

DIODES INC /DEL/
Form 10-Q
August 08, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

Or

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____.

Commission file number: 002-25577

DIODES INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware 95-2039518
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

4949 Hedgcoxe Road, Suite 200

Plano, Texas

75024

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(Address of principal executive offices) (Zip code)

(972) 987-3900

(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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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:

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

The number of shares of the registrant's Common Stock outstanding as of August 4, 2014 was 47,565,351.

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PART I—FINANCIAL INFORMATION

Item 1—Financial Statements

DIODES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(In thousands)

ASSETS

	June 30, 2014 (Unaudited)	December 31, 2013
CURRENT ASSETS		
Cash and cash equivalents	\$ 235,465	\$ 196,635
Short-term investments	17,656	22,922
Accounts receivable, net	187,839	192,267
Inventories	182,781	180,396
Deferred income taxes, current	9,823	10,513
Prepaid expenses and other	54,628	47,352
Total current assets	688,192	650,085
PROPERTY, PLANT AND EQUIPMENT, net		
	312,542	322,013
DEFERRED INCOME TAXES, non-current		
	22,360	28,237
OTHER ASSETS		
Goodwill	85,960	84,714
Intangible assets, net	49,976	53,571
Other	26,705	23,638
Total assets	\$ 1,185,735	\$ 1,162,258

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

DIODES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS (continued)

LIABILITIES AND EQUITY

(In thousands, except share data)

	June 30, 2014 (Unaudited)	December 31, 2013
CURRENT LIABILITIES		
Lines of credit	\$ 2,487	\$ 5,814
Accounts payable	101,050	89,212
Accrued liabilities	63,134	60,684
Income tax payable	1,241	1,206
Total current liabilities	167,912	156,916
LONG-TERM DEBT, net of current portion		
	162,702	182,799
OTHER LONG-TERM LIABILITIES		
	74,324	78,866
Total liabilities	404,938	418,581
COMMITMENTS AND CONTINGENCIES (See Note H)		
EQUITY		
Diodes Incorporated stockholders' equity		
Preferred stock - par value \$1.00 per share; 1,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock - par value \$0.66 2/3 per share; 70,000,000 shares authorized; 47,078,198 and 46,680,973 issued and outstanding at June 30, 2014 and December 31, 2013, respectively	31,387	31,120
Additional paid-in capital	298,920	289,668
Retained earnings	453,915	426,328
Accumulated other comprehensive loss	(45,070)	(44,374)
Total Diodes Incorporated stockholders' equity	739,152	702,742
Noncontrolling interest	41,645	40,935
Total equity	780,797	743,677
Total liabilities and equity	\$ 1,185,735	\$ 1,162,258

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

DIODES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
NET SALES	\$223,217	\$214,379	\$433,203	\$391,343
COST OF GOODS SOLD	152,913	153,086	301,318	283,867
Gross profit	70,304	61,293	131,885	107,476
OPERATING EXPENSES				
Selling, general and administrative	33,291	35,080	65,621	65,456
Research and development	12,781	12,145	25,701	22,225
Other operating expenses	1,089	3,830	3,077	5,781
Total operating expenses	47,161	51,055	94,399	93,462
Income from operations	23,143	10,238	37,486	14,014
OTHER INCOME (EXPENSES)	359	277	(991)	798
Income before income taxes and noncontrolling interest	23,502	10,515	36,495	14,812
INCOME TAX PROVISION	5,651	1,475	8,198	8,049
NET INCOME	17,851	9,040	28,297	6,763
Less: NET INCOME attributable to noncontrolling interest	(466)	(405)	(710)	(54)
NET INCOME attributable to common stockholders	\$17,385	\$8,635	\$27,587	\$6,709
EARNINGS PER SHARE attributable to common stockholders				
Basic	\$0.37	\$0.19	\$0.59	\$0.15
Diluted	\$0.36	\$0.18	\$0.57	\$0.14
Number of shares used in computation				
Basic	46,889	46,148	46,794	46,085
Diluted	48,423	47,507	48,223	47,383

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

DIODES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$17,851	\$9,040	\$28,297	\$6,763
Translation adjustment	3,712	(859)	(145)	(8,395)
Unrealized gain (loss) on defined benefit plan, net of tax	(1,816)	2,659	(550)	1,181
Comprehensive income (loss)	19,747	10,840	27,602	(451)
Less: Comprehensive income attributable to noncontrolling interest	(466)	(405)	(710)	(54)
Total comprehensive income (loss) attributable to common stockholders	\$19,281	\$10,435	\$26,892	\$(505)

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

DIODES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES	\$80,066	\$61,173
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition, net of cash acquired	-	(124,916)
Purchases of property, plant and equipment	(23,668)	(23,751)
Proceeds from sales of property, plant and equipment	1,428	51
Proceeds from maturity of short-term investments	5,380	-
Purchases of equity securities	(1,842)	-
Proceeds from sale of equity securities	-	7,458
Other	1,280	(3,799)
Net cash used by investing activities	(17,422)	(144,957)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances on lines of credit	4,335	4,963
Repayments on lines of credit	(7,622)	(25,711)
Borrowings of long-term debt	-	181,002
Repayments of long-term debt	(20,710)	(15,536)
Net proceeds from issuance of common stock	2,913	1,366
Other	(147)	(2,844)
Net cash provided by (used by) financing activities	(21,231)	143,240
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(2,583)	(3,031)
INCREASE IN CASH AND CASH EQUIVALENTS	38,830	56,425
CASH AND CASH EQUIVALENTS, beginning of period	196,635	157,121
CASH AND CASH EQUIVALENTS, end of period	\$235,465	\$213,546
SUPPLEMENTAL CASH FLOW INFORMATION:		
Non-cash financing activities:		
Property, plant and equipment purchased on accounts payable	\$(1,968)	\$(330)
Acquisition:		
Fair value of assets acquired	\$-	\$247,012
Liabilities assumed	-	(92,277)
Cash acquired	-	(29,819)
Net assets acquired	\$-	\$124,916

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

DIODES INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE A – Nature of Operations, Basis of Presentation and Recently Issued Accounting Pronouncements

Nature of Operations

Diodes Incorporated, together with its subsidiaries (collectively, the “Company”), is a leading global manufacturer and supplier of high-quality, application specific standard products within the broad discrete, logic and analog semiconductor markets, serving the consumer electronics, computing, communications, industrial and automotive markets throughout Asia, North America and Europe.

Basis of Presentation

The accompanying unaudited consolidated condensed 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 Form 10-Q. 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 consolidated condensed 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 year ended December 31, 2013. 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 period presented have been included in the interim period. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for other interim periods or the year ending December 31, 2014. The consolidated condensed financial data at December 31, 2013 is derived from audited financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013, filed on February 27, 2014.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. As permitted under U.S. GAAP, interim accounting for certain expenses, including income taxes, are based on full year forecasts. For interim financial reporting purposes, income taxes are recorded based upon estimated annual effective income tax rates taking into consideration discrete items occurring in a quarter.

Certain prior year’s balances have been reclassified to conform to the current financial statement presentation.

Recently Issued Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Under ASU 2014-08, only disposals that represent a strategic shift that has (or will have) a major effect on the entity’s results and operations would qualify as discontinued operations, which could include a disposal of a major geographical area, a major line of business, a major equity method investment, or other major parts of an entity. ASU 2014-08 also expands the

disclosure requirements for disposals of operations to include more information about assets, liabilities, income and expenses and requires entities to disclose information about disposals of individually significant components. ASU 2014-08 is effective in the first quarter of 2015, with early adoption permitted and could impact the Company's consolidated financial results in the event of a transaction as described above.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective in the first quarter of 2017, with early adoption not permitted and requires either a retrospective or a modified retrospective approach to adoption. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.

NOTE B – Earnings Per Share

Basic earnings per share is calculated by dividing net income attributable to common stockholders by the weighted-average number of shares of Common Stock outstanding during the period. Diluted earnings per share is calculated similarly but includes potential dilution from the exercise of stock options and stock awards, except when the effect would be anti-dilutive.

The computation of basic and diluted earnings per common share is as follows (in thousands, except per share data):

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	2013		2014	2013
BASIC				
Weighted average number of common shares outstanding				
used in computing basic earnings per share	46,889	46,148	46,794	46,085
Net income attributable to common stockholders	\$17,385	\$8,635	\$27,587	\$6,709
Earnings per share attributable to common stockholders	\$0.37	\$0.19	\$0.59	\$0.15
DILUTED				
Weighted average number of common shares outstanding				
used in computing basic earnings per share	46,889	46,148	46,794	46,085
Add: Dilutive effect of stock options and stock awards outstanding	1,534	1,359	1,429	1,298
	48,423	47,507	48,223	47,383
Net income attributable to common stockholders	\$17,385	\$8,635	\$27,587	\$6,709
Earnings per share attributable to common stockholders	\$0.36	\$0.18	\$0.57	\$0.14

NOTE C – Inventories

Inventories stated at the lower of cost or market value are as follows (in thousands):

	December
June 30,	31,

	2014	2013
Raw materials	\$71,197	\$69,878
Work-in-progress	46,540	43,031
Finished goods	65,044	67,487
Total	\$182,781	\$180,396

NOTE D – Goodwill and Intangible Assets

Changes in goodwill are as follows (in thousands):

Balance at December 31, 2013	\$84,714
Translation adjustment	1,246
Balance at June 30, 2014	\$85,960

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Intangible assets are as follows (in thousands):

	June 30, 2014	December 31, 2013
Intangible assets subject to amortization:		
Gross carrying amount	\$86,929	\$86,925
Accumulated amortization	(36,220)	(32,245)
Translation adjustment	(6,710)	(7,000)
Total	43,999	47,680
Intangible assets with indefinite lives:		
Gross carrying amount	6,403	6,403
Translation adjustment	(426)	(512)
Total	5,977	5,891
Total intangible assets, net	\$49,976	\$53,571

Amortization expense related to intangible assets subject to amortization was approximately \$2 million for both the three months ended June 30, 2014 and 2013, and approximately \$4 million for both the six months ended June 30, 2014 and 2013.

NOTE E – Income Tax Provision

Income tax expense of approximately \$6 million and \$1 million was recorded for the three months ended June 30, 2014 and 2013, respectively, and income tax expense of approximately \$8 million was recorded for both the six months ended June 30, 2014 and 2013. This resulted in an effective tax rate of 22% for the six months ended June 30, 2014, as compared to 54% in the same period last year and compared to 38% for the full year of 2013. The effective tax rate for the six months ended June 30, 2014 includes a \$2 million benefit for discrete items, primarily resulting from the conclusion of a tax audit. The effective tax rate for the six months ended June 30, 2013 includes a \$6 million charge for discrete items during the period, primarily resulting from a tax audit by the China tax authorities. The estimated annual tax rate for 2014 is expected to be approximately 28%, excluding discrete items. The Company's effective tax rates for the six months ended June 30, 2014 and 2013, excluding discrete items, were lower than the U.S. statutory tax rate of 35%, principally from the impact of income in lower-taxed jurisdictions.

For the three months ended June 30, 2014, the Company reported domestic and foreign pre-tax income of approximately \$1 million and \$23 million, respectively. For the six months ended June 30, 2014, the Company reported domestic and foreign pre-tax income of approximately \$4 million and \$32 million, respectively. Funds repatriated from foreign subsidiaries to the U.S. may be subject to federal and state income taxes. The Company intends to permanently reinvest overseas all of its earnings from its foreign subsidiaries, except to the extent such undistributed earnings have previously been subject to US tax; accordingly, deferred U.S. taxes are not recorded on undistributed foreign earnings.

The impact of tax holidays decreased the Company's tax expense by approximately \$1 million and \$2 million for the six months ended June 30, 2014 and 2013, respectively. The benefit of the tax holidays on both basic and diluted earnings per share for the six months ended June 30, 2014 was approximately \$0.03. The benefit of the tax holidays

on both basic and diluted earnings per share for the six months ended June 30, 2013 was approximately \$0.04.

The Company files income tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examinations by tax authorities for tax years before 2007, or for the 2010 tax year. With respect to state and local jurisdictions and countries outside of the U.S., with limited exceptions, the Company is no longer subject to income tax audits for years before 2006. Although the outcome of tax audits is always uncertain, the Company believes that adequate amounts of tax, interest and penalties, if any, have been provided for in the Company's reserve for any adjustments that may result from tax audits. The Company recognizes accrued interest and penalties related to unrecognized tax benefits in interest expense. As of June 30, 2014, the gross amount of unrecognized tax benefits was approximately \$21 million.

It is reasonably possible that the amount of the unrecognized benefit with respect to certain of the Company's unrecognized tax positions will significantly increase or decrease within the next 12 months. At this time, an estimate of the range of the reasonably possible outcomes cannot be made.

NOTE F – Share-Based Compensation

The following table shows the total compensation expensed for share-based compensation plans, including stock options and share grants, recognized in the statements of operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Cost of sales	\$107	\$126	\$203	\$249
Selling and administrative expense	2,979	2,877	5,829	5,720
Research and development expense	305	301	578	591
Total share-based compensation expense	\$3,391	\$3,304	\$6,610	\$6,560

Stock Options. Stock options generally vest in equal annual installments over a four-year period and expire eight years after the grant date, and expense was estimated on the date of grant using the Black-Scholes-Merton option pricing model.

The total net cash proceeds received from stock option exercises during the six months ended June 30, 2014 was approximately \$3 million. Stock option expense was approximately \$1 million for both the three months ended June 30, 2014 and 2013, and \$2 million for both the six months ended June 30, 2014 and 2013.

A summary of the stock option grants is as follows:

Stock Options	Shares (000)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (yrs)	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2014	3,126	\$ 18.93	4	\$ 17,461
Granted	176	27.92		
Exercised	(304)	9.66		5,422
Forfeited or expired	(2)	29.21		
Outstanding at June 30, 2014	2,996	\$ 20.39	4	\$ 25,754
Exercisable at June 30, 2014	2,406	\$ 19.43	3	\$ 22,967

The aggregate intrinsic value in the table above is before applicable income taxes and represents the amount option holders would have received if all options had been exercised on the last business day of the period indicated, based on the Company's closing stock price.

As of June 30, 2014, total unrecognized share-based compensation expense related to unvested stock options, net of forfeitures, was approximately \$7 million, before income taxes, and is expected to be recognized over a weighted average period of approximately 3 years.

Share Grants. Restricted stock awards and restricted stock units generally vest in equal annual installments over a four-year period.

Share grant expense for the three months ended June 30, 2014 and 2013 was approximately \$3 million and \$2 million, respectively, and share grant expense for both the six months ended June 30, 2014 and 2013 was approximately \$5 million.

A summary of the Company's non-vested share grants is as follows:

Share Grants	Shares (000)	Weighted Average Grant-Date Fair Value	Aggregate Intrinsic Value (\$000)
Non-vested at January 1, 2014	1,131	\$ 22.35	\$ 26,656
Granted	234	27.46	
Vested	(95)	22.42	2,606
Forfeited	(12)	21.81	
Non-vested at June 30, 2014	1,258	\$ 23.32	\$ 30,650

As of June 30, 2014, total unrecognized share-based compensation expense related to non-vested stock awards, net of forfeitures, was approximately \$20 million, before income taxes, and is expected to be recognized over a weighted average period of approximately 3 years.

NOTE G – Segment Information and Enterprise-Wide Disclosure

For financial reporting purposes, the Company operates in a single segment, standard semiconductor products, through the Company's various manufacturing and distribution facilities. The Company aggregates its products because the products are similar and have similar economic characteristics, and the products are similar in production process and share the same customer type.

The Company's primary operations include the domestic operations in Asia, North America and Europe.

Revenues are attributed to geographic areas based on the location of subsidiaries producing the revenues (in thousands):

Three Months Ended June 30, 2014	Asia	North America	Europe	Consolidated
Total sales	\$200,955	\$38,304	\$47,383	\$ 286,642
Inter-company sales	(25,518)	(15,650)	(22,257)	(63,425)
Net sales	\$175,437	\$22,654	\$25,126	\$ 223,217

Three Months Ended June 30, 2013	Asia	North America	Europe	Consolidated
Total sales	\$195,735	\$37,253	\$39,993	\$ 272,981
Inter-company sales	(18,873)	(18,657)	(21,072)	(58,602)
Net sales	\$176,862	\$18,596	\$18,921	\$ 214,379

As of and for the Six Months Ended June 30, 2014	Asia	North America	Europe	Consolidated
Total sales	\$390,322	\$75,089	\$88,929	\$ 554,340
Inter-company sales	(48,802)	(30,387)	(41,948)	(121,137)
Net sales	\$341,520	\$44,702	\$46,981	\$ 433,203
Property, plant and equipment, net	\$262,186	\$28,016	\$22,340	\$ 312,542
Total assets	\$866,715	\$130,085	\$188,935	\$ 1,185,735

As of and for the Six Months Ended June 30, 2013	Asia	North America	Europe	Consolidated
Total sales	\$352,535	\$72,061	\$77,630	\$ 502,226
Inter-company sales	(34,896)	(35,424)	(40,563)	(110,883)
Net sales	\$317,639	\$36,637	\$37,067	\$ 391,343

Property, plant and equipment, net	\$277,608	\$30,579	\$23,100	\$331,287
Total assets	\$837,332	\$150,733	\$183,509	\$1,171,574

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Geographic Information

Revenues were derived from (shipped to) customers located in the following countries (in thousands):

	Net Sales		Percentage			
	for the Three Months		of			
	Ended June 30,		Net Sales			
	2014	2013	2014	2013		
China	\$139,703	\$139,113	63 %	65 %		
United States	21,765	16,604	10 %	8 %		
Germany	16,372	12,263	7 %	6 %		
Korea	14,110	16,119	6 %	8 %		
Singapore	12,498	12,784	6 %	6 %		
Taiwan	6,698	6,763	3 %	3 %		
All Others ⁽¹⁾	12,071	10,733	5 %	5 %		
Total	\$223,217	\$214,379	100 %	100 %		

	Net Sales		Percentage			
	for the Six Months		of			
	Ended June 30,		Net Sales			
	2014	2013	2014	2013		
China	\$267,160	\$246,757	62 %	63 %		
United States	41,406	34,021	10 %	9 %		
Korea	34,235	31,566	8 %	8 %		
Germany	31,199	23,291	7 %	6 %		
Singapore	22,116	21,719	5 %	6 %		
Taiwan	13,581	11,916	3 %	3 %		
All Others ⁽¹⁾	23,506	22,073	5 %	6 %		
Total	\$433,203	\$391,343	100 %	100 %		

⁽¹⁾ Represents countries with less than 3% of the total revenues each.

NOTE H – Commitments and Contingencies

Purchase commitments – As of June 30, 2014, the Company had approximately \$17 million in non-cancelable purchase contracts related to capital expenditures, primarily for manufacturing equipment in China.

Contingencies – From time to time, the Company may be involved in a variety of legal matters that arise in the normal course of business. Based on information available, the Company evaluates the likelihood of potential outcomes. The Company records the appropriate liability when it is considered probable and the amount is reasonably estimable. In addition, the Company does not accrue for estimated legal fees and other directly related costs as they are expensed as incurred.

The Company is currently a party to a purported stockholder derivative action in the United States District Court for the District of Delaware, entitled Scherer v. Keh-Shew Lu, Civil Action No. 1:13-cv-00358-UNA (D. Del. filed Mar.

5, 2013), on behalf of the Company against its directors, in which plaintiff alleges that (a) the Board approved awards of stock options to Dr. Keh-Shew Lu, our President and Chief Executive Officer, in 2009, 2010, 2011 and 2012 that exceeded the limitation on the number of shares of the Company's Common Stock that may be purchased upon the exercise of options granted to any person in any given year under the Company's 2001 Omnibus Equity Incentive Plan as amended by the stockholders on May 28, 2009; (b) the Company's disclosures in its 2010, 2011 and 2012 proxy statements regarding the limitation on the number of shares of the Company's Common Stock that may be purchased upon the exercise of options granted to any person in any given year under the Company's 2001 Omnibus Equity Incentive Plan as amended by the stockholders on May 28, 2009 were inaccurate; and (c) the Company's disclosures in its 2010, 2011 and 2012 proxy statements that the grants of stock options to Dr. Lu in 2009, 2010, 2011 and 2012 complied with the terms of the Company's 2001 Omnibus Equity Incentive Plan as amended by the stockholders on May 28, 2009 were incorrect. The Compensation Committee reviewed the grants of stock options to Dr. Lu in 2009, 2010, 2011 and 2012 (each such annual grant, an "Option Grant"), and approved a Confirmation Agreement, dated April 1, 2013, in which the Company and Dr. Lu agreed and confirmed that Dr. Lu will assert no claim that any Option Grant in 2009, 2010, 2011 or 2012 provided for the purchase of more than 100,000 shares of the Company's Common Stock, and that each Option Grant document be deemed amended to reflect the foregoing 100,000 share

limitation. On April 3, 2013, defendants and the Company filed answers to the complaint. On May 8, 2013, defendants filed a motion for judgment on the pleadings dismissing the action on the ground that the claims are moot. On June 24, 2013, the Court approved the parties' stipulation providing for the withdrawal of the motion for judgment on the pleadings and the dismissal of the action as moot upon the filing and adjudication of plaintiff's motion for an award of attorney's fees and costs. On July 29, 2013, plaintiff filed a motion for an award of attorneys' fees and costs. On September 20, 2013, the Company filed its opposition to plaintiff's motion. On October 11, 2013, plaintiff filed her reply in further support of her motion. No hearing date has been set for this motion.

The Company is also currently a party to a putative securities class action in the United States District Court for the Eastern District of Texas, entitled *Local 731 I.B. of T. Excavators and Pavers Pension Trust Fund v. Diodes, Inc.*, Civil Action No. 6:13-cv-00247 (E.D. Tex. filed Mar. 15, 2013), (the "Class Action") against the Company, Dr. Lu and Richard D. White. In this action, plaintiff purportedly on behalf of a class of investors who purchased the Company's Common Stock between February 9, 2011 and June 9, 2011, alleges that defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5 promulgated thereunder by making allegedly misleading public statements during the class period regarding the labor market in China and its impact on the Company's business and prospects. On June 14, 2013, the Court entered an order appointing Local 731 I.B. of T. Excavators and Pavers Pension Trust Fund as lead plaintiff and approved lead plaintiff's selection of Robbins Geller Rudman & Dowd as lead plaintiff's counsel and the Ward & Smith Law Firm as lead plaintiff's liaison counsel. On August 1, 2013, lead plaintiff filed an amended complaint reiterating the same claims for relief against the same defendants as asserted in the original complaint. On September 16, 2013, defendants filed a motion to dismiss the amended complaint. Lead plaintiff's opposition to defendants' motion to dismiss was filed on October 31, 2013. No hearing date has been set for this motion. Pursuant to the Private Securities Litigation Reform Act of 1995, all discovery and other proceedings are stayed pending a ruling on any motion to dismiss. The defendants intend to defend this action vigorously.

On February 20, 2014, a purported stockholder derivative action was filed in the United States District Court for the Eastern District of Texas, entitled *Persson v. Keh-Shew Lu*, Case No. 4:14-cv-00108-RC-ALM (E.D. Tex. filed Feb. 20, 2014), on behalf of the Company against its directors, in which plaintiff alleges that the directors breached their fiduciary duties by allowing the Company to make allegedly misleading public statements in 2011 regarding the labor market in China and its impact on the Company's business and prospects, by failing to maintain internal controls and by selling shares of Diodes stock while allegedly in possession of material nonpublic information regarding the labor market in China and its impact on the Company's business and prospects. The complaint does not seek any damages or other relief from the Company. On March 3, 2014, defendants accepted service of the complaint in this action. On April 2, 2014, this action was transferred to the judge presiding over the Class Action. On April 3, 2014, the Court granted defendants' unopposed motion to extend their time to respond to the complaint to May 28, 2014. On April 17, 2014, the Court granted the parties' unopposed motion to stay this action until such time that the Court rules on defendants' motion to dismiss in the Class Action. The defendants intend to defend the action vigorously.

NOTE I – Employee Benefit Plans

Defined Benefit Plan

The Company has a contributory defined benefit plan that covers certain employees in the United Kingdom ("U.K."). The net pension and supplemental retirement benefit obligations and the related periodic costs are based on, among other things, assumptions regarding the discount rate, estimated return on plan assets and mortality rates. These obligations and related periodic costs are measured using actuarial techniques and assumptions. The projected unit credit method is the actuarial cost method used to compute the pension liabilities and related expenses.

Net periodic benefit costs associated with the defined benefit plan were approximately \$0 million for both the three months ended June 30, 2014 and 2013, and \$1 million and \$0 million for the six months ended June 30, 2014 and 2013, respectively.

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The following tables set forth the benefit obligation, the fair value of plan assets, and the funded status of the Company's plan (in thousands):

	Defined Benefit Plan
Change in benefit obligation:	
Balance at December 31, 2013	\$ 149,316
Service cost	167
Interest cost	3,436
Actuarial loss	1,447
Benefits paid	(2,308)
Settlements	-
Currency changes	4,919
Benefit obligation at June 30, 2014	\$ 156,977
Change in plan assets:	
Fair value of plan assets at December 31, 2013	\$ 116,568
Actual return on plan assets	3,851
Employer contribution	334
Benefits paid	(2,308)
Currency changes	3,834
Fair value of plan assets at June 30, 2014	\$ 122,279
Underfunded status at June 30, 2014	\$(34,698)

Based on an actuarial study performed as of June 30, 2014, the plan is underfunded and a liability is reflected in the Company's consolidated financial statements as a long-term liability. The weighted-average discount rate assumption used to determine benefit obligations as of June 30, 2014 was 4.5%.

The following weighted-average assumptions were used to determine net periodic benefit costs for the six months ended June 30, 2014:

Discount rate	4.6%
Expected long-term return on plan assets	5.9%

During the second quarter of 2012, the Company adopted a payment plan with the trustees of the defined benefit plan, in which the Company will pay approximately 2 million British Pound Sterling (“GBP”) (approximately \$3 million based on a USD:GBP exchange rate of 1.6:1) every year from 2012 through 2019. As part of the required pension review, which occurs every three years under the United Kingdom pension regulations, the Company is currently in discussions with the trustees regarding future contributions for the pension scheme.

The Company also has pension plans in Asia for which the benefit obligation, fair value of the plan assets and the funded status amounts are deemed immaterial and therefore, are not included in the figures or assumptions above.

Deferred Compensation

The Company maintains a Non-Qualified Deferred Compensation Plan (the “Deferred Compensation Plan”) for executive officers, key employees and members of the Board of Directors (the “Board”). The Deferred Compensation Plan allows eligible participants to defer the receipt of eligible compensation, including equity awards, until designated future dates. The Company offsets its obligations under the Deferred Compensation Plan by investing in the actual underlying investments. These investments are classified as trading securities and are carried at fair value. At June 30, 2014, these investments totaled approximately \$4 million. All gains and losses in these investments are materially offset by corresponding gains and losses in the Deferred Compensation Plan liabilities.

NOTE J – Related Parties

The Company conducts business with three related companies: Lite-On Semiconductor Corporation and its subsidiaries and affiliates (collectively, “LSC”), Keylink International (B.V.I.) Inc. and its subsidiaries and affiliates (collectively, “Keylink”) and Nuvoton Technology Corporation and its subsidiaries and affiliates (collectively, “Nuvoton”). LSC owned approximately 18% of the Company’s outstanding Common Stock as of June 30, 2014. Keylink is the Company’s 5% joint venture partner in two of the Company’s Shanghai manufacturing facilities. A member of the Company’s Board of Directors who is also the Company’s President and Chief Executive Officer is a member of the Board of Directors of Nuvoton. In addition, another member of the Company’s Board of Directors is a Supervisor of the Board of Directors of Nuvoton.

The Audit Committee of the Company’s Board reviews all related party arrangements for potential conflict of interest situations on an ongoing basis, in accordance with such procedures as the Audit Committee may adopt from time to time.

Lite-On Semiconductor Corporation – The Company sells products to LSC and purchases semiconductor products from LSC for subsequent sale, making LSC one of the Company’s largest suppliers.

Net sales to, and purchases from, LSC are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net sales	\$164	\$296	\$279	\$399
Purchases	\$8,374	\$9,650	\$15,712	\$17,159

Keylink International (B.V.I.) Inc. – The Company sells products to Keylink and purchases semiconductor products for subsequent sale. In addition, two of the Company’s subsidiaries in China lease their manufacturing facilities from, and subcontract a portion of their manufacturing process (including, but not limited to, metal plating and environmental services) to Keylink. The Company also pays a consulting fee to Keylink. The aggregate amounts for these services

for both the three months ended June 30, 2014 and 2013 were approximately \$5 million. The aggregate amounts for these services for both the six months ended June 30, 2014 and 2013 were approximately \$9 million.

Net sales to, and purchases from, Keylink are as follows (in thousands):

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	2013		2013	
Net sales	\$2,116	\$1,561	\$4,380	\$5,209
Purchases	\$2,070	\$2,138	\$3,716	\$3,666

Nuvoton Technology Corporation – The Company purchases wafers from Nuvoton that it uses in the production of finished goods.

Net purchases from Nuvoton are as follows (in thousands):

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	2014	2013	2014	2013
Purchases	\$3,237	\$3,248	\$6,573	\$5,095

Accounts receivable from, and accounts payable to, LSC, Keylink and Nuvoton are as follows (in thousands):

	June 30, 2014	December 31, 2013
Accounts receivable		
LSC	\$ 155	\$ 140
Keylink	3,400	4,927
	\$3,555	\$ 5,067
Accounts payable		
LSC	\$5,919	\$ 5,670
Keylink	6,230	6,505
Nuvoton	1,154	770
	\$13,303	\$12,945

NOTE K – Subsequent Event

Zetex (Chengdu) Electronics Co., Ltd (“ZCEL”) was established in 1995; in which one of the Company’s subsidiaries became a 33% equity owner of ZCEL. The Company has historically treated the investment under the equity method of accounting. On July 7, 2014, the Company increased its equity ownership in ZCEL to 95% when it paid \$4 million for an additional 62% of equity.

The Company purchased the additional equity from a subsidiary of our joint venture partner, Chengdu Ya Guang Electric Company Limited, with whom the Company established a semiconductor manufacturing facility for surface-mounted component production, assembly and test in Chengdu, China and who owns 5% of the joint venture.

The Company acquired the additional equity in ZCEL to secure local plating services for its joint venture manufacturing facility in Chengdu, China where the Company can have its plating services completed locally. The

Company intends to account for the additional equity purchase as a business combination achieved in stages and will consolidate ZCEL as of July 1, 2014, which is not materially different from July 7, 2014.

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 and as identified under the heading “Cautionary Statement for Purposes of the “Safe Harbor” Provision of the Private Securities Litigation Reform Act of 1995” herein. 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 “Diodes,” the “Company,” “we,” “us” and “our” refer to Diodes Incorporated and its subsidiaries.

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 December 31, 2013, previously filed with Securities and Exchange Commission. (Amounts are rounded to the nearest million).

Highlights

Net sales for the three months ended June 30, 2014 was approximately \$223 million, an increase of \$9 million, or 4%, over the same period last year, and a sequential increase of 6% compared to the \$210 million in the first quarter of 2014;

Net sales for the six months ended June 30, 2014 was approximately \$433 million, an increase of \$42 million, or 11%, over the same period last year;

Gross profit for the three months ended June 30, 2014 was approximately \$70 million, an increase of \$9 million, or 15%, over the same period last year, and a sequential increase of 14% compared to the \$62 million in the first quarter of 2014;

Gross profit for the six months ended June 30, 2014 was approximately \$132 million, an increase of \$24 million, or 23%, over the same period last year;

Gross profit margin for the three months ended June 30, 2014 was 32%, compared to 29% in the same period last year, and 29% in the first quarter of 2014;

Gross profit margin for the six months ended June 30, 2014 was 30%, compared to 27% in the same period last year;

Net income attributable to common stockholders for the three months ended June 30, 2014 was approximately \$17 million, or \$0.36 per diluted share, compared to net income attributable to common stockholders of \$9 million, or \$0.18 per diluted share, in the same period last year, and net income attributable to common stockholders of \$10 million, or \$0.21 per diluted share, in the first quarter of 2014;

Net income attributable to common stockholders for the six months ended June 30, 2014 was approximately \$28 million, or \$0.57 per diluted share, compared to net income attributable to common stockholders of \$7 million, or \$0.14 per diluted share, in the same period last year; and

Cash flows from operating activities was approximately \$80 million for the six months ended June 30, 2014.

Overview

We are a leading global manufacturer and supplier of high-quality, application specific standard products within the broad discrete, logic and analog semiconductor markets, serving the consumer electronics, computing, communications, industrial and automotive markets. Our products are sold primarily throughout Asia, North America and Europe.

We design, manufacture and market semiconductors for diverse end-use applications. Semiconductors, which provide electronic signal amplification and switching functions, are basic building-block electronic components that are incorporated into almost every electronic device. We believe that our focus on application-specific standard products utilizing innovative, highly efficient packaging and cost-effective process technologies, coupled with our collaborative, customer-focused product development, provides us with a meaningful competitive advantage relative to other semiconductor companies.

First Two Quarters of 2014

For the first quarter of 2014, revenue was essentially flat despite the Chinese New Year slowdown due to shipping inventory that we had strategically built-up during the fourth quarter of 2013. Most notably, gross margin improved by 50 basis points

sequentially and 320 basis points year-over-year as a result of improved wafer fabrication performance, especially at BCD Fab 2 where the ramp-up is going smoothly, combined with an overall improvement in product mix. Also during the quarter, we improved our balance sheet by reducing long-term debt by approximately \$17 million, which followed a reduction of almost \$20 million last quarter. We generated approximately \$46 million of cash flow from operations while reducing inventory and capital expenditure spending. During the first quarter, we experienced a rebound in Europe after a soft fourth quarter of 2013, while North America also showed some strength. Our strongest end-markets in the quarter were the automotive and industrial markets, largely offset by the computing and communications end-markets.

For the second quarter of 2014, financial results were at the upper end of our guidance. Revenue grew over 6% sequentially and gross profit reached a quarterly record reflecting our improved product mix and increased capacity utilization. Our achievement of 32% gross margin was the highest level since the second quarter of 2011. During the quarter, North America and Europe were stronger than expected, which contributed to further gains in industrial end-markets. These regions have solid product mix distribution due to the end-markets and customers we serve in these geographies. Our strongest end-market in the quarter was industrial primarily due to strength in North America and Europe, as well as communications as a result of continued gains in smartphones and smartphone chargers. In addition, we had a strong quarter in automotive and better than expected results in computing.

Business Outlook

Our strong second quarter results demonstrate the leverage in our operating model, and we expect to generate increased profits and cash as revenue continues to grow. For the third quarter of 2014, we expect revenue to increase to a range of \$228 million and \$238 million, or up 2.1% to 6.6% sequentially. We expect gross margin to be 31.8%, plus or minus 2%. Operating expenses are expected to be approximately 21.0% of revenue, plus or minus 1%. We expect our income tax rate to be 22%, plus or minus 3%, and shares used to calculate diluted earnings per share for the second quarter are anticipated to be approximately 48.8 million.

Factors Relevant to Our Results of Operations

The following has affected, and, we believe, will continue to affect, our results of operations:

Net sales for the six months ended June 30, 2014 was \$433 million, compared to \$391 million in the same period last year. This increase in net sales mainly reflects the inclusion of 6 months of BCD revenue in 2014 compared to 4 months in 2013, an increase in units sold and an increase in average selling price ("ASP").

Our gross profit margin was 30% for the six months ended June 30, 2014, compared to 27% in the same period last year. Our gross margin percentage increased over the same period last year due primarily to improved wafer fabrication performance and improved product mix. Future gross profit margins will depend primarily on market prices, our product mix, manufacturing cost savings, and the demand for our products. For the six months ended June 30, 2014 and 2013, the percentage of our net sales derived from our Asian subsidiaries was approximately 79% and 81%, respectively. Europe accounted for approximately 11% of our revenues for the six months ended June 30, 2014, compared to 10% in the same period last year. In addition, North America accounted for approximately 10% of our revenues for the six months ended June 30, 2014, compared to 9% in the same period last year.

Since inception, we have invested over \$500 million in our manufacturing facilities in Asia, including costs for acquisitions. For the six months ended June 30, 2014, we invested approximately \$12 million in these manufacturing facilities, and we expect to continue to invest in our manufacturing facilities, although the amount to be invested will depend on, among other factors, product demand and new product developments.

For the six months ended June 30, 2014, our OEM and electronic manufacturing services ("EMS") customers together accounted for approximately 32% of our net sales, while our global network of distributors accounted for approximately 68% of our net sales. Compared to prior years, the percentage of net sales to our global network of

distributors has increased mainly due to acquisitions in which the majority of the net sales of the acquired companies are to distributors.

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Results of Operations for the Three Months Ended June 30, 2014 and 2013

The following table sets forth the percentage that certain items in the statements of operations bear to net sales and the percentage dollar increase (decrease) of such items from period to period.

	Percent of Net Sales Three Months Ended June 30, 2014 2013		Percentage Dollar Increase (Decrease) '13 to '14
Net sales	100 %	100 %	4
Cost of goods sold	(68)	(71)	-
Gross profit	32	29	15
Operating expenses	(22)	(24)	(8)
Income from operations	10	5	127
Other income (expense)	-	-	(3)
Income before income taxes and noncontrolling interest	10		