MONOLITHIC POWER SYSTEMS INC
Form 10-Q
May 01, 2014

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 March 31, 2014

OR

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware	**77-0466789**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

79 Great Oaks Boulevard, San Jose, CA 95119 (408) 826-0600

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE AND TELEPHONE NUMBER)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

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

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

There were 38,605,790 shares of the registrant’s common stock issued and outstanding as of April 25, 2014.

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)

	March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$88,885	$101,213
Short-term investments	139,750	125,126
Accounts receivable, net of allowances of $0 as of March 31, 2014 and December 31, 2013	22,057	23,730
Inventories	39,829	39,737
Deferred income tax assets, net	292	294
Prepaid expenses and other current assets	2,444	1,986
Total current assets	293,257	292,086
Property and equipment, net	65,897	64,837
Long-term investments	9,843	9,860
Deferred income tax assets, net	476	481
Other long-term assets	5,159	1,644
Total assets	$374,632	$368,908
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$11,748	$10,694
Accrued compensation and related benefits	10,332	10,419
Accrued liabilities	8,559	17,376
Total current liabilities	30,639	38,489
Income tax liabilities	5,652	5,542
Other long-term liabilities	3,674	1,478
Total liabilities	39,965	45,509
Commitments and contingencies (Notes 6 and 8)		
Stockholders' equity:		

Common stock, $0.001 par value; shares authorized: 150,000; shares issued and outstanding: 38,672 and 38,291 as of March 31, 2014 and December 31, 2013, respectively	237,059	234,201
Retained earnings	91,956	82,938
Accumulated other comprehensive income	5,652	6,260
Total stockholders’ equity	334,667	323,399
Total liabilities and stockholders’ equity	$ 374,632	$ 368,908

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 March 31,	
	2014	**2013**
Revenue	$60,061	$51,470
Cost of revenue	27,964	24,085
Gross profit	32,097	27,385
Operating expenses:		
Research and development	15,603	12,123
Selling, general and administrative	16,109	13,258
Litigation benefit, net	(8,700)	(301)
Total operating expenses	23,012	25,080
Income from operations	9,085	2,305
Interest and other income (expense), net	190	(10)
Income before income taxes	9,275	2,295
Income tax provision (benefit)	257	(204)
Net income	$9,018	$2,499
Basic net income per share	$0.23	$0.07
Diluted net income per share	$0.23	$0.07
Weighted average common shares outstanding:		
Basic	38,470	36,259
Diluted	39,517	37,708

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2014	**2013**
Net income	$9,018	$2,499
Other comprehensive income (loss), net of tax:		
Change in unrealized losses on auction-rate securities, net of $0 tax in 2014 and 2013	(17)	(15)
Change in unrealized gains on other available-for-sale securities, net of $0 tax in 2014 and 2013	5	(7)
Foreign currency translation adjustments	(596)	303
Total other comprehensive income (loss), net of tax	(608)	281
Comprehensive income	$8,410	$2,780

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended March 31, 2014	2013
Cash flows from operating activities:		
Net income	$ 9,018	$ 2,499
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,182	2,709
Amortization and realized loss (gain) on investments	71	98
Excess tax benefit from stock option transactions	-	(132)
Stock-based compensation	7,598	4,660
Changes in operating assets and liabilities:		
Accounts receivable	1,673	(3,285)
Inventories	(81)	(2,836)
Prepaid expenses and other current assets	(2,036)	315
Accounts payable	1,058	2,135
Accrued liabilities	(8,473)	1,889
Accrued income taxes payable and noncurrent tax liabilities	38	(526)
Accrued compensation and related benefits	(63)	(822)
Net cash provided by operating activities	11,985	6,704
Cash flows from investing activities:		
Property and equipment purchases	(4,516)	(3,435)
Purchases of short-term investments	(41,977)	(17,590)
Proceeds from sale of short-term investments	27,252	21,250
Proceeds from sale of long-term investments	-	25
Net cash provided by (used in) investing activities	(19,241)	250
Cash flows from financing activities:		
Proceeds from issuance of common shares	5,554	9,839
Proceeds from employee stock purchase plan	1,053	1,167
Repurchases of common shares	(11,358)	-
Excess tax benefits from stock option transactions	-	132
Net cash provided by (used in) financing activities	(4,751)	11,138
Effect of change in exchange rates	(321)	91
Net increase (decrease) in cash and cash equivalents	(12,328)	18,183
Cash and cash equivalents, beginning of period	101,213	75,104
Cash and cash equivalents, end of period	$ 88,885	$ 93,287
Supplemental disclosures for cash flow information:		

Cash paid for taxes	$	217	$	324
Supplemental disclosures of non-cash activities:				
Liability accrued for property and equipment purchases	$	445	$	4,230

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. ***Basis of Presentation***

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

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

Summary of Significant Accounting Policies

There have been no changes to the Company’s significant accounting policies during the three months ended March 31, 2014 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, 2013.

Recently Adopted Accounting Pronouncement

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The standard gives guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists,

with the purpose of reducing diversity in practice. This new standard requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. The Company adopted this standard in the first quarter of 2014 prospectively and the adoption did not have an impact on its consolidated financial position, results of operations, or cash flows.

2. ***Stock-Based Compensation***

Stock Plans

As of March 31, 2014, approximately 2.9 million shares were available for future issuance under the 2004 Equity Incentive Plan (the "2004 Plan"). The 2004 Plan will expire on November 12, 2014. Once the 2004 Plan expires, the Company will no longer be able to grant equity awards under the 2004 Plan, and any shares otherwise remaining available for future grants under the 2004 Plan will no longer be available for issuance.

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

Stock-Based Compensation Expense

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

	Three Months Ended March 31,	
	2014	**2013**
Cost of revenue	$205	$156
Research and development	2,005	1,373
Selling, general and administrative	5,388	3,131
Tax benefit	-	(47)
Total	$7,598	$4,613

Restricted Stock

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

	Time-Based RSUs	**Weighted-Average Grant Date Fair Value Per Share**	**PSUs**	**Weighted-Average Grant Date Fair Value Per Share**	**MSUs**	**Weighted-Average Grant Date Fair Value Per Share**	**Total**	**Weighted-Average Grant Date Fair Value Per Share**
Outstanding at January 1, 2014	754,306	$ 19.41	1,027,782	$ 23.02	1,800,000	$ 23.57	3,582,088	$ 22.53
Awards granted (1)	120,135	$ 32.06	756,684	$ 31.58	-	$ -	876,819	$ 31.65
Performance adjustment (2)	-	$ -	(155,255)	$ 29.65	-	$ -	(155,255)	$ 29.65
Awards released	(145,524)	$ 18.97	(165,136)	$ 17.76	-	$ -	(310,660)	$ 18.33
Awards forfeited	(3,892)	$ 18.39	-	$ -	-	$ -	(3,892)	$ 18.39
	725,025	$ 21.60	1,464,075	$ 27.33	1,800,000	$ 23.57	3,989,100	$ 24.59

Outstanding at March 31, 2014

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(1) The number of PSUs granted reflects the maximum number of shares that can ultimately be earned assuming the achievement of the highest level of performance conditions under the programs.

(2) The performance adjustment reflects the number of PSUs that have not been earned or will not ultimately be earned based on management's probability assessment.

The intrinsic value related to awards released for the three months ended March 31, 2014 and 2013 was $10.2 million and $8.7 million, respectively. As of March 31, 2014, the total intrinsic value of outstanding awards was $154.7 million, based on the closing stock price of $38.77. As of March 31, 2014, unamortized compensation expense related to outstanding awards was approximately $61.2 million with a weighted-average remaining recognition period of approximately six years.

2014 Time-Based RSUs and PSUs:

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

Stock Options

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

	Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2014	1,356,446	$ 15.86	1.9	$25,505,753

Options exercised	(350,920)	$ 15.83		
Options forfeited and expired	(1,167)	$ 11.48		
Outstanding at March 31, 2014	1,004,359	$ 15.87	1.7	$22,998,787
Options exercisable at March 31, 2014 and expected to vest	1,002,281	$ 15.88	1.7	$22,942,298
Options exercisable at March 31, 2014	942,757	$ 16.01	1.5	$21,459,665

Total intrinsic value of options exercised was $6.9 million and $5.6 million for the three months ended March 31, 2014 and 2013, respectively. The net cash proceeds from the exercise of stock options were $5.6 million and $9.8 million for the three months ended March 31, 2014 and 2013, respectively. At March 31, 2014, unamortized compensation expense related to unvested options was approximately $0.4 million with a weighted-average remaining recognition period of approximately one year.

Employee Stock Purchase Plan

For the three months ended March 31, 2014 and 2013, 43,000 and 65,000 shares, respectively, were issued under the Employee Stock Purchase Plan. As of March 31, 2014, 4.8 million shares were available for future issuance.

The intrinsic value of stock purchased was $0.5 million for both the three months ended March 31, 2014 and 2013. As of March 31, 2014, the unamortized expense was $0.2 million, which will be recognized over five months. The Black-Scholes model was used to value the employee stock purchase rights with the following assumptions:

	Three Months Ended March 31,	
	2014	**2013**
Expected term (years)	0.5	0.5
Expected volatility	33.9%	28.5%
Risk-free interest rate	0.1 %	0.1 %
Dividend yield	-	-

Cash proceeds from employee stock purchases for the three months ended March 31, 2014 and 2013 were $1.1 million and $1.2 million, respectively.

3. Balance Sheet Components

Inventories

Inventories consist of the following (in thousands):

	March 31, 2014	December 31, 2013
Work in process	$24,874	$ 26,605
Finished goods	14,955	13,132
Total inventories	$39,829	$ 39,737

Other Long-Term Assets

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

	March 31, 2014	December 31, 2013
Deferred compensation plan assets	$2,570	$ 607
Prepaid expense	1,632	57
Other	957	980
Total other long-term assets	$5,159	$ 1,644

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	March 31, 2014	December 31, 2013
Proceeds from litigation (see Note 6)	$-	$ 9,489
Deferred revenue and customer prepayments	2,940	2,523
Stock rotation reserve	1,779	1,459
Sales rebate	1,072	900
Commissions	786	931
Warranty	334	451
Other	1,648	1,623
Total accrued liabilities	$8,559	$ 17,376

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

	Three Months Ended March 31,	
	2014	2013
Balance at beginning of period	$451	$331
Warranty provision for product sales	60	103
Settlements made	(74)	(93)
Unused warranty provision	(103)	(66)
Balance at end of period	$334	$275

Other Long-Term Liabilities

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

	March 31,	December 31,

	2014	2013
Deferred compensation plan liabilities	$2,567	$ 628
Other	1,107	850
Total other long-term liabilities	$3,674	$ 1,478

4. Net Income per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock, and calculated using the treasury stock method. The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2014	2013
Numerator:		
Net income	$9,018	$2,499
Denominator:		
Weighted average outstanding shares used to compute basic net income per share	38,470	36,259
Effect of dilutive securities	1,047	1,449
Weighted average outstanding shares used to compute diluted net income per share	39,517	37,708
Net income per share - basic	$0.23	$0.07
Net income per share - diluted	$0.23	$0.07

For the three months ended March 31, 2014, there were no anti-dilutive common stock equivalents. For the three months ended March 31, 2013, approximately 0.2 million common stock equivalents were excluded from the calculation of diluted net income per share because their inclusion would have been anti-dilutive.

5. ***Segment Information***

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

The following table summarizes those distributors with sales greater than 10% of the Company's total revenue:

	Three Months Ended March 31,	
Customer	**2014**	**2013**
A	26%	34 %
B	10%	*

*Represents less than 10%.

The following table summarizes those distributors with accounts receivable balances greater than 10% of the Company’s total accounts receivable:

Customer	**March 31, 2014**	**December 31, 2013**
A	24 %	32 %
B	16 %	17 %

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

	Three Months Ended March 31,	
Country and Region	**2014**	**2013**
China	$36,859	$26,779
Taiwan	9,064	7,519
Europe	4,591	3,950
Korea	2,736	2,418
United States	2,603	1,901
Japan	2,141	1,521
Southeast Asia	2,013	7,329
Other	54	53
Total	$60,061	$51,470

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

	Three Months Ended March 31,	
Product Family	**2014**	**2013**
DC to DC products	$53,935	$46,442
Lighting control products	6,126	5,028
Total	$60,061	$51,470

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

Country	March 31, 2014	December 31, 2013
China	$39,093	$ 41,557
United States	31,753	24,719
Other	210	205
Total	$71,056	$ 66,481

6. ***Litigation***

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

O2 Micro

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

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

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

7. ***Cash, Cash Equivalents and Investments***

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

	Estimated Fair Market Value as of	
	March 31, 2014	**December 31, 2013**
Cash, cash equivalents and investments:		
Cash	$62,857	$62,625
Money market funds	26,028	35,588
U.S. treasuries and government agency bonds	139,750	128,126
Auction-rate securities backed by student-loan notes	9,843	9,860
Total cash, cash equivalents and investments	$238,478	$236,199

Reported as:	March 31, 2014	December 31, 2013
Cash and cash equivalents	$88,885	$101,213
Short-term investments	139,750	125,126
Long-term investments	9,843	9,860
Total cash, cash equivalents and investments	$238,478	$236,199

For the three months ended March 31, 2014, the Company did not redeem any auction-rate securities. For the three months ended March 31, 2013, the Company redeemed $25,000 of auction-rate securities at par.

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

	March 31, 2014	December 31, 2013
Due in less than 1 year	$89,651	$95,509
Due in 1 - 5 years	50,099	29,617
Due in greater than 5 years	9,843	9,860
	$149,593	$134,986

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

	As of March 31, 2014				
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Total Fair Value	Fair Value of Investments in Unrealized Loss Position
Money market funds	$26,028	$ -	$ -	$26,028	$ -

U.S. treasuries and government agency bonds	139,743	32	(25)	139,750	34,000
Auction-rate securities backed by student-loan notes	10,220	-	(377)	9,843	9,843
	$175,991	$ 32	$ (402)	$175,621	$ 43,843

	As of December 31, 2013				
	Adjusted Cost	**Unrealized Gains**	**Unrealized Losses**	**Total Fair Value**	**Fair Value of Investments in Unrealized Loss Position**
Money market funds	$35,588	$ -	$ -	$35,588	$ -
U.S. treasuries and government agency bonds	128,123	26	(23)	128,126	42,880
Auction-rate securities backed by student-loan notes	10,220	-	(360)	9,860	9,860
	$173,931	$ 26	$ (383)	$173,574	$ 52,740

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

	Fair Value Measurement at March 31, 2014			
	Total	**Quoted Prices in Active Markets for Identical Assets Level 1**	**Significant Other Observable Inputs Level 2**	**Significant Unobservable Inputs Level 3**
Money market funds	$26,028	$ 26,028	$ -	$ -
U.S. treasuries and government agency bonds	139,750	-	139,750	-
Auction-rate securities backed by student-loan notes	9,843	-	-	9,843
	$175,621	$ 26,028	$ 139,750	$ 9,843

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

The Company's level 2 assets consist of U.S. treasuries and government agency bonds. These securities generally have market prices available from multiple sources, which are used as inputs into a distribution-curve based algorithm to determine fair value.

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

Balance at January 1, 2014	$9,860
Sales and settlement at par	-
Change in unrealized loss included in other comprehensive income	(17)
Ending balance at March 31, 2014	$9,843

As of March 31, 2014, the Company’s investment portfolio included $9.8 million in government-backed student loan auction-rate securities, net of impairment charges of $407,000, of which $377,000 was temporary and $30,000 was recorded as other-than-temporary. This compares to an investment balance as of December 31, 2013 of $9.9 million, net of impairment charges of $390,000, of which $360,000 was temporary and $30,000 was recorded as other-than-temporary.

Determining the fair value of the auction-rate securities requires significant management judgment regarding projected future cash flows which will depend on many factors, including the quality of the underlying collateral, estimated time for liquidity including potential to be called or restructured, underlying final maturity, insurance guaranty and market conditions, among others. To determine the fair value of the auction-rate securities, the Company used a discounted cash flow model with the following assumptions:

	March 31, 2014			**December 31, 2013**		
Time-to-liquidity (months)		24			24	
Expected return		2.7%			2.5%	
Discount rate	3.6%	-	8.4%	3.3%	-	8.1%

Deferred Compensation Plan:

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

As of March 31, 2014 and December 31, 2013, the plan assets totaled $2.6 million and $0.6 million, and the plan liabilities totaled $2.6 million and $0.6 million, respectively. For the three months ended March 31, 2014, the Company recorded an income of $36,000 in interest and other income (expense), net, related to the changes in the cash surrender value of the plan assets and an operating expense of $13,000 related to the changes in the fair value of the plan liabilities.

8. *Income Taxes*

The income tax provision for the three months ended March 31, 2014 was $0.3 million, or 2.8% of the income before income taxes. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates and because of the benefit that the Company realized as a result of stock options exercises and the releases of RSUs and changes in our valuation allowance.

The income tax benefit for the three months ended March 31, 2013 was $(0.2) million, or (8.9)% of the income before income taxes. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates and because of the benefit that the Company realized as a result of stock option exercises and releases of RSUs.

Unrecognized Tax Benefits

As of March 31, 2014 and December 31, 2013, the Company had unrecognized tax benefits of approximately $15.2 million and $14.9 million, respectively. As of March 31, 2014 and December 31, 2013, the Company had approximately $5.2 million and $5.0 million, respectively, of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate 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. The Company believes that it is reasonably possible that approximately $1.2 million of its unrecognized tax benefits may be released in 2014 as a result of a lapse of the statute of limitations. In addition, it is reasonably possible that over the next twelve-month period the Company may experience other increases or decreases in its unrecognized tax benefits. However, it is not possible to determine either the magnitude or the range of other increases or decreases at this time.

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

Income Tax Audits

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

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

The Company reviewed and responded to the above proposed adjustments. The Company regularly assesses the likelihood of an adverse outcome resulting from such examinations to determine the adequacy of its provision for income taxes. As of March 31, 2014, based on the technical merits of its tax return filing positions and the interactions to date with the IRS, the Company believes that it is more-likely-than-not that the resolution of the audits will not have a significant impact on the Company’s consolidated financial position, results of operations and cash flows.

9. ***Accumulated Other Comprehensive Income***

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

	Unrealized Losses on Auction-Rate Securities	Unrealized Gains on Other Available-for-Sale Securities	Foreign Currency Translation Adjustments	Total
Balance as of January 1, 2014	$ (360)	$ 4	$ 6,616	$ 6,260
Other comprehensive income (loss) before reclassifications	(17)	5	(596)	(608)
Amounts reclassified from accumulated other comprehensive income	-	-	-	-
Net current period other comprehensive income (loss)	(17)	5	(596)	(608)
Balance as of March 31, 2014	$ (377)	$ 9	$ 6,020	$ 5,652

10. ***Stock Repurchase Program***

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

	Shares Repurchased	Average Price Per Share	Amount Repurchased (in thousands)
Cumulative balance at January 1, 2014	663,802	$ 31.06	$ 20,615
Repurchases	323,789	$ 35.08	11,358
Cumulative balance at March 31, 2014	987,591	$ 32.38	$ 31,973

As of March 31, 2014, $68.0 million remained available for future repurchases under the program.

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

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

- the above-average industry growth of product and market areas that we have targeted,
- our plan to increase our revenue through the introduction of new products within our existing product families as well as in new product categories and families,
- our intention to exercise our purchase option with respect to our manufacturing facility in Chengdu, China,
- our belief that we will continue to incur significant legal expenses that vary with the level of activity in each of our legal proceedings,
- the effect of liquidity of our investments on our capital resources,
- the application of our products in the communications, storage and computing, consumer and industrial markets continuing to account for our revenue,
- estimates of our future liquidity requirements,
- the cyclical nature of the semiconductor industry,
- protection of our proprietary technology,
- near term business outlook for 2014 and beyond,
- the factors that we believe will impact our ability to achieve revenue growth,

- the outcome of the IRS audit of our tax returns,
- the percentage of our total revenue from various market segments, and
- the factors that differentiate us from our competitors.

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

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

Overview

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

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

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

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

We derive most of our revenue from sales through distribution arrangements and direct sales to customers in Asia, where the products we produce are incorporated into end-user products. For the three months ended March 31, 2014 and 2013, 88% and 89% of our revenue, respectively, was attributable to direct or indirect sales to customers in Asia. We derive a majority of our revenue from the sales of our DC to DC converter product family which services the communications, storage and computing, consumer and industrial markets. We believe our ability to achieve revenue growth will depend, in part, on our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates on an on-going basis, including those related to revenue recognition, stock-based compensation, financial instruments, inventories, income taxes, warranty obligations and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making the judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Estimates and judgments used in the preparation of our financial statements are, by their nature, uncertain and unpredictable, and depend upon, among other things, many factors outside of our control, such as demand for our products and economic conditions. Accordingly, our estimates and judgments may prove to be incorrect and actual results may differ, perhaps significantly, from these estimates.

We believe the following critical accounting policies reflect our more significant judgments used in the preparation of our consolidated financial statements.

Revenue Recognition. We recognize revenue when the following four basic criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed or determinable; and (4) collectability is reasonably assured. Determination of criteria (3) and (4) are based on management's judgment regarding the fixed nature of the fee charged for products delivered and the collectability of those fees. The application of these criteria has resulted in us generally recognizing revenue upon shipment (when title passes) to customers, including distributors, original equipment manufacturers and electronic manufacturing service providers. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely impacted.

Our revenue consists primarily of sales of assembled and tested finished goods. We also sell die in wafer form to our customers and value-added resellers, and we receive royalty revenue from third parties and value-added resellers.

For the three months ended March 31, 2014 and 2013, approximately 91% and 93%, respectively, of our distributor sales, including sales to our value-added resellers, were made through distribution arrangements with third parties. These arrangements do not include any special payment terms (our normal payment terms are 30-45 days for our distributors), price protection or exchange rights. Returns are limited to our standard product warranty. Certain of our large distributors have contracts that include limited stock rotation rights that permit the return of a small percentage of the products purchased during the previous six months.

For the three months ended March 31, 2014 and 2013, approximately 9% and 7%, respectively, of our distributor sales were made through small distributors primarily based on purchase orders. These distributors typically have no stock rotation rights.

We maintain a sales reserve for stock rotation rights, which is based on historical experience of actual stock rotation returns on a per distributor basis, where available, and information related to products in the distribution channel. This reserve is recorded at the time of sale. Historically, these returns were not material to our consolidated financial statements.

We generally recognize revenue upon shipment of products to the distributors for the following reasons:

(1) Our price is fixed or determinable at the date of sale. We do not offer special payment terms, price protection or price adjustments to distributors when we recognize revenue upon shipment.
(2) Our distributors are obligated to pay us and this obligation is not contingent on the resale of our products.
(3) The distributors' obligation is unchanged in the event of theft or physical destruction or damage to the products.
(4) Our distributors have stand-alone economic substance apart from our relationship.
(5) We do not have any obligations for future performance to directly bring about the resale of our products by the distributors.
(6) The amount of future returns can be reasonably estimated. We have the ability and the information necessary to track inventory sold to and held at our distributors. We maintain a history of returns and have the ability to estimate the stock rotation returns on a quarterly basis.

If we enter into arrangements that have rights of return that are not estimable, we recognize revenue under such arrangements only after the distributors have sold our products to end customers. Two of our U.S. distributors have distribution agreements where revenue is recognized upon sale by these distributors to their end customers because these distributors have certain rights of return which management believes are not estimable. The deferred revenue balance from these two distributors as of March 31, 2014 and December 31, 2013 was $1.7 million. The deferred costs

as of March 31, 2014 and December 31, 2013 were $0.2 million.

We generally provide a one to two-year warranty against defects in materials and workmanship. Under this warranty, we will repair the goods, provide replacements at no charge, or, under certain circumstances, provide a refund to the customer for defective products. Estimated warranty returns and warranty costs are based on historical experience and are recorded at the time product revenue is recognized.

Inventory Valuation. We value our inventory at the lower of the standard cost (which approximates actual cost on a first-in, first-out basis) or its current estimated market value. We write down inventory for obsolescence or lack of demand, based on assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Conversely, if market conditions are more favorable, inventory may be sold that was previously reserved.

Accounting for Income Taxes. ASC 740-10*, Income Taxes – Overall*, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on classification, interest and penalties, accounting in interim periods and disclosure. In accordance with ASC 740-10, we recognize federal, state and foreign current tax liabilities or assets based on our estimate of taxes payable or refundable in the current fiscal year by tax jurisdiction. We also recognize federal, state and foreign deferred tax assets or liabilities for our estimate of future tax effects attributable to temporary differences and carryforwards. We record a valuation allowance to reduce any deferred tax assets by the amount of any tax benefits that, based on available evidence and judgment, are not expected to be realized.

Our calculation of current and deferred tax assets and liabilities is based on certain estimates and judgments and involves dealing with uncertainties in the application of complex tax laws. Our estimates of current and deferred tax assets and liabilities may change based, in part, on added certainty or finality or uncertainty to an anticipated outcome, changes in accounting or tax laws in the U.S., or foreign jurisdictions where we operate, or changes in other facts or circumstances. In addition, we recognize liabilities for potential U.S. and foreign income tax for uncertain income tax positions taken on our tax returns if it has less than a 50% likelihood of being sustained. If we determine that payment of these amounts is unnecessary or if the recorded tax liability is less than our current assessment, we may be required to recognize an income tax benefit or additional income tax expense in our financial statements in the period such determination is made. We have calculated our uncertain tax positions which were attributable to certain estimates and judgments primarily related to transfer pricing, cost sharing and our international tax structure exposure.

As of March 31, 2014 and December 31, 2013, we had a valuation allowance of $16.7 million attributable to management's determination that it is more likely than not that most of the deferred tax assets in the U.S. will not be realized. Should it be determined that additional amounts of the net deferred tax asset will not be realized in the future, an adjustment to increase the deferred tax asset valuation allowance will be charged to income in the period such determination is made. Likewise, in the event we were to determine that it is more likely than not that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the valuation allowance for the deferred tax asset would increase income in the period such determination was made.

As a result of the cost sharing arrangements with our international subsidiaries (cost share arrangements), relatively small changes in costs that are not subject to sharing under the cost share arrangements can significantly impact the overall profitability of the U.S. entity. Because of the U.S. entity's inconsistent earnings history and uncertainty of future earnings, we have determined that it is more likely than not that the U.S. deferred tax benefits will not be realized.

We incurred significant stock-based compensation expense, which related to employee stock purchase plans for which no corresponding tax benefit will be recognized unless a disqualifying disposition occurs. Disqualifying dispositions result in a reduction of income tax expense in the period when the disqualifying disposition occurs. Tax benefits related to realized tax deductions in excess of previously expensed stock compensation are recorded as an addition to paid-in-capital.

Contingencies. We are a party to actions and proceedings incidental to our business in the ordinary course of business, including litigation regarding our intellectual property, challenges to the enforceability or validity of our intellectual property and claims that our products infringe on the intellectual property rights of others. The pending proceedings involve complex questions of fact and law and will require the expenditure of significant funds and the diversion of other resources to prosecute and defend. In addition, from time to time, we become aware that we are subject to other contingent liabilities. When this occurs, we will evaluate the appropriate accounting for the potential contingent liabilities using ASC 450-20-25, *Contingencies – Loss Contingencies – Recognition,* to determine whether a contingent liability should be recorded. In making this determination, management may, depending on the nature of the matter, consult with internal and external legal counsel and technical experts. Based on the facts and circumstances

in each matter, we use our judgment to determine whether it is probable that a contingent loss has occurred and whether the amount of such loss can be estimated. If we determine a loss is probable and estimable, we record a contingent loss in accordance with ASC 450-20-25-2. In determining the amount of a contingent loss, we take into account advice received from experts for each specific matter regarding the status of legal proceedings, settlement negotiations (which may be ongoing), prior case history and other factors. Should the judgments and estimates made by management need to be adjusted as additional information becomes available, we may need to record additional contingent losses that could materially and adversely impact our results of operations. Alternatively, if the judgments and estimates made by management are adjusted, for example, if a particular contingent loss does not occur, the contingent loss recorded would be reversed which could result in a favorable impact on our results of operations.

Stock-Based Compensation. We account for stock-based compensation under the provisions of ASC 718-10-30, *Compensation – Stock Compensation – Overall – Initial Measurement.* This standard requires us to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. We use the Black-Scholes model to estimate the fair value of our options and employee stock purchase plan. The fair value of our time-based and performance-based restricted stock units is based on the grant date share price. The fair value of our market-based restricted stock units is estimated using a Monte Carlo simulation model.

We recognize compensation expense equal to the grant-date fair value for all share-based payment awards that are expected to vest. This expense is recorded on a straight-line basis over the requisite service period of the entire awards, unless the awards are subject to performance or market conditions, in which case we recognize compensation expense over the requisite service period of each separate vesting tranche. For our performance-based awards, we recognize compensation expense when it becomes probable that the performance criteria specified in the plan will be achieved. For our market-based awards, compensation expense is not reversed if the market condition is not satisfied. The amount of stock-based compensation that we recognize is also based on an expected forfeiture rate. If there is a difference between the forfeiture assumptions used in determining stock-based compensation expense and the actual forfeitures which become known over time, we may change the forfeiture rate, which could have a significant impact on our stock-based compensation expense.

Results of Operations

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

	Three Months Ended March 31,			
	2014		**2013**	
	(in thousands, except percentages)			
Revenue	$60,061	100.0%	$51,470	100.0%
Cost of revenue	27,964	46.6	24,085	46.8
Gross profit	32,097	53.4	27,385	53.2
Operating expenses:				
Research and development	15,603	26.0	12,123	23.5
Selling, general and administrative	16,109	26.8	13,258	25.8
Litigation benefit, net	(8,700)	(14.5)	(301)	(0.6)
Total operating expenses	23,012	38.3	25,080	48.7
Income from operations	9,085	15.1	2,305	4.5
Interest and other income (expense), net	190	0.3	(10)	(0.0)
Income before income taxes	9,275	15.4	2,295	4.5
Income tax provision (benefit)	257	0.4	(204)	(0.4)
Net income	$9,018	15.0 %	$2,499	4.9 %

Revenue

The following table shows our revenue by product family:

	Three Months Ended March 31,				
Product Family	**2014**	**% of Revenue**	**2013**	**% of Revenue**	**Percentage Change**
	(In thousands, except percentages)				
DC to DC products	$53,935	89.8 %	$46,442	90.2 %	16.1 %
Lighting control products	6,126	10.2 %	5,028	9.8 %	21.8 %
Total	$60,061	100.0 %	$51,470	100.0 %	16.7 %

Revenue for the three months ended March 31, 2014 was $60.1 million, an increase of $8.6 million, or 16.7%, from $51.5 million for the three months ended March 31, 2013. This increase was due to higher sales of both DC to DC and lighting control products, as higher unit shipments were offset in part by lower average selling prices for these

products. Revenue from our DC to DC products was $53.9 million for the three months ended March 31, 2014, an increase of $7.5 million, or 16.1%, from the same period in 2013. This increase was primarily due to higher sales of our DC to DC converters and battery charger products, offset in part by lower sales of our Mini-Monsters and PMIC products. Revenue from our lighting control products was $6.1 million for the three months ended March 31, 2014, an increase of $1.1 million, or 21.8%, compared with the same period in 2013. This increase was primarily due to higher sales of our WLED products, offset in part by decreased demand for our CCFLC products.

Cost of Revenue and Gross Margin

Cost of revenue consists primarily of costs incurred to manufacture, assemble and test our products, as well as other overhead costs and stock-based compensation expenses.

	Three Months Ended March 31,		
	2014	**2013**	**Percentage Change**
	(in thousands, except percentages)		
Cost of revenue	$27,964	$24,085	16.1 %
Cost of revenue as a percentage of revenue	46.6 %	46.8 %	
Gross profit	$32,097	$27,385	17.2 %
Gross margin	53.4 %	53.2 %	

Gross profit as a percentage of revenue, or gross margin, was 53.4% for the three months ended March 31, 2014, compared to 53.2% for the three months ended March 31, 2013. The increase in gross margin year-over-year was primarily due to an improved product mix of higher margin products, offset in part by lower overhead capitalization, compared to the same period in 2013.

Research and Development

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

	Three Months Ended March 31,		
	2014	**2013**	**Percentage Change**
	(in thousands, except percentages)		
Research and development ("R&D")	$15,603	$12,123	28.7 %
R&D as a percentage of revenue	26.0 %	23.5 %	

R&D expenses were $15.6 million, or 26.0% of revenue, for the three months ended March 31, 2014 and $12.1 million, or 23.5% of revenue, for the three months ended March 31, 2013. The increase in R&D expenses was primarily due to an increase in bonus accrual and salary and benefits expenses, and an increase in stock-based compensation expenses associated with the performance-based and market-based equity awards. Our R&D headcount as of March 31, 2014 was 452 employees, compared with 398 employees as of March 31, 2013.

Selling, General and Administrative

Selling, general and administrative expenses include salary and benefit expenses and stock-based compensation expenses for sales, marketing and administrative personnel, sales commissions, travel expenses, related facilities costs, and outside legal and accounting fees.

	Three Months Ended March 31,		**Percentage Change**
	2014	**2013**	
	(in thousands, except percentages)		
Selling, general and administrative ("SG&A")	$16,109	$13,258	21.5 %
SG&A as a percentage of revenue	26.8 %	25.8 %	

SG&A expenses were $16.1 million, or 26.8% of revenue, for the three months ended March 31, 2014 and $13.3 million, or 25.8% of revenue, for the three months ended March 31, 2013. The increase in SG&A expenses was primarily due to an increase in stock-based compensation expenses associated with the performance-based and market-based equity awards, an increase in bonus accrual and an increase in commission expenses due to higher revenue. Our SG&A headcount was 251 employees as of March 31, 2014, compared with 253 employees as of March 31, 2013.

Litigation Benefit, Net

Litigation benefit, net, includes primarily patent litigation and other contract-related matters.

Net litigation benefit was $(8.7) million for the three months ended March 31, 2014, compared to a net litigation benefit of $(0.3) million for the three months ended March 31, 2013. The increase in net litigation benefit was primarily due to the recognition of the $9.5 million settlement of the O2 Micro litigation, net of $500,000 of additional legal fees incurred in connection with the final resolution of the litigation. This increase in net litigation benefit was partially offset by higher expenses incurred in other litigation matters for the three months ended March 31, 2014 compared to the same period in 2013.

Interest and Other Income (Expense), Net

For the three months ended March 31, 2014, interest and other income, net, was $190,000, compared with a net expense of $(10,000) for the three months ended March 31, 2013. The increase in interest and other income, net, was primarily due to lower foreign exchange losses and higher interest income.

Income Tax Provision

The income tax provision for the three months ended March 31, 2014 was $0.3 million, or 2.8% of the income before income taxes. This differs from the federal statutory rate primarily because our foreign income was taxed at lower rates and because of the benefit that we realized as a result of stock options exercises and the releases of RSUs and changes in our valuation allowance. The income tax benefit for the three months ended March 31, 2013 was $(0.2) million, or (8.9)% of the income before income taxes. This differs from the federal statutory rate primarily because our foreign income was taxed at lower rates and because of the benefit that we realized as a result of stock option exercises and releases of RSUs.

Liquidity and Capital Resources

	March 31, 2014	**December 31, 2013**
	(In thousands)	
Cash and cash equivalents	$ 88,885	$ 101,213
Short-term investments	139,750	125,126
Total cash, cash equivalents and short-term investments	$ 228,635	$ 226,339
Percentage of total assets	61.0 %	61.4 %
Total current assets	$ 293,257	$ 292,086

Total current liabilities	(30,639)	(38,489)
Working capital	$ 262,618	$ 253,597

As of March 31, 2014, we had cash and cash equivalents of $88.9 million and short-term investments of $139.8 million, compared with cash and cash equivalents of $101.2 million and short-term investments of $125.1 million as of December 31, 2013. As of March 31, 2014, $64.2 million of cash and cash equivalents and $17.0 million of short-term investments were held by our international subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to indefinitely reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

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

As of March 31, 2014, we had working capital of $262.6 million, compared with working capital of $253.6 million as of December 31, 2013. The $9.0 million increase in working capital was due to a $1.2 million increase in current assets and a $7.8 million decrease in current liabilities. The increase in current assets was primarily due to an increase in short-term investments, partially offset by a decrease in cash and cash equivalents and accounts receivable. The decrease in current liabilities was primarily due to a decrease in accrued liabilities as we released the liability of $9.5 million related to the O2 Micro litigation in the first quarter of 2014 and recorded it in litigation benefit, net, in the Condensed Consolidated Statement of Operations.

Summary of Cash Flows

The table below summarizes the cash and cash equivalents provided by (used in) in our operating, investing and financing activities:

	Three Months Ended March 31,	
	2014	**2013**
	(In thousands)	
Cash provided by operating activities	$11,985	$6,704
Cash provided by (used in) investing activities	(19,241)	250
Cash provided by (used in) financing activities	(4,751)	11,138
Effect of exchange rate changes on cash and cash equivalents	(321)	91
Net increase (decrease) in cash and cash equivalents	$(12,328)	$18,183

For the three months ended March 31, 2014, net cash provided by operating activities was $12.0 million, primarily due to our net income adjusted for certain non-cash items, including depreciation and amortization and stock-based compensation, and a decrease in accrued liabilities. The decrease in accrued liabilities was primarily driven by the release of the liability of $9.5 million related to the O2 Micro litigation. For the three months ended March 31, 2013, net cash provided by operating activities was $6.7 million, primarily due to cash contributed from our operating results during the year, which was partially offset by increases in both accounts receivable and inventories. The increase in accounts receivable resulted primarily from an increase in shipments in the first quarter of 2013 and the timing of those shipments. The increase in inventories was primarily due to an increase in strategic wafer and die bank inventories as well as an increase in finished goods necessary to meet anticipated future demand.

For the three months ended March 31, 2014, net cash used in investing activities was $19.2 million, primarily reflecting net purchases of short-term investments of $14.7 million and purchases of property and equipment of $4.5 million. For the three months ended March 31, 2013, net cash provided by investing activities was $0.3 million reflecting net proceeds of $3.7 million from short-term investments, which was offset by $3.4 million of equipment and software purchases.

As of March 31, 2014, our investment portfolio included $9.8 million in government-backed student loan auction-rate securities, net of impairment charges of $407,000, of which $377,000 was temporary and $30,000 was recorded as other-than-temporary. This compares to an investment balance as of December 31, 2013 of $9.9 million, net of impairment charges of $390,000, of which $360,000 was temporary and $30,000 was recorded as other-than-temporary. For the three months ended March 31, 2014 and 2013, we redeemed $0 and $25,000 of auction-rate securities at par.

For the three months ended March 31, 2014, net cash used in financing activities was $4.8 million, primarily reflecting $11.4 million used in the repurchases of our common stock, partially offset by $6.6 million of cash proceeds from stock option exercises and stock purchases through our employee stock purchase plan. For the three months ended March 31, 2013, net cash provided by financing activities was $11.1 million, primarily reflecting $11.0 million of cash received from the exercise of stock options and stock purchases through our employee stock purchase plan.

In July 2013, our Board of Directors approved a stock repurchase program that authorizes us to repurchase up to $100 million in the aggregate of our common stock through June 30, 2015. All shares are retired upon repurchase. For the three months ended March 31, 2014, we repurchased a total of 324,000 shares for $11.4 million, at an average price of $35.08 per share. From the inception of the program through March 31, 2014, we repurchased a total of 988,000 shares for $32.0 million, at an average price of $32.38 per share. As of March 31, 2014, $68.0 million remained available for future repurchases under the program.

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. For further details regarding our operating, investing and financing activities, see the Condensed Consolidated Statements of Cash Flows.

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

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

Contractual Obligations

We lease our research and development and sales offices in the United States, Japan, China, Taiwan and Korea. Certain of our facility leases provide for periodic rent increases.

Currently, we are leasing a manufacturing facility in Chengdu, China. We have an option to acquire this manufacturing facility for approximately $1.7 million, which consists of total construction cost incurred minus total rent paid by us during the lease term. This option became exercisable in March 2011 and does not expire. We will likely exercise our purchase option and enter into a purchase agreement for this facility in the future.

Our outstanding purchase commitments primarily consist of wafer purchases from our foundries and assembly services. As of March 31, 2014, the outstanding balance was $14.2 million, compared with $12.4 million as of December 31, 2013.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this Annual Report on Form 10-K.

Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of March 31, 2014, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

O2 Micro

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

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

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

ITEM 1A. RISK FACTORS

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

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

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

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

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

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

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

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

- changes in general demand for electronic products as a result of worldwide macro-economic conditions;
- changes in business conditions at our distributors, value-added resellers and/or end-customers;
- changes in general economic conditions in the countries where our products are sold or used;
- the timing of developments and related expenses in our litigation matters;
- the possibility of lost business as a result of customer and prospective customer concerns about being litigation targets;
- continued dependence on our turns business (orders received and shipped within the same fiscal quarter);
- continued dependence on the Asian markets for our customer base;
- increases in assembly costs due to commodity price increases, such as the price of gold;

- the timing of new product introductions by us and our competitors;
- changes in our revenue mix between OEMs, ODMs, distributors and value-added resellers;
- changes in product mix 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;
- the fluctuations in our estimate for stock rotation reserves;
- our ability to manage our inventory levels, including the levels of inventory held by our distributors;
- inventory levels and product obsolescence;
- seasonality and variability in the storage and computing, consumer electronics, and communications markets;
- the availability of adequate manufacturing capacity from our outside suppliers;
- increases in prices for finished wafers due to general capacity shortages;
- the potential loss of future business resulting from capacity issues;
- changes in manufacturing yields;

- movements in exchange rates, interest rates or tax rates; and

- accounting charges resulting from equity awards granted to our employees.

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

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

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

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

Our profitability is dependent on many factors, including:

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

periods, if at all.

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

We may not experience growth rates comparable to past years.

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

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

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

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

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

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

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

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

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

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

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

- timely and efficient completion of process design and device structure improvements;
- timely and efficient implementation of manufacturing, assembly, and test processes;

- the ability to secure and effectively utilize fabrication capacity in different geometries;
- product performance;
- product availability;
- product quality and reliability; and
- effective marketing, sales and service.

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

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

We derive most of our revenue from customers located in Asia through direct sales or indirect sales through distribution arrangements and value-added reseller agreements with parties located in Asia. As a result, we are subject to increased risks due to this geographic concentration of business and operations. For the three months ended March 31, 2014, approximately 88% of our revenue was from customers in Asia. There are risks inherent in doing business in Asia, and internationally in general, including:

- changes in, or impositions of, legislative or regulatory requirements, including tax laws in the United States and in the countries in which we manufacture or sell our products;
- trade restrictions, including restrictions imposed by the United States on trading with parties in foreign countries;
- currency exchange rate fluctuations impacting intra-company transactions;

- transportation delays;
- changes in tax regulations in China that may impact our tax status in Chengdu;
- multi-tiered distribution channels that lack visibility to end customer pricing and purchase patterns;
- international political relationships and threats of war;
- terrorism and threats of terrorism;
- epidemics and illnesses;
- work stoppages and infrastructure problems due to adverse weather conditions or natural disasters;
- work stoppages related to employee dissatisfaction;
- economic, social and political instability;
- changes in import/export regulations, tariffs, and freight rates;
- longer accounts receivable collection cycles and difficulties in collecting accounts receivables;
- enforcing contracts generally; and
- less effective protection of intellectual property and contractual arrangements.

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

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

Historically, we have generated most of our revenue from a limited number of customers. For example, as a result of consolidations in recent years among distributors, sales to our largest distributor accounted for approximately 26% of revenue for the three months ended March 31, 2014. We continue to rely on a limited number of customers for a significant portion of our revenue. Because we rely on a limited number of customers for significant percentages of our revenue, a decrease in demand for our products from any of our major customers for any reason (including due to market conditions, catastrophic events or otherwise) could have a materially adverse impact on our financial conditions and results of operations.

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

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

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

We market our products through distribution arrangements and value-added resellers and through our direct sales and applications support organization to customers that include OEMs, ODMs and electronic manufacturing service providers. Receivables from our customers are generally not secured by any type of collateral and are subject to the risk of being uncollectible. As a result of consolidations in recent years among distributors, sales to our largest distributor accounted for approximately 26% of our total revenue for the three months ended March 31, 2014. Significant deterioration in the liquidity or financial condition of any of our major customers or any group of our customers could have a material adverse impact on the collectability of our accounts receivable and our future operating results. We primarily conduct our sales on a purchase order basis, and we do not have any long-term supply commitments.

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

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

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

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

Although we provide our suppliers with rolling forecasts of our production requirements, their ability to provide wafers to us is limited by the available capacity, particularly capacity in the geometries we require, at the facilities in which they manufacture wafers for us. As a result, this lack of capacity has at times constrained our product sales and revenue growth. In addition, an increased need for capacity to meet internal demands or demands of other customers could cause our suppliers to reduce capacity available to us. Our suppliers may also require us to pay amounts in excess of contracted or anticipated amounts for wafer deliveries or require us to make other concessions in order to acquire the wafer supply necessary to meet our customer requirements. If our suppliers extend lead times, limit supplies or the types of capacity we require, or increase prices due to capacity constraints or other factors, our revenue and gross margin may materially decline. In addition, if we experience supply delays or limitations, our customers may reduce their purchase levels with us and/or seek alternative solutions to meet their demand, which could materially and adversely impact our business and results of operations. For example, due to lack of capacity, which resulted in product shortages in 2010, several major customers in Korea sought alternative suppliers, which impacted our revenue particularly in 2011 and may continue to impact our revenue sources and growth in future periods.

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

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

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

Further, as is common in the semiconductor industry, our customers may reschedule or cancel orders on relatively short notice. Under our agreement with our suppliers, we have an option to order wafers based on a committed forecast that can cover a period of one to six months. If our customers cancel orders after we submit a committed forecast to our suppliers for the corresponding wafers, we may be required to purchase wafers that we may not be able to resell, which would adversely affect our operating results, financial condition, and cash flows.

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

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

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

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

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

- unforeseen environmental, engineering or manufacturing qualification problems relating to existing or new foundry facilities.

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

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

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

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

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

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

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

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

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof and discrete items such as future exercises or dispositions of stock options and restricted stock releases. In addition, we are subject to the continuous examination of our income tax returns by the IRS and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these

examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

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

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

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

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

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

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

Future legal proceedings may divert our financial and management resources.

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

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

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

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

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

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

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

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

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

The market for government-backed student loan auction-rate securities with interest rates that reset through a Dutch auction every 7 to 35 days became illiquid in 2008. We experienced our first failed auction in mid-February 2008. At March 31, 2014, $10.3 million of our auction-rate security investments have failed to reset through successful auctions and it is unclear as to when these investments will regain their liquidity. The underlying maturity of these auction-rate securities is up to 34 years.

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

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

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

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

avoid any material weakness in the future. In addition, we cannot assure you that we will not in the future identify further material weaknesses in our internal control over financial reporting that we have not discovered to date, which may impact the reliability of our financial reporting and financial statements.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our success depends on us investing significant amounts of resources into research and development. We expect to have to continue to invest heavily in research and development in the future in order to continue to innovate and come

to market with new products in a timely manner and increase our revenue and profitability. If we have to invest more resources in research and development than we anticipate, we could see an increase in our operating expenses which may negatively impact our operating results. Also, if we are unable to properly manage and effectively utilize our research and development resources, we could see adverse effects on our business, financial condition and operating results.

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

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

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

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

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

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

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

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

As a part of our business strategy, from time to time we review acquisition prospects that would complement our current product offerings, enhance our design capability or offer other competitive opportunities. In the event of future acquisitions, we could use a significant portion of our available cash, cash equivalents and short-term investments, issue equity securities which would dilute current stockholders' percentage ownership, incur substantial debt or contingent liabilities, and incur impairment charges related to goodwill or other intangibles. Such actions by us 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.

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

- unexpected losses of key employees or customers of the acquired companies or businesses;
- conforming the acquired company's standards, processes, procedures and controls with our operations;
- coordinating new product and process development;
- hiring additional management and other critical personnel;
- increasing the scope, geographic diversity and complexity of our operations;
- difficulties in consolidating facilities and transferring processes and know-how;
- other difficulties in the assimilation of acquired operations, technologies or products;
- the risk of undisclosed liabilities of the acquired businesses and potential legal disputes with founders or stockholders of acquired companies;
- our inability to commercialize acquired technologies;

- the risk that the future business potential as projected is not realized and as a result, we may be required to take a charge to earnings that would impact our profitability;

- the need to take impairment charges or write-downs with respect to acquired assets and technologies;

- diversion of management's attention from other business concerns; and

- adverse effects on existing business relationships with customers.

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

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

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

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

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

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

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

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

Issuer Purchases of Equity Securities

Stock repurchase activities during the three months ended March 31, 2014 were as follows:

	Total Number of Shares Purchased (a)	**Average Price Paid per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Program**	**Dollar Value of Shares That May Yet Be Purchased Under the Program (in thousands)**
January 1 - January 31	123,902	$ 33.86	123,902	
February 1 - February 28	108,441	$ 34.37	108,441	
March 1 - March 31	91,446	$ 37.57	91,446	
Total	323,789	$ 35.08	323,789	$ 68,027

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

ITEM 6. EXHIBITS

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

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

** XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

MONOLITHIC POWER SYSTEMS, INC

SIGNATURE

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

MONOLITHIC POWER SYSTEMS, INC.

Dated: May 1, 2014

/s/ MEERA RAO
Meera Rao
Chief Financial Officer
(Principal Financial and Accounting Officer)

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