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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

Commission file number: 000-51026

**Monolithic Power Systems, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**77-0466789**

(I.R.S. Employer  
Identification Number)

**79 Great Oaks Boulevard, San Jose, CA 95119**

(Address of principal executive offices)(Zip code)

**(408) 826-0600**

(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  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

There were 38,745,011 shares of the registrant's common stock issued and outstanding as of October 24, 2014.

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MONOLITHIC POWER SYSTEMS, INC.

<b>TABLE OF CONTENTS</b>		<b>PAGE</b>
<b>PART I. FINANCIAL INFORMATION</b>		<b>3</b>
ITEM 1. FINANCIAL STATEMENTS (Unaudited)		3
CONDENSED CONSOLIDATED BALANCE SHEETS		3
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS		4
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME		5
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS		6
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS		7
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS		21
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK		28
ITEM 4. CONTROLS AND PROCEDURES		28
<b>PART II. OTHER INFORMATION</b>		<b>29</b>
ITEM 1. LEGAL PROCEEDINGS		29
ITEM 1A. RISK FACTORS		29
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS		44
ITEM 6. EXHIBITS		45

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**MONOLITHIC POWER SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except par value)  
(Unaudited)

	September 30, 2014	December 31, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 101,812	\$ 101,213
Short-term investments	126,849	125,126
Accounts receivable, net	24,274	23,730
Inventories	41,587	39,737
Prepaid expenses and other current assets	2,788	2,280
Total current assets	<u>297,310</u>	<u>292,086</u>
Property and equipment, net	63,428	64,837
Long-term investments	9,795	9,860
Goodwill	6,571	-
Acquisition-related intangible assets, net	7,178	-
Deferred income tax assets, net	477	481
Other long-term assets	7,940	1,644
Total assets	<u>\$ 392,699</u>	<u>\$ 368,908</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 14,793	\$ 10,694
Accrued compensation and related benefits	6,607	10,419
Accrued liabilities	15,528	17,376
Total current liabilities	<u>36,928</u>	<u>38,489</u>
Income tax liabilities	4,746	5,542
Other long-term liabilities	9,364	1,478
Total liabilities	<u>51,038</u>	<u>45,509</u>
Commitments and contingencies (Notes 8 and 12)		
Stockholders' equity:		
Common stock, \$0.001 par value; shares authorized: 150,000; shares issued and outstanding: 38,804 and 38,291 as of September 30, 2014 and December 31, 2013, respectively	238,602	234,201
Retained earnings	97,398	82,938
Accumulated other comprehensive income	5,661	6,260
Total stockholders' equity	<u>341,661</u>	<u>323,399</u>
Total liabilities and stockholders' equity	<u>\$ 392,699</u>	<u>\$ 368,908</u>

See accompanying notes to unaudited condensed consolidated financial statements.

**MONOLITHIC POWER SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share amounts)  
(Unaudited)

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2014	2013	2014	2013
Revenue	\$ 78,335	\$ 65,347	\$ 206,832	\$ 174,531
Cost of revenue	35,872	30,053	95,173	80,924
Gross profit	<u>42,463</u>	<u>35,294</u>	<u>111,659</u>	<u>93,607</u>
Operating expenses:				
Research and development	14,679	12,643	43,649	37,246
Selling, general and administrative	17,006	13,891	49,968	40,941
Litigation expense (benefit), net	332	104	(8,093)	(455)
Total operating expenses	<u>32,017</u>	<u>26,638</u>	<u>85,524</u>	<u>77,732</u>
Income from operations	10,446	8,656	26,135	15,875
Interest and other income (expense), net	202	(59)	686	149
Income before income taxes	10,648	8,597	26,821	16,024
Income tax provision (benefit)	(573)	1,187	186	625
Net income	<u>\$ 11,221</u>	<u>\$ 7,410</u>	<u>\$ 26,635</u>	<u>\$ 15,399</u>
Net income per share:				
Basic	\$ 0.29	\$ 0.20	\$ 0.69	\$ 0.42
Diluted	\$ 0.28	\$ 0.19	\$ 0.67	\$ 0.40
Weighted-average shares outstanding:				
Basic	38,785	37,910	38,646	37,079
Diluted	39,727	39,009	39,618	38,419
Cash dividends declared per common share	\$ 0.15	\$ -	\$ 0.30	\$ -

See accompanying notes to unaudited condensed consolidated financial statements.

**MONOLITHIC POWER SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in thousands)  
(Unaudited)

	<b>Three Months Ended September</b>		<b>Nine Months Ended September</b>	
	<b>30,</b>		<b>30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income	\$ 11,221	\$ 7,410	\$ 26,635	\$ 15,399
Other comprehensive income (loss), net of tax:				
Change in unrealized gains (losses) on auction-rate securities, net of \$0 tax for the three and nine months ended September 30, 2014 and 2013	(53)	149	(65)	117
Change in unrealized gains (losses) on other available-for-sale securities, net of \$0 tax for the three and nine months ended September 30, 2014 and 2013	(28)	34	(16)	12
Foreign currency translation adjustments	(98)	431	(518)	1,595
Total other comprehensive income (loss), net of tax	(179)	614	(599)	1,724
Comprehensive income	<u>\$ 11,042</u>	<u>\$ 8,024</u>	<u>\$ 26,036</u>	<u>\$ 17,123</u>

See accompanying notes to unaudited condensed consolidated financial statements.

**MONOLITHIC POWER SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(Unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 26,635	\$ 15,399
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,688	8,960
Amortization and realized gain/loss on investments	197	320
Stock-based compensation	24,872	15,081
Changes in operating assets and liabilities, net of effects of an acquisition:		
Accounts receivable	(516)	(2,573)
Inventories	(1,800)	(10,851)
Prepaid expenses and other assets	(1,868)	463
Accounts payable	3,864	1,164
Accrued liabilities	(2,885)	3,492
Accrued income taxes payable and noncurrent tax liabilities	(801)	(215)
Accrued compensation and related benefits	(3,789)	(1,002)
Net cash provided by operating activities	<u>53,597</u>	<u>30,238</u>
<b>Cash flows from investing activities:</b>		
Property and equipment purchases	(7,730)	(15,424)
Purchases of short-term investments	(100,706)	(62,374)
Proceeds from sale of short-term investments	98,752	55,700
Proceeds from sale of long-term investments	-	25
Investments related to deferred compensation plan	(4,860)	(309)
Cash paid for an acquisition, net of cash acquired	(11,590)	-
Net cash used in investing activities	<u>(26,134)</u>	<u>(22,382)</u>
<b>Cash flows from financing activities:</b>		
Property and equipment purchased on extended payment terms	(250)	-
Proceeds from issuance of common shares	10,403	32,654
Proceeds from employee stock purchase plan	2,078	2,145
Repurchases of common shares	(32,976)	(7,973)
Dividends and dividend equivalents paid	(5,817)	-
Net cash provided by (used in) financing activities	<u>(26,562)</u>	<u>26,826</u>
Effect of change in exchange rates	(302)	660
Net increase in cash and cash equivalents	599	35,342
Cash and cash equivalents, beginning of period	101,213	75,104
Cash and cash equivalents, end of period	<u>\$ 101,812</u>	<u>\$ 110,446</u>
<b>Supplemental disclosures for cash flow information:</b>		
Cash paid for taxes	\$ 981	\$ 847
<b>Supplemental disclosures of non-cash investing and financing activities:</b>		
Liability accrued for property and equipment purchases	783	2,081
Liability accrued for dividends and dividend equivalents	6,359	-
Fair value of contingent consideration related to an acquisition	2,507	-

See accompanying notes to unaudited condensed consolidated financial statements.

**MONOLITHIC POWER SYSTEMS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared by Monolithic Power Systems, Inc. (the “Company” or “MPS”) in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been condensed or omitted in accordance with these rules and regulations. The information in this report should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 10, 2014.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company’s financial position, results of operations and cash flows for the interim periods presented. The financial statements contained in this Form 10-Q are not necessarily indicative of the results that may be expected for the year ending December 31, 2014 or for any other future period.

***Summary of Significant Accounting Policies***

Other than the adoption of the following new significant accounting policies, there have been no changes to the Company’s significant accounting policies during the three and nine months ended September 30, 2014 as compared to those described in the Company’s audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2013.

**Goodwill and Acquisition-Related Intangible Assets** – Goodwill represents the excess of the fair value of purchase consideration over the fair value of net tangible and identified intangible assets as of the date of acquisition. In-process research and development (“IPR&D”) assets represent the fair value of incomplete R&D projects that had not reached technological feasibility as of the date of acquisition. The IPR&D assets are initially capitalized at fair value as intangible assets with indefinite lives. When the IPR&D projects are completed, they are reclassified as amortizable intangible assets and are amortized over their estimated useful lives. Alternatively, if the IPR&D projects are abandoned, they are impaired and expensed to research and development. Acquisition-related intangible assets with finite lives consist of know-how and developed technologies. These assets are amortized on a straight-line basis over estimated useful lives ranging from three to five years and the amortization expense is recorded in cost of revenue in the Condensed Consolidated Statements of Operations.

***Recent Accounting Pronouncements***

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The standard gives guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists, with the purpose of reducing diversity in practice. This new standard requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. The Company adopted this standard in the first quarter of 2014 prospectively and the adoption did not have an 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*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The standard’s core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under the new standard, entities will apply the following five-step model when evaluating revenue contracts with customers:

- Identify the contract with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognize revenue when the entity satisfies a performance obligation

The new standard is effective for annual and interim reporting periods beginning after December 15, 2016. Entities have the option of using either a full retrospective or a modified retrospective application in the adoption of this standard. The Company will adopt the standard in the first quarter of 2017 and is evaluating the transition method and the impact of the adoption on its consolidated financial position, results of operations and cash flows.

## 2. STOCK-BASED COMPENSATION

### *Stock Plans*

As of September 30, 2014, approximately 4.4 million shares were available for future issuance under the 2004 Equity Incentive Plan (the “2004 Plan”). The 2004 Plan will expire on November 12, 2014. Once the 2004 Plan expires, the Company will no longer be able to grant equity awards under the 2004 Plan, and any shares otherwise remaining available for future grants under the 2004 Plan will no longer be available for issuance.

The Company’s Board of Directors adopted the 2014 Equity Incentive Plan (the “2014 Plan”) in April 2013, and the Company’s stockholders approved it in June 2013. In October 2014, the Board of Directors approved certain amendments to the 2014 Plan. The 2014 Plan will become effective on November 13, 2014, the day after the 2004 Plan expires. The 2014 Plan provides for the issuance of up to 5,500,000 shares and will expire on November 13, 2024.

### *Stock-Based Compensation Expense*

The Company recognized stock-based compensation expenses as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Cost of revenue	\$ 246	\$ 163	\$ 669	\$ 465
Research and development	2,388	1,491	6,638	4,557
Selling, general and administrative	6,225	3,577	17,565	10,059
Tax benefit	-	(80)	-	(175)
Total stock-based compensation expense	<u>\$ 8,859</u>	<u>\$ 5,151</u>	<u>\$ 24,872</u>	<u>\$ 14,906</u>

### *Restricted Stock*

The Company’s restricted stock units (“RSUs”) include time-based RSUs, performance-based RSUs (“PSUs”) and market-based RSUs (“MSUs”). A summary of the RSUs is presented in the table below:

	Time-Based RSUs	Weighted-Average Grant Date Fair Value Per Share	PSUs	Weighted-Average Grant Date Fair Value Per Share	MSUs	Weighted-Average Grant Date Fair Value Per Share	Total	Weighted-Average Grant Date Fair Value Per Share
Outstanding at January 1, 2014	754,306	\$ 19.41	1,027,782	\$ 23.02	1,800,000	\$ 23.57	3,582,088	\$ 22.53
Awards granted	312,697	36.52	1,091,001 (1)	34.23	-	-	1,403,698	34.74
Performance adjustment	-	-	(141,626) (2)	31.54	-	-	(141,626)	31.54
Awards released	(378,142)	19.76	(276,512)	18.12	-	-	(654,654)	19.07
Awards forfeited	(24,039)	19.81	(17,097)	19.79	-	-	(41,136)	19.80
Outstanding at September 30, 2014	<u>664,822</u>	27.25	<u>1,683,548</u>	27.87	<u>1,800,000</u>	23.57	<u>4,148,370</u>	25.90

- (1) The number of PSUs granted reflects the maximum number of shares that can ultimately be earned assuming the achievement of the highest level of performance conditions under the programs.
- (2) The performance adjustment reflects the number of PSUs that have not been earned or may not ultimately be earned based on management’s probability assessment.



The intrinsic value related to awards released for the three months ended September 30, 2014 and 2013 was \$5.3 million and \$3.2 million, respectively. The intrinsic value related to awards released for the nine months ended September 30, 2014 and 2013 was \$23.8 million and \$14.8 million, respectively. As of September 30, 2014, the total intrinsic value of outstanding awards was \$182.7 million, based on the closing stock price of \$44.05. As of September 30, 2014, unamortized compensation expense related to outstanding awards was approximately \$79.5 million with a weighted-average remaining recognition period of approximately six years.

#### 2014 PSUs and Time-Based RSUs:

In February 2014, the Board of Directors granted 336,000 shares to the Company's executive officers. These grants included 25% time-based RSUs which vest over two years on a quarterly basis, and 75% PSUs which represent a target number of RSUs to be awarded based on the Company's achievement of an average two-year (2014 and 2015) revenue growth rate compared against the analog industry's average two-year revenue growth rate as determined by the Semiconductor Industry Association ("2014 Executive PSUs"). The maximum number of 2014 Executive PSUs that an executive officer can ultimately earn is 300% of the target shares. Half of the 2014 Executive PSUs will vest in February 2016 if the pre-determined performance goals are met and approved by the Compensation Committee. The remaining shares will vest over the following two years on a quarterly basis. The vesting is subject to continued employment with the Company.

In April 2014, the Board of Directors granted 139,000 shares to the Company's non-executive employees. These grants included 78,000 shares of time-based RSUs which vest over four years on an annual or quarterly basis, and 61,000 shares of PSUs which represent a target number of RSUs to be awarded based on the Company's achievement of revenue goals for certain regions or product line divisions, or the Company's achievement of an average two-year (2014 and 2015) revenue growth rate compared against the analog industry's average two-year revenue growth rate as determined by the Semiconductor Industry Association ("2014 Non-Executive PSUs"). The maximum number of 2014 Non-Executive PSUs that an employee can ultimately earn is either 200% or 300% of the target shares, depending on the job classifications of the employees. Half of the 2014 Non-Executive PSUs will vest in the second quarter of 2016 if the pre-determined performance goals are met and approved by the Compensation Committee. The remaining shares will vest over the following two years on an annual or quarterly basis. The vesting is subject to continued employment with the Company.

Based on the Company's revenue forecast as of September 30, 2014, the Company has determined that it is probable that it will be able to achieve or exceed the pre-determined revenue targets set for the 2014 Executive PSUs and the majority of the 2014 Non-Executive PSUs. The Company continues to evaluate the expected performance against the pre-determined goals and will adjust stock-based compensation expense based on this assessment accordingly.

In connection with the acquisition of Sensima Technology SA ("Sensima") in July 2014, the Board of Directors granted time-based RSUs and PSUs to key Sensima employees who became employees of the Company. See Note 3 for further discussion.

#### **Stock Options**

A summary of the stock options activities is presented in the table below:

	<b>Stock Options</b>	<b>Weighted-Average Exercise Price</b>	<b>Weighted-Average Contractual Term (Years)</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at January 1, 2014	1,356,446	\$ 15.86	1.9	\$ 25,505,753
Options exercised	(638,018)	16.30		
Options forfeited and expired	(8,397)	11.22		
Outstanding at September 30, 2014	<u>710,031</u>	15.51	1.3	20,265,815
Options exercisable at September 30, 2014 and expected to vest	709,524	15.52	1.3	20,245,815
Options exercisable at September 30, 2014	677,985	15.63	1.2	19,268,944

Total intrinsic value of options exercised was \$2.3 million and \$11.3 million for the three months ended September 30, 2014 and 2013, respectively. Total intrinsic value of options exercised was \$14.1 million and \$22.2 million for the nine months ended September 30, 2014 and 2013, respectively. The net cash proceeds from the exercise of stock options were \$10.4 million and \$32.7 million for the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, unamortized compensation expense related to unvested options was approximately \$0.2 million with a weighted-average remaining recognition period of approximately one year.

### **Employee Stock Purchase Plan (“ESPP”)**

For the three months ended September 30, 2014 and 2013, 34,000 and 46,000 shares, respectively, were issued under the ESPP. For the nine months ended September 30, 2014 and 2013, 78,000 and 111,000 shares, respectively, were issued under the ESPP. As of September 30, 2014, 4.7 million shares were available for future issuance.

The intrinsic value of stock purchased was \$0.5 million and \$0.3 million for the three months ended September 30, 2014 and 2013, respectively. The intrinsic value of stock purchased was \$0.9 million and \$0.8 million for the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, the unamortized expense was \$0.2 million, which will be recognized through the first quarter of 2015. The Black-Scholes model was used to value the employee stock purchase rights with the following weighted-average assumptions:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Expected term (years)	0.5	0.5	0.5	0.5
Expected volatility	25.1%	27.5%	29.5%	28.0%
Risk-free interest rate	0.1%	0.1%	0.1%	0.1%
Dividend yield	1.4%	-	0.7%	-

Cash proceeds from employee stock purchases were \$2.1 million for both the nine months ended September 30, 2014 and 2013.

### **3. ACQUISITION**

On July 22, 2014 (the “Acquisition Date”), the Company acquired 100% of the outstanding capital stock of Sensima, a company based in Switzerland that develops magnetic sensor technologies for angle measurements as well as three-dimensional magnetic field sensing. The acquisition is expected to create new opportunities with customers by offering enhanced solutions in power management for key industries such as automotive, industrial and cloud computing. Subsequent to the Acquisition Date, Sensima became a subsidiary of the Company and its results of operations have been included in the Company’s consolidated financial statements.

#### **Purchase Consideration**

The fair value of the purchase consideration consists of the following (in thousands):

Cash paid at the Acquisition Date	\$	11,735
Contingent consideration		2,507
Total	\$	<u>14,242</u>

Cash paid at the Acquisition Date included \$1.2 million that is being held at an escrow account for a one-year period for Sensima’s satisfaction of certain representations and warranties.

The contingent consideration arrangement requires the Company to pay up to an additional \$8.9 million to certain former Sensima shareholders if Sensima achieves a new product introduction as well as certain product revenue and direct margin targets in 2016. The fair value of the contingent consideration at the Acquisition Date was \$2.5 million, which was estimated based on a probability-weighted analysis of possible future cash flow outcomes. The fair value of the contingent consideration is recorded in other long-term liability in the Condensed Consolidated Balance Sheets and is remeasured at the end of each reporting period, with any changes in fair value recorded in operating expense in the Condensed Consolidated Statements of Operations. Actual amounts that will ultimately be paid may differ from the obligations recorded.

The Company incurred \$0.6 million of transaction costs that were expensed as incurred and included in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

### **Preliminary Purchase Consideration Allocation**

The estimated fair value of assets acquired and liabilities assumed is as follows (in thousands):

Cash	\$	145
Other tangible assets acquired, net of liabilities assumed		42
Intangible assets:		
Know-how		1,018
Developed technologies		4,421
IPR&D		2,045
Total identifiable net assets acquired		7,671
Goodwill		6,571
Total net assets acquired	\$	14,242

Intangible assets with finite lives include know-how and developed technologies with estimated useful lives of three to five years. The fair value of know-how was determined using the relief from royalty method, and the fair value of the developed technologies was determined using the income approach. Intangible assets with indefinite lives include IPR&D, which consists of incomplete R&D projects that had not reached technological feasibility as of the Acquisition Date. The fair value of the IPR&D assets was determined using the income approach.

The goodwill arising from the acquisition was primarily attributed to synergies which will enable the Company to develop advanced solutions in power management combining with Sensima's magnetic sensor technologies. The goodwill is not expected to be deductible for tax purposes.

The purchase price allocation is considered preliminary and dependent upon the finalization of the valuation of assets acquired and liabilities assumed, primarily related to deferred taxes. The Company is currently determining if the acquisition qualifies as a tax-free reorganization within the meaning of Swiss tax rules pursuant to the tax holiday granted to Sensima by the Swiss tax authorities. Final determination of the valuation could result in an adjustment to the preliminary purchase price allocation, with an offsetting adjustment to goodwill.

### **Equity Awards**

On the Acquisition Date, the Board of Directors granted \$1.7 million of time-based RSUs (or 40,000 shares) to key Sensima employees who became employees of the Company. These awards vest over four years. In addition, the Board of Directors granted \$2.0 million of PSUs (or 47,000 shares) to these employees, with the right to earn up to a maximum of \$8.0 million based on the achievement of certain cumulative Sensima product revenue targets during the performance period from the Acquisition Date to July 22, 2019. One half of the awards subject to each revenue goal will vest immediately when the pre-determined revenue goal is met and approved by the Compensation Committee, and the remaining 50% will vest over the following two years. The vesting is subject to continued employment with the Company. These equity awards are considered arrangements for post-acquisition services and the related compensation expense is being recognized over the requisite service period.

### **Pro Forma Information (Unaudited)**

Supplemental information on a pro forma basis, as if the Sensima acquisition had been consummated on January 1, 2013, is presented as follows (in thousands):

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2014	2013	2014	2013
Revenue	\$ 78,336	\$ 65,357	\$ 206,882	\$ 174,589
Net income	\$ 11,025	\$ 6,801	\$ 24,886	\$ 13,351
Diluted net income per share	\$ 0.28	\$ 0.17	\$ 0.63	\$ 0.35

These pro forma results are not necessarily indicative of the Company's consolidated results of operations in future periods or the results that actually would have been realized had the Company acquired Sensima during the periods presented. The pro forma results include adjustments primarily related to Sensima's results of operations, amortization of intangible assets and stock-based compensation expense.

#### 4. BALANCE SHEET COMPONENTS

##### *Inventories*

Inventories consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Work in process	\$ 25,594	\$ 26,605
Finished goods	15,993	13,132
Total	<u>\$ 41,587</u>	<u>\$ 39,737</u>

##### *Other Long-Term Assets*

Other long-term assets consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Deferred compensation plan assets	\$ 5,490	\$ 607
Prepaid expense	1,490	57
Other	960	980
Total	<u>\$ 7,940</u>	<u>\$ 1,644</u>

##### *Accrued Liabilities*

Accrued liabilities consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Deferred proceeds from litigation	\$ -	\$ 9,489
Dividends and dividend equivalents	5,994	-
Deferred revenue and customer prepayments	4,110	2,523
Stock rotation reserve	2,095	1,459
Commissions	1,228	931
Sales rebate	451	900
Warranty	240	451
Other	1,410	1,623
Total	<u>\$ 15,528</u>	<u>\$ 17,376</u>

A roll-forward of the warranty reserve is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance at beginning of period	\$ 290	\$ 334	\$ 451	\$ 331
Warranty provision for product sales	78	130	207	349
Settlements made	-	(3)	(74)	(98)
Unused warranty provision	(128)	(78)	(344)	(199)
Balance at end of period	<u>\$ 240</u>	<u>\$ 383</u>	<u>\$ 240</u>	<u>\$ 383</u>

#### Other Long-Term Liabilities

Other long-term liabilities consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Deferred compensation plan liabilities	\$ 5,433	\$ 628
Contingent consideration	2,507	-
Other	1,424	850
Total	<u>\$ 9,364</u>	<u>\$ 1,478</u>

#### 5. GOODWILL AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET

There have been no changes in the balance of goodwill from the Acquisition Date to September 30, 2014.

Acquisition-related intangible assets consist of the following (in thousands):

	As of September 30, 2014		
	Gross Amount	Accumulated Amortization	Net Amount
Subject to amortization:			
Know-how	\$ 1,018	\$ (43)	\$ 975
Developed technologies	4,421	(263)	4,158
Not subject to amortization:			
IPR&D	2,045	-	2,045
Total	<u>\$ 7,484</u>	<u>\$ (306)</u>	<u>\$ 7,178</u>

Amortization expense was recorded in cost of revenue in the Condensed Consolidated Statements of Operations and totaled \$0.3 million for the three and nine months ended September 30, 2014.

The estimated future amortization expense as of September 30, 2014 is as follows (in thousands):

Remainder of 2014	\$ 366
2015	1,467
2016	1,467
2017	1,467
2018 and thereafter	366
Total	<u>\$ 5,133</u>

## 6. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock, and calculated using the treasury stock method.

The Company's outstanding RSUs contain forfeitable rights to receive dividend equivalents, which are accrued quarterly during the vesting periods of the RSUs and paid to the employees when the awards vest. Dividend equivalents accrued on the RSUs are forfeited if the employees do not fulfill their service requirement during the vesting periods. Accordingly, these awards are not treated as participating securities in the net income per share calculation.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
<b>Numerator:</b>				
Net income	\$ 11,221	\$ 7,410	\$ 26,635	\$ 15,399
<b>Denominator:</b>				
Weighted average outstanding shares used to compute basic net income per share	38,785	37,910	38,646	37,079
Effect of dilutive securities	942	1,099	972	1,340
Weighted average outstanding shares used to compute diluted net income per share	39,727	39,009	39,618	38,419
Net income per share - basic	\$ 0.29	\$ 0.20	\$ 0.69	\$ 0.42
Net income per share - diluted	\$ 0.28	\$ 0.19	\$ 0.67	\$ 0.40

For the three and nine months ended September 30, 2014, there were no anti-dilutive common stock equivalents. For the three and nine months ended September 30, 2013, approximately 1,000 and 7,000 common stock equivalents, respectively, were excluded from the calculation of diluted net income per share because their inclusion would have been anti-dilutive.

## 7. SEGMENT AND GEOGRAPHIC INFORMATION

As defined by the requirements of ASC 280-10-55, *Segment Reporting – Overall – Implementation*, the Company operates in one reportable segment that includes the design, development, marketing and sale of high-performance, mixed-signal analog semiconductors for the communications, storage and computing, consumer and industrial markets. The Company's chief operating decision maker is its chief executive officer. The Company derives a majority of its revenue from sales to customers located outside North America, with geographic revenue based on the customers' ship-to locations.

The Company sells its products primarily through third-party distributors, value-added resellers and directly to original equipment manufacturers, original design manufacturers, and electronic manufacturing service providers. The following table summarizes those customers with sales greater than 10% of the Company's total revenue or accounts receivable balances greater than 10% of the Company's total accounts receivable:

Customers	Revenue				Accounts Receivable	
	Three Months Ended September 30,		Nine Months Ended September 30,		September 30,	December 31,
	2014	2013	2014	2013	2014	2013
Distributor A	26%	33%	26%	32%	25%	32%
Distributor B	10%	*	10%	*	13%	17%

\* Represents less than 10%.

Both of the customers are third-party distributors. The Company's agreements with these distributors were made in the ordinary course of business and may be terminated with or without cause by either party with advance notice. Although the Company may experience a short-term disruption in the distribution of its products and a short-term decline in revenue if its agreement with either of these distributors was terminated, the Company believes that such termination would not have a material adverse effect on its financial statements because it would be able to engage alternative distributors, resellers and other distribution channels to deliver its products to end customers within a few quarters following the termination of any agreement with a distributor.

The following is a summary of revenue by geographic regions (in thousands):

Country and Region	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
China	\$ 51,796	\$ 40,577	\$ 132,585	\$ 102,099
Taiwan	9,379	8,886	28,080	24,726
Europe	5,212	3,949	14,377	11,226
Korea	4,067	2,599	10,693	7,425
United States	4,079	1,812	9,913	5,552
Japan	2,221	2,285	6,075	5,446
Southeast Asia	1,534	5,103	4,955	17,817
Other	47	136	154	240
<b>Total</b>	<b>\$ 78,335</b>	<b>\$ 65,347</b>	<b>\$ 206,832</b>	<b>\$ 174,531</b>

The following is a summary of revenue by product family (in thousands):

Product Family	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
DC to DC products	\$ 70,196	\$ 57,823	\$ 185,304	\$ 154,801
Lighting control products	8,139	7,524	21,528	19,730
<b>Total</b>	<b>\$ 78,335</b>	<b>\$ 65,347</b>	<b>\$ 206,832</b>	<b>\$ 174,531</b>

The following is a summary of long-lived assets by geographic regions (in thousands):

Country	September 30, 2014	December 31, 2013
China	\$ 37,450	\$ 41,557
United States	33,695	24,719
Bermuda	13,749	-
Other	223	205
<b>Total</b>	<b>\$ 85,117</b>	<b>\$ 66,481</b>

## 8. LITIGATION

The Company and certain of its subsidiaries are parties to actions and proceedings in the ordinary course of business, including litigation regarding its shareholders and its intellectual property, challenges to the enforceability or validity of its intellectual property and claims that the Company's products infringe on the intellectual property rights of others. These proceedings often involve complex questions of fact and law and may require the expenditure of significant funds and the diversion of other resources to prosecute and defend. The Company defends itself vigorously against any such claims.

### *O2 Micro*

In May 2012, the United States District Court for the Northern District of California (the "District Court") issued an order finding O2 Micro International, Ltd. ("O2 Micro") liable for approximately \$9.1 million in attorneys' fees and non-taxable costs, plus interest, in connection with the patent litigation that the Company won in 2010. This award was in addition to the approximately \$0.3 million in taxable costs that the District Court had earlier ordered O2 Micro to pay to the Company in connection with the same lawsuit. In October 2012, O2 Micro appealed the District Court's judgment to the United States Court of Appeals for the Federal Circuit (the "Federal Circuit"). In August 2013, the Federal Circuit affirmed O2 Micro's liability for the full amount of the award. In September 2013, O2 Micro filed a petition for rehearing of that ruling, but the Federal Circuit denied O2 Micro's petition for rehearing on October 16, 2013.

In November 2013, the Company received a cash payment of \$9.5 million from O2 Micro. In January 2014, O2 Micro filed an appeal with the United States Supreme Court. Had O2 Micro been successful in obtaining a favorable ruling against the Company, the Company could have been liable to return a portion or all of the \$9.5 million to O2 Micro. Accordingly, the Company recorded the \$9.5 million as a current liability as of December 31, 2013.

In March 2014, the Supreme Court declined to hear the case. As O2 Micro had no further legal avenues to appeal, the Company released the current liability of \$9.5 million and recorded the amount in litigation expense (benefit), net, in the Condensed Consolidated Statement of Operations in the first quarter of 2014. In addition, the Company incurred additional legal fees of \$0.5 million in connection with the final resolution of the lawsuit.

## 9. CASH, CASH EQUIVALENTS AND INVESTMENTS

The following is a summary of the Company's cash and cash equivalents, short-term and long-term investments (in thousands):

	September 30, 2014	December 31, 2013
<b>Cash, cash equivalents and investments:</b>		
Cash	\$ 72,709	\$ 62,625
Money market funds	29,103	35,588
U.S. treasuries and government agency bonds	126,849	128,126
Auction-rate securities backed by student-loan notes	9,795	9,860
<b>Total</b>	<b>\$ 238,456</b>	<b>\$ 236,199</b>
	<b>September 30, 2014</b>	<b>December 31, 2013</b>
<b>Reported as:</b>		
Cash and cash equivalents	\$ 101,812	\$ 101,213
Short-term investments	126,849	125,126
Long-term investments	9,795	9,860
<b>Total</b>	<b>\$ 238,456</b>	<b>\$ 236,199</b>

The contractual maturities of the Company's short-term and long-term available-for-sale investments are as follows (in thousands):

	September 30, 2014	December 31, 2013
Due in less than 1 year	\$ 79,562	\$ 95,509
Due in 1 - 5 years	47,287	29,617
Due in greater than 5 years	9,795	9,860
<b>Total</b>	<b>\$ 136,644</b>	<b>\$ 134,986</b>

The following tables summarize unrealized gains and losses related to our investments in marketable securities designated as available-for sale (in thousands):

	As of September 30, 2014				Fair Value of Investments in Unrealized Loss Position
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Total Fair Value	
Money market funds	\$ 29,103	\$ -	\$ -	\$ 29,103	\$ -
U.S. treasuries and government agency bonds	126,861	37	(49)	126,849	37,455
Auction-rate securities backed by student-loan notes	10,220	-	(425)	9,795	9,795
<b>Total</b>	<b>\$ 166,184</b>	<b>\$ 37</b>	<b>\$ (474)</b>	<b>\$ 165,747</b>	<b>\$ 47,250</b>



**As of December 31, 2013**

	<b>Adjusted Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Total Fair Value</b>	<b>Fair Value of Investments in Unrealized Loss Position</b>
Money market funds	\$ 35,588	\$ -	\$ -	\$ 35,588	\$ -
U.S. treasuries and government agency bonds	128,123	26	(23)	128,126	42,880
Auction-rate securities backed by student-loan notes	10,220	-	(360)	9,860	9,860
<b>Total</b>	<b>\$ 173,931</b>	<b>\$ 26</b>	<b>\$ (383)</b>	<b>\$ 173,574</b>	<b>\$ 52,740</b>

**10. DEFERRED COMPENSATION PLAN**

The Company has a non-qualified, unfunded deferred compensation plan, which became effective in July 2013 and provides certain key employees, including our executive management, with the ability to defer the receipt of compensation in order to accumulate funds for retirement on a tax deferred basis. The Company does not make contributions to the plan or guarantee returns on the investments. The Company is responsible for the plan's administrative expenses. Participant deferrals and investment gains and losses remain as the Company's liabilities and the underlying assets are subject to claims of general creditors. As of September 30, 2014 and December 31, 2013, the plan assets totaled \$5.5 million and \$0.6 million, and the plan liabilities totaled \$5.4 million and \$0.6 million, respectively.

**11. FAIR VALUE MEASUREMENTS**

The following table details the fair value measurement of the financial assets and liabilities (in thousands):

<b>Fair Value Measurement at September 30, 2014</b>				
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
<b>Assets:</b>				
Money market funds	\$ 29,103	\$ 29,103	\$ -	\$ -
U.S. treasuries and government agency bonds	126,849	-	126,849	-
Auction-rate securities backed by student-loan notes	9,795	-	-	9,795
<b>Total</b>	<b>\$ 165,747</b>	<b>\$ 29,103</b>	<b>\$ 126,849</b>	<b>\$ 9,795</b>
<b>Liabilities:</b>				
Contingent consideration	\$ 2,507	\$ -	\$ -	\$ 2,507
<b>Total</b>	<b>\$ 2,507</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,507</b>

<b>Fair Value Measurement at December 31, 2013</b>				
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
<b>Assets:</b>				
Money market funds	\$ 35,588	\$ 35,588	\$ -	\$ -
U.S. treasuries and government agency bonds	128,126	-	128,126	-
Auction-rate securities backed by student-loan notes	9,860	-	-	9,860
<b>Total</b>	<b>\$ 173,574</b>	<b>\$ 35,588</b>	<b>\$ 128,126</b>	<b>\$ 9,860</b>

The Company's level 3 assets consist of government-backed student loan auction-rate securities, with interest rates that reset through a Dutch auction every 7 to 35 days and which became illiquid in 2008. The following table provides a rollforward of the fair value of the auction-rate securities (in thousands):

Balance at January 1, 2014	\$ 9,860
Change in unrealized loss included in other comprehensive income	(65)
<b>Ending balance at September 30, 2014</b>	<b>\$ 9,795</b>

The Company determined the fair value of the auction-rate securities using a discounted cash flow model with the following assumptions:

	September 30, 2014	December 31, 2013
Time-to-liquidity (months)	24	24
Expected return	2.9%	2.5%
Discount rate	4.1% - 7.1%	3.3% - 8.1%

The Company's level 3 liabilities consist of the contingent consideration related to the acquisition of Sensima in July 2014. The arrangement requires the Company to pay up to \$8.9 million to certain former Sensima shareholders if Sensima achieves a new product introduction as well as certain product revenue and direct margin targets in 2016. The fair value of the contingent consideration at the Acquisition Date was \$2.5 million, which was estimated based on a probability-weighted analysis of possible future cash flow outcomes. There were no significant changes in the fair value of the contingent consideration from the Acquisition Date to September 30, 2014. The fair value is calculated using the following assumptions:

	September 30, 2014
Project revenue in 2016 (in millions)	\$2.1 - \$3.8
Discount rate	9.0%
Probability of occurrence	20% - 50%

## 12. INCOME TAXES

The income tax provision (benefit) for the three and nine months ended September 30, 2014 was \$(0.6) million, or (5.4)% of pre-tax income, and \$0.2 million, or 0.7% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates, and because of the benefit that the Company realized from the release of a reserve where the statute of limitations expired and the benefit realized as a result of stock option exercises and releases of restricted stock.

The income tax expense for the three and nine months ended September 30, 2013 was \$1.2 million, or 13.8% of the pre-tax income, and \$0.6 million, or 3.9% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates, and because of the benefit that the Company realized from the release of a reserve where the statute of limitations expired.

### *Unrecognized Tax Benefits*

As of September 30, 2014 and December 31, 2013, the Company had unrecognized tax benefits of approximately \$15.1 million and \$14.9 million, respectively. As of September 30, 2014 and December 31, 2013, the Company had unrecognized tax benefits of approximately \$4.2 million and \$5.0 million, respectively that would result in an adjustment to the Company's effective tax rate if recognized after considering the valuation allowance.

Uncertain tax positions relate to the allocation of income and deductions among the Company's global entities and to the determination of the research and development tax credit. It is reasonably possible that over the next twelve-month period, the Company may experience other increases or decreases in its unrecognized tax benefits. However, it is not possible to determine either the magnitude or the range of other increases or decreases at this time.

The Company recognizes interest and penalties, if any, related to uncertain tax positions in its income tax provision. As of September 30, 2014 and December 31, 2013, the Company had \$0.4 million and \$0.8 million, respectively, of accrued interest related to uncertain tax positions.

### Income Tax Audits

The Company is subject to examination of its income tax returns by the IRS and other tax authorities. The Company's U.S. Federal income tax returns for the years ended December 31, 2005 through December 31, 2007 are under examination by the IRS. In April 2011, the Company received from the IRS a Notice of Proposed Adjustment ("NOPA") relating to a cost-sharing agreement entered into by the Company and its international subsidiaries on January 1, 2004. In the NOPA, the IRS objected to the Company's allocation of certain litigation expenses between the Company and its international subsidiaries and the amount of "buy-in payments" made by the international subsidiaries to the Company in connection with the cost-sharing agreement, and proposed to increase the Company's U.S. taxable income according to a few alternative methodologies. In February 2012, the Company received a revised NOPA from the IRS ("Revised NOPA"). In this Revised NOPA, the IRS raised the same issues as in the NOPA issued in April 2011 but under a different methodology. Under the Revised NOPA, the largest potential federal income tax adjustment, if the IRS were to prevail on all matters in dispute, is \$10.5 million, plus interest and penalties, if any. The Company responded to the IRS Revised NOPA in May 2012. In June 2013, the IRS responded and continued to disagree with the Company's rebuttal. The Company met with the IRS Office of Appeals in March, May and September 2014. However, no resolutions were reached in those meetings, and both parties are scheduled to meet again in November 2014. Meanwhile, the Company agreed to grant the IRS an extension of the statute of limitations for taxable years 2005 through 2007 to September 30, 2015.

The IRS also audited the research and development credits carried forward into year 2005 and the credits generated in the years 2005 through 2007. The Company received a NOPA from the IRS in February 2011, proposing to reduce the research and development credits generated in year 2005 through 2007 and the carryforwards, which would then reduce the value of such credits carried forward to subsequent tax years.

The Company reviewed and responded to the above proposed adjustments. The Company regularly assesses the likelihood of an adverse outcome resulting from such examinations to determine the adequacy of its provision for income taxes. As of September 30, 2014, based on the technical merits of its tax return filing positions and the interactions to date with the IRS, the Company believes that it is more-likely-than-not that the resolution of the audits will not have a material impact on the Company's consolidated financial position, results of operations and cash flows.

### 13. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table summarizes the changes in accumulated other comprehensive income (in thousands):

	Unrealized Losses on Auction- Rate Securities	Unrealized Gains (Losses) on Other Available-for- Sale Securities	Foreign Currency Translation Adjustments	Total
Balance as of January 1, 2014	\$ (360)	\$ 4	\$ 6,616	\$ 6,260
Other comprehensive income (loss) before reclassifications	(17)	5	(596)	(608)
Amounts reclassified from accumulated other comprehensive income	-	-	-	-
Net current period other comprehensive income (loss)	(17)	5	(596)	(608)
Balance as of March 31, 2014	(377)	9	6,020	5,652
Other comprehensive income before reclassifications	5	8	176	189
Amounts reclassified from accumulated other comprehensive income	-	(1)	-	(1)
Net current period other comprehensive income	5	7	176	188
Balance as of June 30, 2014	(372)	16	6,196	5,840
Other comprehensive loss before reclassifications	(53)	(28)	(98)	(179)
Amounts reclassified from accumulated other comprehensive income	-	-	-	-
Net current period other comprehensive loss	(53)	(28)	(98)	(179)
Balance as of September 30, 2014	<u>\$ (425)</u>	<u>\$ (12)</u>	<u>\$ 6,098</u>	<u>\$ 5,661</u>

## 14. STOCK REPURCHASE PROGRAM

In July 2013, the Board of Directors approved a stock repurchase program that authorizes the Company to repurchase up to \$100 million in the aggregate of its common stock through June 30, 2015. All shares are retired upon repurchase. The following table summarizes the repurchase activities under the program:

	<b>Shares Repurchased</b>	<b>Average Price Per Share</b>	<b>Total Amount</b>
			(in thousands)
Cumulative balance at January 1, 2014	663,802	\$ 31.06	\$ 20,615
Repurchases	323,789	\$ 35.08	11,358
Cumulative balance at March 31, 2014	987,591	\$ 32.38	31,973
Repurchases	321,764	\$ 38.65	12,438
Cumulative balance at June 30, 2014	1,309,355	\$ 33.92	44,411
Repurchases	212,035	\$ 43.29	9,180
Cumulative balance at September 30, 2014	<u>1,521,390</u>	<u>\$ 35.22</u>	<u>\$ 53,591</u>

As of September 30, 2014, \$46.4 million remained available for future repurchases under the program.

## 15. DIVIDENDS AND DIVIDEND EQUIVALENTS

In June 2014, the Board of Directors approved a dividend program pursuant to which the Company intends to pay quarterly cash dividends on its common stock. Stockholders of record as of the last day of the quarter are entitled to receive the quarterly cash dividends declared by the Board of Directors, which are payable on the 15<sup>th</sup> of the following month. The Board of Directors declared the following dividends in 2014:

	<b>Dividend Declared per Share</b>	<b>Total Amount</b>
		(in thousands)
<b>2014</b>		
Second quarter	\$ 0.15	\$ 5,817
Third quarter	0.15	5,823

As of September 30, 2014, accrued dividends totaled \$5.8 million, which was paid to stockholders on October 15, 2014.

The declaration of any future cash dividend is at the discretion of the Board of Directors and will depend on the Company's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination that cash dividends are in the best interests of the Company's stockholders. The Company anticipates that the cash used for future dividends will come from its current domestic cash and cash generated from ongoing U.S. operations. If cash held by the Company's international subsidiaries is needed for the payment of dividends, the Company may be required to accrue and pay U.S. taxes to repatriate the funds.

Under the 2004 Plan, RSU awards contain rights to receive dividend equivalents, which entitle employees who hold RSUs to the same dividend value per share as holders of common stock. The dividend equivalents are accrued quarterly during the vesting periods of the RSUs and paid to the employees when the awards vest. Dividend equivalents accrued on the RSUs are forfeited if the employees do not fulfill their service requirement during the vesting periods. As of September 30, 2014, accrued dividend equivalents totaled \$0.5 million.

## 16. SUBSEQUENT EVENT

### *Equity Awards*

In October 2014, the Board of Directors approved 337,000 shares of PSUs to non-executive employees with five consecutive two-year performance periods that will begin from 2015 and end in 2020. In addition, the Board of Directors approved 218,000 shares of PSUs to executive officers with a two-year performance period that will begin in 2015. The performance metrics for all of the PSUs will be determined by the Board of Directors prior to the inception of each performance period.

The Company reserved these shares from the 2004 Plan. In addition, the Company will determine the grant date fair value of these awards and begin recognizing the related expense when the performance criteria are approved by the Board of Directors and communicated to employees prior to the inception of each performance period.

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

This Quarterly Report on Form 10-Q contains forward-looking statements that involve many risks and uncertainties. These statements relate to future events and our future performance and are based on current expectations, estimates, forecasts and projections about the industries in which we operate and the beliefs and assumptions of our management. These include statements concerning, among others:

- the above-average industry growth of product and market areas that we have targeted,
- our plan to increase our revenue through the introduction of new products within our existing product families as well as in new product categories and families,
- our intention to exercise our purchase option with respect to our manufacturing facility in Chengdu, China,
- our belief that we will continue to incur significant legal expenses that vary with the level of activity in each of our legal proceedings,
- the effect of liquidity of our investments on our capital resources,
- the application of our products in the communications, storage and computing, consumer and industrial markets continuing to account for our revenue,
- estimates of our future liquidity requirements,
- the cyclical nature of the semiconductor industry,
- protection of our proprietary technology,
- near term business outlook for 2014 and beyond,
- the factors that we believe will impact our ability to achieve revenue growth,
- the outcome of the IRS audit of our tax returns,
- the percentage of our total revenue from various market segments,
- our ability to integrate Sensima successfully and achieve the anticipated benefits from the acquisition,
- our ability to identify, acquire and integrate future acquisitions and achieve the anticipated benefits from such acquisitions,
- our intention and ability to continue the stock repurchase program and pay future cash dividends, and
- the factors that differentiate us from our competitors.

In some cases, words such as “would,” “could,” “may,” “should,” “predict,” “potential,” “targets,” “continue,” “anticipate,” “expect,” “intend,” “plan,” “believe,” “seek,” “estimate,” “project,” “forecast,” “will,” the negative of these terms or other variations of such terms and similar expressions relating to the future identify forward-looking statements. All forward-looking statements are based on our current outlook, expectations, estimates, projections, beliefs and plans or objectives about our business and our industry. These statements are not guarantees of future performance and are subject to risks and uncertainties. Actual events or results could differ materially and adversely from those expressed in any such forward-looking statements. Risks and uncertainties that could cause actual results to differ materially include those set forth throughout this Quarterly Report on Form 10-Q and, in particular, in the section entitled “Part II. Other Information, Item 1A. Risk Factors”. Except as required by law, we disclaim any duty to and undertake no obligation to update any forward-looking statements, whether as a result of new information relating to existing conditions, future events or otherwise or to release publicly the results of any future revisions we may make to forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are cautioned not to place undue reliance on such statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Readers should carefully review future reports and documents that we file from time to time with the Securities and Exchange Commission, such as our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

The following management's discussion and analysis should be read in connection with the information presented in our unaudited condensed consolidated financial statements and related notes for the three and nine months ended September 30, 2014 included in this report and our audited consolidated financial statements and related notes for the year ended December 31, 2013 included in our Annual Report on Form 10-K.

## **Overview**

We are a fabless semiconductor company that designs, develops, and markets proprietary, advanced analog and mixed-signal semiconductors. Our products are used extensively in storage and computing products, network communications products, set top boxes, lighting products, a wide variety of consumer and portable electronics products, and automotive and industrial markets. We believe that we differentiate ourselves by offering solutions that are more highly integrated, smaller in size, more energy efficient, more accurate with respect to performance specifications and, consequently, more cost-effective than many competing solutions. We plan to continue to introduce new products within our existing product families, as well as in new innovative product categories.

We operate in the cyclical semiconductor industry where there is seasonal demand for certain products. We are not and will not be immune from current and future industry downturns, but we have targeted product and market areas that we believe have the ability to offer above average industry performance.

We work with third parties to manufacture and assemble our integrated circuits ("ICs"). This has enabled us to limit our capital expenditures and fixed costs, while focusing our engineering and design resources on our core strengths.

Following the introduction of a product, our sales cycle generally takes a number of quarters after we receive an initial customer order for a new product to ramp up. Typical lead time for orders is fewer than 90 days. These factors, combined with the fact that orders in the semiconductor industry can typically be cancelled or rescheduled without significant penalty to the customer, make the forecasting of our orders and revenue difficult.

We derive most of our revenue from sales through distribution arrangements and direct sales to customers in Asia, where the products we produce are incorporated into end-user products. Our revenue from direct or indirect sales to customers in Asia was 88% for both the three and nine months ended September 30, 2014. We derive a majority of our revenue from the sales of our DC to DC converter product family which services the communications, storage and computing, consumer and industrial markets. We believe our ability to achieve revenue growth will depend, in part, on our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity.

In July 2014, we completed the acquisition of Sensima Technology SA ("Sensima"), a company located in Switzerland that develops magnetic sensors for angle measurements as well as three-dimensional magnetic field sensing. The acquisition is expected to create new opportunities with customers by offering enhanced solutions in power management for key industries such as automotive, industrial and cloud computing. The purchase consideration consisted of an upfront cash payment of \$11.7 million and additional consideration that is contingent upon Sensima achieving a new product introduction and certain revenue and direct margin goals in 2016, with a fair value of \$2.5 million at the date of acquisition. In addition, key employees received \$1.7 million of time-based restricted stock units and up to \$8.0 million of performance-based restricted stock units in connection with the transaction. These equity awards are considered arrangements for post-acquisition services and the related compensation expense is being recognized over the requisite service period. The results of operations of Sensima have been included in our consolidated financial statements subsequent to the acquisition date.

## **Critical Accounting Policies and Estimates**

Other than the adoption of the following new significant accounting policies, there have been no significant changes in our critical accounting policies and estimates used in the preparation of our financial statements during the three and nine months ended September 30, 2014, as compared to those disclosed in the Annual Report on Form 10-K for the year ended December 31, 2013.

**Valuation of Goodwill and Acquisition-Related Intangible Assets.** We evaluate intangible assets with finite lives for impairment whenever events or changes in circumstances indicate that an impairment may exist. We perform an annual impairment assessment for goodwill and intangible assets with indefinite lives in the fourth quarter, or more frequently if indicators of potential impairment exist. Impairment of intangible assets is recognized based on the difference between the fair value of the assets and their carrying value. Impairments for goodwill occur if the fair value of a reporting unit including goodwill is less than its carrying value and are recognized based on the difference between the implied fair value of the reporting unit's goodwill and the carrying value of the goodwill. The assumptions and estimates used to determine future values of goodwill and intangible assets are complex and subjective. They can be affected by various factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and revenue forecasts. If there is a significant adverse change in our business in the future, including macroeconomic and market conditions, we may be required to record impairment charges on our goodwill and acquisition-related intangible assets.

## Results of Operations

The table below sets forth the data in the Condensed Consolidated Statement of Operations as a percentage of revenue:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014		2013		2014		2013	
	(in thousands, except percentages)				(in thousands, except percentages)			
Revenue	\$ 78,335	100.0%	\$ 65,347	100.0%	\$ 206,832	100.0%	\$ 174,531	100.0%
Cost of revenue	35,872	45.8	30,053	46.0	95,173	46.0	80,924	46.4
Gross profit	42,463	54.2	35,294	54.0	111,659	54.0	93,607	53.6
Operating expenses:								
Research and development	14,679	18.7	12,643	19.3	43,649	21.1	37,246	21.3
Selling, general and administrative	17,006	21.8	13,891	21.3	49,968	24.1	40,941	23.5
Litigation expense (benefit), net	332	0.4	104	0.2	(8,093)	(3.9)	(455)	(0.3)
Total operating expenses	32,017	40.9	26,638	40.8	85,524	41.3	77,732	44.5
Income from operations	10,446	13.3	8,656	13.2	26,135	12.7	15,875	9.1
Interest and other income (expense), net	202	0.3	(59)	(0.1)	686	0.3	149	0.1
Income before income taxes	10,648	13.6	8,597	13.1	26,821	13.0	16,024	9.2
Income tax provision (benefit)	(573)	(0.7)	1,187	1.8	186	0.1	625	0.4
Net income	\$ 11,221	14.3%	\$ 7,410	11.3%	\$ 26,635	12.9%	\$ 15,399	8.8%

## Revenue

The following table shows our revenue by product family:

Product Family	Three Months Ended September 30,					Nine Months Ended September 30,				
	2014	% of Revenue	2013	% of Revenue	Change	2014	% of Revenue	2013	% of Revenue	Change
	(In thousands, except percentages)									
DC to DC products	\$ 70,196	89.6%	\$ 57,823	88.5%	21.4%	\$ 185,304	89.6%	\$ 154,801	88.7%	19.7%
Lighting control products	8,139	10.4%	7,524	11.5%	8.2%	21,528	10.4%	19,730	11.3%	9.1%
Total	\$ 78,335	100.0%	\$ 65,347	100.0%	19.9%	\$ 206,832	100.0%	\$ 174,531	100.0%	18.5%

Revenue for the three months ended September 30, 2014 was \$78.3 million, an increase of \$13.0 million, or 19.9%, from \$65.3 million for the three months ended September 30, 2013. This increase was due to higher sales of both DC to DC and lighting control products, as unit shipments increased 41% due to increased market demand, which were offset in part by a 15% decrease in average sales prices. Revenue from our DC to DC products was \$70.2 million for the three months ended September 30, 2014, an increase of \$12.4 million, or 21.4%, from the same period in 2013. This increase was primarily due to higher sales of our DC to DC converters, offset in part by lower sales of our battery charger and Mini-Monsters products. Revenue from our lighting control products was \$8.1 million for the three months ended September 30, 2014, an increase of \$0.6 million, or 8.2%, compared with the same period in 2013.

Revenue for the nine months ended September 30, 2014 was \$206.8 million, an increase of \$32.3 million, or 18.5%, from \$174.5 million for the nine months ended September 30, 2013. This increase was due to higher sales of both DC to DC and lighting control products, as unit shipments increased 39% due to increased market demand, which were offset in part by a 15% decrease in average sales prices. Revenue from our DC to DC products was \$185.3 million for the nine months ended September 30, 2014, an increase of \$30.5 million, or 19.7%, from the same period in 2013. This increase was primarily due to higher sales of our DC to DC converters and battery charger products, offset in part by lower sales of our Mini-Monsters products. Revenue from our lighting control products was \$21.5 million for the nine months ended September 30, 2014, an increase of \$1.8 million, or 9.1%, compared with the same period in 2013.





### Cost of Revenue and Gross Margin

Cost of revenue consists primarily of costs incurred to manufacture, assemble and test our products, as well as warranty costs, inventory-related expenses and other overhead costs and stock-based compensation expenses. In addition, cost of revenue includes amortization of intangible assets from the Sensima acquisition.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
	(in thousands, except percentages)					
Cost of revenue	\$ 35,872	\$ 30,053	19.4%	\$ 95,173	\$ 80,924	17.6%
Cost of revenue as a percentage of revenue	45.8%	46.0%		46.0%	46.4%	
Gross profit	\$ 42,463	\$ 35,294	20.3%	\$ 111,659	\$ 93,607	19.3%
Gross margin	54.2%	54.0%		54.0%	53.6%	

Cost of revenue was \$35.9 million, or 45.8% of revenue, for the three months ended September 30, 2014 and \$30.1 million, or 46.0% of revenue, for the three months ended September 30, 2013. The increase in cost of revenue was primarily due to a 41% increase in unit shipments, which was partially offset by a 15% decrease in the average direct cost of units shipped. In addition, the increase in cost of revenue was driven by an increase of \$0.4 million in the provision for inventory reserve, and an increase of \$0.3 million in amortization of intangible assets from the Sensima acquisition in July 2014.

Gross profit as a percentage of revenue, or gross margin, was 54.2% for the three months ended September 30, 2014, compared to 54.0% for the three months ended September 30, 2013. The increase in gross margin was primarily due to higher absorption of in-house test manufacturing overhead, compared to the same period in 2013. This increase was partially offset by an increase in the provision for inventory reserve and an increase in the amortization of intangible assets from the Sensima acquisition in July 2014.

Cost of revenue was \$95.2 million, or 46.0% of revenue, for the nine months ended September 30, 2014 and \$80.9 million, or 46.4% of revenue, for the nine months ended September 30, 2013. The increase in cost of revenue was primarily due to a 39% increase in unit shipments, which was partially offset by a 16% decrease in the average direct cost of units shipped. In addition, the increase in cost of revenue was driven by an increase of \$0.7 million in the provision for inventory reserve.

Gross margin was 54.0% for the nine months ended September 30, 2014, compared to 53.6% for the nine months ended September 30, 2013. The increase in gross margin was primarily due to higher absorption of in-house test manufacturing overhead and increased sales of higher margin products, compared to the same period in 2013. This increase was partially offset by a higher provision for inventory reserve.

### Research and Development

Research and development expenses primarily consist of salary and benefit expenses, bonuses and stock-based compensation expenses for design and product engineers, expenses related to new product development and supplies, and facility costs.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
	(in thousands, except percentages)					
Research and development ("R&D")	\$ 14,679	\$ 12,643	16.1%	\$ 43,649	\$ 37,246	17.2%
R&D as a percentage of revenue	18.7%	19.3%		21.1%	21.3%	

R&D expenses were \$14.7 million, or 18.7% of revenue, for the three months ended September 30, 2014 and \$12.6 million, or 19.3% of revenue, for the three months ended September 30, 2013. The increase in R&D expenses was primarily due to an increase of \$0.9 million in stock-based compensation expenses primarily associated with the performance-based and market-based equity awards, an increase of \$0.6 million in new product development expenses, and an increase of \$0.2 million in cash compensation expenses, which include salary, benefits and bonuses. Our R&D headcount was 457 employees as of September 30, 2014, compared with 441 employees as of September 30, 2013.

R&D expenses were \$43.6 million, or 21.1% of revenue, for the nine months ended September 30, 2014 and \$37.2 million, or 21.3% of revenue, for the nine months ended September 30, 2013. The increase in R&D expenses was primarily due to an increase of \$2.1 million in stock-based compensation expenses primarily associated with the performance-based and market-based equity awards, an increase of \$2.0 million in cash compensation expenses, which include salary, benefits and bonuses, an increase of \$1.0 million in new product development expenses, and an increase of \$0.5 million in manufacturing and lab supplies.

#### ***Selling, General and Administrative***

Selling, general and administrative expenses primarily include salary and benefit expenses, bonuses and stock-based compensation expenses for sales, marketing and administrative personnel, sales commissions, travel expenses, facilities costs, and professional service fees.

	<b>Three Months Ended September 30,</b>			<b>Nine Months Ended September 30,</b>		
	<b>2014</b>	<b>2013</b>	<b>Change</b>	<b>2014</b>	<b>2013</b>	<b>Change</b>
	(in thousands, except percentages)					
Selling, general and administrative ("SG&A")	\$ 17,006	\$ 13,891	22.4%	\$ 49,968	\$ 40,941	22.0%
SG&A as a percentage of revenue	21.8%	21.3%		24.1%	23.5%	

SG&A expenses were \$17.0 million, or 21.8% of revenue, for the three months ended September 30, 2014 and \$13.9 million, or 21.3% of revenue, for the three months ended September 30, 2013. The increase in SG&A expenses was primarily due to an increase of \$2.6 million in stock-based compensation expenses primarily associated with the performance-based and market-based equity awards, an increase of \$0.2 million in commission expenses due to higher revenue, and an increase of \$0.2 million in professional service fees primarily due to the acquisition of Sensima. Our SG&A headcount was 270 employees as of September 30, 2014, compared with 251 employees as of September 30, 2013.

SG&A expenses were \$50.0 million, or 24.1% of revenue, for the nine months ended September 30, 2014 and \$40.9 million, or 23.5% of revenue, for the nine months ended September 30, 2013. The increase in SG&A expenses was primarily due to an increase of \$7.5 million in stock-based compensation expenses primarily associated with the performance-based and market-based equity awards, an increase of \$0.5 million in commission expenses due to higher revenue, an increase of \$0.5 million in cash compensation expenses, which include salary, benefits and bonuses, and an increase of \$0.4 million in professional service fees primarily due to the acquisition of Sensima.

#### ***Litigation Expense (Benefit), Net***

Litigation expense was \$0.3 million for the three months ended September 30, 2014, compared to litigation expense of \$0.1 million for the three months ended September 30, 2013. The increase in litigation expense was due to higher expenses we incurred in litigation matters for the three months ended September 30, 2014 compared to the same period in 2013.

Net litigation benefit was \$(8.1) million for the nine months ended September 30, 2014, compared to net litigation benefit of \$(0.5) million for the nine months ended September 30, 2013. Net litigation benefit for the nine months ended September 30, 2014 included the recognition of the \$9.5 million award from the O2 Micro litigation, partially offset by \$0.5 million of additional legal fees incurred in connection with the final resolution of the litigation. Net litigation benefit for the nine months ended September 30, 2013 included \$0.8 million of proceeds received in connection with the legal settlement with Silergy Corporation. The increase in net litigation benefit for the nine months ended September 30, 2014 was partially offset by higher expenses we incurred in other litigation matters, compared to the same period in 2013.

#### ***Interest and Other Income (Expense), Net***

For the three months ended September 30, 2014, interest and other income, net, was \$0.2 million, compared with a net expense of \$(59,000) for the three months ended September 30, 2013. The increase in interest and other income, net, was primarily due to higher foreign exchange gains and interest income.

For the nine months ended September 30, 2014, interest and other income, net, was \$0.7 million, compared with \$0.1 million for the nine months ended September 30, 2013. The increase in interest and other income, net, was primarily due to higher foreign exchange gains and interest income.

### *Income Tax Provision (Benefit)*

The income tax provision (benefit) for the three and nine months ended September 30, 2014 was \$(0.6) million, or (5.4)% of pre-tax income, and \$0.2 million, or 0.7% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because our foreign income was taxed at lower rates, and because of the benefit that we realized from the release of a reserve where the statute of limitations expired and the benefit realized as a result of stock option exercises and releases of restricted stock.

The income tax expense for the three and nine months ended September 30, 2013 was \$1.2 million, or 13.8% of the pre-tax income, and \$0.6 million, or 3.9% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because our foreign income was taxed at lower rates, and because of the benefit that we realized from the release of a reserve where the statute of limitations expired.

### **Liquidity and Capital Resources**

	<b>September 30, 2014</b>	<b>December 31, 2013</b>
	(In thousands)	
Cash and cash equivalents	\$ 101,812	\$ 101,213
Short-term investments	126,849	125,126
Total cash, cash equivalents and short-term investments	<u>\$ 228,661</u>	<u>\$ 226,339</u>
Percentage of total assets	58.2%	61.4%
Total current assets	\$ 297,310	\$ 292,086
Total current liabilities	<u>(36,928)</u>	<u>(38,489)</u>
Working capital	<u>\$ 260,382</u>	<u>\$ 253,597</u>

As of September 30, 2014, we had cash and cash equivalents of \$101.8 million and short-term investments of \$126.8 million, compared with cash and cash equivalents of \$101.2 million and short-term investments of \$125.1 million as of December 31, 2013. As of September 30, 2014, \$67.1 million of cash and cash equivalents and \$17.0 million of short-term investments were held by our international subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to indefinitely reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

The significant components of our working capital are cash and cash equivalents, short-term investments, accounts receivable, inventories, prepaid expenses and other current assets, reduced by accounts payable, accrued compensation and related benefits, and other current liabilities.

As of September 30, 2014, we had working capital of \$260.4 million, compared with working capital of \$253.6 million as of December 31, 2013. The \$6.8 million increase in working capital was due to a \$5.2 million increase in current assets and a \$1.6 million decrease in current liabilities. The increase in current assets was primarily due to an increase in cash and short-term investments and an increase in inventory. The decrease in current liabilities was primarily due to a decrease in accrued compensation and related benefits, partially offset by an increase in accounts payable.

### *Summary of Cash Flows*

The following table summarizes our cash flow activities:

	<b>Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
	(In thousands)	
Net cash provided by operating activities	\$ 53,597	\$ 30,238
Net cash used in investing activities	(26,134)	(22,382)
Net cash provided by (used in) financing activities	(26,562)	26,826
Effect of exchange rate changes on cash and cash equivalents	(302)	660
Net increase in cash and cash equivalents	<u>\$ 599</u>	<u>\$ 35,342</u>

For the nine months ended September 30, 2014, net cash provided by operating activities was \$53.6 million, primarily due to our net income adjusted for certain non-cash items, including depreciation and amortization and stock-based compensation, and a net decrease of \$7.8 million from the changes in our operating assets and liabilities. The increase in inventories was primarily due to an increase in strategic wafer and die bank inventories as well as an increase in finished goods necessary to meet anticipated future demand. The increase in accounts payable was primarily driven by increased inventory purchases to meet anticipated future demand. The decrease in accrued compensation and related benefits was primarily due to the payment of bonuses accrued as of December 31, 2013. The decrease in accrued liabilities was primarily driven by the release of the liability related to the O2 Micro litigation, partially offset by an increase in employee contributions to the deferred compensation plan. For the nine months ended September 30, 2013, net cash provided by operating activities was \$30.2 million, primarily due to cash contributed from our operating results and an increase in accrued liabilities, which was partially offset by increases in both accounts receivable and inventories. The increase in accounts receivable resulted primarily from an increase in shipments and the timing of those shipments. The increase in inventories was primarily due to an increase in strategic wafer and die bank inventories as well as an increase in finished goods necessary to meet anticipated future demand.

For the nine months ended September 30, 2014, net cash used in investing activities was \$26.1 million, primarily due to net cash of \$11.6 million paid to acquire Sensima, purchases of property and equipment of \$7.7 million, and net purchases of investments of \$6.8 million. For the nine months ended September 30, 2013, net cash used in investing activities was \$22.4 million, primarily reflecting \$15.4 million of property and equipment purchases and \$7.0 million net purchases of investments.

For the nine months ended September 30, 2014, net cash used in financing activities was \$26.6 million, primarily reflecting \$33.0 million used in repurchases of our common stock and \$5.8 million used to pay dividends and dividend equivalents, partially offset by \$12.5 million of cash proceeds from stock option exercises and stock purchases through our employee stock purchase plan. Net cash provided by financing activities for the nine months ended September 30, 2013 was \$26.8 million, primarily reflecting \$32.7 million of cash received from the exercise of stock options and \$2.1 million of cash received from common stock sold through our ESPP, partially offset by \$8.0 million of cash used in repurchases of common stock.

In July 2013, our Board of Directors approved a stock repurchase program that authorizes us to repurchase up to \$100 million in the aggregate of our common stock through June 30, 2015. All shares are retired upon repurchase. For the nine months ended September 30, 2014, we repurchased a total of 858,000 shares for \$33.0 million, at an average price of \$38.45 per share. As of September 30, 2014, \$46.4 million remained available for future repurchases under the program.

In June 2014, the Board of Directors approved a dividend program pursuant to which we intend to pay quarterly cash dividends on our common stock. In addition, RSU awards contain rights to receive dividend equivalents, which entitle employees who hold RSUs to the same dividend value per share as holders of common stock. Dividend equivalents accrued on the RSUs are forfeited if the employees do not fulfill their service requirement during the vesting periods. For the nine months ended September 30, 2014, we paid dividend and dividend equivalents totaling \$5.8 million.

Although cash requirements will fluctuate based on the timing and extent of many factors such as those discussed above, we believe that cash generated from operations, together with the liquidity provided by existing cash balances and short-term investments, will be sufficient to satisfy our liquidity requirements for the next 12 months. We anticipate the cash used for future dividends, dividend equivalents and the stock repurchase program will come from our current domestic cash and cash generated from ongoing U.S. operations. If cash held by our international subsidiaries is needed for these payments, we may be required to accrue and pay U.S. taxes to repatriate these funds.

In the future, in order to strengthen our financial position, in the event of unforeseen circumstances, or in the event we need to fund our growth in future financial periods, we may need to raise additional funds by any one or a combination of the following: issuing equity securities, issuing debt or convertible debt securities, incurring indebtedness secured by our assets, or selling certain product lines and/or portions of our business. There can be no guarantee that we will be able to raise additional funds on terms acceptable to us, or at all.

From time to time, we have engaged in discussions with third parties concerning potential acquisitions of product lines, technologies, businesses and companies, and we continue to consider potential acquisition candidates. Any such transactions could involve the issuance of a significant number of new equity securities, assumptions of debt, and/or payment of cash consideration. We may also be required to raise additional funds to complete any such acquisition, through either the issuance of equity and debt securities or incurring indebtedness secured by our assets. If we raise additional funds or acquire businesses or technologies through the issuance of equity securities or convertible debt securities, our existing stockholders may experience significant dilution.

### ***Contractual Obligations***

We lease our research and development and sales offices in the United States, Europe, Japan, China, Taiwan and Korea. Certain of our facility leases provide for periodic rent increases. Currently, we are leasing a manufacturing facility in Chengdu, China. We have an option to acquire this manufacturing facility for approximately \$1.7 million, which consists of total construction cost incurred minus total rent paid by us during the lease term. This option became exercisable in March 2011 and does not expire. We will likely exercise our purchase option and enter into a purchase agreement for this facility in the future.

Our outstanding purchase commitments primarily consist of wafer purchases from our foundries and assembly services. As of September 30, 2014, the outstanding balance was \$24.4 million, compared with \$12.4 million as of December 31, 2013.

Our other contractual obligations have not changed significantly from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For a discussion of market risks, refer to Item 7A, “Quantitative and Qualitative Disclosures about Market Risk” in our annual report on Form 10-K for the year ended December 31, 2013. During the three and nine months ended September 30, 2014, there were no material changes or developments that would materially alter the market risk assessment performed as of December 31, 2013.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **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 pursuant to Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of September 30, 2014, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in 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, as appropriate, to allow timely decisions regarding required disclosure.

#### **Changes in Internal Control over Financial Reporting**

We completed the acquisition of Sensima Technology SA (“Sensima”) in July 2014 and are currently evaluating the internal control at Sensima. We intend to include the acquired entity in our assessment of the effectiveness of internal control over financial reporting in the annual management report following the first anniversary of the acquisition. There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2014, other than the Sensima acquisition, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **Limitations on Effectiveness of Controls and Procedures**

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We and certain of our subsidiaries are parties to actions and proceedings in the ordinary course of business, including litigation regarding our shareholders and our intellectual property, challenges to the enforceability or validity of our intellectual property and claims that our products infringe on the intellectual property rights of others. These proceedings often involve complex questions of fact and law and may require the expenditure of significant funds and the diversion of other resources to prosecute and defend. We defend ourselves vigorously against any such claims.

#### *O2 Micro*

In May 2012, the United States District Court for the Northern District of California (the “District Court”) issued an order finding O2 Micro International, Ltd. (“O2 Micro”) liable for approximately \$9.1 million in attorneys’ fees and non-taxable costs, plus interest, in connection with the patent litigation that we won in 2010. This award was in addition to the approximately \$0.3 million in taxable costs that the District Court had earlier ordered O2 Micro to pay to us in connection with the same lawsuit. In October 2012, O2 Micro appealed the District Court’s judgment to the United States Court of Appeals for the Federal Circuit (the “Federal Circuit”). In August 2013, the Federal Circuit affirmed O2 Micro’s liability for the full amount of the award. In September 2013, O2 Micro filed a petition for rehearing of that ruling, but the Federal Circuit denied O2 Micro’s petition for rehearing on October 16, 2013.

In November 2013, we received a cash payment of \$9.5 million from O2 Micro. In January 2014, O2 Micro filed an appeal with the United States Supreme Court. Had O2 Micro been successful in obtaining a favorable ruling against us, we could have been liable to return a portion or all of the \$9.5 million to O2 Micro. Accordingly, we recorded the \$9.5 million as a current liability as of December 31, 2013.

In March 2014, the Supreme Court declined to hear the case. As O2 Micro had no further legal avenues to appeal, we released the current liability of \$9.5 million and recorded the amount in litigation expense (benefit), net, in the Condensed Consolidated Statement of Operations in the first quarter of 2014. In addition, we incurred additional legal fees of \$500,000 in connection with the final resolution of the lawsuit.

### ITEM 1A. RISK FACTORS

Our business involves risks and uncertainties. You should carefully consider the risks described below, together with all of the other information in this quarterly report on Form 10-Q and other filings with the Securities and Exchange Commission in evaluating our business. If any of the following risks actually occur, our business, financial condition, operating results, and growth prospects would likely be adversely affected. In such an event, the trading price of our common stock could decline, and you could lose all or part of your investment in our common stock. Our past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods. These risks involve forward-looking statements and our actual results may differ substantially from those discussed in these forward-looking statements.

#### **The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors.**

The future trading price of our common stock is likely to be highly volatile and could be subject to wide fluctuations in response to various factors, many of which are beyond our control, including:

- our results of operations and financial performance;
- general economic, industry and market conditions worldwide;
- our ability to outperform the market, and outperform at a level that meets or exceeds our investors’ expectations;
- whether our forward guidance meets the expectations of our investors;
- the depth and liquidity of the market for our common stock;
- developments generally affecting the semiconductor industry;

- commencement of or developments relating to our involvement in litigation;
- investor perceptions of us and our business strategies;
- changes in securities analysts' expectations or our failure to meet those expectations;
- actions by institutional or other large stockholders;
- terrorist acts or acts of war;
- actual or anticipated fluctuations in our results of operations;
- developments with respect to intellectual property rights;
- introduction of new products by us or our competitors;
- our sale of common stock or other securities in the future;
- conditions and trends in technology industries;
- changes in market valuation or earnings of our competitors;
- any mergers, acquisitions or divestitures of assets undertaken by us;
- government debt default;
- our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity;
- our ability to increase our gross margins;
- market reactions to guidance from other semiconductor companies or third-party research groups;
- our ability to continue the stock repurchase program and pay quarterly cash dividends to stockholders; and
- changes in the estimation of the future size and growth rate of our markets.

In addition, the stock market in general often experiences substantial volatility that is seemingly unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

**We expect our operating results to fluctuate from quarter to quarter and year to year, which may make it difficult to predict our future performance and could cause our stock price to decline and be volatile.**

Our revenue, expenses, and results of operations are difficult to predict, have varied significantly in the past and will continue to fluctuate significantly in the future due to a number of factors, many of which are beyond our control. We expect fluctuations to continue for a number of reasons, including:

- changes in general demand for electronic products as a result of worldwide macro-economic conditions;
- changes in business conditions at our distributors, value-added resellers and/or end-customers;
- changes in general economic conditions in the countries where our products are sold or used;
- the timing of developments and related expenses in our litigation matters;
- the possibility of lost business as a result of customer and prospective customer concerns about being litigation targets;

- continued dependence on turns business (orders received and shipped within the same fiscal quarter);
- continued dependence on the Asian markets for our customer base;
- increases in assembly costs due to commodity price increases, such as the price of gold;
- the timing of new product introductions by us and our competitors;
- changes in our revenue mix between OEMs, ODMs, distributors and value-added resellers;
- changes in product mix, product returns, and actual and potential product liability;
- the acceptance of our new products in the marketplace;
- our ability to develop new process technologies and achieve volume production;
- our ability to meet customer product demand in a timely manner;
- the scheduling, rescheduling, or cancellation of orders by our customers;
- the cyclical nature of demand for our customers' products;
- fluctuations in our estimate for stock rotation reserves;
- our ability to manage our inventory levels, including the levels of inventory held by our distributors;
- inventory levels and product obsolescence;
- seasonality and variability in the storage and computing, consumer electronics, and communications markets;
- the availability of adequate manufacturing capacity from our outside suppliers;
- increases in prices for finished wafers due to general capacity shortages;
- the potential loss of future business resulting from capacity issues;
- changes in manufacturing yields;
- movements in exchange rates, interest rates or tax rates; and
- accounting charges resulting from equity awards granted to our employees.

Due to the factors noted above and other risks described in this section, many of which are beyond our control, you should not rely on quarter-to-quarter or year-over-year comparisons to predict our future financial performance. Unfavorable changes in any of the above factors may seriously harm our business and cause our stock price to decline and be volatile.

**Our business has been and may continue to be significantly impacted by worldwide economic conditions and uncertainty in the outlook for the global economy makes it more likely that our actual results will differ materially from expectations.**

Global credit and financial markets have experienced disruptions, and may continue to experience disruptions in the future, including diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates, and continued uncertainty about economic stability. These economic uncertainties affect businesses such as ours in a number of ways, making it difficult to accurately forecast and plan our future business activities. The continued or further tightening of credit in financial markets may lead consumers and businesses to postpone spending, which may cause our customers to cancel, decrease or delay their existing and future orders with us. In addition, financial difficulties experienced by our suppliers or distributors could result in product delays, increased accounts receivable defaults and inventory challenges. The volatility in the credit markets has severely diminished liquidity and capital availability. Demand for consumer electronics is a function of the health of the economies in the United States, Europe, China and the rest of the world. We cannot predict the timing, strength or duration of any economic disruption or subsequent economic recovery, worldwide, in the United States, in our industry, or in the consumer electronics market. These and other economic factors have had and may continue to have a material adverse effect on demand for our products and on our financial condition and operating results.



**We may not be profitable on a quarterly or annual basis.**

Our profitability is dependent on many factors, including:

- our sales, which because of our turns business (i.e., orders received and shipped within the same fiscal quarter), are difficult to accurately forecast;
- our customers' orders may be canceled or rescheduled without significant penalty to our customers;
- changes in general demand for electronic products as a result of worldwide macro-economic conditions;
- changes in revenue mix between OEMs, ODMs, distributors and value-added resellers;
- changes in product mix and actual and potential product liability;
- changes in revenue mix between end market segments (i.e. communication, storage and computing, consumer and industrial);
- our competition, which could adversely impact our selling prices and our potential sales;
- our manufacturing costs, including our ability to negotiate with our vendors and our ability to efficiently run our test facility in China;
- manufacturing capacity constraints;
- settlements of tax audits;
- stock-based compensation accounting charges; and
- our operating expenses, including general and administrative expenses, selling and marketing expenses, and research and development expenses relating to products that will not be introduced and will not generate revenue until later periods, if at all.

We may not achieve profitability on a quarterly or annual basis in the future. Unfavorable changes in our operations, including any of the factors noted above, may have a material adverse effect on our quarterly or annual profitability.

**We may not experience growth rates comparable to past years.**

In the past, our revenue increased significantly in certain years due to increased sales of certain of our products. Due to various factors, including increased competition, loss of certain of our customers, unfavorable changes in our operations, reduced global electronics demand, end-customer market downturn, market acceptance and penetration of our current and future products and ongoing litigation, we may not experience growth rates comparable to past periods, which could materially and adversely affect our stock price and results of operations.

**We may be unsuccessful in developing and selling new products with margins similar to or better than what we have experienced in the past, which would impact our overall gross margin and financial performance.**

Our success depends on products that are differentiated in the market, which result in gross margins that have historically been above industry averages. Should we fail to improve our gross margin in the future, and accordingly develop and introduce sufficiently differentiated products that result in higher gross margins than industry averages, our financial condition could be materially adversely affected.

**The highly cyclical nature of the semiconductor industry, which has produced significant and sometimes prolonged downturns, could materially adversely affect our operating results, financial condition and cash flows.**

Historically, the semiconductor industry has been highly cyclical and, at various times, has experienced significant downturns and wide fluctuations in supply and demand. These conditions have caused significant variances in product demand and production capacity, as well as rapid erosion of average selling prices. The industry may experience severe or prolonged downturns in the future, which could result in downward pressure on the price of our products as well as lower demand for our products. Because significant portions of our expenses are fixed in the short term or incurred in advance of anticipated sales, we may not be able to decrease our expenses in a timely manner to offset any sales shortfall. These conditions could have a material adverse effect on our operating results, financial condition and cash flows.

**If demand for our products declines in the major end markets that we serve, our revenue will decrease and our results of operations and financial condition would be materially and adversely affected.**

We believe that the application of our products in the storage and computer, consumer electronics, communications and industrial markets will continue to account for the majority of our revenue. If the demand for our products declines in the major end markets that we serve, our revenue will decrease and our results of operations and financial condition would be materially and adversely affected. In addition, as technology evolves, the ability to integrate the functionalities of various components, including our discrete semiconductor products, onto a single chip and/or onto other components of systems containing our products increases. Should our customers require integrated solutions that we do not offer, demand for our products could decrease, and our business and results of operations would be materially and adversely affected.

**We may be unsuccessful in developing and selling new products or in penetrating new markets required to maintain or expand our business.**

Our competitiveness and future success depend on our ability to design, develop, manufacture, assemble, test, market, and support new products and enhancements on a timely and cost-effective basis. A fundamental shift in technologies in any of our product markets could have a material adverse effect on our competitive position within these markets. Our failure to timely develop new technologies or to react quickly to changes in existing technologies could materially delay our development of new products, which could result in product obsolescence, decreased revenue, and/or a loss of market share to competitors.

As we develop new product lines, we must adapt to market conditions that are unfamiliar to us, such as competitors and distribution channels that are different from those we have known in the past. Some of our new product lines require us to re-equip our labs to test parameters we have not tested in the past. If we are unable to adapt rapidly to these new and additional conditions, we may not be able to successfully penetrate new markets.

The success of a new product depends on accurate forecasts of long-term market demand and future technological developments, as well as on a variety of specific implementation factors, including:

- timely and efficient completion of process design and device structure improvements;
- timely and efficient implementation of manufacturing, assembly, and test processes;
- the ability to secure and effectively utilize fabrication capacity in different geometries;
- product performance;
- product availability;
- product quality and reliability; and
- effective marketing, sales and service.

To the extent that we fail to timely introduce new products or to quickly penetrate new markets, our revenue and financial condition could be materially adversely affected.

**We derive most of our revenue from direct or indirect sales to customers in Asia and have significant operations in Asia, which may expose us to political, cultural, regulatory, economic, foreign exchange, and operational risks.**

We derive most of our revenue from customers located in Asia through direct sales or indirect sales through distribution arrangements and value-added reseller agreements with parties located in Asia. As a result, we are subject to increased risks due to this geographic concentration of business and operations. For the three months ended September 30, 2014, approximately 88% of our revenue was from customers in Asia. There are risks inherent in doing business in Asia, and internationally in general, including:

- changes in, or impositions of, legislative or regulatory requirements, including tax laws in the United States and in the countries in which we manufacture or sell our products;
- trade restrictions, including restrictions imposed by the United States on trading with parties in foreign countries;
- currency exchange rate fluctuations impacting intra-company transactions;
- transportation delays;
- changes in tax regulations in China that may impact our tax status in Chengdu;
- multi-tiered distribution channels that lack visibility to end customer pricing and purchase patterns;
- international political relationships and threats of war;
- terrorism and threats of terrorism;
- epidemics and illnesses;
- work stoppages and infrastructure problems due to adverse weather conditions or natural disasters;
- work stoppages related to employee dissatisfaction;
- economic, social and political instability;
- changes in import/export regulations, tariffs, and freight rates;
- longer accounts receivable collection cycles and difficulties in collecting accounts receivables;
- enforcing contracts generally; and
- less effective protection of intellectual property and contractual arrangements.

If we fail to expand our customer base and significantly reduce the geographic concentration of our customers, we will continue to be subject to the foregoing risks, which could materially and adversely affect our revenue and financial condition.

**We depend on a limited number of customers for a significant percentage of our revenue.**

Historically, we have generated most of our revenue from a limited number of customers. For example, as a result of consolidations in recent years among distributors, sales to our two largest distributors accounted for approximately 26% and 10% of our total revenue for the three months ended September 30, 2014. We continue to rely on a limited number of customers for a significant portion of our revenue. Because we rely on a limited number of customers for significant percentages of our revenue, a decrease in demand for our products from any of our major customers for any reason (including due to market conditions, catastrophic events or otherwise) could have a materially adverse impact on our financial conditions and results of operations.

**We are subject to anti-corruption laws in the jurisdictions in which we operate, including the U.S. Foreign Corrupt Practices Act, or the FCPA. Our failure to comply with these laws could result in penalties which could harm our reputation and have a material adverse effect on our business, results of operations and financial condition.**

We are subject to the FCPA, which generally prohibits companies and their intermediaries from making improper payments to foreign officials for the purpose of obtaining or keeping business and/or other benefits, along with various other anti-corruption laws. Although we have implemented policies and procedures designed to ensure that we, our employees and other intermediaries comply with the FCPA and other anti-corruption laws to which we are subject, there is no assurance that such policies or procedures will work effectively all of the time or protect us against liability under the FCPA or other laws for actions taken by our employees and other intermediaries with respect to our business or any businesses that we may acquire. We have significant operations in Asia, which places us in frequent contact with persons who may be considered “foreign officials” under the FCPA, resulting in an elevated risk of potential FCPA violations. If we are not in compliance with the FCPA and other laws governing the conduct of business with government entities (including local laws), we may be subject to criminal and civil penalties and other remedial measures, which could have an adverse impact on our business, financial condition, results of operations and liquidity. Any investigation of any potential violations of the FCPA or other anti-corruption laws by U.S. or foreign authorities could harm our reputation and have an adverse impact on our business, financial condition and results of operations.

**We receive a significant portion of our revenue from distribution arrangements, value-added resellers and direct customers, and the loss of any one of these distributors, value-added resellers or direct customers or failure to collect a receivable from them could adversely affect our operations and financial position.**

We market our products through distribution arrangements and value-added resellers and through our direct sales and applications support organization to customers that include OEMs, ODMs and EMSs. Receivables from our customers are generally not secured by any type of collateral and are subject to the risk of being uncollectible. As a result of consolidations in recent years among distributors, sales to our two largest distributors accounted for approximately 26% and 10% of our total revenue for the three months ended September 30, 2014. Significant deterioration in the liquidity or financial condition of any of our major customers or any group of our customers could have a material adverse impact on the collectability of our accounts receivable and our future operating results. We primarily conduct our sales on a purchase order basis, and we do not have any long-term supply commitments.

Moreover, we believe a high percentage of our products are eventually sold to a number of OEMs. Although we communicate with OEMs in an attempt to achieve “design wins,” which are decisions by OEMs and/or ODMs to incorporate our products, we do not have purchase commitments from these end users. Therefore, there can be no assurance that the OEMs and/or ODMs will continue to incorporate our ICs into their products. OEM technical specifications and requirements can change rapidly, and we may not have products that fit new specifications from an end-customer for whom we have had previous design wins. We cannot be certain that we will continue to achieve design wins from large OEMs, that our direct customers will continue to be successful in selling to the OEMs, or that the OEMs will be successful in selling products which incorporate our ICs. The loss of any significant customer, any material reduction in orders by any of our significant customers or by their OEM customers, the cancellation of a significant customer order, or the cancellation or delay of a customer’s or OEM’s significant program or product could reduce our revenue and adversely affect our operations and financial condition.

**Due to the nature of our business as a component supplier, we may have difficulty both in accurately predicting our future revenue and appropriately managing our expenses.**

Because we provide components for end products and systems, demand for our products is influenced by our customers’ end product demand. As a result, we may have difficulty in accurately forecasting our revenue and expenses. Our revenue depends on the timing, size, and speed of commercial introductions of end products and systems that incorporate our products, all of which are inherently difficult to forecast, as well as the ongoing demand for previously introduced end products and systems. In addition, demand for our products is influenced by our customers’ ability to manage their inventory. Our sales to distributors are subject to higher volatility because they service demand from multiple levels of the supply chain which, in itself, is inherently difficult to forecast. If our customers, including distributors, do not manage their inventory correctly or misjudge their customers’ demand, our shipments to and orders from our customers may vary significantly on a quarterly basis.

**Our ability to increase product sales and revenue may be constrained by the manufacturing capacity of our suppliers.**

Although we provide our suppliers with rolling forecasts of our production requirements, their ability to provide wafers to us is limited by the available capacity, particularly capacity in the geometries we require, at the facilities in which they manufacture wafers for us. As a result, this lack of capacity has at times constrained our product sales and revenue growth. In addition, an increased need for capacity to meet internal demands or demands of other customers could cause our suppliers to reduce capacity available to us. Our suppliers may also require us to pay amounts in excess of contracted or anticipated amounts for wafer deliveries or require us to make other concessions in order to acquire the wafer supply necessary to meet our customer requirements. If our suppliers extend lead times, limit supplies or the types of capacity we require, or increase prices due to capacity constraints or other factors, our revenue and gross margin may materially decline. In addition, if we experience supply delays or limitations, our customers may reduce their purchase levels with us and/or seek alternative solutions to meet their demand, which could materially and adversely impact our business and results of operations.

**We currently depend on third-party suppliers to provide us with wafers for our products. If any of our wafer suppliers become insolvent or capacity constrained and are unable and/or fail to provide us sufficient wafers at acceptable yields and at anticipated costs, our revenue and gross margin may decline or we may not be able to fulfill our customer orders.**

We have a supply arrangement with certain suppliers for the production of wafers. Should any of our suppliers become insolvent or capacity constrained, we may not be able to fulfill our customer orders, which would likely cause a decline in our revenue.

While certain aspects of our relationship with these suppliers are contractual, many important aspects of this relationship depend on our suppliers' continued cooperation and our management relationships. In addition, the fabrication of ICs is a highly complex and precise process. Problems in the fabrication process can cause a substantial percentage of wafers to be rejected or numerous ICs on each wafer to be non-functional. This could potentially reduce yields. The failure of our suppliers to supply us wafers at acceptable yields could prevent us from fulfilling our customer orders for our products and would likely cause a decline in our revenue.

Further, as is common in the semiconductor industry, our customers may reschedule or cancel orders on relatively short notice. If our customers cancel orders after we submit a committed forecast to our suppliers for the corresponding wafers, we may be required to purchase wafers that we may not be able to resell, which would adversely affect our operating results, financial condition, and cash flows.

**We might not be able to deliver our products on a timely basis if our relationships with our assembly and test subcontractors are disrupted or terminated.**

We do not have direct control over product delivery schedules or product quality because all of our products are assembled by third-party subcontractors and a portion of our testing is currently performed by third-party subcontractors. Also, due to the amount of time typically required to qualify assembly and test subcontractors, we could experience delays in the shipment of our products if we were forced to find alternate third parties to assemble or test our products. In addition, events such as the recent global economic crisis may materially impact our assembly suppliers' ability to operate. Any future product delivery delays or disruptions in our relationships with our subcontractors could have a material adverse effect on our operating results, financial condition, and cash flows.

**There may be unanticipated costs associated with adding to or supplementing our third-party suppliers' manufacturing capacity.**

We anticipate that future growth of our business will require increased manufacturing capacity on the part of third-party supply foundries, assembly shops, and testing facilities for our products. In order to facilitate such growth, we may need to enter into strategic transactions, investments and other activities. Such activities are subject to a number of risks, including:

- the costs and expense associated with such activities;
- the availability of modern foundries to be developed, acquired, leased or otherwise made available to us or our third-party suppliers;
- the ability of foundries and our third-party suppliers to obtain the advanced equipment used in the production of our products;
- delays in bringing new foundry operations online to meet increased product demand; and
- unforeseen environmental, engineering or manufacturing qualification problems relating to existing or new foundry facilities.

These and other risks may affect the ultimate cost and timing of any expansion of our third-party suppliers' capacity.

**We purchase inventory in advance based on expected demand for our products, and if demand is not as expected, we may have insufficient or excess inventory, which could adversely impact our financial position.**

As a fabless semiconductor company, we purchase our inventory from third party manufacturers in advance of selling our product. We place orders with our manufacturers based on existing and expected orders from our customers for particular products. While most of our contracts with our customers and distributors include lead time requirements and cancellation penalties that are designed to protect us from misalignment between customer orders and inventory levels, we must nonetheless make some predictions when we place orders with our manufacturers. In the event that our predictions are inaccurate due to unexpected increases in orders or unavailability of product within the timeframe that is required, we may have insufficient inventory to meet our customer demands. In the event that we order products that we are unable to sell due to a decrease in orders, unexpected order cancellations, injunctions due to patent litigations, or product returns, we may have excess inventory which, if not sold, may need to be disposed of or would result in a decrease in our revenue in future periods as the excess inventory at our distributors is sold. If any of these situations were to arise, it could have a material impact on our business and financial position.

**The outcome of currently ongoing and future examinations of our income tax returns by the IRS and foreign tax authorities could have a material adverse effect on our results of operations.**

We are subject to examination of our income tax returns by the IRS and other tax authorities. Our U.S. Federal income tax returns for the years ended December 31, 2005 through December 31, 2007 are under examination by the IRS. In April 2011, we received from the IRS a Notice of Proposed Adjustment, or "NOPA", relating to a cost-sharing agreement entered into by us and our international subsidiaries on January 1, 2004. In the NOPA, the IRS objected to our allocation of certain litigation expenses between us and our international subsidiaries and the amount of "buy-in payments" made by our international subsidiaries to us in connection with the cost-sharing agreement, and proposed to increase our U.S. taxable income according to a few alternative methodologies. In February 2012, we received a revised NOPA from the IRS (Revised NOPA). In this Revised NOPA, the IRS raised the same issues as in the NOPA issued in April 2011 but under a different methodology. Under the Revised NOPA, the largest potential federal income tax adjustment, if the IRS were to prevail on all matters in dispute, is \$10.5 million, plus interest and penalties, if any. We responded to the IRS Revised NOPA in May 2012. In June 2013, the IRS responded and continued to disagree with our rebuttal. We met with the IRS Office of Appeals in March, May and September 2014. However, no resolutions were reached in those meetings, and both parties are scheduled to meet again in November 2014. Meanwhile, we agreed to grant the IRS an extension of the statute of limitations for taxable years 2005 through 2007 to September 30, 2015.

The IRS also audited the research and development credits carried forward into year 2005 and the credits generated in the years 2005 through 2007. We received a NOPA from the IRS in February 2011, proposing to reduce the research and development credits generated in year 2005 through 2007 and the carryforwards, which would then reduce the value of such credits carried forward to subsequent tax years.

We have reviewed and responded to the above proposed adjustments. We regularly assess the likelihood of an adverse outcome resulting from such examinations to determine the adequacy of our provision for income taxes. Based on the technical merits of our tax return filing positions and the interactions to date with the IRS, we believe that it is more likely than not that the resolution of these audits will not have a material impact on our consolidated financial position and the results of operations and cash flows.

**Changes in effective tax rates or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.**

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof and discrete items such as future exercises or dispositions of stock options and restricted stock releases. In addition, we are subject to the continuous examination of our income tax returns by the IRS and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

**The complexity of calculating our tax provision may result in errors that could result in restatements of our financial statements.**

Due to the complexity associated with the calculation of our tax provision, we have hired independent tax advisors to assist us in the calculation. If we or our independent tax advisors fail to resolve or fully understand certain issues that we may have had in the past and issues that may arise in the future, we could be subject to errors, which would result in us having to restate our financial statements. For example, because of the complexity of our tax structure, we have had errors in our financial statements in the calculation of our tax provision that previously resulted in restatements of our 2005 and 2006 financial results. Restatements are generally costly and could adversely impact our results of operations and/or have a negative impact on the trading price of our common stock.

**If we are unsuccessful in legal proceedings brought against us or any of our customers, we could be prevented from selling many of our products and/or be required to pay substantial damages. An unfavorable outcome or an additional award of damages, attorneys' fees or an injunction could cause our revenue to decline significantly and could severely harm our business and operating results.**

From time to time we are party to various legal proceedings. If we are not successful in litigation that could be brought against us or our customers, we could be ordered to pay monetary fines and/or damages. If we are found liable for willful patent infringement, damages could be doubled or tripled. We and/or our customers could also be prevented from selling some or all of our products. Moreover, our customers and end-users could decide not to use our products, and our products and our customers' accounts payable to us could be seized. Finally, interim developments in these proceedings could increase the volatility in our stock price as the market assesses the impact of such developments on the likelihood that we will or will not ultimately prevail in these proceedings.

**Given our inability to control the timing and nature of significant events in our legal proceedings that either have arisen or may arise, our legal expenses are difficult to forecast and may vary substantially from our publicly-disclosed forecasts with respect to any given quarter, which could contribute to increased volatility in our stock price and financial condition.**

Historically, we have incurred significant expenses in connection with various legal proceedings that vary with the level of activity in the proceeding. It is difficult for us to forecast our legal expenses for any given quarter, which adversely affects our ability to forecast our expected results of operations in general. We may also be subject to unanticipated legal proceedings, which would result in our incurrence of unexpected legal expenses. If we fail to meet the expectations of securities or industry analysts as a result of unexpected changes in our legal expenses, our stock price could be impacted.

**Future legal proceedings may divert our financial and management resources.**

The semiconductor industry is characterized by frequent claims of infringement and litigation regarding patent and other intellectual property rights. Patent infringement is an ongoing risk, in part because other companies in our industry could have patent rights that may not be identifiable when we initiate development efforts. Litigation may be necessary to enforce our intellectual property rights, and we may have to defend ourselves against additional infringement claims. Such litigation is very costly. In the event any third party makes a new infringement claim against us or our customers, we could incur additional ongoing legal expenses. In addition, in connection with these legal proceedings, we may be required to post bonds to defend our intellectual property rights in certain countries for an indefinite period of time, until such dispute is resolved. If our legal expenses materially increase or exceed anticipated amounts, our capital resources and financial condition could be adversely affected. Further, if we are not successful in any of our intellectual property defenses, our financial condition could be adversely affected and our business could be harmed. In addition, our management team may also be required to devote a great deal of time, effort and energy to these legal proceedings, which could divert management's attention from focusing on our operations and adversely affect our business.

**We will continue to vigorously defend and enforce our intellectual property rights around the world, especially as it relates to patent litigation.**

From time to time, we are faced with having to defend our intellectual property rights throughout the world. Should we become engaged in such proceedings, it could divert management's attention from focusing on and implementing our business strategy. Further, should we not be successful in any of our intellectual property enforcement actions, our revenue may be affected and our business could be harmed.

**Failure to protect our proprietary technologies or maintain the right to certain technologies may negatively affect our ability to compete.**

We rely heavily on our proprietary technologies. Our future success and competitive position depend in part upon our ability to obtain and maintain protection of certain proprietary technologies used in our products. We pursue patents for some of our new products and unique technologies, and we also rely on a combination of nondisclosure agreements and other contractual provisions, as well as our employees' commitment to confidentiality and loyalty, to protect our technology, know-how, and processes. Despite the precautions we take, it may be possible for unauthorized third parties to copy aspects of our current or future technology or products or to obtain and use information that we regard as proprietary. We intend to continue to protect our proprietary technology, including through patents. However, there can be no assurance that the steps we take will be adequate to protect our proprietary rights, that our patent applications will lead to issued patents, that others will not develop or patent similar or superior products or technologies, or that our patents will not be challenged, invalidated, or circumvented by others. Furthermore, the laws of the countries in which our products are or may be developed, manufactured, or sold may not protect our products and intellectual property rights to the same extent as laws in the United States. Our failure to adequately protect our proprietary technologies could harm our business.

**The downgrade of the credit rating for U.S. long-term sovereign debt and that of certain Eurozone countries could affect global and domestic financial markets, which may affect our business, financial condition and liquidity.**

Although a downgrade of long-term sovereign credit ratings is not unprecedented, a downgrade of the U.S. credit rating is, and the potential impact is uncertain. Management will continue to monitor the situation and there could be future changes in capital requirements or a rebalancing of investment portfolios in response to management's assessment of the related risk weightings. At this time, however, U.S. treasuries continue to trade in active markets, and the yield curve on U.S. treasuries remains an appropriate basis for determining risk-free rates.

Should there be a deterioration of the global and financial markets as a result of the downgraded credit rating for U.S. long-term sovereign debt, and that of certain Eurozone countries, our business, financial condition and liquidity could be adversely affected.

**The market for government-backed student loan auction-rate securities has suffered a decline in liquidity which may impact the liquidity and potential value of our investment portfolio.**

The market for government-backed student loan auction-rate securities with interest rates that reset through a Dutch auction every 7 to 35 days became illiquid in 2008. We experienced our first failed auction in mid-February 2008. At September 30, 2014, \$10.3 million of our auction-rate security investments have failed to reset through successful auctions and it is unclear as to when these investments will regain their liquidity. The underlying maturity of these auction-rate securities is up to 34 years.

We recorded temporary and other-than-temporary impairment charges on these investments. The valuation is subject to fluctuations in the future, which will depend on many factors, including the quality of underlying collateral, estimated time for liquidity including potential to be called or restructured, underlying final maturity, insurance guaranty and market conditions, among others.

Should there be further deterioration in the market for auction-rate securities, the value of our portfolio may decline, which may have an adverse impact on our cash position and our earnings. If the accounting rules for these securities change, there may be an adverse impact on our earnings.

**We face risks in connection with our internal control over financial reporting.**

Effective internal control over financial reporting is necessary for us to provide reliable and accurate financial reports. If we cannot provide reliable financial reports or prevent fraud or other financial misconduct, our business and operating results could be harmed. Our failure to implement and maintain effective internal control over financial reporting could result in a material misstatement of our financial statements or otherwise cause us to fail to meet our financial reporting obligations. This, in turn, could result in a loss of investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our results of operations and/or have a negative impact on the trading price of our common stock, and could subject us to stockholder litigation. For example, because of the complexity of our tax structure, we have had errors in our financial statements in the calculation of our tax provision that previously resulted in restatements of our 2005 and 2006 financial results. Although we believe that we have implemented appropriate internal control over financial reporting related to the computation of our income tax provision, we cannot be certain that any measures we have taken or may take in the future will ensure that we implement and maintain adequate internal control over financial reporting and that we will avoid any material weakness in the future. In addition, we cannot assure you that we will not in the future identify further material weaknesses in our internal control over financial reporting that we have not discovered to date, which may impact the reliability of our financial reporting and financial statements.



**Our products must meet specifications, and undetected defects and failures may occur, which may cause customers to return or stop buying our products and may expose us to product liability risk.**

Our customers generally establish demanding specifications for quality, performance, and reliability that our products must meet. Integrated circuits as complex as ours often encounter development delays and may contain undetected defects or failures when first introduced or after commencement of commercial shipments, which might require product replacement or recall. Further, our third-party manufacturing processes or changes thereof, or raw material used in the manufacturing processes may cause our products to fail. We have from time to time in the past experienced product quality, performance or reliability problems. Our standard warranty period is generally one to two years, which exposes the company to significant risks of claims for defects and failures. If defects and failures occur in our products, we could experience lost revenue, increased costs, including warranty expense and costs associated with customer support, delays in, cancellations or rescheduling of orders or shipments, and product returns or discounts, any of which would harm our operating results.

In addition, product liability claims may be asserted with respect to our technology or products. Although we currently have insurance, there can be no assurance that we have obtained a sufficient amount of insurance coverage, that asserted claims will be within the scope of coverage of the insurance, or that we will have sufficient resources to satisfy any asserted claims.

**The price and availability of commodities (e.g., gold, copper and silicon) may adversely impact our ability to deliver our products in a timely and cost-effective manner and may adversely affect our business and results of operations.**

Our products incorporate commodities such as gold, copper and silicon. An increase in the price or a decrease in the availability of these commodities and similar commodities that we use could negatively impact our business and results of operations.

**Devaluation of the U.S. Dollar relative to other foreign currencies, including the renminbi, may adversely affect results of operations.**

Our manufacturing and packaging suppliers are and will continue to be primarily located in China for the foreseeable future. If the value of the renminbi rises against the U.S. Dollar, there could be an increase in our manufacturing costs relative to competitors who have manufacturing facilities located in the U.S., which could adversely affect our operations. In addition, because we collect payments from all customers in U.S. dollars, fluctuations in the value of foreign currencies could have an adverse impact on our customers' business, which could negatively impact our business and results of operations.

**We and our manufacturing partners are or will be subject to extensive Chinese government regulation, and the benefit of various incentives from Chinese governments that we and our manufacturing partners receive may be reduced or eliminated, which could increase our costs or limit our ability to sell products and conduct activities in China.**

Most of our manufacturing partners are located in China. In addition, we have established a facility in China, initially for the testing of our ICs. The Chinese government has broad discretion and authority to regulate the technology industry in China. China's government has implemented policies from time to time to regulate economic expansion in China. It also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. New regulations or the readjustment of previously implemented regulations could require us and our manufacturing partners to change our business plans, increase our costs, or limit our ability to sell products and conduct activities in China, which could adversely affect our business and operating results.

In addition, the Chinese government and provincial and local governments have provided, and continue to provide, various incentives to encourage the development of the semiconductor industry in China. Such incentives include tax rebates, reduced tax rates, favorable lending policies and other measures, some or all of which may be available to our manufacturing partners and to us with respect to our facility in China. Any of these incentives could be reduced or eliminated by governmental authorities at any time. Any such reduction or elimination of incentives currently provided to our manufacturing partners could adversely affect our business and operating results.

**There are inherent risks associated with the operation of our testing facility in China, which could increase product costs or cause a delay in product shipments.**

We have a testing facility in China that began operations in 2006. We face the following risks, among others, with respect to our testing facility in China:

- inability to hire and maintain a qualified workforce;
- inability to maintain appropriate and acceptable manufacturing controls; and
- higher than anticipated overhead and other costs of operation.

If we are unable to maintain our testing facility in China at fully operational status with qualified workers, appropriate manufacturing controls and reasonable cost levels, we may incur higher costs than our current expense levels, which would affect our gross margins. In addition, if capacity restraints result in significant delays in product shipments, our business and results of operations would be adversely affected.

**The average selling prices of products in our markets have historically decreased over time and will likely do so in the future, which could harm our revenue and gross profits.**

Average selling prices of semiconductor products in the markets we serve have historically decreased over time. Our gross profits and financial results will suffer if we are unable to offset any reductions in our average selling prices by reducing our costs, developing new or enhanced products on a timely basis with higher selling prices or gross profits, or increasing our sales volumes. Additionally, because we do not operate our own manufacturing or assembly facilities, we may not be able to reduce our costs as rapidly as companies that operate their own facilities, and our costs may even increase, which could also reduce our profit margins.

**Because of the lengthy sales cycles for our products and the fixed nature of a significant portion of our expenses, we may incur substantial expenses before we earn associated revenue and may not ultimately achieve our forecasted sales for our products.**

The introduction of new products presents significant business challenges because product development plans and expenditures must be made up to two years or more in advance of any sales. It takes us up to 12 months or more to design and manufacture a new product prototype. Only after we have a prototype do we introduce the product to the market and begin selling efforts in an attempt to achieve design wins. This sales process requires us to expend significant sales and marketing resources without any assurance of success. Volume production of products that use our ICs, if any, may not be achieved for an additional period of time after an initial sale. Sales cycles for our products are lengthy for a number of reasons, including:

- our customers usually complete an in-depth technical evaluation of our products before they place a purchase order;
- the commercial adoption of our products by OEMs and ODMs is typically limited during the initial release of their product to evaluate product performance and consumer demand;
- our products must be designed into our customers' products or systems; and
- the development and commercial introduction of our customers' products incorporating new technologies frequently are delayed.

As a result of our lengthy sales cycles, we may incur substantial expenses before we earn associated revenue because a significant portion of our operating expenses is relatively fixed and based on expected revenue. The lengthy sales cycles of our products also make forecasting the volume and timing of orders difficult. In addition, the delays inherent in lengthy sales cycles raise additional risks that customers may cancel or change their orders. Our sales are made by purchase orders. Because industry practice allows customers to reschedule or cancel orders on relatively short notice, backlog is not always a good indicator of our future sales. If customer cancellations or product changes occur, we could lose anticipated sales and not have sufficient time to reduce our inventory and operating expenses.

**Our success depends on our investment of significant resources in research and development. We may have to invest more resources in research and development than anticipated, which could increase our operating expenses and negatively impact our operating results.**

Our success depends on us investing significant amounts of resources into research and development. We expect to have to continue to invest heavily in research and development in the future in order to continue to innovate and come to market with new products in a timely manner and increase our revenue and profitability. If we have to invest more resources in research and development than we anticipate, we could see an increase in our operating expenses which may negatively impact our operating results. Also, if we are unable to properly manage and effectively utilize our research and development resources, we could see adverse effects on our business, financial condition and operating results.

In addition, if new competitors, technological advances by existing competitors, our entry into new markets, or other competitive factors require us to invest significantly greater resources than anticipated in our research and development efforts, our operating expenses would increase. If we are required to invest significantly greater resources than anticipated in research and development efforts without a corresponding increase in revenue, our operating results could decline. Research and development expenses are likely to fluctuate from time to time to the extent we make periodic incremental investments in research and development and these investments may be independent of our level of revenue which could negatively impact our financial results. In order to remain competitive, we anticipate that we will continue to devote substantial resources to research and development, and we expect these expenses to increase in absolute dollars in the foreseeable future due to the increased complexity and the greater number of products under development.

**The loss of any of our key personnel or the failure to attract or retain specialized technical and management personnel could impair our ability to grow our business.**

Our future success depends upon our ability to attract and retain highly qualified technical and managerial personnel. We are particularly dependent on the continued services of our key executives, including Michael Hsing, our President and Chief Executive Officer, who founded our company and developed our proprietary process technology. In addition, personnel with highly skilled analog and mixed-signal design engineering expertise are scarce and competition for personnel with these skills is intense. There can be no assurance that we will be able to retain existing key employees or that we will be successful in attracting, integrating or retaining other highly qualified personnel with critical capabilities in the future. If we are unable to retain the services of existing key employees or are unsuccessful in attracting new highly qualified employees quickly enough to meet the demands of our business, including design cycles, our business could be harmed.

**If we fail to retain key employees in sales, applications, finance and legal or to make continued improvements to our internal systems, particularly in the accounting and finance area, our business may suffer.**

If we fail to continue to adequately staff our sales, applications, financial and legal staff, maintain or upgrade our business systems and maintain internal control that meet the demands of our business, our ability to operate effectively will suffer. The operation of our business also depends upon our ability to retain these employees, as these employees hold a significant amount of institutional knowledge about us and our products, and, if they were to terminate their employment, our sales and internal control over financial reporting could be adversely affected.

**We intend to continue to expand our operations, which may strain our resources and increase our operating expenses.**

We plan to continue to expand our domestic and foreign operations through internal growth, strategic relationships, and/or acquisitions. We expect that any such expansion will strain our systems and operational and financial controls. In addition, we are likely to incur significantly higher operating costs. To manage our growth effectively, we must continue to improve and expand our systems and controls, as well as hire experienced administrative and financial personnel. If we fail to do so, our growth will be limited. If we fail to effectively manage our planned expansion of operations, our business and operating results may be harmed.

**We may engage in acquisitions that dilute the ownership interests of our stockholders and cause us to incur debt or to assume contingent liabilities, and we may be unable to successfully integrate these companies into our operations, which would adversely affect our business.**

As a part of our business strategy, from time to time we review acquisition prospects that would complement our current product offerings, enhance our design capability or offer other competitive opportunities. For example, we completed our acquisition of Sensima Technology SA in July 2014 to further our diversification strategy and create new opportunities with key customers. As a result of completing acquisitions, we could use a significant portion of our available cash, cash equivalents and short-term investments, issue equity securities that would dilute current stockholders' percentage ownership, incur substantial debt or contingent liabilities, and incur impairment charges related to goodwill or other intangibles. Such actions could impact our operating results and the price of our common stock.

In addition, we may be unable to identify or complete prospective acquisitions for various reasons, including competition from other companies in the semiconductor industry, the valuation expectations of acquisition candidates and applicable antitrust laws or related regulations. If we are unable to identify and complete acquisitions, we may not be able to successfully expand our business and product offerings.

We cannot guarantee that the Sensima acquisition or any future acquisitions will improve our results of operations or that we will otherwise realize the anticipated benefits. In addition, if we are unsuccessful in integrating any acquired company into our operations or if integration is more difficult than anticipated, we may experience disruptions that could harm our business and fail to realize the anticipated benefits of the acquisitions. Some of the risks that may adversely affect our ability to integrate or realize any anticipated benefits from the acquired companies, businesses or assets include those associated with:

- unexpected losses of key employees or customers of the acquired companies or businesses;
- conforming the acquired company's standards, processes, procedures and controls with our operations;
- coordinating new product and process development;
- hiring additional management and other critical personnel;
- increasing the scope, geographic diversity and complexity of our operations;
- difficulties in consolidating facilities and transferring processes and know-how;
- other difficulties in the assimilation of acquired operations, technologies or products;
- the risk of undisclosed liabilities of the acquired businesses and potential legal disputes with founders or stockholders of acquired companies;
- our inability to commercialize acquired technologies;
- the risk that the future business potential as projected is not realized and as a result, we may be required to take a charge to earnings that would impact our profitability;
- the need to take impairment charges or write-downs with respect to acquired assets and technologies;
- diversion of management's attention from other business concerns; and
- adverse effects on existing business relationships with customers.

**We compete against many companies with substantially greater financial and other resources, and our market share may be reduced if we are unable to respond to our competitors effectively.**

The analog and mixed-signal semiconductor industry is highly competitive, and we expect competitive pressures to continue. Our ability to compete effectively and to expand our business will depend on our ability to continue to recruit applications and design talent, our ability to introduce new products, and our ability to maintain the rate at which we introduce these new products. We compete with domestic and non-domestic semiconductor companies, many of which have substantially greater financial and other resources with which to pursue engineering, manufacturing, marketing, and distribution of their products. We are in direct and active competition, with respect to one or more of our product lines, with at least 10 manufacturers of such products, of varying size and financial strength. The number of our competitors has grown due to the expansion of the market segments in which we participate.

We cannot assure you that our products will continue to compete favorably or that we will be successful in the face of increasing competition from new products and enhancements introduced by existing competitors or new companies entering this market, which would materially and adversely affect our results of operations and our financial condition.

**If securities or industry analysts downgrade our stock or do not continue to publish research or reports about our business, our stock price and trading volume could decline.**

The trading market for our common stock will depend, in part, on the research and reports that industry or securities analysts publish about us or our business. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our stock, our stock price would likely decline. If one or more of these analysts cease coverage of us or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

**Major earthquakes or other natural disasters and resulting systems outages may cause us significant losses.**

Our corporate headquarters, the production facilities of our third-party wafer suppliers, our IC testing facility, a portion of our assembly and research and development activities, and certain other critical business operations are located in or near seismically active regions and are subject to periodic earthquakes. We do not maintain earthquake insurance and could be materially and adversely affected in the event of a major earthquake. Much of our revenue, as well as our manufacturers and assemblers, are concentrated in Asia. Such concentration increases the risk that other natural disasters, labor strikes, terrorism, war, political unrest, epidemics, and/or health advisories could disrupt our operations. In addition, we rely heavily on our internal information and communications systems and on systems or support services from third parties to manage our operations efficiently and effectively. Any of these are subject to failure due to a natural disaster or other disruption. System-wide or local failures that affect our information processing could have material adverse effects on our business, financial condition, operating results, and cash flows.

**There can be no assurance that we will continue to declare cash dividends at all or in any particular amounts.**

In June 2014, the Board of Directors approved a dividend program pursuant to which we intend to pay quarterly cash dividends on our common stock. We anticipate the cash used for future dividends will come from our current domestic cash and cash generated from ongoing U.S. operations. If cash held by our international subsidiaries is needed for the payment of dividends, we may be required to accrue and pay U.S. taxes to repatriate these funds.

The declaration of cash dividends on our common stock is at the discretion of the Board of Directors. Any future decision to declare and pay a cash dividend on our common stock will be subject to, among other things, our results of operations, cash balances and future cash requirements, financial condition, statutory requirements of Delaware law, compliance with the terms of future indebtedness and credit facilities, and other factors that the Board of Directors may deem relevant. Our dividend payments may change from time to time, and we cannot provide assurance that we will continue to declare dividends at all or in any particular amounts. A reduction in or elimination of our dividend payments could have a negative effect on the price of our common stock.

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

**Issuer Purchases of Equity Securities**

Stock repurchase activities during the three months ended September 30, 2014 were as follows:

			<u>Total Number of Shares Purchased (a)</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Program</u>	<u>Dollar Value of Shares That May Yet Be Purchased Under the Program</u> (in thousands)
July 1	-	July 31	100,992	\$ 42.00	100,992	
August 1	-	August 31	65,671	43.54	65,671	
September 1	-	September 30	<u>45,372</u>	45.81	<u>45,372</u>	
Total			<u>212,035</u>	43.29	<u>212,035</u>	\$ 46,410

- (a) In July 2013, the Board of Directors approved a stock repurchase program that authorizes us to repurchase up to \$100 million in the aggregate of our common stock through June 30, 2015. Under the program, shares may be repurchased in privately negotiated or open market transactions, including under a Rule 10b5-1 plan. Shares are retired upon repurchase.

**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 and 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

\* This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, nor shall it be deemed incorporated by reference in any filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

**MONOLITHIC POWER SYSTEMS, INC**

**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.

MONOLITHIC POWER SYSTEMS, INC.

Dated: October 30, 2014

/s/ MEERA RAO

Meera Rao

Chief Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting Officer)

## EXHIBIT INDEX

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**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**

I, Michael R. Hsing, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Monolithic Power Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 30, 2014

/s/ MICHAEL R. HSING  
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Michael R. Hsing  
Chief Executive Officer

**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**

I, Meera Rao, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Monolithic Power Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 30, 2014

/s/ MEERA RAO  
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Meera Rao  
Chief Financial Officer

The following certification shall not be deemed "filed" for purposes of section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND  
CHIEF FINANCIAL OFFICER PURSUANT TO  
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report on Form 10-Q of Monolithic Power Systems, Inc., a Delaware corporation, for the period ended September 30, 2014, as filed with the Securities and Exchange Commission, each of the undersigned officers of Monolithic Power Systems, Inc. certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the accompanying report on Form 10-Q of the Company for the period ended September 30, 2014, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Monolithic Power Systems, Inc. for the periods presented therein.

Date: October 30, 2014

/s/ MICHAEL R. HSING

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Michael R. Hsing  
Chief Executive Officer

Date: October 30, 2014

/s/ MEERA RAO

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Meera Rao  
Chief Financial Officer

A signed original of the above certification has been provided to Monolithic Power Systems, Inc. and will be retained by Monolithic Power Systems, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

