.44	$ 0.42
Net income per diluted share	$ 0.22	$ 0.21	$ 0.37	$ 0.37
Shares used in calculating basic net income per share	123,456	123,095	124,987	121,882

Shares used in calculating diluted net income per share	141,765	140,951	147,447	138,682

See accompanying notes to the condensed consolidated financial statements.

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ILLUMINA, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six Months Ended	
	July 3, 2011	**July 4, 2010**
Cash flows from operating activities:		
Net income	$ 54,757	$ 51,004
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	25,989	15,804
Amortization of acquired intangible assets	6,313	3,215
Share-based compensation expense	45,705	33,844
Accretion of debt discount	15,185	10,504
Loss on extinguishment of debt	36,856	
Contingent compensation expense	2,573	1,838
Gain on acquisition		(2,914)
Incremental tax benefit related to stock options exercised	(33,320)	(8,000)
Deferred income taxes	4,121	8,040
Other non-cash adjustments	4,837	1,436
Changes in operating assets and liabilities:		
Accounts receivable	(20,751)	6,162
Inventory	4,524	(27,766)
Prepaid expenses and other current assets	(6,539)	2,092
Other assets	(3,632)	(1,460)
Accounts payable	(9,969)	16,383
Accrued liabilities	30,671	22,398
Other long-term liabilities	1,248	(799)
Unrealized gain on foreign exchange	1,230	4,483
Net cash provided by operating activities	159,798	136,264
Cash flows from investing activities:		
Purchases of available-for-sale securities	(806,985)	(313,017)
Sales and maturities of available-for-sale securities	476,460	256,034
Sales and maturities of trading securities		54,900
Net cash paid for acquisitions	(58,302)	(75,069)
Purchases of investments	(6,708)	(17,650)
Purchases of property and equipment	(28,503)	(24,322)
Cash paid for intangible assets	(1,102)	(2,000)
Net cash used in investing activities	(425,140)	(121,124)
Cash flows from financing activities:		
Payments on current portion of long-term debt	(340,909)	
Proceeds from issuance of convertible notes	903,492	
Incremental tax benefit related to stock options exercised	33,320	8,000
Common stock repurchases	(366,326)	

Proceeds from exercises of warrants	5,512	9,587
Proceeds from issuance of common stock	41,909	59,935
Net cash provided by financing activities	276,998	77,522
Effect of exchange rate changes on cash and cash equivalents	481	(108)
Net increase in cash and cash equivalents	12,137	92,554
Cash and cash equivalents at beginning of period	248,947	144,633
Cash and cash equivalents at end of period	$ 261,084	$ 237,187

See accompanying notes to the condensed consolidated financial statements.

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Illumina, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

Unless the context requires otherwise, references in this report to Illumina, we, us, the Company, and our refer to Illumina, Inc. and its consolidated subsidiaries.

1. Summary of Significant Accounting Principles

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. In management s opinion, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented.

Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited financial statements should be read in conjunction with the Company s audited financial statements and footnotes included in the Company s Annual Report on Form 10-K for the fiscal year ended January 2, 2011 from which the balance sheet information herein was derived.

The preparation of financial statements requires that management make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses, and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Fiscal Year

The Company s fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, September 30, and December 31. The three and six months ended July 3, 2011 and July 4, 2010 were both 13 and 26 weeks, respectively.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current year presentation.

Revenue Recognition

The Company s revenue is generated primarily from the sale of products and services. Product revenue primarily consists of sales of instrumentation and consumables used in genetic analysis. Service and other revenue primarily consists of revenue generated from instrument service contracts, genotyping and sequencing services, and research agreements with government grants.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. In instances where final acceptance of the product is required, revenue is deferred until all the acceptance criteria have been met. All revenue is recorded net of discounts.

Revenue for product sales is recognized generally upon transfer of title to the customer, provided that no significant obligations remain and collection of the receivable is reasonably assured. Revenue from instrument service contracts is recognized as the services are rendered, typically evenly over the contract term, and revenue from genotyping and sequencing services is recognized when earned, which is generally at the time the genotyping or sequencing analysis data is made available to the customer or agreed upon milestones are reached. Revenue from research agreements with government grants is recognized in the period during which the related costs are incurred.

In order to assess whether the price is fixed or determinable, the Company evaluates whether refund rights exist. If there are refund rights or payment terms based on future performance, the Company defers revenue recognition until the price becomes fixed or determinable. The Company assesses collectibility based on a number of factors, including past transaction history with the customer and the creditworthiness of the customer. If the Company determines that collection of a payment is not reasonably assured, revenue recognition is deferred until receipt of payment.

The Company regularly enters into contracts where revenue is derived from multiple deliverables including any mix of products or services. These products or services are generally delivered within a short time frame, approximately three to six months, after the contract execution date. Revenue recognition for contracts with multiple deliverables is based on the individual units of accounting determined to exist in the contract. A delivered item is considered a separate unit of accounting when the delivered item has value to the customer on a stand-alone basis. Items are considered to have stand-alone value when they are sold separately by any vendor or when the customer could resell the item on a stand-alone basis. Consideration is allocated at the inception of the contract to all deliverables based on their relative selling price. The relative selling price for each deliverable is determined using vendor specific objective evidence (VSOE) of selling price or third-party evidence of selling price if VSOE does not exist. If neither VSOE nor third-party evidence exists, the Company uses its best estimate of the selling price for the deliverable.

In order to establish VSOE of selling price, the Company must regularly sell the product or service on a stand-alone basis with a substantial majority priced within a relatively narrow range. VSOE of selling price is usually the midpoint of that range. If there are not a sufficient number of standalone sales and VSOE of selling price cannot be determined, then the Company considers whether third party evidence can be used to establish selling price. Due to the lack of similar products and services sold by other companies within the industry, the Company has rarely established selling price using third-party evidence. If neither VSOE nor third party evidence of selling price exists, the Company determines its best estimate of selling price using average selling prices over a rolling 12-month period coupled with an assessment of current market conditions. If the product or service has no history of sales or if the sales volume is not sufficient, the Company relies upon prices set by the Company s pricing committee adjusted for applicable discounts. The Company recognizes revenue for delivered elements only when it determines there are no uncertainties regarding customer acceptance.

In the first quarter of 2010, the Company offered an incentive with the HiSeq 2000 launch that enabled existing Genome Analyzer customers to trade in their Genome Analyzer and receive a discount on the purchase of a HiSeq 2000. The incentive was limited to customers who had purchased a Genome Analyzer as of the date of the announcement and was the first significant trade-in program offered by the Company. The Company accounts for HiSeq 2000 discounts related to the Genome Analyzer trade-in program as reductions to revenue upon recognition of the HiSeq 2000 sales revenue, which is later than the date the trade-in program was launched.

In certain markets within Europe, the Asia-Pacific region, Latin America, the Middle East, and South Africa, the Company sells products and provides services to customers through distributors that specialize in life science products. In most sales through distributors, the product is delivered directly to customers. In cases where the product is delivered to a distributor, revenue recognition is deferred until acceptance is received from the distributor, and/or the end-user, if required by the applicable sales contract. The terms of sales transactions through distributors are consistent with the terms of direct sales to customers. These transactions are accounted for in accordance with the Company s revenue recognition policy described herein.

Goodwill, Intangible Assets, and Other Long-Lived Assets

Goodwill represents the excess of cost over fair value of net assets acquired. The change in the carrying value of goodwill during the six months ended July 3, 2011 was due to goodwill recorded in connection with the Company s acquisition of Epicentre Technologies Corporation (Epicentre) in January 2011.

The Company s identifiable intangible assets are comprised primarily of in-process research and development (IPR&D), licensed technology, acquired core technologies, customer relationships, trade names, and license agreements. Except IPR&D, the cost of all identifiable intangible assets is amortized on a straight-line basis over their respective useful lives. The Company regularly performs reviews to determine if the carrying values of its long-lived assets are impaired. A review of intangible assets that have finite useful lives and other long-lived assets is performed when an event occurs indicating the potential for impairment. If indicators of impairment exist, the Company assesses the recoverability of the affected long-lived assets by determining whether the carrying amount of such assets exceeds the undiscounted expected future cash flows associated with such assets. If impairment is indicated, the Company compares the carrying amount to the estimated fair value of the affected assets and adjusts the value of such assets accordingly. Factors that would necessitate an impairment assessment include a significant decline in the Company s

stock price and market capitalization compared to its net book value, significant changes in the ability of a particular asset to generate positive cash flows, and significant changes in the Company s strategic business objectives and utilization of a particular asset. The Company performed quarterly reviews of its long-lived assets and noted no indications of impairment for the three and six months ended July 3, 2011.

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Goodwill and IPR&D, which have indefinite useful lives, are reviewed for impairment at least annually during the second fiscal quarter, or more frequently if an event occurs indicating the potential for impairment. The performance of the goodwill impairment test is a two-step process. The first step of the impairment test involves comparing the estimated fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the Company performs the second step of the goodwill impairment test to determine the amount of loss, which involves comparing the implied fair value of the goodwill with the carrying value of the goodwill. The Company performed its annual impairment test of goodwill in the second fiscal quarter of 2011, noting no impairment. In its impairment test, the Company concluded that it has a single reporting unit and that its fair value exceeded its book value, using market capitalization as a reference for the Company s fair value. Therefore, the first step recoverability test was passed and the second step analysis was not required.

The IPR&D impairment test requires the Company to assess the fair value of the asset as compared to its carrying value, and if the carrying value exceeds the fair value, record an impairment charge. The Company performed its annual impairment test of its IPR&D in the second fiscal quarter of 2011, noting no impairment. In its impairment test, the Company assessed the fair value of IPR&D using an income approach, taking into consideration various factors such as future revenue contributions, additional research and development costs to be incurred, and contributory asset charges. The rate used to discount net future cash flows to their present values was based on a risk-adjusted rate of return.

Fair Value Measurements

The Company determines the fair value of its assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The Company uses a fair value hierarchy with three levels of inputs, of which the first two are considered observable and the last unobservable, to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs, other than Level 1, that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The carrying amounts of financial instruments such as cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, and accrued liabilities, excluding acquisition related contingent consideration liabilities, approximate the related fair values due to the short-term maturities of these instruments.

Derivatives

The Company is exposed to foreign exchange rate risks in the normal course of business. To manage a portion of the accounting exposure resulting from changes in foreign currency exchange rates, the Company enters into foreign exchange contracts to hedge monetary assets and liabilities that are denominated in currencies other than the United States dollar. These foreign exchange contracts are carried at fair value, do not qualify for hedge accounting treatment, and are not designated as hedging instruments. Changes in the value of the foreign exchange contracts are recognized in other (expense) income, net, in the consolidated statements of income for the current period, along with an offsetting gain or loss on the underlying assets or liabilities.

As of July 3, 2011, the Company had foreign exchange forward contracts in place to hedge exposures in the euro, Japanese yen, and Australian dollar. As of July 3, 2011, the total notional amount of outstanding forward contracts in place for foreign currency purchases was approximately $27.8 million. Losses related to the non-designated foreign exchange forward contracts for the three and six months ended July 3, 2011 were immaterial.

Leases

Leases are reviewed and classified as capital or operating at their inception. For leases that contain rent escalations, the Company records rent expense on a straight-line basis over the term of the lease, which includes the construction build-out period and lease extension periods, if appropriate. The difference between rent payments and straight-line

rent expense is recorded as deferred rent in

other long-term liabilities. Landlord allowances are recorded in other long-term liabilities and amortized on a straight-line basis over the lease term as a reduction to rent expense. The Company capitalizes leasehold improvements and amortizes them over the shorter of the lease term or their expected useful lives.

In December 2010, the Company agreed to lease a facility in San Diego, California that will serve as its new corporate headquarters. Headquarter relocation expense is recorded in the Company s operating expenses and includes a cease-use loss to be recorded upon vacating its current headquarter facility expected near the end of 2011, additional rent expense during the transition to the new facility, and accelerated depreciation of certain property and equipment. The cease-use loss will be calculated as the present value of the expected difference between the remaining lease payments obligation and estimated sublease rental during the remaining lease period, adjusted for deferred rent and leasehold improvements. The Company will record rent expense upon obtaining control of the new facility, and as a result, will incur additional rent expense until vacating the current facility. In addition, the Company records accelerated depreciation expense for leasehold improvements at its current headquarter facility based on the reassessed useful lives of less than a year. Headquarter relocation expense of $2.5 million and $5.1 million recorded in the three and six months ended July 3, 2011 represent accelerated depreciation expense.

Net Income per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the reporting period increased to include dilutive potential common shares calculated using the treasury stock method. Diluted net income per share reflects the potential dilution from outstanding stock options, restricted stock units, employee stock purchase plan (ESPP), warrants, shares subject to forfeiture, and convertible senior notes. Under the treasury stock method, convertible senior notes will have a dilutive impact when the average market price of the Company s common stock is above the applicable conversion price of the respective notes. In addition, the following amounts are assumed to be used to repurchase shares: the amount that must be paid to exercise stock options and warrants and purchase shares under the ESPP; the amount of compensation expense for future services that the Company has not yet recognized for stock options, restricted stock units, ESPP, and shares subject to forfeiture; and the amount of tax benefits that will be recorded in additional paid-in capital when the expenses related to respective awards become deductible.

The following table presents the calculation of weighted average shares used to calculate basic and diluted net income per share (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2011	**July 4, 2010**	**July 3, 2011**	**July 4, 2010**
Weighted average shares outstanding	123,456	123,095	124,987	121,882
Effect of dilutive potential common shares:				
Dilutive convertible senior notes	2,408	8,404	6,681	7,926
Dilutive equity awards	5,607	4,295	5,698	4,244
Dilutive warrants sold in connection with convertible senior notes	10,294	4,351	10,081	3,645
Dilutive warrants assumed in an acquisition		806		985
Weighted average shares used in calculation of diluted net income per share	141,765	140,951	147,447	138,682
Weighted average shares excluded from calculation due to anti-dilutive effect	1,194	1,480	1,012	1,325

Comprehensive Income

Total comprehensive income consisted of the following (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2011	**July 4, 2010**	**July 3, 2011**	**July 4, 2010**
Net income	$ 30,620	$ 29,796	$ 54,757	$ 51,004
Unrealized gain (loss) on available-for-sale securities, net of deferred tax	1,227	(39)	582	(217)
Total comprehensive income	$ 31,847	$ 29,757	$ 55,339	$ 50,787

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Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued an amendment to the Fair value Measurements and Disclosures topic of the Accounting Standards Codification (ASC). The amendment clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This amendment is effective for the Company in first quarter of fiscal 2012. The amendment is to be adopted prospectively and early adoption is not permitted. The Company does not believe that adoption of the amendment will have a significant impact on its financial position, results of operations, or cash flows.

In June 2011, the FASB issued an update to the Comprehensive Income topic of the ASC. This update requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update eliminates the option to present the components of other comprehensive income as part of the statement of equity. It is effective for the Company in first quarter of fiscal 2012 and should be applied retrospectively. The update is to be adopted prospectively and early adoption is permitted. The Company does not believe that adoption of this update will have an impact on its financial position, results of operations, or cash flows.

2. Balance Sheet Account Details

Short-Term Investments

The following is a summary of short-term investments (in thousands):

	July 3, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Debt securities in government sponsored entities	$ 437,406	$ 480	$ (166)	$ 437,720
Corporate debt securities	484,715	1,400	(251)	485,864
U.S. Treasury securities	49,076	176	(6)	49,246
Total available-for-sale securities	$ 971,197	$ 2,056	$ (423)	$ 972,830

	January 2, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				

(1,975	)	
Other comprehensive income, net of tax		
Foreign currency translation adjustment	70	(166)
Comprehensive income (loss)	2,500	(2,141)
Noncontrolling interest	(898)	—
Comprehensive income (loss) attributable to Alpha and Omega Semiconductor Limited	$ 3,398	$ (2,141)

See accompanying notes to these condensed consolidated financial statements.

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ALPHA AND OMEGA SEMICONDUCTOR LIMITED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Three Months Ended September 30,	
	2016	2015
Cash flows from operating activities		
Net income (loss)	$2,430	$(1,975)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,503	6,895
Share-based compensation expense	1,316	789
Deferred income taxes, net	6,645	571
Gain on disposal of property and equipment	(377)	—
Changes in assets and liabilities:		
Accounts receivable	(465)	1,583
Inventories	(1,170)	2,217
Other current and long-term assets	(5,690)	595
Accounts payable	(2,804)	(5,193)
Income taxes payable	327	389
Accrued and other liabilities	2,582	1,936
Net cash provided by operating activities	9,297	7,807
Cash flows from investing activities		
Purchases of property and equipment	(17,374)	(6,002)
Proceeds from sale of property and equipment	417	—
(Increase) decrease in restricted cash	(37)	172
Net cash used in investing activities	(16,994)	(5,830)
Cash flows from financing activities		
Proceeds from investment by noncontrolling interest	33,000	—
Withholding tax on restricted stock units	(132)	(51)
Proceeds from exercise of stock options	6,011	424
Payment for repurchases of common shares	—	(35,240)
Principal payments on capital leases	(215)	(227)
Net cash provided by (used in) financing activities	38,664	(35,094)
Effect of exchange rate changes on cash and cash equivalents	33	(100)
Net increase (decrease) in cash and cash equivalents	31,000	(33,217)
Cash and cash equivalents at beginning of period	87,774	106,085
Cash and cash equivalents at end of period	$118,774	$72,868
Supplemental disclosures of non-cash investing and financing information:		
Property and equipment purchased but not yet paid	$5,226	$4,472
Re-issuance of treasury stock	$10	$—

See accompanying notes to these condensed consolidated financial statements.

ALPHA AND OMEGA SEMICONDUCTOR LIMITED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. The Company and Significant Accounting Policies

The Company

Alpha and Omega Semiconductor Limited and its subsidiaries (the “Company,” "AOS," "we" or "us") design, develop and supply a broad range of power semiconductors. The Company's portfolio of products targets high-volume applications, including personal computers, flat panel TVs, LED lighting, smart phones, battery packs, consumer and industrial motor controls and power supplies for TVs, computers, servers and telecommunications equipment. The Company conducts its operations primarily in the United States of America (“USA”), Hong Kong, China, Taiwan, Korea and Japan.

Basis of Preparation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and with the instructions to Article 10 of Securities and Exchange Commission Regulation S-X, as amended. They do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with U.S. GAAP for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2016. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair presentation of the results of operations for the periods presented have been included in the interim periods. Operating results for the three months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2017. The condensed consolidated balance sheet at June 30, 2016 is derived from the audited financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2016.

Reclassification

The Company has reclassified certain amounts previously reported in its financial statements to conform to the current presentation. These reclassifications did not have a material impact on our consolidated financial statements.

Joint Venture

In March 2016, the Company executed an agreement with two strategic investment funds owned by the Municipality of Chongqing, China (the "Chongqing Funds") to form a joint venture for a new state-of-the-art power semiconductor packaging, testing and wafer fabrication facility in Liangjiang New Area of Chongqing (the "Joint Venture"). The initial capitalization of the Joint Venture under the agreement is $330.0 million, which includes cash contribution from the Chongqing Funds and contributions of cash, equipment and intangible assets from the Company. The Company owns 51% and the Chongqing Funds owns 49% of the equity interest of the Joint Venture. The Joint Venture is accounted under the provisions of the consolidation guidance since the Company has controlling financial interest.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires the Company to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. To the extent there are material differences between these estimates and actual results, the Company's condensed consolidated financial statements will be affected. On an ongoing basis, the Company evaluates the estimates, judgments and assumptions including those related to stock rotation returns, price adjustments, allowance for doubtful accounts, inventory reserves, warranty accrual, income taxes, share-based compensation, and useful lives for property, plant and equipment and intangible assets.

Fair Value of Financial Instruments
The fair value of cash equivalents are based on observable market prices and have been categorized in Level 1 in the fair value hierarchy. Cash equivalents consist primarily of short term bank deposits. The carrying values of financial instruments

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such as cash and cash equivalents, accounts receivable and accounts payable approximate their carrying values due to their short-term maturities.

Impairment of Long-Lived Assets

Long-lived assets or asset groups are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. Factors that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets may not be recoverable. Where such factors indicate potential impairment, the recoverability of an asset or asset group is assessed by determining if the carrying value of the asset or asset group exceeds the sum of the projected undiscounted cash flows expected to result from the use and eventual disposition of the assets over the remaining economic life. The impairment loss is measured based on the difference between the carrying amount and the estimated fair value.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The Company's accumulated other comprehensive income (loss) consists of cumulative foreign currency translation adjustments. Total comprehensive income (loss) is presented in the condensed consolidated statements of comprehensive income (loss).

Recent Accounting Pronouncements

In October 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-16, "Income Taxes - Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"). ASU 2016-16 requires entities to recognize income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amended guidance is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods wihin annual periods beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-16 will have on its consolidated financial statements.

In August 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). ASU 2016-15 identifies how certain cash receipts and cash payments are presented and classified in the Statement of Cash Flows under Topic 230. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. Upon adoption, entities must apply the guidance retrospectively to all periods presented. The Company is currently evaluating the impact the adoption of ASU 2016-15 will have on its consolidated financial statements.

In May 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-12, "Revenue from Contracts with Customers (Topic 606) - Narrow-Scope Improvements and Practical Expedients." ASU 2016-12 provides additional guidance established by the FASB-IASB Joint Transition Resource Group for Revenue Recognition regarding the implementation of certain aspects of the new revenue recognition guidance. More specifically, the amendment provides additional guidance regarding assessing the collectibility criterion, the presentation of sales taxes and other similar taxes collected from customers, noncash consideration, contract modifications or completed contracts at transition of the new revenue recognition guidance and technical corrections. The effective date is consistent with the effective date of ASU 2014-09. The Company is currently evaluating the impact the adoption of ASU 2016-12 will have on its consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing ("ASU 2016-10"). ASU 2016-10 clarify two aspects of Topic 606: (a) identifying performance obligations; and (b) the licensing implementation guidance. The update is effective for annual periods beginning after December 15, 2017 including interim reporting periods therein. The Company is currently evaluating the impact the adoption of ASU 2016-10 will have on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification of related

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amounts within the statement of cash flows. This guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. The Company does not expect the adoption of this guidance will have a material impact on its consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued No. 2016-02, Leases ("ASU 2016-02"). This guidance requires a dual approach for lessee accounting under which a lessee will account for leases as finance leases or operating leases. Both finance and operating leases will result in the lessee recognizing a right-of-use asset and a corresponding liability on its balance sheet, with differing methodology for income statement recognition. This guidance is effective for public business entities for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. A modified retrospective approach is required for all leases existing or entered into after the beginning of the earliest comparative period in the consolidated financial statements. The Company is currently assessing the impact that adoption of this guidance will have on its consolidated financial statements.

In July 2015, the FASB issued No. 2015-11, Inventory - Simplifying the Measurement of Inventory ("ASU 2015-11"). ASU 2015-11 is additional guidance regarding the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. This guidance is effective for fiscal years and interim periods beginning after December 15, 2016. Early adoption is permitted. The Company does not expect the adoption of this guidance will have a material impact on its consolidated financial position, results of operations or cash flows.

In April 2015, the FASB issued ASU No. 2015-03, Interest -Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts and the accounting for debt issue costs under IFRS. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. ASU 2015-03 is effective for the annual period ending after December 15, 2015, and interim periods within those fiscal years. Early adoption of the amendments in this Update is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of this guidance will have a material impact on its consolidated financial position, results of operations or cash flows.

In February 2015, the FASB issued ASU No. 2015-2, “Consolidation (Topic 820): Amendments to the Consolidation Analysis.” ASU 2015-2 provides a revised consolidation model for all reporting entities to use in evaluating whether they should consolidate certain legal entities. All legal entities will be subject to reevaluation under this revised consolidation model. The revised consolidation model, among other things, (i) modifies the evaluation of whether limited partnerships and similar legal entities are VIEs or voting interest entities, (ii) eliminates the presumption that a general partner should consolidate a limited partnership, and (iii) modifies the consolidation analysis of reporting entities that are involved with VIEs through fee arrangements and related party relationships. ASU 2015-2 is effective for fiscal years, and interim reporting periods within those fiscal years, beginning after December 15, 2015. The Company does not expect the adoption of this guidance will have a material impact on its consolidated financial position, results of operations or cash flows.

In August 2014, the FASB issued amended standards No. 2014-15, Presentation of Financial Statements - Going Concern ("ASU 2014-15"), to provide guidance about management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures requirement. The amendments (1) provide a definition of the term substantial doubt, (2) require an evaluation for each annual and interim reporting period, (3) provide principles for considering the mitigating effect of management’s plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management’s plans,

(5) require an express statement and other disclosures when substantial doubt is not alleviated, and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early adoption is permitted. The Company does not expect the adoption of this guidance will have a material impact on its consolidated financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. In August 2015, the FASB issued an accounting standard update for a one-year deferral of the effective date of ASU 2014-09 to annual and interim periods beginning after December 15, 2017 and permits entities to early adopt the standard of ASU 2014-09 for annual and interim

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reporting periods beginning after December 15, 2016. Companies are permitted to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is in the process of evaluating the timing of its adoption and the impact of adoption on its consolidated financial statements.

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2. Net Income (Loss) Per Common Share Attributable to Alpha and Omega Semiconductor Limited

The following table presents the calculation of basic and diluted net income (loss) per share attributable to common shareholders:

	Three Months Ended September 30,	
	2016	2015
	(in thousands, except per share data)	
Numerator:		
Net income (loss) attributable to Alpha and Omega Semiconductor Limited	$3,307	$(1,975)
Denominator:		
Basic:		
Weighted average number of common shares used to compute basic net income (loss) per share	23,031	22,698
Diluted:		
Weighted average number of common shares used to compute basic net income (loss) per share	23,031	22,698
Effect of potentially dilutive securities:		
Stock options, RSUs and ESPP shares	1,382	—
Weighted average number of common shares used to compute diluted net income (loss) per share	24,413	22,698
Net income (loss) per share attributable to Alpha and Omega Semiconductor Limited:		
Basic	$0.14	$(0.09)
Diluted	$0.14	$(0.09)

The following potential dilutive securities were excluded from the computation of diluted net income (loss) per share as their effect would have been anti-dilutive:

	Three Months Ended September 30,	
	2016	2015
	(in thousands)	
Employee stock options and RSUs	247	3,617
ESPP	—	188
Total potential dilutive securities	247	3,805

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3. Concentration of Credit Risk and Significant Customers

The Company manages its credit risk associated with exposure to distributors and direct customers on outstanding accounts receivable through the application and review of credit approvals, credit ratings and other monitoring procedures. In some instances, the Company also obtains letters of credit from certain customers.

Credit sales, which are mainly on credit terms of 30 to 60 days, are only made to customers who meet the Company's credit requirements, while sales to new customers or customers with low credit ratings are usually made on an advance payment basis. The Company considers its trade accounts receivable to be of good credit quality because its key distributors and direct customers have long-standing business relationships with the Company and the Company has not experienced any significant write-offs of accounts receivable in the past. The Company closely monitors the aging of accounts receivable from its distributors and direct customers, and regularly reviews their financial positions, when available.

Summarized below are individual customers whose revenue or accounts receivable balances were more than 10% of the respective total consolidated amounts:

	Three Months Ended September 30,	
Percentage of revenue	2016	2015
Customer A	24.2%	23.1%
Customer B	36.5%	36.0%
Customer C	13.9%	14.3%

Percentage of accounts receivable	September 30, 2016	June 30, 2016
Customer A	27.6 %	21.3 %
Customer B	6.9 %	16.7 %
Customer C	35.3 %	27.2 %

4. Balance Sheet Components

Accounts receivable:

	September 30, 2016	June 30, 2016
	(in thousands)	
Accounts receivable	$46,104	$43,324
Less: Allowance for price adjustments	(19,015)	(16,700)
Less: Allowance for doubtful accounts	(30)	(30)
Accounts receivable, net	$27,059	$26,594

Inventories:

	September 30, 2016	June 30, 2016
	(in thousands)	
Raw materials	$26,352	$23,982
Work in-process	31,345	32,446
Finished goods	12,321	12,420
	$70,018	$68,848

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Property, plant and equipment, net:

	September 30, 2016	June 30, 2016
	(in thousands)	
Land	$4,877	$4,877
Building	4,325	4,323
Manufacturing machinery and equipment	200,778	193,164
Equipment and tooling	13,118	12,289
Computer equipment and software	23,791	23,448
Office furniture and equipment	1,943	1,822
Leasehold improvements	28,825	28,660
	277,657	268,583
Less: Accumulated depreciation	(175,012)	(168,687)
	102,645	99,896
Equipment and construction in progress	20,403	16,188
Property, plant and equipment, net	$123,048	$116,084

Other long-term assets:

	September 30, 2016	June 30, 2016
	(in thousands)	
Prepayments for property and equipment	$3,404	$ 506
Prepayment for others	204	42
Prepaid income tax	5,308	—
Investment in a privately held company	100	100
Office leases deposits	1,342	1,427
Intangible assets	15	15
Goodwill	269	269
	$10,642	$ 2,359

Accrued liabilities:

	September 30, 2016	June 30, 2016
	(in thousands)	
Accrued compensation and benefit	$10,368	$10,211
Warranty accrual	2,938	1,495
Stock rotation accrual	2,015	1,988
Accrued professional fees	1,936	1,867
Accrued inventory	1,272	918
Accrued facilities related expenses	1,382	1,544
Other accrued expenses	6,066	4,567
	$25,977	$22,590

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The activities in the warranty accrual, included in accrued liabilities, are as follows:

	Three Months Ended September 30,	
	2016	2015
	(in thousands)	
Beginning balance	$1,495	$1,957
Additions	1,491	305
Utilization	(48)	(59)
Ending balance	$2,938	$2,203

The activities in the stock rotation accrual, included in accrued liabilities, are as follows:

	Three Months Ended September 30,	
	2016	2015
	(in thousands)	
Beginning balance	$1,988	$1,894
Additions	1,626	1,510
Utilization	(1,599)	(1,494)
Ending balance	$2,015	$1,910

Other Long-term liabilities:

	September 30, 2016	June 30, 2016
	(in thousands)	
Deferred rent	$ 680	$ 741

5. Joint Venture

On March 29, 2016, the Company entered into a joint venture contract (the “JV Agreement”) with two investment funds owned by the Municipality of Chongqing (the “Chongqing Funds”), pursuant to which the Company and the Chongqing Funds formed a joint venture, (the “JV Company”), for the purpose of constructing a power semiconductor packaging, testing and 12-inch wafer fabrication facility in the Liangjiang New Area of Chongqing, China (the “JV Transaction”). The total initial capitalization of the JV Company is $330.0 million (the “Initial Capitalization”), which includes cash contribution from the Chongqing Funds and contributions of cash, equipments and intangible assets from the Company. The Initial Capitalization will be completed in stages commencing on the incorporation of the JV Company. The Company owns 51%, and the Chongqing Funds owns 49%, of the equity interest in the JV Company. If both parties agree that the termination of the JV Company is the best interest of each party or the JV Company is bankrupt or insolvent where either party may terminate early, after paying the debts of the JV Company, the remaining assets of the JV Company shall be paid to the Chongqing Funds to cover the principal of its total paid-in contributions plus interest at 10% simple annual rate prior to distributing the balance of the JV Company's assets to the Company. The Company expects the JV Company to commence its initial production in the first half of fiscal 2018.

The Company began consolidating the financial statements of the JV Company in the quarter ended June 30, 2016. During the quarter ended September 30, 2016, the Chongqing Funds contributed $33.0 million of initial capital in cash

and the Company fulfilled its obligation to contribute certain packaging equipments as required by the JV Agreement by transferring the legal titles of such equipment to the JV Company. Within one year from June 30, 2016, the Company expects to contribute certain intangible assets and cash of $10.0 million pursuant to the terms of the JV Agreement.

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The changes in total stockholders' equity and noncontrolling interest were as follows (in thousands):

	Total AOS Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance, June 30, 2016	$ 242,142	$ (103)	$ 242,039
Contributions from noncontrolling interest	—	33,000	33,000
Exercise of common stock options and release of RSUs	5,988	—	5,988
Reissuance of treasury stock upon exercise of common stock options and release of RSUs	23	—	23
Withholding tax on restricted stock units	(132)	—	(132)
Stock-based compensation expense	1,316	—	1,316
Net income (loss)	3,307	(877)	2,430
Cumulative translation adjustment	91	(21)	70
Balance, September 30, 2016	$ 252,735	$ 31,999	$ 284,734

6. Shareholders' Equity and Share-based Compensation
Share Repurchase

In April 2015, the Board of Directors approved an increase in the remaining available amount under the Company's then effective share repurchase program from approximately $17.8 million to $50.0 million. The repurchases may be made from the open market pursuant to a pre-established Rule 10b5-1 trading plan (as amended, the "Repurchase Trading Plan") or through privately negotiated transactions.

In July 2015, the Company completed a Dutch tender offer (the "Tender Offer") in which it purchased 3,296,703 shares of its common shares, at a purchase price of $9.10 per share, for an aggregate purchase price of $30.0 million, excluding fees and expenses relating to the Tender Offer. The Tender Offer was part of the $50.0 million share repurchase program approved by the Board on April 15, 2015. Shares repurchased are accounted for as treasury shares and the total cost of shares repurchased is recorded as a reduction of shareholders' equity.

During the three months ended September 30, 2016, the Company did not repurchased any shares pursuant to the repurchase program. Since the inception of the program in 2010, the Company repurchased an aggregate of 5,723,093 shares from the open market for a total cost of $50.8 million, at an average price of $8.87 per share, excluding fees and related expenses. No repurchased shares have been retired. Of the 5,723,093 repurchased shares, 75,678 shares with a weighted average repurchase price of $12.14 per share, were reissued at an average price of $4.37 per share pursuant to option exercises and vested restricted share units. As of September 30, 2016, $6.4 million remained available under the share repurchase program.
Stock Options
The Company did not grant any stock options during the three months ended September 30, 2016. Options expected to vest are the result of applying the pre-vesting forfeiture rate assumption to total outstanding options.

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The following table summarizes the Company's stock option activities for the three months ended September 30, 2016:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at June 30, 2016	1,859,260	$ 11.37	4.71	$5,959,720
Granted	—	$ —		
Exercised	(503,236)	$ 11.95		$3,805,159
Canceled or forfeited	(75,000)	$ 13.43		
Outstanding at September 30, 2016	1,281,024	$ 11.03	5.00	$13,693,937
Options vested and expected to vest	1,266,146	$ 11.07	4.97	$13,483,674
Exercisable at September 30, 2016	1,059,449	$ 11.75	4.49	$10,565,183

Restricted Stock Units ("RSU")

The following table summarizes the Company's RSU activities for the three months ended September 30, 2016:

	Number of Restricted Stock Units	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Recognition Period (Years)	Aggregate Intrinsic Value
Nonvested at June 30, 2016	933,063	$ 9.18	1.73	$12,997,568
Granted	54,376	$ 19.33		
Vested	(30,973)	$ 9.49		
Forfeited	(12,575)	$ 11.9		
Nonvested at September 30, 2016	943,891	$ 9.72	1.57	$20,501,313
RSUs vested and expected to vest	814,711		1.46	$17,695,533

The fair value of RSU is estimated based on the market price of the Company's share on the date of grant.

Employee Share Purchase Plan ("ESPP")

The assumptions used to estimate the fair values of common shares issued under the ESPP were as follows:

	Three Months Ended September 30, 2016
Volatility rate	34.76%
Risk-free interest rate	0.4% - 0.8%
Expected term	1.3 years
Dividend yield	0%

Share-based Compensation Expense

The total share-based compensation expense related to stock options, RSUs and ESPP described above, recognized in the condensed consolidated statements of operations for the periods presented was as follows:

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	Three Months Ended September 30,	
	2016	2015
	(in thousands)	
Cost of goods sold	$195	$131
Research and development	360	193
Selling, general and administrative	761	465
	$1,316	$789

As of September 30, 2016, total unrecognized compensation cost under the Company's equity plans was $5.4 million, which is expected to be recognized over a weighted-average period of 1.5 years.

7. Income Taxes

The Company recognized income tax expense of approximately $1.2 million and $1.2 million for the three months ended September 30, 2016 and 2015, respectively. The estimated effective tax rate for the three months ended September 30, 2016 was 33.7% compared to (159.5)% for the three months ended September 30, 2015. The changes in the effective tax rate and tax expense between the periods resulted primarily from changes in the mix of earnings in various geographic jurisdictions between the current quarter and the same period of last year.

During the quarter ended September 30, 2016, the Company fulfilled its obligations to contribute certain packaging equipment as required by the JV Agreement by transferring the legal titles of such equipment to the JV Company. The Company recorded $6.6 million on both deferred tax assets and prepaid tax asset, which will be amortized to tax expense over the useful life of the assets. As of September 30, 2016, the prepaid tax asset was amortized down to $6.4 million, of which $1.1 million and $5.3 million were included in prepaid and other current assets and other long-term assets on the Company’s balance sheet, respectively.

The Company files its income tax returns in the United States and in various foreign jurisdictions. The tax years 2001 to 2016 remain open to examination by U.S. federal and state tax authorities. The tax years 2009 to 2016 remain open to examination by foreign tax authorities.

The Company's income tax returns are subject to examinations by the Internal Revenue Service and other tax authorities in various jurisdictions. In accordance with the guidance on the accounting for uncertainty in income taxes, the Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. These assessments can require considerable estimates and judgments. As of September 30, 2016, the gross amount of unrecognized tax benefits was approximately $6.8 million, of which $4.4 million, if recognized, would reduce the effective income tax rate in future periods. If the Company's estimate of income tax liabilities proves to be less than the ultimate assessment, then a further charge to expense would be required. If events occur and the payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when the Company determines the liabilities are no longer necessary. The Company does not anticipate any material changes to its uncertain tax positions during the next twelve months.

On July 27, 2015, in Altera Corp. v. Commissioner, the U.S. Tax Court issued an opinion related to the treatment of share-based compensation expense in an intercompany cost-sharing arrangement. A final decision has yet to be issued by the Tax Court due to other outstanding issues related to the case. At this time, the U.S. Department of the Treasury has not withdrawn the requirement to include share-based compensation from its regulations. Due to the uncertainty

surrounding the status of the current regulations, questions related to the scope of potential benefits, and the risk of the Tax Court's decision being overturned upon appeal, the Company has not recorded any benefit as of September 30, 2016. The Company will continue to monitor ongoing developments and potential impacts to its financial statements.

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8. Segment and Geographic Information
The Company is organized as, and operates in, one operating segment: the design, development and supply of power semiconductor products for computing, consumer electronics, communication and industrial applications. The chief operating decision-maker is the Chief Executive Officer. The financial information presented to the Company's Chief Executive Officer is on a consolidated basis, accompanied by information about revenue by customer and geographic region, for purposes of evaluating financial performance and allocating resources. The Company has one business segment, and there are no segment managers who are held accountable for operations, operating results and plans for products or components below the consolidated unit level. Accordingly, the Company reports as a single operating segment.
The Company sells its products primarily to distributors in the Asia Pacific region, who in turn sell these products to end customers. Because the Company's distributors sell their products to end customers which may have a global presence, revenue by geographical location is not necessarily representative of the geographical distribution of sales to end user markets.
The revenue by geographical location in the following tables is based on the country or region to which the products were shipped to:

	Three Months Ended September 30,	
	2016	2015
	(in thousands)	
Hong Kong	$82,835	$70,453
China	12,442	9,016
South Korea	366	658
United States	894	717
Other Countries	825	595
	$97,362	$81,439

The following is a summary of revenue by product type:

	Three Months Ended September 30,	
	2016	2015
	(in thousands)	
Power discrete	$71,428	$59,912
Power IC	22,998	17,514
Packaging and testing services	2,936	4,013
	$97,362	$81,439

Long-lived assets, net consisting of property, plant and equipment, by geographical area are as follows:

	September 30, 2016	June 30, 2016
	(in thousands)	
China	$69,567	$64,272
United States	52,859	51,214
Other Countries	622	598
	$123,048	$116,084

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9. Commitments and Contingencies
Purchase Commitments
As of September 30, 2016 and June 30, 2016, the Company had approximately $38.6 million and $39.6 million, respectively, of outstanding purchase commitments primarily for purchases of semiconductor raw materials, wafers, spare parts and packaging and testing services, and approximately $6.2 million and $6.6 million, respectively, of capital commitments for the purchase of property and equipment.
Contingencies and Indemnities
The Company is currently not a party to any pending material legal proceedings. The Company has in the past, and may from time to time in the future, become involved in legal proceedings arising from the normal course of business activities. The semiconductor industry is characterized by frequent claims and litigation, including claims regarding patent and other intellectual property rights as well as improper hiring practices. Irrespective of the validity of such claims, the Company could incur significant costs in the defense of such claims and suffer adverse effects on its operations.
The Company is a party to a variety of agreements that it has contracted with various third parties. Pursuant to these agreements, the Company may be obligated to indemnify another party to such an agreement with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the Company, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to such matters as title to assets sold, certain intellectual property rights, specified environmental matters and certain income taxes. In these circumstances, payment by the Company is customarily conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party's claim. Further, the Company's obligations under these agreements may be limited in time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by it under these agreements. The Company has not historically paid or recorded any material indemnifications and no accrual has been made at September 30, 2016 and June 30, 2016.
The Company has agreed to indemnify its directors and certain employees as permitted by law and pursuant to its bye-laws, and has entered into indemnification agreements with its directors and executive officers. The Company has not recorded a liability associated with these indemnification arrangements, as it historically has not incurred any material costs associated with such indemnification obligations. Costs associated with such indemnification obligations may be mitigated by insurance coverage that the Company maintains. However, such insurance may not cover any, or may cover only a portion of, the amounts the Company may be required to pay. In addition, the Company may not be able to maintain such insurance coverage in the future.

Joint Venture

In March 2016, the Company executed an agreement with two strategic investment funds owned by the Municipality of Chongqing, China to form a joint venture for a new state-of-the-art power semiconductor packaging, testing and wafer fabrication facility in Liangjiang New Area of Chongqing (the "Joint Venture"). The initial capitalization of the Joint Venture under the agreement is $330.0 million, which includes cash contribution from the Chongqing Funds and contributions of cash, equipments and intangible assets from the Company. The Company owns 51% and the Chongqing Funds owns 49% of the equity interest of the Joint Venture. The Joint Venture is accounted under the provisions of the consolidation guidance since the Company has controlling financial interest.

The Joint Venture is expected to commence its initial packaging production in the first half of fiscal 2018. Within one year from June 30, 2016, the Company is expected to contribute cash of $10.0 million and certain intangible assets. Over the long term, the Joint Venture plans to construct a 12-inch wafer fabrication facility for the production of power semiconductors.

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

Except for the historical information contained herein, the matters addressed in this Item 2 constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements are subject to a variety of risks and uncertainties, including those discussed below under the heading “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q, that could cause actual results to differ materially from those anticipated by the Company’s management. The Private Securities Litigation Reform Act of 1995 (the “Act”) provides certain “safe harbor” provisions for forward-looking statements. All forward-looking statements made in this Quarterly Report on Form 10-Q are made pursuant to the Act. The Company undertakes no obligation to publicly release the results of any revisions to its forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unexpected events. Unless the context otherwise requires, the words “AOS,” the “Company,” “we,” “us” and “ou refer to Alpha and Omega Semiconductor Limited and its subsidiaries, except the JV Company.

This management’s discussion should be read in conjunction with the management’s discussion included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2016, filed with the Securities and Exchange Commission on August 26, 2016.

Overview

We are a designer, developer and global supplier of a broad portfolio of power semiconductors. Our portfolio of power semiconductors includes approximately 1,600 products, and has grown significantly with the introduction of over 90 new products during each of the fiscal years ended June 30, 2016, 2015 and 2014. During the three months ended September 30, 2016, we introduced an additional 24 new products. Our teams of scientists and engineers have developed extensive intellectual properties and technical knowledge that encompass major aspects of power semiconductors, which we believe enables us to introduce and develop innovative products to address the increasingly complex power requirements of advanced electronics. We have an extensive patent portfolio that consists of 635 patents and 198 patent applications in the United States as of September 30, 2016. We differentiate ourselves by integrating our expertise in technology, design and advanced packaging to optimize product performance and cost. Our portfolio of products targets high-volume applications, including personal computers, flat panel TVs, LED lighting, smart phones, battery packs, consumer and industrial motor controls and power supplies for TVs, computers, servers and telecommunications equipment.

Our business model leverages global resources, including research and development and manufacturing in the United States and Asia. Our sales and technical support teams are localized in several growing markets. We operate a 200mm wafer fabrication facility in Hillsboro, Oregon, or the Oregon fab, which is critical for us to accelerate proprietary technology development and new product introduction as well as to improve our financial performance in the long run. To meet the market demand for more mature high volume products, we also utilize the wafer manufacturing capacity of selected third party foundries. For assembly and test, we primarily rely upon our in-house facilities in China. In addition, we utilize subcontracting partners for industry standard packages. We believe our in-house packaging and testing capability provides us with a competitive advantage in proprietary packaging technology, product quality, cost and sales cycle time.

On March 29, 2016, we entered into a joint venture contract (the “JV Agreement”) with two investment funds owned by the Municipality of Chongqing (the “Chongqing Funds”), pursuant to which we and the Chongqing Funds formed a joint venture, (the “JV Company”), for the purpose of constructing a power semiconductor packaging, testing and wafer fabrication facility in the Liangjiang New Area of Chongqing, China (the “JV Transaction”). The total initial capitalization of the JV Company is $330.0 million (the “Initial Capitalization”). The Initial Capitalization will be completed in stages commencing on the incorporation of the JV Company. During the quarter ended September 30, 2016, the Chongqing Funds contributed $33.0 million of initial capital in cash and we fulfilled our obligations to contribute certain packaging equipment as required by the JV Agreement by transferring the legal titles of such equipment to the JV Company. We own 51%, and the Chongqing Funds owns 49%, of the equity interest in the JV Company. If both parties agree that the termination of the JV Company is the best interest of each party or the JV

Company is bankrupt or insolvent where either party may terminate early, after paying the debts of the JV Company, the remaining assets of the JV Company shall be paid to the Chongqing Funds to cover the principal of its total paid-in contributions plus the interest at 10% simple annual rate prior to distributing the balance of the JV Company's assets to us. During the quarter ended September 30, 2016, we recorded $0.9 million in net loss attributable to noncontrolling interest, representing 49% of the net loss incurred in the JV Company, which was attributable to operating expenses and depreciation expenses offset by equipment lease income and interest income. We expect the JV Company to commence its initial production in the first half of fiscal 2018. Over the long term, the JV Company plans to construct a 12-inch wafer fabrication facility for the

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production of power semiconductors. We expect the joint venture to deliver significant cost savings, enhance our market positions in China, and drive meaningful improvements in working capital and capital expenditures.

During the three months ended September 30, 2016, we released AOZ5166QI-01, the high efficiency power modules which are fully compliant with Intel's DrMOS specifications. This new device enables high power density voltage regulator solutions ideal for servers, work stations, graphic cards and high-end desktop PC applications. We also announced the addition of AOK30B135W1 to its 1350V AlphaIGBT™ family. The new AOK30B135W1 has been optimized to deliver high performance by reducing switching loss in soft-switching home appliance applications such as induction cooking, rice cookers, and inverter-based microwave ovens. In addition, we introduced two new products based on its high efficiency XS-PairFET package and latest low voltage technology. The AOE6932 and AOE6936 are the newest extensions to the flagship device, AOE6930, that was released in 2015. Both products are newly optimized for enhanced driving and switching performance.

Factors affecting our performance

Our performance is affected by several key factors, including the following:

The global, regional economic and PC market conditions: Because our products primarily serve consumer electronic applications, a deterioration of the global and regional economic conditions could materially affect our revenue and results of operations. In particular, because a significant amount of our revenue is derived from sales of products in the personal computing ("PC") markets, such as notebooks, motherboards and notebook battery packs, a significant decline or downturn in the PC market can have a material adverse effect on our revenue and results of operations. Our revenue from the PC market accounted for approximately 35.9% and 46.0% of our total revenue for the three months ended September 30, 2016 and 2015, respectively. Since the beginning of calendar year 2013, we have experienced a significant global decline in the PC market due to continued growth of demand in tablets and smart phones, worldwide economic conditions and the industry inventory correction which had and may continue to have a material negative impact on the demand for our products, revenue, factory utilization, gross margin, our ability to resell excess inventory, and other performance measures.

In response to this trend, we executed and continue to execute strategies to diversify our portfolio of products and expand into other market segments, including the consumer, communications and industrial market segments, and to improve gross margin and profit by implementing cost control measures. While making progress in reducing our reliance on the PC market, we continue to support our computing business and capitalize on opportunities with a more focused and competitive PC product strategy. As we develop and sell new products that serve more diversified markets, we expect sales based on the PC market, as a percentage of the total revenue to decline. If the rate of decline in the PC market is faster than our expectation, or if we cannot successfully diversify or introduce new products to offset the decline in the PC market, we may not be able to alleviate its negative impact on our operating results.

Manufacturing costs: Our gross margin may be affected by our manufacturing costs, including utilization of our manufacturing facilities, pricing of wafers from third party foundries and semiconductor raw materials, which may fluctuate from time to time largely due to the market demand and supply. Capacity utilization affects our gross margin because we have certain fixed costs associated with our packaging and testing facilities and our Oregon fab. If we are unable to utilize our manufacturing facilities at a desired level, our gross margin may be adversely affected. In addition, we expect that in the long term our joint venture agreement with the Chongqing Funds will reduce our costs of manufacturing. However, our manufacturing costs may increase in the short term prior to the commencement of operation of the JV Company, because we may be required to incur additional costs to acquire packaging and testing capacity in order make up for the reduced capacity during the period in which we transfer and relocate our equipment from Shanghai to Chongqing.

Erosion of average selling price: Erosion of average selling prices of established products is typical in our industry. Consistent with this historical trend, we expect our average selling prices of existing products to decline in the future. However, in the normal course of business, we seek to offset the effect of declining average selling price by introducing new and higher value products, expanding existing products for new applications and new customers and reducing the manufacturing cost of existing products.

Product introductions and customers' product requirements: Our success depends on our ability to introduce products on a timely basis that meet or are compatible with our customers' specifications and performance requirements. Both factors, timeliness of product introductions and conformance to customers' requirements, are equally important in securing design wins with our customers. As we accelerate the development of new technology platforms, we expect to increase the pace at which we introduce new products and obtain design wins. Our failure to introduce new products on a timely basis that meet customers' specifications and performance requirements, particularly those products with major OEM customers, and our inability to continue to expand our serviceable markets, could adversely affect our financial performance, including loss of market share. We

expect our joint venture with the Chongqing Funds to commence operation in the first half of fiscal 2018, and we believe that the joint venture will increase and diversify our customer base, particularly in China, in the long term. However, there is no guarantee that the joint venture will commence timely or at all. Even if we are able to commence operation, we may not be successful in acquiring a sufficient number of new customers to offset the additional costs due to various factors, including but are not limited to, competition from other semiconductor companies in the region, our lack of history and prior relationships with customers as a new entrant, difficulties in executing our joint venture strategies, lack of control over our operations and the general economic conditions in Chongqing and China.
Distributor ordering patterns, customer demand and seasonality: Our distributors place purchase orders with us based on their forecasts of end customer demand, and this demand may vary significantly depending on the sales outlook and market and economic conditions of end customers. Because these forecasts may not be accurate, channel inventory held at our distributors may fluctuate significantly, which in turn may prompt distributors to make significant adjustments to their purchase orders placed with us. As a result, our revenue and operating results may fluctuate significantly from quarter to quarter. In addition, because our products are used in consumer electronics products, our revenue is subject to seasonality. Our sales seasonality is affected by numerous factors, including global and regional economic conditions as well as the PC market conditions, revenue generated from new products, changes in distributor ordering patterns in response to channel inventory adjustments and end customer demand for our products and fluctuations in consumer purchase patterns prior to major holiday seasons. In recent periods, broad fluctuations in the semiconductor markets and the global and regional economic conditions, in particular the decline of the PC market conditions, have had a more significant impact on our results of operations than seasonality. Furthermore, our revenue may be impacted by the level of demand from our major customers due to factors outside of our control. If these major customers experience significant decline in the demand of their products, encounter difficulties or defects in their products, or otherwise fail to execute their sales and marketing strategies successfully, it may adversely affect our revenue and results of operations.
Principal line items of statements of operations
The following describes the principal line items set forth in our condensed consolidated statements of operations:
Revenue
We generate revenue primarily from the sale of power semiconductors, consisting of power discretes and power ICs. Historically, a majority of our revenue was derived from power discrete products and a smaller amount was derived from power IC products. Because our products typically have three to five year life cycles, the rate of new product introduction is an important driver of revenue growth over time. We believe that expanding the breadth of our product portfolio is important to our business prospects, because it provides us with an opportunity to increase our total bill-of-materials within an electronic system and to address the power requirements of additional electronic systems. In addition, a small percentage of our total revenue is generated by providing packaging and testing services to third-parties through one of our subsidiaries.

Our product revenue includes the effect of the estimated stock rotation returns and price adjustments that we expect to provide to our distributors. Stock rotation returns are governed by contract and are limited to a specified percentage of the monetary value of products purchased by the distributor during a specified period. At our discretion or upon our direct negotiations with the original design manufacturers ("ODMs") or original equipment manufacturers ("OEMs"), we may elect to grant special pricing that is below the prices at which we sold our products to the distributors. In these situations, we will grant price adjustments to the distributors reflecting such special pricing. We estimate the price adjustments for inventory at the distributors based on factors such as distributor inventory levels, pre-approved future distributor selling prices, distributor margins and demand for our products.
Cost of goods sold

Our cost of goods sold primarily consists of costs associated with semiconductor wafers, packaging and testing, personnel, including share-based compensation expense, overhead attributable to manufacturing, operations and procurement, and cost associated with yield improvements, capacity utilization, warranty and inventory reserves. As

the volume of sales increases, we expect cost of goods sold to increase. We implemented a process to improve our factory capacity utilization rates by transferring more wafer production to our Oregon fab and reducing our reliance on outside foundries. While our utilization rates cannot be immune to market conditions, our goal is to make such rates less vulnerable to market fluctuations. We believe our market diversification strategy and product growth will drive higher volumes of manufacturing which will improve our factory utilization rates and gross margin in the long run.
Operating expenses

Our operating expenses consist of research and development, selling, general and administrative expenses. We expect our operating expenses as a percentage of revenue to fluctuate from period to period as we continue to exercise cost control measures in response to the declining PC market as well as align our operating expenses to the revenue level.
Research and development expenses. Our research and development expenses consist primarily of salaries, bonuses, benefits, share-based compensation expense, expenses associated with new product prototypes, travel expenses, fees for engineering services provided by outside contractors and consultants, amortization of software and design tools, depreciation of equipment and overhead costs. We continue to invest in developing new technologies and products utilizing our own fabrication and packaging facilities as it is critical to our long-term success. We also evaluate appropriate investment levels and stay focused on new product introductions to improve our competitiveness. We expect that our research and development expenses will fluctuate from time to time.
Selling, general and administrative expenses. Our selling, general and administrative expenses consist primarily of salaries, bonuses, benefits, share-based compensation expense, product promotion costs, occupancy costs, travel expenses, expenses related to sales and marketing activities, amortization of software, depreciation of equipment, maintenance costs and other expenses for general and administrative functions as well as costs for outside professional services, including legal, audit and accounting services. We expect our selling, general and administrative expenses to fluctuate in the near future as we continue to exercise cost control measures in response to the declining PC market.
Impairment of Long-Lived Assets: Long-lived assets or asset groups are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. The recoverability of an asset or asset group is assessed by determining if the carrying value of the asset or asset group exceeds the sum of the projected undiscounted cash flows expected to result from the use and eventual disposition of the assets over the remaining economic life. The impairment loss is measured based on the difference between the carrying amount and estimated fair value.

Income tax expense

We are subject to income taxes in various jurisdictions. Significant judgment and estimates are required in determining our worldwide income tax expense. The calculation of tax liabilities involves dealing with uncertainties in the application of complex tax regulations of different jurisdictions globally. We establish accruals for potential liabilities and contingencies based on a more likely than not threshold to the recognition and de-recognition of uncertain tax positions. If the recognition threshold is met, the applicable accounting guidance permits us to recognize a tax benefit measured at the largest amount of tax benefit that is more likely than not to be realized upon settlement with a taxing authority. If the actual tax outcome of such exposures is different from the amounts that were initially recorded, the differences will impact the income tax and deferred tax provisions in the period in which such determination is made. Changes in the location of taxable income (loss) could result in significant changes in our income tax expense.

We record a valuation allowance against deferred tax assets if it is more likely than not that a portion of the deferred tax assets will not be realized, based on historical profitability and our estimate of future taxable income in a particular jurisdiction. Our judgments regarding future taxable income may change due to changes in market conditions, changes in tax laws, tax planning strategies or other factors. If our assumptions and consequently our estimates change in the future, the deferred tax assets may increase or decrease, resulting in corresponding changes in income tax expense.
Our effective tax rate is highly dependent upon the geographic distribution of our worldwide profits or losses, the tax laws and regulations in each geographical region where we have operations, the availability of tax credits and carry-forwards and the effectiveness of our tax planning strategies.

Results of Operations

The following tables set forth statements of operations, also expressed as a percentage of revenue, for the three months ended September 30, 2016 and 2015. Our historical results of operations are not necessarily indicative of the results for any future period.

	Three Months Ended September 30,			
	2016	2015	2016	2015
	(in thousands)		(% of revenue)	
Revenue	$97,362	$81,439	100.0 %	100.0 %
Cost of goods sold	75,418	66,378	77.5 %	81.5 %
Gross profit	21,944	15,061	22.5 %	18.5 %
Operating expenses				
Research and development	7,019	6,164	7.2 %	7.6 %
Selling, general and administrative	11,183	9,497	11.5 %	11.7 %
Total operating expenses	18,202	15,661	18.7 %	19.3 %
Operating income (loss)	3,742	(600)	3.8 %	(0.8)%
Interest income and other income (loss), net	(49)	(151)	(0.1)%	(0.2)%
Interest expense	(26)	(10)	— %	— %
Net Income (loss) before income taxes	3,667	(761)	3.7 %	(1.0)%
Income tax expense	1,237	1,214	1.3 %	1.5 %
Net income (loss) including noncontrolling interest	2,430	(1,975)	2.4 %	(2.5)%
Net loss attributable to noncontrolling interest	(877)	—	(0.9)%	— %
Net income (loss) attributable to Alpha and Omega Semiconductor Limited	$3,307	$(1,975)	3.3 %	(2.5)%

Share-based compensation expense was allocated as follow:

	Three Months Ended September 30,			
	2016	2015	2016	2015
	(in thousands)		(% of revenue)	
Cost of goods sold	$195	$131	0.2%	0.2%
Research and development	360	193	0.4%	0.2%
Selling, general and administrative	761	465	0.8%	0.6%
Total	$1,316	$789	1.4%	1.0%

Three Months Ended September 30, 2016 and 2015

Revenue

The following is a summary of revenue by product type:

	Three Months Ended September 30,			
	2016	2015	Change	
	(in thousands)		(in thousands)	(in percentage)
Power discrete	$71,428	$59,912	$11,516	19.2 %
Power IC	22,998	17,514	5,484	31.3 %
Packaging and testing services	2,936	4,013	(1,077)	(26.8)%
	$97,362	$81,439	$15,923	19.6 %

Total revenue was $97.4 million for the three months ended September 30, 2016, an increase of $15.9 million, or 19.6%, as compared to $81.4 million for the same quarter last year. The increase consisted of $11.5 million and $5.5 million in sales of power discrete products and power IC products, respectively, partially offset by a $1.1 million decrease in sales of packaging and testing services. The increase in power discrete and power IC products was primarily due to a 2.8% increase in average selling price as compared to the same quarter last year due to a shift in product mix, as well as a 18.7% increase in unit shipments. The

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decrease in packaging and testing services revenue for the three months ended September 30, 2016 compared to the same quarter last year was primarily due to reduced demand as a result of the decline in PC market.

Cost of goods sold and gross profit

	Three Months Ended September 30,			
	2016	2015	Change	
	(in thousands)		(in thousands)	(in percentage)
Cost of goods sold	$75,418	$66,378	$9,040	13.6 %
Percentage of revenue	77.5 %	81.5 %		
Gross profit	$21,944	$15,061	$6,883	45.7 %
Percentage of revenue	22.5 %	18.5 %		

Cost of goods sold was $75.4 million for the three months ended September 30, 2016, an increase of $9.0 million, or 13.6%, as compared to $66.4 million for the same quarter last year. The increase was primarily due to increased unit shipments. The increase was partially offset by the overall manufacturing cost reduction due to improved factory utilization as compared to the same quarter last year. Gross margin increased by 4.0% point to 22.5% for the three months ended September 30, 2016 as compared to 18.5% for the same quarter last year. The increase in gross margin was primarily due to increased average selling prices due to a shift in product mix and higher factory utilization during the three months ended September 30, 2016.

Research and development expenses

	Three Months Ended September 30,			
	2016	2015	Change	
	(in thousands)		(in thousands)	(in percentage)
Research and development	$7,019	$6,164	$855	13.9 %

Research and development expenses were $7.0 million for the three months ended September 30, 2016, an increase of $0.9 million, or 13.9%, as compared to $6.2 million for the same quarter last year. The increase was primarily attributable to a $0.4 million increase in employee compensation and benefit expense primarily due to increased headcount and higher bonus expenses, a $0.2 million increase in product prototyping engineering expenses as a result of increased engineering activities, as well as a $0.2 million increase in share-based compensation expense as a result of a decrease in cancellation of stock options and award in the current quarter.

Selling, general and administrative expenses

	Three Months Ended September 30,			
	2016	2015	Change	
	(in thousands)		(in thousands)	(in percentage)
Selling, general and administrative	$11,183	$9,497	$1,686	17.8 %

Selling, general and administrative expenses were $11.2 million for the three months ended September 30, 2016, an increase of $1.7 million, or 17.8%, as compared to $9.5 million for the same quarter last year. The increase was primarily attributable to a $1.0 million increase in employee compensation and benefits expenses primarily due to increased headcount and higher bonus expenses, a $0.3 million increase in share-based compensation expense as a result of a decrease of cancellation in stock options and award, a $0.1 million increase in consulting fees primarily due to increased professional services costs and recruiting costs, as well as a $0.1 million increase in marketing and commission expenses due to increased sales and marketing activities during the current quarter.

During the quarter ended September 30, 2016. we recognized $0.4 million of expenses related to our joint venture, including noncontrolling interest, in our general and administrative expenses in connection with personnel and benefit related costs, outside professional services and travel expenses.

Interest income and expenses

	Three Months Ended September 30,			
	2016	2015	Change	
	(in thousands)		(in thousands)	(in percentage)
Interest income and other income (loss), net	$(49)	$(151)	$102	(67.5)%

Interest income and other, net was primarily related to interest earned from cash and cash equivalents, as well as foreign exchange gains (losses). The decrease in interest income and other during the three months ended September 30, 2016 as compared to the same quarter last year was primarily due to lower foreign exchange losses as a result of recent appreciation of USD against RMB, offset by higher interest income due to increase in average cash balances.

Income tax expense

	Three Months Ended September 30,			
	2016	2015	Change	
	(in thousands)		(in thousands)	(in percentage)
Income tax expense	$1,237	$1,214	$23	1.9 %

We recognized income tax expense of approximately $1.2 million and $1.2 million for the three months ended September 30, 2016 and 2015, respectively.

The income tax expense for the three months ended September 30, 2016 was slightly higher than the tax expense for the same quarter last year primarily due to the changes in the mix of earnings in various geographic jurisdictions between the current and same quarter of last year.

Liquidity and Capital Resources

Our principal need for liquidity and capital resources is to maintain sufficient working capital to support our operations and to invest adequate capital expenditures to grow of our business. Currently, we financed our operations and capital expenditures primarily through funds generated from operations.

In March 2016, we entered into the JV Agreement with an initial capitalization of $330.0 million. During the quarter ended September 30, 2016, the Chongqing Funds contributed $33.0 million of initial capital in cash and we fulfilled our obligation to contribute of certain packaging equipment as required by the JV Agreement by transferring the legal titles of such equipment to the JV Company. Pursuant to the JV Agreement, within one year from June 30, 2016, we expect to contribute certain intangible assets and cash of $10.0 million pursuant to the terms of the JV Agreement. Over the long term, the JV Company plans to construct a 12-inch wafer fabrication facility for the manufacturing or semiconductor products.

In April 2015, our Board of Directors of the Company approved an increase in the remaining available amount under the Company’s then effective share repurchase program from approximately $17.8 million to $50.0 million. The repurchases may be made from the open market pursuant to a pre-established Rule 10b5-1 trading plan (as amended, the "Repurchase Trading Plan") or through privately negotiated transactions. The amount and timing of any repurchases depend on a number of factors, including but not limited to, the trading price, volume and availability of our common shares, applicable legal requirements, our business and financial conditions and general market environment. There is no guarantee that such repurchases under the Program will enhance the value of our shares.

In June 2015, we commenced a modified Dutch auction tender offer (the "Tender Offer") to repurchase an aggregate of $30.0 million of our outstanding common shares with a price range between $8.50 and $9.20 per share. In July 2015, we completed the Tender Offer in which we purchased 3,296,703 shares of its common shares, at a purchase

price of $9.10 per share, for an aggregate purchase price of $30.0 million, excluding fees and expenses relating to the Tender Offer. These shares represented approximately 12.53% of the total number of the Company's common shares issued and outstanding as of June 30, 2015. The Tender Offer was part of the $50.0 million share repurchase program approved by the Board on April 15, 2015.

During the three months ended September 30, 2016, we did not repurchase any shares pursuant to the share repurchase program. Since the inception of the program in 2010, the Company repurchased an aggregate of 5,723,093 shares from the open market for a total cost of $50.8 million, at an average price of $8.87 per share, excluding fees and related expenses. As of September 30, 2016, approximately $6.4 million remained available under the share repurchase program. Shares repurchased are accounted for as treasury shares and the total cost of shares repurchased is recorded as a reduction of shareholders' equity.

We believe that our current cash and cash equivalents and cash flows from operations will be sufficient to meet our anticipated cash needs, including working capital and capital expenditures, for at least the next twelve months. We may require additional capital due to changing business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If our cash is insufficient to meet our needs, we may seek to raise capital through equity or debt financing. The sale of additional equity securities could result in dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and may include operating and financial covenants that would restrict our operations. We cannot be certain that any financing will be available in the amounts we need or on terms acceptable to us, if at all.

Cash and cash equivalents

As of September 30, 2016 and June 30, 2016, we had $118.8 million and $87.8 million of cash and cash equivalents, including $77.7 million and $66.1 million were held by foreign subsidiaries, respectively. Our cash and cash equivalents primarily consisted of cash on hand and short-term bank deposits with original maturities of three months or less.

The following table shows our cash flows from operating, investing and financing activities for the periods indicated:

	Three Months Ended September 30,	
	2016	2015
	(in thousands)	
Net cash provided by operating activities	$9,297	$7,807
Net cash used in investing activities	(16,994)	(5,830)
Net cash provided by (used in) financing activities	38,664	(35,094)
Effect of exchange rate changes on cash and cash equivalents	33	(100)
Net increase (decrease) in cash and cash equivalents	$31,000	$(33,217)

Cash flows from operating activities

Net cash provided by operating activities of $9.3 million for the three months ended September 30, 2016 resulted primarily from net income of $2.4 million and non-cash expenses of $14.1 million, offset by net changes in assets and liabilities of $7.2 million. The non-cash expenses of $14.1 million include a $6.5 million of depreciation and amortization expenses, a $1.3 million of share-based compensation expense, a $0.4 million of gain on disposal of property and equipment, and a $6.6 million of deferred income taxes. The net changes in assets and liabilities of $7.2 million were primarily due to a $0.5 million increase in accounts receivable from timing of billings and collection of payments, a $1.2 million increase in inventories, a $5.7 million increase in other current and long term assets due to increase in advance payments to vendors, and a $2.8 million decrease in accounts payable due to timing of payment, partially offset by a $0.3 million increase in income taxes payable and a $2.6 million increase in accrued and other liabilities.

Net cash provided by operating activities of $7.8 million for the three months ended September 30, 2015 resulted primarily from net loss of $2.0 million, non-cash charges of $8.3 million, and net change in assets and liabilities providing net cash of $1.5 million. The non-cash charges of $8.3 million included a $6.9 million of depreciation and

amortization expenses, a $0.8 million of share-based compensation expense, and a $0.6 million of deferred income taxes. The net change in assets and liabilities providing net cash of $1.5 million was primarily due to a $1.6 million decrease in accounts receivable due to the timing of billings and collection of payments, a $2.2 million decrease in inventories as we reduced our inventories, a $1.9 million increase in accrued and other liabilities, a $0.6 million decrease in other current and long term assets primarily due to decrease in advance payments to vendors, and a $0.4 million increase in income taxes payable, partially offset by a $5.2 million decrease in accounts payable primarily due to timing of payment.

Cash flows from investing activities

Net cash used in investing activities of $17.0 million for the three months ended September 30, 2016 was primarily attributable to $17.4 million purchases of property and equipment and land to increase our in-house production capacity and to support the Joint Venture Company, partially offset by $0.4 million proceeds from sale of certain equipment.
Net cash used in investing activities of $5.8 million for the three months ended September 30, 2015 was primarily attributable to $6.0 million purchase of property and equipment to increase our in-house production capacity, partially offset by $0.2 million decrease in restricted cash during the period.

Cash flows from financing activities

Net cash used in financing activities of $38.7 million for the three months ended September 30, 2016 was primarily attributable to $33.0 million proceeds from investment by noncontrolling interest and $6.0 million of proceeds from exercise of stock options, partially offset by $0.2 million in payment of capital lease obligations and $0.1 million in common shares acquired to settle withholding tax related to vesting of restricted stock units.
Net cash used in financing activities of $35.1 million for the three months ended September 30, 2015 was primarily attributable to $35.2 million for repurchase of common shares, including repurchases in the Dutch tender offer, and $0.2 million in payment of capital lease obligations, partially offset by $0.4 million of proceeds from exercise of stock options.

Capital expenditures

Capital expenditures were $17.4 million and $6.0 million for the three months ended September 30, 2016 and 2015, respectively. Our capital expenditures primarily consisted of purchases of equipment for our packaging and testing services and for our Oregon fab, and purchase of equipment and land in Chongqing for the Joint Venture Company, as well as for upgrading our operational and financial systems. The increase in capital expenditure was primarily due to the additional purchases of equipment and assets and land to construct the fab for the Joint Venture Company and to improve our technology and support our new product introductions to fuel business growth.

Commitments

As of September 30, 2016 and June 30, 2016, we had approximately $38.6 million and $39.6 million, respectively, of outstanding purchase commitments primarily for purchases of semiconductor raw materials, wafers, spare parts and packaging and testing services.
As of September 30, 2016 and June 30, 2016, we had approximately $6.2 million and $6.6 million, respectively, of capital commitments for the purchase of property and equipment.

Joint Venture Commitments

In March 2016, we executed the JV Agreement with the Chongqing Funds to form a joint venture for the construction of a new state-of -the-art power semiconductor packaging, testing and wafer fabrication facility in Liangjiang New Area of Chongqing. The Joint Venture is expected to commence its initial packaging production in the first half of fiscal 2018. Under the JV Agreement, we are required to contribute $10.0 million in cash and certain intangible assets within one year from June 30, 2016.

Off-Balance Sheet Arrangements

As of September 30, 2016, we had no material off-balance sheet arrangements as defined in Regulation S-K 303(a)(4)(ii) arrangements.

Contractual Obligations

There were no material changes in our contractual obligations, as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2016.

Recent Accounting Pronouncements

See Note 1 of the Notes to the Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q for a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the market risks previously disclosed in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," of our Annual Report on Form 10-K for the year ended June 30, 2016, filed with the SEC on August 26, 2016.

ITEM 4. CONTROLS AND PROCEDURES

Management's Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the “Exchange Act”)), as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of September 30, 2016 have been designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitation on Effectiveness of Controls

While our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance that their respective objectives will be met, we do not expect that our disclosure controls and procedures or our internal control over financial reporting are or will be capable of preventing or detecting all errors and all fraud. Any control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are currently not a party to any material legal proceedings. We have in the past, and may from time to time in the future, become involved in legal proceedings arising from the normal course of business activities. The semiconductor industry is characterized by frequent claims and litigation, including claims regarding patent and other intellectual property rights as well as improper hiring practices. Irrespective of the validity of such claims, we could incur significant costs in the defense thereof or could suffer adverse effects on its operations.

ITEM 1A. RISK FACTORS

Item 1A of Part I of our Annual Report on Form 10-K for the year ended June 30, 2016, filed with the SEC on August 26, 2016, contains risk factors identified by the Company. There have been no material changes to the risk factors we previously disclosed. Our operations could also be affected by additional factors that are not presently known to us or by factors that we currently consider immaterial to our business.

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

In April 2015, our Board of Directors of the Company approved an increase in the remaining available amount under the Company's then existing share repurchase program from approximately $17.8 million to $50.0 million. Under this program, the repurchases may be made from the open market pursuant to a pre-established Rule 10b5-1 trading plan (as amended, the "Repurchase Trading Plan") or through privately negotiated transactions. The amount and timing of any repurchases depend on a number of factors, including but not limited to, the trading price, volume and availability of our common shares, applicable legal requirements, our business and financial conditions an general market environment. There is no guarantee that any repurchases under the program will be made or that such repurchases would enhance the value of our shares.

In June 2015, the Company commenced a modified Dutch auction tender offer (the "Tender Offer") to repurchase an aggregate of $30.0 million of its outstanding common shares with a price range between $8.50 and $9.20 per share. In July 2015, the Company completed the Tender Offer in which it purchased 3,296,703 shares of its common shares, at a purchase price of $9.10 per share, for an aggregate purchase price of $30.0 million, excluding fees and expenses relating to the Tender Offer. These shares represented approximately 12.53% of the total number of the Company's common shares issued and outstanding as of June 30, 2015. The Tender Offer was part of the $50.0 million share repurchase program approved by the Board in April 15, 2015.

During the three months ended September 30, 2016, we did not repurchase any shares under the share repurchase program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable.

ITEM 5. OTHER INFORMATION
Not applicable.

ITEM 6. EXHIBITS

31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation
101.DEF	XBRL Taxonomy Extension Definition
101.LAB	XBRL Taxonomy Extension Labels
101.PRE	XBRL Taxonomy Extension Presentation

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

November 7, 2016
ALPHA AND OMEGA SEMICONDUCTOR
LIMITED

By: /s/ YIFAN LIANG
Yifan Liang
Chief Financial Officer and Corporate Secretary
(Principal Financial Officer)

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