
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 June 30, 2017

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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

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

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

There were 41,384,130 shares of the registrant's common stock issued and outstanding as of July 24, 2017.

MONOLITHIC POWER SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | June 30, 2017 | December 31, 2016 |
|--|--------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 71,110 | \$ 112,703 |
| Short-term investments | 206,561 | 155,521 |
| Accounts receivable, net | 41,982 | 34,248 |
| Inventories | 92,666 | 71,469 |
| Other current assets | 14,894 | 9,043 |
| Total current assets | <u>427,213</u> | <u>382,984</u> |
| Property and equipment, net | 100,562 | 85,171 |
| Long-term investments | 5,348 | 5,354 |
| Goodwill | 6,571 | 6,571 |
| Acquisition-related intangible assets, net | 1,977 | 3,002 |
| Deferred tax assets, net | 650 | 633 |
| Other long-term assets | 25,725 | 27,411 |
| Total assets | <u>\$ 568,046</u> | <u>\$ 511,126</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 25,232 | \$ 17,427 |
| Accrued compensation and related benefits | 14,561 | 12,578 |
| Accrued liabilities | 22,993 | 22,916 |
| Total current liabilities | <u>62,786</u> | <u>52,921</u> |
| Income tax liabilities | 4,303 | 3,870 |
| Other long-term liabilities | 27,164 | 23,219 |
| Total liabilities | <u>94,253</u> | <u>80,010</u> |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock and additional paid-in capital, \$0.001 par value; shares authorized: 150,000; shares issued and outstanding: 41,366 and 40,793 as of June 30, 2017 and December 31, 2016, respectively | 349,447 | 315,969 |
| Retained earnings | 125,726 | 119,362 |
| Accumulated other comprehensive loss | (1,380) | (4,215) |
| Total stockholders' equity | <u>473,793</u> | <u>431,116</u> |
| Total liabilities and stockholders' equity | <u>\$ 568,046</u> | <u>\$ 511,126</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 June 30, | | Six Months Ended June 30, | |
|--|------------------------------------|------------------|----------------------------------|------------------|
| | 2017 | 2016 | 2017 | 2016 |
| Revenue | \$ 112,198 | \$ 94,079 | \$ 212,560 | \$ 178,591 |
| Cost of revenue | 50,773 | 43,153 | 96,293 | 82,155 |
| Gross profit | 61,425 | 50,926 | 116,267 | 96,436 |
| Operating expenses: | | | | |
| Research and development | 20,292 | 17,876 | 39,186 | 35,197 |
| Selling, general and administrative | 25,873 | 21,531 | 47,965 | 39,299 |
| Litigation expense (benefit) | 290 | (8) | 576 | 37 |
| Total operating expenses | 46,455 | 39,399 | 87,727 | 74,533 |
| Income from operations | 14,970 | 11,527 | 28,540 | 21,903 |
| Interest and other income, net | 1,237 | 597 | 2,618 | 1,140 |
| Income before income taxes | 16,207 | 12,124 | 31,158 | 23,043 |
| Income tax provision | 1,193 | 926 | 1,668 | 1,270 |
| Net income | <u>\$ 15,014</u> | <u>\$ 11,198</u> | <u>\$ 29,490</u> | <u>\$ 21,773</u> |
| Net income per share: | | | | |
| Basic | \$ 0.36 | \$ 0.28 | \$ 0.72 | \$ 0.54 |
| Diluted | \$ 0.35 | \$ 0.27 | \$ 0.68 | \$ 0.52 |
| Weighted-average shares outstanding: | | | | |
| Basic | 41,323 | 40,387 | 41,185 | 40,208 |
| Diluted | 43,397 | 41,716 | 43,332 | 41,681 |
| Cash dividends declared per common share | \$ 0.20 | \$ 0.20 | \$ 0.40 | \$ 0.40 |

See accompanying notes to unaudited condensed consolidated financial statements.

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

| | <u>Three Months Ended June 30,</u> | | <u>Six Months Ended June 30,</u> | |
|--|------------------------------------|-----------------|----------------------------------|------------------|
| | <u>2017</u> | <u>2016</u> | <u>2017</u> | <u>2016</u> |
| Net income | \$ 15,014 | \$ 11,198 | \$ 29,490 | \$ 21,773 |
| Other comprehensive income (loss), net of tax: | | | | |
| Foreign currency translation adjustments, net of \$0 tax in 2017 and 2016 | 1,186 | (2,039) | 2,492 | (1,541) |
| Change in unrealized gain (loss) on available-for-sale securities, net of \$0 tax in 2017 and 2016 | 141 | (7) | 343 | 203 |
| Total other comprehensive income (loss), net of tax | <u>1,327</u> | <u>(2,046)</u> | <u>2,835</u> | <u>(1,338)</u> |
| Comprehensive income | <u>\$ 16,341</u> | <u>\$ 9,152</u> | <u>\$ 32,325</u> | <u>\$ 20,435</u> |

See accompanying notes to unaudited condensed consolidated financial statements.

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

| | Six Months Ended June 30, | |
|---|----------------------------------|------------------|
| | 2017 | 2016 |
| Cash flows from operating activities: | | |
| Net income | \$ 29,490 | \$ 21,773 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization of intangible assets | 8,063 | 6,873 |
| Loss on sales or write-off of property and equipment | - | 58 |
| Amortization of premium on available-for-sale investments | 1,005 | 363 |
| Gain on deferred compensation plan investments | (1,266) | (607) |
| Deferred taxes, net | - | 12 |
| Excess tax benefits from equity awards | - | (361) |
| Stock-based compensation expense | 26,789 | 20,726 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (7,729) | (520) |
| Inventories | (21,158) | (6,758) |
| Other assets | (1,167) | (10,417) |
| Accounts payable | 7,755 | 7,176 |
| Accrued compensation and related benefits | 1,733 | 4,386 |
| Accrued liabilities | 3,177 | 769 |
| Income tax liabilities | 78 | 395 |
| Net cash provided by operating activities | <u>46,770</u> | <u>43,868</u> |
| Cash flows from investing activities: | | |
| Property and equipment purchases | (20,528) | (18,678) |
| Purchases of short-term investments | (93,398) | (106,004) |
| Proceeds from maturities and sales of short-term investments | 41,809 | 87,919 |
| Contributions to deferred compensation plan, net | (1,594) | (1,623) |
| Net cash used in investing activities | <u>(73,711)</u> | <u>(38,386)</u> |
| Cash flows from financing activities: | | |
| Property and equipment purchased on extended payment terms | (250) | (150) |
| Proceeds from exercise of stock options | 129 | 1,040 |
| Proceeds from shares issued under the employee stock purchase plan | 1,382 | 1,285 |
| Dividends and dividend equivalents paid | (16,815) | (16,480) |
| Excess tax benefits from equity awards | - | 361 |
| Net cash used in financing activities | <u>(15,554)</u> | <u>(13,944)</u> |
| Effect of change in exchange rates | 902 | (352) |
| Net decrease in cash and cash equivalents | (41,593) | (8,814) |
| Cash and cash equivalents, beginning of period | 112,703 | 90,860 |
| Cash and cash equivalents, end of period | <u>\$ 71,110</u> | <u>\$ 82,046</u> |
| Supplemental disclosures for cash flow information: | | |
| Cash paid for taxes and interest | \$ 1,583 | \$ 712 |
| Supplemental disclosures of non-cash investing and financing activities: | | |
| Liability accrued for property and equipment purchases | \$ 974 | \$ 472 |
| Liability accrued for dividends and dividend equivalents | \$ 9,536 | \$ 9,312 |

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 accounting principles, 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, 2016, filed with the SEC on March 1, 2017.

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, 2017 or for any other future periods.

Summary of Significant Accounting Policies

Other than those discussed in “Recent Accounting Pronouncements” below, there have been no changes to the Company’s significant accounting policies during the three or six months ended June 30, 2017 as compared to the significant accounting policies described in the Company’s audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2016.

Recent Accounting Pronouncements

Stock-Based Compensation:

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Board (“ASU”) No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, which changed how entities account for certain aspects of share-based payment awards, including the accounting for excess tax benefits and tax deficiencies, forfeitures, statutory tax withholding requirements, as well as classification of excess tax benefits in the statements of cash flows. The Company adopted the standard on January 1, 2017 and the primary impact of the adoption was as follows:

- The Company elected to account for forfeitures of equity awards when they occur. The change was applied on a modified retrospective basis and the Company recorded a cumulative-effect adjustment of \$5.1 million to retained earnings on January 1, 2017 (with a corresponding offset to additional paid-in capital).
- Excess tax benefits are recognized in the income tax provision in the Condensed Consolidated Statements of Operations prospectively, rather than in additional paid-in capital in the Condensed Consolidated Balance Sheets. The Company applied the modified retrospective method and there was no net cumulative-effect adjustment to retained earnings on January 1, 2017, as the increase in deferred tax assets was fully offset by a valuation allowance.
- The Company is presenting excess tax benefits as an operating activity in the Condensed Consolidated Statements of Cash Flows on a prospective basis.

Revenue Recognition:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, 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. The standard defines a five-step process in order to achieve this core principle and requires expanded qualitative and quantitative disclosures relating to the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including significant judgments and estimates used by management. The standard will be effective for annual reporting periods beginning after December 15, 2017. Early adoption is permitted for reporting periods beginning after December 15, 2016. The Company does not plan to early adopt, and accordingly, the Company will adopt the new standard effective January 1, 2018.

While the Company continues to assess the impact of the new standard on its accounting policies, processes and system requirements, the primary effects include the timing of recognition of revenue with certain distributors in the U.S. Currently, sales to these distributors are made under agreements which provide these distributors with price adjustment and other rights. The Company determines that uncertainties on the sales price exist under these arrangements primarily because the amount of price adjustments to be claimed by the distributors is not fixed or determinable. As a result, revenue and costs related to these sales are deferred until the Company receives notification from the distributors that products have been sold to the end customers and the amount of price adjustments is finalized. Under the new standard, the transaction price takes into consideration the effect of variable consideration, which is estimated at the time the promised goods are transferred to the customers. Accordingly, the Company will be required to recognize revenue at the time of shipment to the distributors, adjusted for an estimate of the price adjustments based on the information available at the time. As of June 30, 2017, the deferred revenue balance before the final price adjustments from the U.S. distributors and the related deferred costs were \$2.8 million and \$0.3 million, respectively.

Revenue from non-U.S. distributors, which make up the majority of the Company's total sales to distributors, is currently recognized at the time of shipment to the distributors because these arrangements do not contain price adjustments, or other amounts that are not fixed or determinable. Accordingly, revenue recognition will remain substantially unchanged upon adoption of the new standard.

The new standard permits adoption either by using (i) a full retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. The Company currently plans to adopt the modified retrospective method.

While the Company continues to assess the potential impact of the provisions in the new standard, including the areas described above, the Company cannot reasonably estimate quantitative information related to the impact of the new standard on its financial statements upon adoption at this time.

Others:

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires entities to recognize a right-of-use asset and a lease liability on the balance sheets for substantially all leases with a lease term greater than 12 months, including leases currently accounted for as operating leases. The standard requires modified retrospective adoption and will be effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted. The Company is evaluating the impact of the adoption on its consolidated financial position, results of operations, cash flows and disclosures.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which introduces a model based on expected losses to estimate credit losses for most financial assets and certain other instruments. In addition, for available-for-sale debt securities with unrealized losses, the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. The standard will be effective for annual reporting periods beginning after December 15, 2019, with early adoption permitted for annual reporting periods beginning after December 15, 2018. Entities will apply the standard by recording a cumulative-effect adjustment to retained earnings. The Company is evaluating the impact of the adoption on its consolidated financial position, results of operations, cash flows and disclosures.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment*, which simplifies the accounting for goodwill impairment. The guidance removes step two of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. The standard will be applied prospectively, and is effective for annual reporting periods beginning after December 15, 2019. Early adoption is permitted after January 1, 2017. The Company is evaluating the impact of the adoption on its annual goodwill impairment test.

2. STOCK-BASED COMPENSATION

2014 Equity Incentive Plan (the "2014 Plan")

The Board of Directors adopted the 2014 Plan in April 2013, and the stockholders approved it in June 2013. In October 2014, the Board of Directors approved certain amendments to the 2014 Plan. The 2014 Plan became effective on November 13, 2014 and provides for the issuance of up to 5.5 million shares. The 2014 Plan, as amended, will expire on November 13, 2024. As of June 30, 2017, 3.2 million shares remained available for future issuance under the 2014 Plan.

Stock-Based Compensation Expense

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------------|-----------------------------|-----------|---------------------------|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| Cost of revenue | \$ 452 | \$ 380 | \$ 810 | \$ 814 |
| Research and development | 3,961 | 3,318 | 7,459 | 7,016 |
| Selling, general and administrative | 10,714 | 8,049 | 18,520 | 12,896 |
| Total | \$ 15,127 | \$ 11,747 | \$ 26,789 | \$ 20,726 |

In the first quarter of 2016, the Company's then Chief Financial Officer retired. As the service or performance conditions for her outstanding restricted stock units ("RSUs") had not been satisfied at the time of her departure, the Company reversed previously accrued stock-based compensation expenses of approximately \$2.9 million associated with the unvested shares and this credit was reflected in selling, general and administrative expenses for the six months ended June 30, 2016.

RSUs

The Company's RSUs include time-based RSUs, RSUs with performance conditions ("PSUs"), RSUs with market and performance conditions ("MPSUs"), and RSUs with market conditions ("MSUs"). Vesting of all awards requires continued service for the Company. In addition, vesting of awards with performance conditions or market conditions is subject to the achievement of pre-determined performance goals. A summary of RSU activity is presented in the table below (in thousands, except per-share amounts):

| | Time-Based RSUs | Weighted-Average Grant Date Fair Value Per Share | PSUs and MPSUs | 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, 2017 | 366 | \$ 51.35 | 2,284 | \$ 43.24 | 1,620 | \$ 23.57 | 4,270 | \$ 36.47 |
| Granted | 69 | \$ 91.57 | 645(1) | \$ 61.08 | - | \$ - | 714 | \$ 64.02 |
| Released | (103) | \$ 46.84 | (440) | \$ 42.87 | - | \$ - | (543) | \$ 43.63 |
| Forfeited | (10) | \$ 61.12 | (6) | \$ 49.82 | - | \$ - | (16) | \$ 57.05 |
| Outstanding at June 30, 2017 | 322 | \$ 61.12 | 2,483 | \$ 47.92 | 1,620 | \$ 23.57 | 4,425 | \$ 39.96 |

(1) Amount reflects the number of PSUs and MPSUs that may ultimately be earned based on management's probability assessment of the performance conditions at each reporting period. In addition, MPSUs are subject to the achievement of market conditions.

The intrinsic value related to awards released was \$11.4 million and \$13.5 million for the three months ended June 30, 2017 and 2016, respectively. The intrinsic value related to awards released was \$48.8 million and \$42.6 million for the six months ended June 30, 2017 and 2016, respectively. As of June 30, 2017, the total intrinsic value of all outstanding awards was \$390.2 million, based on the closing stock price of \$96.40. As of June 30, 2017, unamortized compensation expense related to all outstanding awards was approximately \$103.0 million with a weighted-average remaining recognition period of approximately four years.

Time-Based RSUs:

For the six months ended June 30, 2017, the Board of Directors granted 69,000 RSUs with time-based vesting conditions to non-executive employees and non-employee directors. The RSUs generally vest over four years for employees and one year for directors, subject to continued service with the Company.

2017 PSUs:

In February 2017, the Board of Directors granted 200,000 PSUs to the executive officers, which represent a target number of shares to be awarded based on the Company's average two-year (2017 and 2018) revenue growth rate compared against the analog industry's average two-year revenue growth rate as published by the Semiconductor Industry Association ("2017 Executive PSUs"). The maximum number of shares that an executive officer can earn is 300% of the target number of the 2017 Executive PSUs. 50% of the 2017 Executive PSUs will vest in the first quarter of 2019 if the pre-determined performance goals are met during the performance period and approved by the Board of Directors. The remaining 2017 Executive PSUs will vest over the following two years on a quarterly basis. Vesting is subject to the employees' continued employment with the Company. Assuming the achievement of the highest level of performance goals, the total stock-based compensation cost for the 2017 Executive PSUs is approximately \$36.3 million.

In February 2017, the Board of Directors granted 48,000 PSUs to certain non-executive employees, which represent a target number of shares to be awarded based on the Company's 2018 revenue goals for certain regions or product line divisions, or the Company's average two-year (2017 and 2018) revenue growth rate compared against the analog industry's average two-year revenue growth rate as published by the Semiconductor Industry Association ("2017 Non-Executive PSUs"). The maximum number of shares that an employee can earn is either 200% or 300% of the target number of the 2017 Non-Executive PSUs, depending on the job classification of the employee. 50% of the 2017 Non-Executive PSUs will vest in the first quarter of 2019 if the pre-determined performance goals are met during the performance period and approved by the Board of Directors. The remaining 2017 Non-Executive PSUs will vest over the following two years on an annual or quarterly basis. Vesting is subject to the employees' continued employment with the Company. Assuming the achievement of the highest level of performance goals, the total stock-based compensation cost for the 2017 Non-Executive PSUs is approximately \$7.1 million.

The 2017 Executive PSUs and the 2017 Non-Executive PSUs contain a purchase price feature, which requires the employees to pay the Company \$30 per share upon vesting of the shares. Shares that do not vest will not be subject to the purchase price payment. The Company determined the grant date fair value of the 2017 Executive PSUs and the 2017 Non-Executive PSUs using the Black-Scholes model with the following assumptions: stock price of \$89.37, expected term of 2.6 years, expected volatility of 28.6% and risk-free interest rate of 1.3%.

2015 MPSUs:

On December 31, 2015, the Board of Directors granted 127,000 MPSUs to the executive officers and certain key employees, which represent a target number of shares to be awarded upon achievement of both market conditions and performance conditions ("2015 MPSUs"). The maximum number of shares that an employee can earn is 500% of the target number of the 2015 MPSUs. The 2015 MPSUs consist of four separate tranches with various performance periods ending on December 31, 2019. The first tranche contains market conditions only, which require the achievement of five stock price targets ranging from \$71.36 to \$95.57 with a performance period from January 1, 2016 to December 31, 2019.

The second, third and fourth tranches contain both market conditions and performance conditions. Each tranche requires the achievement of five stock price targets measured against a base price equal to the greater of: (1) the average closing stock price during the 20 consecutive trading days immediately before the start of the measurement period for that tranche, or (2) the closing stock price immediately before the start of the measurement period for that tranche. The stock price targets for the second tranche range from \$89.56 to \$106.81 with a performance period from January 1, 2017 to December 31, 2019. The stock price targets for the third tranche will be determined on December 31, 2017 with a performance period from January 1, 2018 to December 31, 2019. The stock price targets for the fourth tranche will be determined on December 31, 2018 with a performance period from January 1, 2019 to December 31, 2019.

In addition, each of the second, third and fourth tranches requires the achievement of one of following six operating metrics:

1. Successful implementation of full digital solutions vs. current analog topology for certain products.
2. Successful implementation, and adoption by a key customer, of an integrated, software-based field-oriented-control with sensors to motor drivers.
3. Successful implementation of certain advanced power analog processes.
4. Successful design wins and achievement of a specific level of revenue with a global networking customer.
5. Achievement of a specific level of revenue with a global electronics manufacturer.
6. Achievement of a specific level of market share with certain core power products.

Subject to the employees' continued employment with the Company, the 2015 MPSUs will fully vest on January 1, 2020 if the pre-determined individual market and performance goals in each tranche are met during the performance periods and approved by the Board of Directors. In addition, the 2015 MPSUs contain post-vesting sales restrictions on the vested shares by employees for up to two years.

The Company determined the grant date fair value of the 2015 MPSUs using a Monte Carlo simulation model with the following weighted-average assumptions: stock price of \$61.35, expected volatility of 33.2%, risk-free interest rate of 1.3%, and an illiquidity discount of 7.8% to account for the post-vesting sales restrictions. In March 2016, the Company cancelled 13,000 2015 MPSUs as a result of the departure of its then Chief Financial Officer. Assuming the achievement of all of the required market and performance goals, the total stock-based compensation cost for the 2015 MPSUs is approximately \$24.6 million to be recognized as follows: \$8.3 million for the first tranche, \$4.5 million for the second tranche, \$5.2 million for the third tranche, and \$6.6 million for the fourth tranche.

For the first tranche, stock-based compensation expense is being recognized over the requisite service period even if the market conditions are not satisfied. For the second, third and fourth tranches, stock-based compensation expense for each tranche is recognized depending upon the number of the operating metrics management deems probable of being achieved in each reporting period. As of June 30, 2017, based on management's assessment, three of the six operating metrics were considered probable of being achieved during the performance periods. Accordingly, stock-based compensation expense is being recognized for the second, third and fourth tranches over the requisite service period.

Stock Options

No options were granted for the three and six months ended June 30, 2017 and 2016. Total intrinsic value of options exercised was \$0.3 million and \$1.4 million for the three months ended June 30, 2017 and 2016, respectively. Total intrinsic value of options exercised was \$0.6 million and \$2.5 million for the six months ended June 30, 2017 and 2016, respectively. Cash proceeds from the exercise of stock options were \$0.1 million and \$1.0 million for the six months ended June 30, 2017 and 2016, respectively. As of June 30, 2017, there was no unamortized compensation expense and outstanding options were not material.

Employee Stock Purchase Plan ("ESPP")

No shares were issued under the ESPP for the three months ended June 30, 2017 and 2016. For the six months ended June 30, 2017 and 2016, 22,000 and 29,000 shares, respectively, were issued under the ESPP. As of June 30, 2017, 4.6 million shares were available for future issuance.

The intrinsic value of the shares issued was \$0.5 million and \$0.4 million for the six months ended June 30, 2017 and 2016, respectively. As of June 30, 2017, the unamortized expense was \$0.1 million, which will be recognized through the third quarter of 2017. The Black-Scholes model was used to value the employee stock purchase rights with the following weighted-average assumptions:

| | Six Months Ended June 30, | |
|-------------------------|---------------------------|-------|
| | 2017 | 2016 |
| Expected term (years) | 0.5 | 0.5 |
| Expected volatility | 23.4% | 29.7% |
| Risk-free interest rate | 0.7% | 0.4% |
| Dividend yield | 0.9% | 1.4% |

Cash proceeds from the shares issued under the ESPP were \$1.4 million and \$1.3 million for the six months ended June 30, 2017 and 2016, respectively.

3. BALANCE SHEET COMPONENTS

Inventories

Inventories consist of the following (in thousands):

| | June 30, 2017 | December 31, 2016 |
|-----------------|------------------|----------------------|
| Raw materials | \$ 20,147 | \$ 14,599 |
| Work in process | 38,400 | 26,048 |
| Finished goods | 34,119 | 30,822 |
| Total | \$ 92,666 | \$ 71,469 |

Other Current Assets

Other current assets consist of the following (in thousands):

| | June 30, 2017 | December 31, 2016 |
|------------------------|--------------------------|------------------------------|
| Prepaid wafer purchase | \$ 10,000 | \$ 5,000 |
| Other prepaid expense | 2,238 | 2,249 |
| Interest receivable | 1,222 | 966 |
| Other | 1,434 | 828 |
| Total | \$ 14,894 | \$ 9,043 |

Other Long-Term Assets

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

| | June 30, 2017 | December 31, 2016 |
|-----------------------------------|--------------------------|------------------------------|
| Deferred compensation plan assets | \$ 23,149 | \$ 20,288 |
| Prepaid wafer purchase | - | 5,000 |
| Other prepaid expense | 1,062 | 1,117 |
| Other | 1,514 | 1,006 |
| Total | \$ 25,725 | \$ 27,411 |

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

| | June 30, 2017 | December 31, 2016 |
|---|--------------------------|------------------------------|
| Dividends and dividend equivalents | \$ 9,322 | \$ 8,946 |
| Deferred revenue and customer prepayments | 5,321 | 6,799 |
| Warranty | 2,627 | 1,030 |
| Stock rotation reserve | 1,867 | 1,937 |
| Income tax payable | 899 | 1,239 |
| Commissions | 835 | 1,008 |
| Other | 2,122 | 1,957 |
| Total | \$ 22,993 | \$ 22,916 |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------------------|------------------------------------|---------------|----------------------------------|---------------|
| | 2017 | 2016 | 2017 | 2016 |
| Balance at beginning of period | \$ 1,346 | \$ 336 | \$ 1,030 | \$ 289 |
| Warranty provision for product sales | 1,512 | 734 | 2,303 | 819 |
| Settlements made | - | (42) | (296) | (42) |
| Unused warranty provision | (231) | (78) | (410) | (116) |
| Balance at end of period | \$ 2,627 | \$ 950 | \$ 2,627 | \$ 950 |

Other Long-Term Liabilities

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

| | June 30, 2017 | December 31, 2016 |
|--|------------------|----------------------|
| Deferred compensation plan liabilities | \$ 23,008 | \$ 19,836 |
| Dividend equivalents | 4,087 | 3,294 |
| Other | 69 | 89 |
| Total | <u>\$ 27,164</u> | <u>\$ 23,219</u> |

4. GOODWILL AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET

There have been no changes in the balance of goodwill during the three and six months ended June 30, 2017.

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

| | June 30, 2017 | | |
|------------------------|-----------------|-----------------------------|-----------------|
| | Gross Amount | Accumulated Amortization | Net Amount |
| Know-how | \$ 1,018 | \$ (602) | \$ 416 |
| Developed technologies | 6,466 | (4,905) | 1,561 |
| Total | <u>\$ 7,484</u> | <u>\$ (5,507)</u> | <u>\$ 1,977</u> |

| | December 31, 2016 | | |
|------------------------|-------------------|-----------------------------|-----------------|
| | Gross Amount | Accumulated Amortization | Net Amount |
| Know-how | \$ 1,018 | \$ (500) | \$ 518 |
| Developed technologies | 6,466 | (3,982) | 2,484 |
| Total | <u>\$ 7,484</u> | <u>\$ (4,482)</u> | <u>\$ 3,002</u> |

Amortization expense is recorded in cost of revenue in the Condensed Consolidated Statements of Operations. For both the three months ended June 30, 2017 and 2016, amortization expense totaled \$0.5 million. For both the six months ended June 30, 2017 and 2016, amortization expense totaled \$1.0 million.

As of June 30, 2017, the estimated future amortization expense was as follows (in thousands):

| | |
|-----------------------------|-----------------|
| 2017 (remaining six months) | \$ 1,026 |
| 2018 | 841 |
| 2019 | 110 |
| Total | <u>\$ 1,977</u> |

5. 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. Contingently issuable shares, including equity awards with performance conditions or market conditions, are considered outstanding common shares and included in the basic net income per share as of the date that all necessary conditions to earn the awards have been satisfied. Prior to the end of the contingency period, the number of contingently issuable shares included in the diluted net income per share is based on the number of shares, if any, that would be issuable under the terms of the arrangement at the end of the reporting period.

The Company's outstanding RSUs contain forfeitable rights to receive cash dividend equivalents, which are accumulated and paid to the employees when the underlying RSUs vest. Dividend equivalents accumulated on the underlying RSUs are forfeited if the employees do not fulfill their service requirement and the awards do not vest. 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):

| | <u>Three Months Ended June 30,</u> | | <u>Six Months Ended June 30,</u> | |
|--|------------------------------------|-------------|----------------------------------|-------------|
| | <u>2017</u> | <u>2016</u> | <u>2017</u> | <u>2016</u> |
| Numerator: | | | | |
| Net income | \$ 15,014 | \$ 11,198 | \$ 29,490 | \$ 21,773 |
| Denominator: | | | | |
| Weighted-average outstanding shares used to compute basic net income per share | 41,323 | 40,387 | 41,185 | 40,208 |
| Effect of dilutive securities | 2,074 | 1,329 | 2,147 | 1,473 |
| Weighted-average outstanding shares used to compute diluted net income per share | 43,397 | 41,716 | 43,332 | 41,681 |
| Net income per share: | | | | |
| Basic | \$ 0.36 | \$ 0.28 | \$ 0.72 | \$ 0.54 |
| Diluted | \$ 0.35 | \$ 0.27 | \$ 0.68 | \$ 0.52 |

6. SEGMENT AND GEOGRAPHIC INFORMATION

The Company operates in one reportable segment that includes the design, development, marketing and sale of high-performance analog solutions for the consumer, computing and storage, industrial, automotive and communications markets. The Company's chief operating decision maker is its Chief Executive Officer, who reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. 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 and value-added resellers, and directly to original equipment manufacturers, original design manufacturers and electronic manufacturing service providers. The following table summarizes one customer with sales greater than 10% of the Company's total revenue:

| Customer | <u>Three Months Ended June 30,</u> | | <u>Six Months Ended June 30,</u> | |
|-----------------|------------------------------------|-------------|----------------------------------|-------------|
| | <u>2017</u> | <u>2016</u> | <u>2017</u> | <u>2016</u> |
| Distributor A | 17% | 24% | 17% | 22% |

The following table summarizes two customers with accounts receivable balances greater than 10% of the Company's total accounts receivable:

| Customer | <u>June 30,</u> | <u>December 31,</u> |
|-----------------|-----------------|---------------------|
| | <u>2017</u> | <u>2016</u> |
| Distributor A | 20% | 19% |
| Distributor B | 14% | 17% |

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 these distributors 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 the agreement with the distributor.

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

| Country or Region | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------|-----------------------------|-----------|---------------------------|------------|
| | 2017 | 2016 | 2017 | 2016 |
| China | \$ 62,325 | \$ 60,928 | \$ 118,409 | \$ 113,316 |
| Taiwan | 17,286 | 10,160 | 32,161 | 19,015 |
| Europe | 9,593 | 7,054 | 17,501 | 14,039 |
| Korea | 8,154 | 7,024 | 16,315 | 14,117 |
| Southeast Asia | 6,925 | 3,501 | 13,297 | 7,840 |
| Japan | 4,945 | 3,037 | 9,771 | 5,687 |
| United States | 2,888 | 2,303 | 4,930 | 4,449 |
| Other | 82 | 72 | 176 | 128 |
| Total | \$ 112,198 | \$ 94,079 | \$ 212,560 | \$ 178,591 |

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

| Product Family | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------|-----------------------------|-----------|---------------------------|------------|
| | 2017 | 2016 | 2017 | 2016 |
| DC to DC | \$ 102,187 | \$ 84,221 | \$ 193,611 | \$ 161,339 |
| Lighting Control | 10,011 | 9,858 | 18,949 | 17,252 |
| Total | \$ 112,198 | \$ 94,079 | \$ 212,560 | \$ 178,591 |

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

| Country | June 30, 2017 | December 31, 2016 |
|---------------|------------------|----------------------|
| United States | \$ 59,749 | \$ 50,242 |
| China | 46,598 | 45,728 |
| Taiwan | 16,940 | 8,919 |
| Bermuda | 8,548 | 9,573 |
| Other | 424 | 571 |
| Total | \$ 132,259 | \$ 115,033 |

7. LITIGATION

The Company is a party to actions and proceedings in the ordinary course of business, including potential litigation initiated by its shareholders, challenges to the enforceability or validity of its intellectual property, claims that the Company's products infringe on the intellectual property rights of others, and employment matters. 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.

As of June 30, 2017, there were no material pending legal proceedings to which the Company was a party.

8. CASH, CASH EQUIVALENTS AND INVESTMENTS

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

| | June 30, 2017 | December 31, 2016 |
|--|-------------------|----------------------|
| Cash, cash equivalents and investments: | | |
| Cash | \$ 62,166 | \$ 87,747 |
| Money market funds | 8,944 | 24,956 |
| Certificates of deposit | 7,378 | - |
| Corporate debt securities | 181,269 | 109,644 |
| U.S. treasuries and government agency bonds | 17,914 | 45,877 |
| Auction-rate securities backed by student-loan notes | 5,348 | 5,354 |
| Total | <u>\$ 283,019</u> | <u>\$ 273,578</u> |

| | June 30, 2017 | December 31, 2016 |
|---------------------------|-------------------|----------------------|
| Reported as: | | |
| Cash and cash equivalents | \$ 71,110 | \$ 112,703 |
| Short-term investments | 206,561 | 155,521 |
| Long-term investments | 5,348 | 5,354 |
| Total | <u>\$ 283,019</u> | <u>\$ 273,578</u> |

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

| | June 30, 2017 | December 31, 2016 |
|-----------------------------|-------------------|----------------------|
| Due in less than 1 year | \$ 75,434 | \$ 47,568 |
| Due in 1 - 5 years | 131,127 | 107,953 |
| Due in greater than 5 years | 5,348 | 5,354 |
| Total | <u>\$ 211,909</u> | <u>\$ 160,875</u> |

The following tables summarize the unrealized gain and loss positions related to the Company's investments in marketable securities designated as available-for sale (in thousands):

| | June 30, 2017 | | | | Fair Value of Investments in Unrealized Loss Position |
|--|-------------------|---------------------|----------------------|---------------------|--|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Total Fair Value | |
| Money market funds | \$ 8,944 | \$ - | \$ - | \$ 8,944 | \$ - |
| Certificates of deposit | 7,378 | - | - | 7,378 | - |
| Corporate debt securities | 181,700 | 96 | (527) | 181,269 | 142,294 |
| U.S. treasuries and government agency bonds | 17,941 | 2 | (29) | 17,914 | 16,424 |
| Auction-rate securities backed by student-loan notes | 5,570 | - | (222) | 5,348 | 5,348 |
| Total | <u>\$ 221,533</u> | <u>\$ 98</u> | <u>\$ (778)</u> | <u>\$ 220,853</u> | <u>\$ 164,066</u> |

| | December 31, 2016 | | | | Fair Value of Investments in Unrealized Loss Position |
|--|-------------------|---------------------|----------------------|---------------------|--|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Total Fair Value | |
| Money market funds | \$ 24,956 | \$ - | \$ - | \$ 24,956 | \$ - |
| Corporate debt securities | 110,429 | 65 | (850) | 109,644 | 91,938 |
| U.S. treasuries and government agency bonds | 45,899 | - | (22) | 45,877 | 39,275 |
| Auction-rate securities backed by student-loan notes | 5,570 | - | (216) | 5,354 | 5,354 |
| Total | <u>\$ 186,854</u> | <u>\$ 65</u> | <u>\$ (1,088)</u> | <u>\$ 185,831</u> | <u>\$ 136,567</u> |

9. FAIR VALUE MEASUREMENTS

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

| | Fair Value Measurement at June 30, 2017 | | | |
|--|---|-----------|------------|----------|
| | Total | Level 1 | Level 2 | Level 3 |
| Money market funds | \$ 8,944 | \$ 8,944 | \$ - | \$ - |
| Certificates of deposit | 7,378 | - | 7,378 | - |
| Corporate debt securities | 181,269 | - | 181,269 | - |
| U.S. treasuries and government agency bonds | 17,914 | - | 17,914 | - |
| Auction-rate securities backed by student-loan notes | 5,348 | - | - | 5,348 |
| Mutual funds under deferred compensation plan | 14,239 | 14,239 | - | - |
| Total | \$ 235,092 | \$ 23,183 | \$ 206,561 | \$ 5,348 |

| | Fair Value Measurement at December 31, 2016 | | | |
|--|---|-----------|------------|----------|
| | Total | Level 1 | Level 2 | Level 3 |
| Money market funds | \$ 24,956 | \$ 24,956 | \$ - | \$ - |
| Corporate debt securities | 109,644 | - | 109,644 | - |
| U.S. treasuries and government agency bonds | 45,877 | - | 45,877 | - |
| Auction-rate securities backed by student-loan notes | 5,354 | - | - | 5,354 |
| Mutual funds under deferred compensation plan | 12,108 | 12,108 | - | - |
| Total | \$ 197,939 | \$ 37,064 | \$ 155,521 | \$ 5,354 |

- Level 1—includes instruments with quoted prices in active markets for identical assets.
- Level 2— includes instruments for which the valuations are based upon quoted market prices in active markets involving similar assets or inputs other than quoted prices that are observable for the assets. The market inputs used to value these instruments generally consist of market yields, recently executed transactions, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. Pricing sources may include industry standard data providers, security master files from large financial institutions, and other third party sources used to determine a daily market value.
- Level 3—includes instruments for which the valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

The Company's level 3 assets consist of government-backed student loan auction-rate securities, 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, 2017 | \$ 5,354 |
| Change in unrealized loss included in other comprehensive income | (6) |
| Balance at June 30, 2017 | \$ 5,348 |

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

| | June 30, 2017 | December 31, 2016 |
|----------------------------|------------------|----------------------|
| Time-to-liquidity (months) | 24 | 24 |
| Discount rate | 4.2% - 9.2% | 4.3% - 9.3% |

10. DEFERRED COMPENSATION PLAN

The Company has a non-qualified, unfunded deferred compensation plan, which provides certain key employees, including 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. Participants' deferrals and investment gains and losses remain as the Company's liabilities and the underlying assets are subject to claims of general creditors.

The liabilities for compensation deferred under the plan are recorded at fair value in each reporting period. Changes in the fair value of the liabilities are included in operating expense (credit) in the Condensed Consolidated Statements of Operations. The Company manages the risk of changes in the fair value of the liabilities by electing to match the liabilities with investments in corporate-owned life insurance policies and mutual funds that offset a substantial portion of the exposure. The investments are recorded at the cash surrender value of the corporate-owned life insurance policies and at the fair value of the mutual funds, which are classified as trading securities. Changes in the cash surrender value of the corporate-owned life insurance policies and the fair value of mutual fund investments are included in interest and other income, net in the Condensed Consolidated Statements of Operations. The following table summarizes the deferred compensation plan balances in the Condensed Consolidated Balance Sheets (in thousands):

| | June 30, 2017 | December 31, 2016 |
|---|--------------------------|------------------------------|
| Deferred compensation plan asset components: | | |
| Cash surrender value of corporate-owned life insurance policies | \$ 8,910 | \$ 8,180 |
| Fair value of mutual funds | 14,239 | 12,108 |
| Total | \$ 23,149 | \$ 20,288 |
| Deferred compensation plan assets reported in: | | |
| Other long-term assets | \$ 23,149 | \$ 20,288 |
| Deferred compensation plan liabilities reported in: | | |
| Accrued compensation and related benefits (short-term) | \$ 341 | \$ 479 |
| Other long-term liabilities | 23,008 | 19,836 |
| Total | \$ 23,349 | \$ 20,315 |

11. INTEREST AND OTHER INCOME, NET

The components of interest and other income, net are as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|------------------------------------|---------------|----------------------------------|-----------------|
| | 2017 | 2016 | 2017 | 2016 |
| Interest income | \$ 1,327 | \$ 521 | \$ 2,591 | \$ 1,010 |
| Amortization of premium on available-for-sale investments | (498) | (192) | (1,005) | (363) |
| Gain on deferred compensation plan investments | 533 | 307 | 1,266 | 607 |
| Foreign currency exchange loss | (125) | (39) | (234) | (122) |
| Other | - | - | - | 8 |
| Total | \$ 1,237 | \$ 597 | \$ 2,618 | \$ 1,140 |

12. INCOME TAXES

The income tax provision for the three and six months ended June 30, 2017 was \$1.2 million, or 7.4% of pre-tax income, and \$1.7 million, or 5.4% of pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by the Company's subsidiaries in Bermuda and China was taxed at lower rates. In addition, the effective tax rate was impacted by changes in the valuation allowance primarily related to stock-based compensation.

The income tax provision for the three and six months ended June 30, 2016 was \$0.9 million, or 7.6% of the pre-tax income, and \$1.3 million, or 5.5% of the pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by the Company's subsidiaries in Bermuda and China was taxed at lower rates, and because of the benefit that the Company realized from the release of RSUs. In addition, the effective tax rate was impacted by changes in the valuation allowance primarily related to stock-based compensation.

On July 27, 2015, in *Altera Corp. v. Commissioner*, the U.S. Tax Court issued an opinion related to the treatment of stock-based compensation expense in an intercompany cost-sharing arrangement. A final decision was issued in December 2015, and the Internal Revenue Service ("IRS") appealed the decision in February 2016. At this time, the U.S. Department of the Treasury has not withdrawn the requirement from its regulations to include stock-based compensation in the cost pool to be shared under a cost-sharing arrangement. Due to the uncertainty surrounding the status of the current regulations, questions related to the scope of potential benefits, and the risk of the Tax Court's decision being overturned upon appeal, the Company has not recorded any adjustments as of June 30, 2017. The Company will continue to monitor developments related to this opinion and the potential impact on its financial statements.

Adoption of ASU No. 2016-09

Upon adoption of ASU No. 2016-09 on January 1, 2017, excess tax benefits are now recognized in the income tax provision in the Condensed Consolidated Statements of Operations prospectively, rather than in additional paid-in capital in the Condensed Consolidated Balance Sheets. The Company applied the modified retrospective method and there was no net cumulative-effect adjustment to retained earnings on January 1, 2017, as the increase in deferred tax assets for previously unrecognized excess tax benefits was fully offset by a valuation allowance.

Unrecognized Tax Benefits

As of June 30, 2017, the Company had \$15.3 million of unrecognized tax benefits, \$3.9 million of which would affect its effective tax rate if recognized after considering the valuation allowance. As of December 31, 2016, the Company had \$14.4 million of unrecognized tax benefits, \$3.5 million of which would affect its 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 increases or decreases in its unrecognized tax benefits. However, it is not possible to determine either the magnitude or the range of 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 June 30, 2017 and December 31, 2016, the Company has approximately \$0.4 million and \$0.3 million of accrued interest related to uncertain tax positions, respectively, which were recorded in long-term income tax liabilities in the Condensed Consolidated Balance Sheets.

13. ACCUMULATED OTHER COMPREHENSIVE LOSS

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

| | Unrealized Losses on Available-for- Sale Securities | Foreign Currency Translation Adjustments | Total |
|--|--|---|-------------------|
| Balance as of January 1, 2017 | \$ (1,023) | \$ (3,192) | \$ (4,215) |
| Other comprehensive income before reclassifications | 202 | 1,306 | 1,508 |
| Amounts reclassified from accumulated other comprehensive loss | - | - | - |
| Net current period other comprehensive income | 202 | 1,306 | 1,508 |
| Balance as of March 31, 2017 | (821) | (1,886) | (2,707) |
| Other comprehensive income before reclassifications | 144 | 1,186 | 1,330 |
| Amounts reclassified from accumulated other comprehensive loss | (3) | - | (3) |
| Net current period other comprehensive income | 141 | 1,186 | 1,327 |
| Balance as of June 30, 2017 | <u>\$ (680)</u> | <u>\$ (700)</u> | <u>\$ (1,380)</u> |

The amounts reclassified from accumulated other comprehensive loss were recorded in interest and other income, net, in the Condensed Consolidated Statements of Operations.

14. STOCK REPURCHASE

In February 2016, the Board of Directors approved a stock repurchase program (the "2016 Program") that authorized the Company to repurchase up to \$50 million in the aggregate of its common stock through December 31, 2016. In December 2016, the Board of Directors approved an extension of the 2016 Program through December 31, 2017.

For the three and six months ended June 30, 2017 and 2016, the Company did not repurchase any shares under the 2016 Program. As of June 30, 2017, \$50 million remained available for future repurchases. Shares will be retired upon repurchase.

15. DIVIDENDS AND DIVIDEND EQUIVALENTS

Cash Dividend Program

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. Based on the Company's historical practice, stockholders of record as of the last business day of the quarter are entitled to receive the quarterly cash dividends when and if declared by our Board of Directors, which are payable to the stockholders in the following month. The Board of Directors declared the following cash dividends (in thousands, except per-share amounts):

| | <u>Three Months Ended June 30,</u> | | <u>Six Months Ended June 30,</u> | |
|-----------------------------|------------------------------------|-------------|----------------------------------|-------------|
| | <u>2017</u> | <u>2016</u> | <u>2017</u> | <u>2016</u> |
| Dividend declared per share | \$ 0.20 | \$ 0.20 | \$ 0.40 | \$ 0.40 |
| Total amount declared | \$ 8,273 | \$ 8,096 | \$ 16,521 | \$ 16,143 |

As of June 30, 2017 and December 31, 2016, accrued dividends totaled \$8.3 million and \$8.2 million, respectively.

The declaration of any future cash dividends is at the discretion of the Board of Directors and will depend on, among other things, the Company's financial condition, results of operations, capital requirements, business conditions, statutory requirements of Delaware law, compliance with the terms of any future indebtedness and credit facilities and other factors that the Board of Directors may deem relevant, as well as a determination that cash dividends are in the best interests of the 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.

Cash Dividend Equivalent Rights

Under the Company's stock plans, outstanding RSUs contain rights to receive cash dividend equivalents, which entitle employees who hold RSUs to the same dividend value per share as holders of common stock. The dividend equivalents are accumulated and paid to the employees when the underlying RSUs vest. Dividend equivalents accumulated on the underlying RSUs are forfeited if the employees do not fulfill their service requirement and the awards do not vest. As of June 30, 2017 and December 31, 2016, accrued dividend equivalents totaled \$5.1 million and \$4.1 million, respectively.

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 within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that have been made pursuant to and in reliance on the provisions of the Private Securities Litigation Reform Act of 1995. These statements include among other things, statements concerning:

- 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 belief that we may incur significant legal expenses that vary with the level of activity in each of our current or future legal proceedings,
- the effect that liquidity of our investments has on our capital resources,
- the continuing application of our products in the consumer, computing and storage, industrial, automotive and communications markets,
- estimates of our future liquidity requirements,
- the cyclical nature of the semiconductor industry,
- protection of our proprietary technology,
- business outlook for the remainder of 2017 and beyond,
- the factors that we believe will impact our ability to achieve revenue growth,
- the percentage of our total revenue from various market segments,
- our ability to identify, acquire and integrate the companies, businesses and products that we acquire and achieve the anticipated benefits from such acquisitions,
- our intention and ability to repurchase shares under our 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 “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 six months ended June 30, 2017 included in this Quarterly Report on Form 10-Q and our audited consolidated financial statements and related notes for the year ended December 31, 2016 included in our Annual Report on Form 10-K.

Overview

We are a leading company that designs, develops and markets high-performance power solutions. Founded in 1997, MPS's core strengths include deep system-level and applications knowledge, strong analog design expertise and an innovative proprietary process technology. These combined strengths enable MPS to deliver highly integrated monolithic products that offer energy efficient, cost-effective, easy-to-use solutions for systems found in industrial applications, telecommunication infrastructures, cloud computing, automotive, and consumer applications. Our mission is to reduce total energy consumption in our customers' systems with green, practical and compact solutions. 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 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 over the long term.

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 89% and 90% for the three months ended June 30, 2017 and 2016, and 89% and 90% for the six months ended June 30, 2017 and 2016, respectively. We derive a majority of our revenue from the sales of our DC to DC converter products which serve the consumer, computing and storage, industrial, automotive and communications 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.

Critical Accounting Policies and Estimates

Other than those discussed in "Recent Accounting Pronouncements" in Note 1 to Condensed Consolidated Financial Statements, 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 six months ended June 30, 2017, as compared to those disclosed in the Annual Report on Form 10-K for the year ended December 31, 2016.

Results of Operations

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

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|-------------------------------------|------------------------------------|--------|-----------|--------|---------------------------|--------|------------|--------|
| | 2017 | | 2016 | | 2017 | | 2016 | |
| | (in thousands, except percentages) | | | | | | | |
| Revenue | \$ 112,198 | 100.0% | \$ 94,079 | 100.0% | \$ 212,560 | 100.0% | \$ 178,591 | 100.0% |
| Cost of revenue | 50,773 | 45.3 | 43,153 | 45.9 | 96,293 | 45.3 | 82,155 | 46.0 |
| Gross profit | 61,425 | 54.7 | 50,926 | 54.1 | 116,267 | 54.7 | 96,436 | 54.0 |
| Operating expenses: | | | | | | | | |
| Research and development | 20,292 | 18.1 | 17,876 | 19.0 | 39,186 | 18.4 | 35,197 | 19.7 |
| Selling, general and administrative | 25,873 | 23.1 | 21,531 | 22.9 | 47,965 | 22.6 | 39,299 | 22.0 |
| Litigation expense (benefit) | 290 | 0.2 | (8) | - | 576 | 0.3 | 37 | - |
| Total operating expenses | 46,455 | 41.4 | 39,399 | 41.9 | 87,727 | 41.3 | 74,533 | 41.7 |
| Income from operations | 14,970 | 13.3 | 11,527 | 12.2 | 28,540 | 13.4 | 21,903 | 12.3 |
| Interest and other income, net | 1,237 | 1.1 | 597 | 0.7 | 2,618 | 1.3 | 1,140 | 0.6 |
| Income before income taxes | 16,207 | 14.4 | 12,124 | 12.9 | 31,158 | 14.7 | 23,043 | 12.9 |
| Income tax provision | 1,193 | 1.0 | 926 | 1.0 | 1,668 | 0.8 | 1,270 | 0.7 |
| Net income | \$ 15,014 | 13.4% | \$ 11,198 | 11.9% | \$ 29,490 | 13.9% | \$ 21,773 | 12.2% |

Revenue

The following table summarizes our revenue by end market, based on management's assessment of available end market data:

| End Market | Three Months Ended June 30, | | | | | Six Months Ended June 30, | | | | |
|------------------------------------|-----------------------------|---------------|------------------|---------------|--------------|---------------------------|---------------|-------------------|---------------|--------------|
| | 2017 | % of Revenue | 2016 | % of Revenue | Change | 2017 | % of Revenue | 2016 | % of Revenue | Change |
| (in thousands, except percentages) | | | | | | | | | | |
| Consumer | \$ 43,917 | 39.1% | \$ 38,311 | 40.7% | 14.6% | \$ 79,528 | 37.4% | \$ 72,116 | 40.4% | 10.3% |
| Computing and storage | 24,466 | 21.8% | 18,301 | 19.5% | 33.7% | 45,083 | 21.2% | 33,694 | 18.9% | 33.8% |
| Industrial | 15,034 | 13.4% | 14,598 | 15.5% | 3.0% | 30,388 | 14.3% | 26,024 | 14.6% | 16.8% |
| Automotive | 12,854 | 11.5% | 8,254 | 8.8% | 55.7% | 25,185 | 11.9% | 15,266 | 8.5% | 65.0% |
| Communications | 15,927 | 14.2% | 14,615 | 15.5% | 9.0% | 32,376 | 15.2% | 31,491 | 17.6% | 2.8% |
| Total | <u>\$ 112,198</u> | <u>100.0%</u> | <u>\$ 94,079</u> | <u>100.0%</u> | <u>19.3%</u> | <u>\$ 212,560</u> | <u>100.0%</u> | <u>\$ 178,591</u> | <u>100.0%</u> | <u>19.0%</u> |

Revenue for the three months ended June 30, 2017 was \$112.2 million, an increase of \$18.1 million, or 19.3%, from \$94.1 million for the three months ended June 30, 2016. This increase was driven by higher sales in all of our end markets. Overall unit shipments increased by 11% due to higher market demand with current customers and design wins with new customers, coupled with a 7% increase in average sales prices.

Revenue from the consumer market for the three months ended June 30, 2017 increased \$5.6 million, or 14.6%, from the same period in 2016. This increase was primarily driven by higher demand in home appliances and gaming products. Revenue from the computing and storage market increased \$6.2 million, or 33.7%, from the same period in 2016. This increase was primarily driven by strength in the solid-state drive storage, high-performance notebook and cloud computing markets. Revenue from the industrial market increased \$0.4 million, or 3.0%, from the same period in 2016. This increase was primarily driven by higher sales in power sources and point of sale systems. Revenue from the automotive market increased \$4.6 million, or 55.7%, from the same period in 2016. This increase was primarily driven by higher sales in infotainment and lighting applications. Revenue from the communications market increased \$1.3 million, or 9.0%, from the same period in 2016. This increase was primarily driven by higher demand in networking and telecommunication applications.

Revenue for the six months ended June 30, 2017 was \$212.6 million, an increase of \$34.0 million, or 19.0%, from \$178.6 million for the six months ended June 30, 2016. This increase was driven by higher sales in all of our end markets. Overall unit shipments increased by 9% due to higher market demand with current customers and design wins with new customers, coupled with a 9% increase in average sales prices.

Revenue from the consumer market for the six months ended June 30, 2017 increased \$7.4 million, or 10.3%, from the same period in 2016. This increase was primarily driven by higher demand in home appliances and gaming products. Revenue from the computing and storage market increased \$11.4 million, or 33.8%, from the same period in 2016. This increase was primarily driven by strength in the solid-state drive storage, high-performance notebook and cloud computing markets. Revenue from the industrial market increased \$4.4 million, or 16.8%, from the same period in 2016. This increase was primarily driven by higher sales in power sources and point of sale systems. Revenue from the automotive market increased \$9.9 million, or 65.0%, from the same period in 2016. This increase was primarily driven by higher sales in infotainment and lighting applications. Revenue from the communications market was essentially flat compared to the same period in 2016.

Cost of Revenue and Gross Margin

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

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|------------------------------------|-----------------------------|-----------|--------|---------------------------|-----------|--------|
| | 2017 | 2016 | Change | 2017 | 2016 | Change |
| (in thousands, except percentages) | | | | | | |
| Cost of revenue | \$ 50,773 | \$ 43,153 | 17.7% | \$ 96,293 | \$ 82,155 | 17.2% |
| As a percentage of revenue | 45.3% | 45.9% | | 45.3% | 46.0% | |
| Gross profit | \$ 61,425 | \$ 50,926 | 20.6% | \$ 116,267 | \$ 96,436 | 20.6% |
| Gross margin | 54.7% | 54.1% | | 54.7% | 54.0% | |

Cost of revenue was \$50.8 million, or 45.3% of revenue, for the three months ended June 30, 2017, and \$43.2 million, or 45.9% of revenue, for the three months ended June 30, 2016. The \$7.6 million increase in cost of revenue was primarily due to an 11% increase in overall unit shipments, coupled with a 7% increase in the average direct cost of units shipped. The increase in cost of revenue was also driven by an increase of \$0.9 million in inventory write-downs and an increase of \$0.4 million in warranty expenses.

Gross margin was 54.7% for the three months ended June 30, 2017, compared with 54.1% for the three months ended June 30, 2016. The increase in gross margin was primarily due to lower labor and overhead costs as a percentage of revenue, partially offset by higher inventory write-downs and warranty expenses.

Cost of revenue was \$96.3 million, or 45.3% of revenue, for the six months ended June 30, 2017, and \$82.2 million, or 46.0% of revenue, for the six months ended June 30, 2016. The \$14.1 million increase in cost of revenue was primarily due to a 9% increase in overall unit shipments, coupled with an 8% increase in the average direct cost of units shipped. The increase in cost of revenue was also driven by an increase of \$1.7 million in inventory write-downs and an increase of \$1.0 million in warranty expenses.

Gross margin was 54.7% for the six months ended June 30, 2017, compared with 54.0% for the six months ended June 30, 2016. The increase in gross margin was primarily due to increased sales of higher margin products and lower labor and overhead costs as a percentage of revenue, partially offset by higher inventory write-downs and warranty expenses.

Research and Development

Research and development (“R&D”) 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 June 30, | | | Six Months Ended June 30, | | |
|----------------------------|------------------------------------|-------------|---------------|----------------------------------|-------------|---------------|
| | 2017 | 2016 | Change | 2017 | 2016 | Change |
| | (in thousands, except percentages) | | | | | |
| R&D expenses | \$ 20,292 | \$ 17,876 | 13.5% | \$ 39,186 | \$ 35,197 | 11.3% |
| As a percentage of revenue | 18.1% | 19.0% | | 18.4% | 19.7% | |

R&D expenses were \$20.3 million, or 18.1% of revenue, for the three months ended June 30, 2017 and \$17.9 million, or 19.0% of revenue, for the three months ended June 30, 2016. The \$2.4 million increase in R&D expenses was primarily due to an increase of \$0.7 million in new product development expenses, an increase of \$0.6 million in stock-based compensation expenses mainly associated with the performance-based equity awards, an increase of \$0.6 million in manufacturing and laboratory supplies, and an increase of \$0.5 million in compensation expenses, which include salary, benefits and bonuses. Our R&D headcount was 592 employees as of June 30, 2017, compared with 540 employees as of June 30, 2016.

R&D expenses were \$39.2 million, or 18.4% of revenue, for the six months ended June 30, 2017 and \$35.2 million, or 19.7% of revenue, for the six months ended June 30, 2016. The \$4.0 million increase in R&D expenses was primarily due to an increase of \$1.2 million in compensation expenses, which include salary, benefits and bonuses, an increase of \$1.1 million in new product development expenses, an increase of \$0.9 million in manufacturing and laboratory supplies, and an increase of \$0.4 million in stock-based compensation expenses mainly associated with the performance-based equity awards.

Selling, General and Administrative

Selling, general and administrative (“SG&A”) 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.

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|----------------------------|------------------------------------|-------------|---------------|----------------------------------|-------------|---------------|
| | 2017 | 2016 | Change | 2017 | 2016 | Change |
| | (in thousands, except percentages) | | | | | |
| SG&A expenses | \$ 25,873 | \$ 21,531 | 20.2% | \$ 47,965 | \$ 39,299 | 22.1% |
| As a percentage of revenue | 23.1% | 22.9% | | 22.6% | 22.0% | |

SG&A expenses were \$25.9 million, or 23.1% of revenue, for the three months ended June 30, 2017 and \$21.5 million, or 22.9% of revenue, for the three months ended June 30, 2016. The \$4.4 million increase in SG&A expenses was primarily due to an increase of \$2.7 million in stock-based compensation expenses mainly associated with the performance-based equity awards, an increase of \$1.2 million in compensation expenses, which include salary, benefits and bonuses, and an increase of \$0.4 million in depreciation expense. Our SG&A headcount was 369 employees as of June 30, 2017, compared with 331 employees as of June 30, 2016.

SG&A expenses were \$48.0 million, or 22.6% of revenue, for the six months ended June 30, 2017 and \$39.3 million, or 22.0% of revenue, for the six months ended June 30, 2016. The \$8.7 million increase in SG&A expenses was primarily due to an increase of \$2.7 million in stock-based compensation expenses mainly associated with the performance-based equity awards, an increase of \$1.6 million in compensation expenses, which include salary, benefits and bonuses, and an increase of \$0.9 million in depreciation expense. In addition, contributing to the increase in SG&A expenses for the six months ended June 30, 2017 was a stock-based compensation credit recorded in the six months ended June 30, 2016 due to the retirement of our then Chief Financial Officer. As the service or performance conditions for her outstanding restricted stock units had not been satisfied at the time of her departure, we reversed previously accrued stock-based compensation expenses of approximately \$2.9 million associated with the unvested shares and recorded the credit in SG&A expenses for the six months ended June 30, 2016.

Litigation Expense (Benefit), Net

Litigation expense was \$0.3 million for the three months ended June 30, 2017, compared with net litigation benefit of \$8,000 for the three months ended June 30, 2016. The net litigation benefit was attributable to \$0.2 million in proceeds received in connection with a litigation settlement for the three months ended June 30, 2016.

Litigation expense was \$0.6 million for the six months ended June 30, 2017, compared with litigation expense of \$37,000 for the six months ended June 30, 2016. The increase in litigation expense was due to increased litigation activity. In addition, we recorded \$0.2 million in proceeds received in connection with a litigation settlement for the six months ended June 30, 2016.

Interest and Other Income, Net

Interest and other income, net, was \$1.2 million for the three months ended June 30, 2017, compared with \$0.6 million for the three months ended June 30, 2016. The increase was primarily due to an increase of \$0.8 million in interest income and an increase of \$0.2 million in income related to changes in the value of the deferred compensation plan investments, partially offset by an increase of \$0.3 million in amortization of premium on available-for-sale investments.

Interest and other income, net, was \$2.6 million for the six months ended June 30, 2017, compared with \$1.1 million for the six months ended June 30, 2016. The increase was primarily due to an increase of \$1.6 million in interest income and an increase of \$0.7 million in income related to changes in the value of the deferred compensation plan investments, partially offset by an increase of \$0.6 million in amortization of premium on available-for-sale investments.

Income Tax Provision

The income tax provision for the three and six months ended June 30, 2017 was \$1.2 million, or 7.4% of pre-tax income, and \$1.7 million, or 5.4% of pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by our subsidiaries in Bermuda and China was taxed at lower rates. In addition, the effective tax rate was impacted by changes in the valuation allowance primarily related to stock-based compensation.

The income tax provision for the three and six months ended June 30, 2016 was \$0.9 million, or 7.6% of the pre-tax income, and \$1.3 million, or 5.5% of the pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by our subsidiaries in Bermuda and China was taxed at lower rates, and because of the benefit that we realized from the release of RSUs. In addition, the effective tax rate was impacted by changes in the valuation allowance primarily related to stock-based compensation.

On July 27, 2015, in *Altera Corp. v. Commissioner*, the U.S. Tax Court issued an opinion related to the treatment of stock-based compensation expense in an intercompany cost-sharing arrangement. A final decision was issued in December 2015, and the IRS appealed the decision in February 2016. At this time, the U.S. Department of the Treasury has not withdrawn the requirement from its regulations to include stock-based compensation in the cost pool to be shared under a cost-sharing arrangement. Due to the uncertainty surrounding the status of the current regulations, questions related to the scope of potential benefits, and the risk of the Tax Court's decision being overturned upon appeal, we have not recorded any adjustments as of June 30, 2017. We will continue to monitor developments related to this opinion and the potential impact on our financial statements.

Liquidity and Capital Resources

| | June 30, 2017 | December 31, 2016 |
|---|------------------------------------|------------------------------|
| | (in thousands, except percentages) | |
| Cash and cash equivalents | \$ 71,110 | \$ 112,703 |
| Short-term investments | 206,561 | 155,521 |
| Total cash, cash equivalents and short-term investments | <u>\$ 277,671</u> | <u>\$ 268,224</u> |
| Percentage of total assets | 48.9% | 52.5% |
| Total current assets | \$ 427,213 | \$ 382,984 |
| Total current liabilities | (62,786) | (52,921) |
| Working capital | <u>\$ 364,427</u> | <u>\$ 330,063</u> |

As of June 30, 2017, we had cash and cash equivalents of \$71.1 million and short-term investments of \$206.6 million, compared with cash and cash equivalents of \$112.7 million and short-term investments of \$155.5 million as of December 31, 2016. As of June 30, 2017, \$52.2 million of cash and cash equivalents and \$105.6 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 these funds to fund our U.S. operations.

The significant components of our working capital are cash and cash equivalents, short-term investments, accounts receivable and inventories, reduced by accounts payable, accrued compensation and related benefits, and other accrued liabilities. As of June 30, 2017, we had working capital of \$364.4 million, compared with working capital of \$330.1 million as of December 31, 2016. The \$34.3 million increase in working capital was due to a \$44.2 million increase in current assets, partially offset by a \$9.9 million increase in current liabilities. The increase in current assets was primarily due to an increase in short-term investments, accounts receivable, inventories and prepaid expenses, partially offset by a decrease in cash and cash equivalents. The increase in current liabilities was primarily due to an increase in accounts payable and accrued compensation and related benefits.

Summary of Cash Flows

The following table summarizes our cash flow activities:

| | Six Months Ended June 30, | |
|--|----------------------------------|-------------------|
| | 2017 | 2016 |
| | (in thousands) | |
| Net cash provided by operating activities | \$ 46,770 | \$ 43,868 |
| Net cash used in investing activities | (73,711) | (38,386) |
| Net cash used in financing activities | (15,554) | (13,944) |
| Effect of exchange rate changes on cash and cash equivalents | 902 | (352) |
| Net decrease in cash and cash equivalents | <u>\$ (41,593)</u> | <u>\$ (8,814)</u> |

For the six months ended June 30, 2017, net cash provided by operating activities was \$46.8 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 \$17.3 million from the changes in our operating assets and liabilities. The increase in accounts receivable was primarily driven by higher sales and the timing of shipments. The increase in inventories was primarily driven by an increase in strategic wafer and die bank inventories as well as an increase in finished goods to meet current demand and future growth. The increase in accounts payable was primarily driven by increased inventory and capital asset purchases to meet future demand. The increase in accrued liabilities was primarily driven by an increase in employee contributions to the deferred compensation plan. For the six months ended June 30, 2016, net cash provided by operating activities was \$43.9 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 \$5.0 million from the changes in our operating assets and liabilities. The increase in other assets was primarily due to a prepaid wafer purchase agreement we funded in the second quarter of 2016. 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 current demand and future growth. The increase in accounts payable was primarily driven by increased inventory and other purchases to meet future growth.

For the six months ended June 30, 2017, net cash used in investing activities was \$73.7 million, primarily due to net purchases of short-term investments of \$51.6 million, purchases of property and equipment of \$20.5 million, and net contributions to the deferred compensation plan of \$1.6 million. For the six months ended June 30, 2016, net cash used in investing activities was \$38.4 million, primarily due to purchases of property and equipment of \$18.7 million, net purchases of short-term investments of \$18.1 million, and net contributions to the deferred compensation plan of \$1.6 million.

During the first half of 2017, we funded the purchases of land in Kirkland, Washington, and land and six units of an office building in Taipei, Taiwan for approximately \$13.3 million. During the first half of 2016, we funded the purchases of a previously leased manufacturing facility in Chengdu, China and two units of an office building in Shenzhen, China for approximately \$9.1 million.

For the six months ended June 30, 2017, net cash used in financing activities was \$15.6 million, primarily reflecting \$16.8 million used to pay dividends to our stockholders and dividend equivalents to our employees who hold RSUs, partially offset by \$1.5 million of cash proceeds from stock option exercises and issuance of shares through our employee stock purchase plan. For the six months ended June 30, 2016, net cash used in financing activities was \$13.9 million, primarily reflecting \$16.5 million used to pay dividends to our stockholders and dividend equivalents to our employees who hold RSUs, partially offset by \$2.3 million of cash proceeds from stock option exercises and issuance of shares through our employee stock purchase plan.

In June 2014, our Board of Directors approved a dividend program pursuant to which we intend to pay quarterly cash dividends on our common stock. In addition, outstanding 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 accumulated and paid to the employees when the underlying RSUs vest. Dividend equivalents accumulated on the underlying RSUs are forfeited if the employees do not fulfill their service requirement and the awards do not vest. For the six months ended June 30, 2017, we paid dividends and dividend equivalents totaling \$16.8 million. For the six months ended June 30, 2016, we paid dividends and dividend equivalents totaling \$16.5 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, respond to changes in our circumstance or unforeseen events or conditions, or fund our growth, we may need to discontinue paying dividends and dividend equivalents or repurchasing shares, and 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. Accordingly, we cannot ensure that we will continue to pay dividends and dividend equivalents or repurchase shares in the future, and 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 acquisitions, 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

Our outstanding purchase commitments primarily consist of wafer purchases from our foundries, assembly services and license arrangements. As of June 30, 2017, the outstanding balance under our purchase commitments was \$58.6 million, compared with \$46.3 million as of December 31, 2016.

Other long-term obligations include long-term liabilities reflected in our Condensed Consolidated Balance Sheets, which primarily consist of the employee deferred compensation plan liabilities and accrued dividend equivalents. As of June 30, 2017, the outstanding obligations were \$27.2 million, compared with \$23.2 million as of December 31, 2016.

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, 2016.

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, 2016. During the three and six months ended June 30, 2017, there were no material changes or developments that would materially alter the market risk assessment performed as of December 31, 2016.

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 June 30, 2017, 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

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2017 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 the 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 are a party to actions and proceedings in the ordinary course of business, including potential litigation initiated by our shareholders, challenges to the enforceability or validity of our intellectual property, claims that our products infringe on the intellectual property rights of others, and employment matters. 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.

As of June 30, 2017, there were no material pending legal proceedings to which we were a party.

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 materially and 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 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;
- actual or anticipated manufacturing capacity limitations;
- 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;
- our loss of key customers;
- changes in market valuation or earnings of our competitors;
- any mergers, acquisitions or divestitures of assets undertaken by us;
- government debt default;
- government policies and regulations on international trade restrictions and corporate taxes;
- 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;
- market reactions to merger and acquisition activities in the semiconductor industry, and rumors or expectations of further consolidation in the industry;
- investments in sales and marketing resources to enter new markets;
- costs of increasing wafer capacity and qualifying additional third-party wafer fabrication facilities;

- our ability to repurchase shares under our 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 often experiences substantial volatility that may be 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 over 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 macroeconomic 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 loss of key customers or our inability to attract new customers due to 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 original equipment manufacturers (“OEMs”), original design manufacturers (“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;
- product obsolescence;
- seasonality and variability in the consumer, computing and storage, industrial, automotive 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 foreign exchange rates, interest rates or tax rates; and,
- stock-based compensation charges primarily resulting from performance and market-based 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 results of operations, and may 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.

In recent years, 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. Volatility in the credit markets could severely diminish liquidity and capital availability. Demand for our products 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 different markets that we serve. These and other economic factors have had, and may in the future 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, are difficult to accurately forecast;
- the cancellation or rescheduling of our customers' orders, which may occur without significant penalty to our customers;
- changes in general demand for electronic products as a result of worldwide macroeconomic 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. consumer, computing and storage, industrial, automotive and communications);
- 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;
- level of activity in our legal proceedings, which could result in significant legal expenses;
- stock-based compensation charges primarily resulting from performance and market-based equity awards granted to our employees; 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. We are subject to numerous risks and factors that could cause a decrease in our growth rates compared to past periods, 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. A material decrease in our growth rates could adversely affect our stock price and results of operations.

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, which may have a material adverse effect on our financial condition and results of operations.

The declaration of any future cash dividends is at the discretion of our Board of Directors and will depend on, among other things, our financial condition, results of operations, capital requirements, business conditions, statutory requirements of Delaware law, compliance with the terms of future indebtedness and credit facilities and other factors that our Board of Directors may deem relevant, as well as a determination that cash dividends are in the best interests of our stockholders. 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.

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 and results of operations could be materially and 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.

Industry consolidation may lead to increased competition and may harm our operating results.

In recent years, there has been a trend toward semiconductor industry consolidation. We expect this trend to continue as companies attempt to improve the leverage of growing research and development costs, strengthen or hold their market positions in an evolving industry, or become unable to continue operations unless they find an acquirer or consolidate with another company. In addition, companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe that semiconductor industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, operating results and financial condition.

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 consumer, computing and storage, industrial, automotive and communications 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 may face competition from customers developing products internally.

Our customers generally have substantial technological capabilities and financial resources. Some customers have traditionally used these resources to develop their own products internally. The future prospects for our products in these markets are dependent in part upon our customers' acceptance of our products as an alternative to their internally developed products. Future sales prospects also are dependent upon acceptance of third-party sourcing for products as an alternative to in-house development. Customers may in the future continue to use internally developed components. They also may decide to develop or acquire components, technologies or products that are similar to, or that may be substituted for, our products. If our customers fail to accept our products as an alternative, if they develop or acquire the technology to develop such components internally rather than purchase our products, or if we are otherwise unable to develop or maintain strong relationships with them, our business, financial condition and results of operations could be materially and 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 both the three and six months ended June 30, 2017, 89% 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;
- the fluctuations in the value of the U.S. Dollar relative to other foreign currencies, which could affect the competitiveness of our products;
- transportation delays;
- changes in tax regulations in China that may impact our tax status in Chengdu and other regions where we have significant operations;
- 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;
- 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, including distributors, for a significant percentage of our revenue.

Historically, we have generated most of our revenue from a limited number of customers, including distributors. For example, sales to our largest distributor accounted for approximately 17% of our total revenue for both the three and six months ended June 30, 2017. 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 or significant pricing pressure for our products from any of our major customers for any reason (including due to competition, 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 the U.S. or foreign authorities could harm our reputation and have an adverse impact on our business, financial condition and results of operations.

Regulations related to “conflict minerals” may force us to incur additional expenses, may make our supply chain more complex and may result in damage to our reputation with customers.

Pursuant to the Dodd-Frank Act, the SEC adopted requirements for companies that use certain minerals and metals, known as conflict minerals, in their products, whether or not these products are manufactured by third parties. These requirements require companies to conduct diligence, disclose and report whether or not such minerals originate from the Democratic Republic of Congo and adjoining countries. We have undertaken the necessary diligence to determine whether such minerals are used in the manufacture of our products. However, the implementation of these new requirements could adversely affect the sourcing, availability and pricing of such minerals if they are found to be used in the manufacture of our products. In addition, regardless of our findings, we will incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. Since our supply chain is complex, we may not be able to sufficiently verify the origins for these minerals and metals used in our products through the due diligence procedures that we implement, which may harm our reputation. In such event, we may also face difficulties in satisfying customers who require that all of the components of our products are certified as conflict mineral free.

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 electronic manufacturing service providers (“EMSs”). Receivables from our customers are generally not secured by any type of collateral and are subject to the risk of being uncollectible. Sales to our largest distributor accounted for approximately 17% of our total revenue for both the three and six months ended June 30, 2017. 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 an OEM’s significant program or product could reduce our revenue and adversely affect our results of 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. Delays in increasing third-party manufacturing capacity may also limit our ability to meet customer demand.

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 of the supplier 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 global economic crises 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, including delays in qualification of new foundries by our customers.

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 products. 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 litigation, 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.

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 potential future examinations of our income tax returns by the Internal Revenue Service ("IRS") and other tax authorities. For example, our U.S. federal income tax returns for the years ended December 31, 2005 through December 31, 2007 were examined by the IRS. We reached a resolution on the audits in April 2015 and recorded a one-time net charge of \$2.7 million to our income tax provision in the second quarter of 2015. In addition, our U.S. federal income tax return for the year ended December 31, 2014 was under examination by the IRS. No adjustments were made by the IRS upon conclusion of the examination. We 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 any 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 third-party 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, if material, would result in us having to restate our financial statements. 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.

Implementation of an enterprise resource planning ("ERP") or other information technology systems could result in significant disruptions to our operations.

From time to time, we may implement new ERP software solutions or upgrade existing systems. Implementation of these solutions and systems is highly dependent on coordination of system providers and internal business teams. We may experience difficulties as we transition to these new or upgraded systems and processes, including loss or corruption of financial, business or customer data. In addition, transitioning to these new systems requires significant capital investments and personnel resources. Difficulties in implementing new or upgraded information systems or significant system failures could disrupt our operations, which could have a material adverse effect on our capital resources, financial condition or results of operations.

System security risks, data protection or privacy breaches, cyber attacks and systems integration issues could disrupt our internal operations and/or harm our reputation, and any such disruption or harm could cause a reduction in our expected revenue, increase our expenses, negatively impact our results of operation or otherwise adversely affect our stock price.

Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate or compromise our confidential and proprietary information, create system disruptions or cause shutdowns. The costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions and delays that may impede our sales, manufacturing, distribution or other critical functions.

In the ordinary course of business, we store sensitive data on our internal systems, network and servers, such as proprietary business and financial information, and confidential data pertaining to our customers, suppliers and business partners. The secure maintenance of sensitive information on our networks and the protection features of our solutions are both critical to our operations and business strategy. We devote significant resources to network security, data encryption, and other security measures to protect our systems and data. However, these security measures cannot provide absolute security. Although we make significant efforts to maintain the security and integrity of our systems and solutions, any destructive or intrusive breach could compromise our networks, creating system disruptions or slowdowns, and the information stored on our networks could be accessed, publicly disclosed, lost or stolen. If any of these types of security breaches were to occur and we were unable to protect sensitive data, our relationships with our business partners and customers could be materially damaged, our reputation could be materially harmed, and we could be exposed to a risk of litigation and possible significant liability.

Portions of our IT infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and our remediation efforts may be expensive, time consuming, disruptive and resource-intensive. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes. Delayed sales or lost customers resulting from these disruptions could adversely affect our financial results, stock price and reputation.

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 a 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 significant. 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 us incurring 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 materially 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. 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.

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 technologies or products, or to obtain and use information that we regard as proprietary. We intend to continue to protect our proprietary technologies, 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 materially harm our business.

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 became illiquid in 2008. Since 2008, we have redeemed 87% of the original portfolio of our auction-rate securities at par. It is unclear as to when the remaining balance of our auction-rate securities will regain their liquidity. The underlying maturity of these auction-rate securities is up to 31 years. We have historically 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. In addition, we cannot assure you that we will not in the future identify 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 us 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, 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.

Fluctuations in the value 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, our sales are primarily denominated in the U.S. Dollar. If the value of the U.S. Dollar rises against other currencies, it may adversely affect the demand for our products in international markets, which could negatively impact our business and results of operations.

We incur foreign currency exchange gains or losses related to the timing of payments for transactions between the U.S. and our foreign subsidiaries, which are reported in interest and other income in the statements of operations. Fluctuations in the value of the U.S. Dollar relative to the foreign currencies could increase the amount of foreign currency exchange losses we record, which could have an adverse impact on our results of operations.

Our business is subject to various governmental laws and regulations, and compliance with these regulations may impact our revenue and cause us to incur significant expense. If we fail to maintain compliance with applicable regulations, we may be forced to recall products and cease their distribution, and we could be subject to civil or criminal penalties.

Our business is subject to various significant laws and other legal requirements imposed by the U.S. and other countries we conduct business with, including export control laws such as the U.S. Export Administration Regulations. These laws and regulations are complex, change frequently and have generally become more stringent over time. We may be required to incur significant expense to comply with these regulations or to remedy violations of these regulations. In addition, if our customers fail to comply with these regulations, we may be required to suspend sales to these customers, which could negatively impact our results of operations. We must conform the manufacture and distribution of our products to various laws and adapt to regulatory requirements in many countries as these requirements change. If we fail to comply with these requirements in the manufacture or distribution of our products, we could be required to pay civil penalties, face criminal prosecution and, in some cases, be prohibited from distributing our products commercially until the products are brought into compliance.

Environmental laws and regulations could cause a disruption in our business and operations.

We are subject to various state, federal and international laws and regulations governing the environment, including those restricting the presence of certain substances in electronic products and making manufacturers of those products financially responsible for the collection, treatment, recycling and disposal of certain products. Such laws and regulations have been passed in several jurisdictions in which we operate, including various European Union member countries and countries in Asia. There can be no assurance that similar laws and regulations will not be implemented in other jurisdictions resulting in additional costs, possible delays in delivering products, and even the discontinuance of existing and planned future product replacements if the cost were to become prohibitive.

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.

We have manufacturing and testing facilities in China and most of our manufacturing partners are located in China. The Chinese government has broad discretion and authority to regulate the technology industry in China. Additionally, China's government has implemented policies from time to time to regulate economic expansion in China. It 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.

Additionally, personal privacy, cyber security, and data protection are becoming increasingly significant issues in China. To address these issues, the Standing Committee of the National People's Congress promulgated the Cyber Security Law of the People's Republic of China (the "Cyber Security Law"), which took effect on June 1, 2017. The Cyber Security Law sets forth various requirements relating to the collection, use, storage, disclosure and security of data, among other things. Various Chinese agencies are expected to issue additional regulations in the future to define these requirements more precisely. These requirements may increase our costs of compliance. We cannot assure you that we will be able to comply with all of these regulatory requirements. Any failure to comply with the Cyber Security Law and the relevant regulations and policies could result in additional cost and liability to us and could adversely affect our business and results of operations. Additionally, increased costs to comply with, and other burdens imposed by, the Cyber Security Law and relevant regulations and policies that are applicable to the businesses of our suppliers, vendors and other service providers, as well as our customers, could adversely affect our business and results of operations.

Any additional new regulations or the amendment or modification 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.

The Chinese government and provincial and local governments also 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 facilities 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 manufacturing and testing facilities in China, which could increase product costs or cause a delay in product shipments.

We have manufacturing and testing facilities in China that began operations in 2006. We face the following risks, among others, with respect to our operations 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 facilities 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 wafer 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 may be made up to two years or more in advance of any sales. It generally 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 introduce 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 material 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 affect our operations or 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. Furthermore, if we lose key personnel, the search for a qualified replacement and the transition could interrupt our operations as the search could take us longer than expected and divert management resources, and the newly hired employee could take longer than expected to integrate into the team.

If we fail to retain key employees in our sales, applications, finance and legal staff 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 not realize the anticipated benefits of any company or business that we acquire. In addition, acquisitions could result in diluting the ownership interests of our stockholders, reduce our cash balances, and cause us to incur debt or to assume contingent liabilities, which could 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. 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, or incur impairment charges related to goodwill or other acquisition-related 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 any future acquisitions will improve our results of operations or that we will otherwise realize the anticipated benefits of any acquisitions. In addition, if we are unsuccessful in integrating any acquired company or business into our operations or if integration is more difficult than anticipated, we may experience disruptions that could harm our business and result in our failure 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;
- 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;
- difficulties in assessing the fair value of earn-out arrangements;
- diversion of management's attention from other business concerns; and,
- adverse effects on existing business relationships with customers.

If we issue additional shares of stock in the future, it may have a dilutive effect on our stockholders.

We may issue additional shares of common stock in the future in order to raise additional capital to fund our global operations or in connection with an acquisition. We also issue restricted stock units to employees, which convert into shares of common stock upon vesting. Any issuance of our common stock may result in immediate dilution of our stockholders. In addition, the issuance of a significant amount of our common stock may result in additional regulatory requirements, such as stockholder approval.

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 many 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 and manufacturing facilities, 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, particularly in China. 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.

ITEM 6. EXHIBITS

| <u>Exhibit No.</u> | <u>Description</u> |
|--------------------|---|
| 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.

Dated: July 31, 2017

MONOLITHIC POWER SYSTEMS, INC.

/s/ T. Bernie Blegen

T. Bernie Blegen
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 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: July 31, 2017

/s/ Michael Hsing

Michael 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, T. Bernie Blegen, 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: July 31, 2017

/s/ T. Bernie Blegen

T. Bernie Blegen
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 quarter ended June 30, 2017, 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 Monolithic Power Systems, Inc. for the quarter ended June 30, 2017, 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: July 31, 2017

/s/ Michael Hsing
Michael Hsing
Chief Executive Officer

Date: July 31, 2017

/s/ T. Bernie Blegen
T. Bernie Blegen
Chief Financial Officer

