

MONOLITHIC POWER SYSTEMS INC
Form 10-Q
July 29, 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 June 30, 2014

OR

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware **77-0466789**
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification Number)

79 Great Oaks Boulevard, San Jose, CA 95119

(Address of principal executive offices)(Zip code)

(408) 826-0600

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
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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 38,724,657 shares of the registrant's common stock issued and outstanding as of July 24, 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)

	June 30,	December
	2014	31,
		2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 107,863	\$ 101,213
Short-term investments	133,012	125,126
Accounts receivable, net of allowances of \$0 as of June 30, 2014 and December 31, 2013	21,420	23,730
Inventories	41,198	39,737
Deferred income tax assets, net	295	294
Prepaid expenses and other current assets	2,509	1,986
Total current assets	306,297	292,086
Property and equipment, net	64,447	64,837
Long-term investments	9,848	9,860
Deferred income tax assets, net	476	481
Other long-term assets	5,586	1,644
Total assets	\$ 386,654	\$ 368,908
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 13,759	\$ 10,694
Accrued compensation and related benefits	12,606	10,419
Accrued liabilities	15,605	17,376
Total current liabilities	41,970	38,489
Income tax liabilities	5,758	5,542
Other long-term liabilities	4,298	1,478
Total liabilities	52,026	45,509
Commitments and contingencies (Notes 6 and 8)		
Stockholders' equity:		

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Common stock, \$0.001 par value; shares authorized: 150,000; shares issued and outstanding: 38,774 and 38,291 as of June 30, 2014 and December 31, 2013, respectively	236,519	234,201
Retained earnings	92,269	82,938
Accumulated other comprehensive income	5,840	6,260
Total stockholders' equity	334,628	323,399
Total liabilities and stockholders' equity	\$ 386,654	\$ 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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue	\$68,436	\$57,714	\$128,497	\$109,184
Cost of revenue	31,337	26,786	59,301	50,871
Gross profit	37,099	30,928	69,196	58,313
Operating expenses:				
Research and development	13,368	12,478	28,971	24,601
Selling, general and administrative	16,853	13,793	32,962	27,051
Litigation expense (benefit), net	274	(257)	(8,426)	(558)
Total operating expenses	30,495	26,014	53,507	51,094
Income from operations	6,604	4,914	15,689	7,219
Interest and other income, net	295	218	485	208
Income before income taxes	6,899	5,132	16,174	7,427
Income tax provision (benefit)	502	(357)	759	(562)
Net income	\$6,397	\$5,489	\$15,415	\$7,989
Net income per share:				
Basic	\$0.17	\$0.15	\$0.40	\$0.22
Diluted	\$0.16	\$0.14	\$0.39	\$0.21
Weighted-average shares outstanding:				
Basic	38,684	37,053	38,577	36,657
Diluted	39,608	38,239	39,563	38,019
Cash dividends declared per common share	\$0.15	\$-	\$0.15	\$-

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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$6,397	\$5,489	\$15,415	\$7,989
Other comprehensive income (loss), net of tax:				
Change in unrealized losses on auction-rate securities, net of \$0 tax for the three and six months ended June 30, 2014 and 2013	5	(17)	(12)	(32)
Change in unrealized gains on other available-for-sale securities, net of \$0 tax for the three and six months ended June 30, 2014 and 2013	7	(15)	12	(22)
Foreign currency translation adjustments	176	862	(420)	1,164
Total other comprehensive income (loss), net of tax	188	830	(420)	1,110
Comprehensive income	\$6,585	\$6,319	\$14,995	\$9,099

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(Unaudited)

	Six Months Ended June 30, 2014	2013
Cash flows from operating activities:		
Net income	\$ 15,415	\$ 7,989
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,300	5,711
Amortization and realized loss (gain) on investments	134	204
Stock-based compensation	16,013	9,850
Changes in operating assets and liabilities:		
Accounts receivable	2,310	(936)
Inventories	(1,457)	(8,140)
Prepaid expenses and other current assets	(1,447)	452
Accounts payable	2,968	4,057
Accrued liabilities	(4,955)	1,775
Accrued income taxes payable and noncurrent tax liabilities	134	(1,137)
Accrued compensation and related benefits	2,173	2,392
Net cash provided by operating activities	37,588	22,217
Cash flows from investing activities:		

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Property and equipment purchases	(5,958)	(10,801)
Investments related to deferred compensation plan	(2,396)	-
Purchases of short-term investments	(86,558)	(40,385)
Proceeds from sale of short-term investments	78,502	37,800
Proceeds from sale of long-term investments	-	25
Net cash used in investing activities	(16,410)	(13,361)
Cash flows from financing activities:		
Property and equipment purchased on extended payment terms	(250)	-
Proceeds from issuance of common shares	8,623	16,184
Proceeds from employee stock purchase plan	1,053	1,167
Repurchases of common shares	(23,796)	-
Net cash provided by (used in) financing activities	(14,370)	17,351
Effect of change in exchange rates	(158)	424
Net increase in cash and cash equivalents	6,650	26,631
Cash and cash equivalents, beginning of period	101,213	75,104
Cash and cash equivalents, end of period	\$ 107,863	\$ 101,735
Supplemental disclosures for cash flow information:		
Cash paid for taxes	\$ 633	\$ 581
Supplemental disclosures of non-cash investing		

and financing
activities:

Liability accrued for property and equipment purchases	\$ 611	\$ 3,744
Dividends and dividend equivalents payable	\$ 6,083	\$ -

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 and six months ended June 30, 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.

Recent Accounting Pronouncements

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

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

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The standard's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under the new standard, entities will apply the following five-step model when evaluating revenue contracts with customers:

Identify the contract with a customer

Identify the performance obligations in the contract

Determine the transaction price

Allocate the transaction price to the performance obligations in the contract

Recognize revenue when the entity satisfy a performance obligation

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

2. Stock-Based Compensation

Stock Plans

As of June 30, 2014, approximately 2.7 million shares were available for future issuance under the 2004 Equity Incentive Plan (as amended, 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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Cost of revenue	\$219	\$146	\$424	\$302
Research and development	2,245	1,693	4,250	3,066
Selling, general and administrative	5,951	3,351	11,339	6,482
Tax benefit	-	(48)	-	(95)
Total	\$8,415	\$5,142	\$16,013	\$9,755

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	236,858	34.54	880,578 (1)	32.36	-	-	1,117,436	32.82
Performance adjustment	-	-	(140,524)(2)	29.49	-	-	(140,524)	29.49
Awards released	(281,602)	19.44	(249,134)	18.12	-	-	(530,736)	18.82
Awards forfeited	(7,412)	17.68	(14,899)	19.18	-	-	(22,311)	18.68
Outstanding at June 30, 2014	702,150	24.52	1,503,803	28.73	1,800,000	23.57	4,005,953	25.67

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

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

The intrinsic value related to awards released for the three months ended June 30, 2014 and 2013 was \$8.3 million and \$2.9 million, respectively. The intrinsic value related to awards released for the six months ended June 30, 2014 and 2013 was \$18.5 million and \$11.5 million, respectively. As of June 30, 2014, the total intrinsic value of outstanding awards was \$169.7 million, based on the closing stock price of \$42.35. As of June 30, 2014, unamortized compensation expense related to outstanding awards was approximately \$63.0 million with a weighted-average remaining recognition period of approximately six years.

2014 Time-Based RSUs and PSUs:*Executive Officers:*

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

Non-Executive Employees:

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

			Contractual Term (Years)	Value
Outstanding at January 1, 2014	1,356,446	\$ 15.86	1.9	\$25,505,753
Options exercised	(555,147)	\$ 16.29		
Options forfeited and expired	(7,641)	\$ 10.78		
Outstanding at June 30, 2014	793,658	\$ 15.60	1.6	\$21,230,524
Options exercisable at June 30, 2014 and expected to vest	792,359	\$ 15.61	1.6	\$21,188,533
Options exercisable at June 30, 2014	749,481	\$ 15.74	1.4	\$19,943,748

Total intrinsic value of options exercised was \$4.9 million and \$5.4 million for the three months ended June 30, 2014 and 2013, respectively. Total intrinsic value of options exercised was \$11.8 million and \$10.9 million for the six months ended June 30, 2014 and 2013, respectively. The net cash proceeds from the exercise of stock options were \$8.6 million and \$16.2 million for the six months ended June 30, 2014 and 2013, respectively. At June 30, 2014, unamortized compensation expense related to unvested options was approximately \$0.3 million with a weighted-average remaining recognition period of approximately one year.

Employee Stock Purchase Plan (“ESPP”)

No shares were issued under the ESPP for the three months ended June 30, 2014 and 2013. For the six months ended June 30, 2014 and 2013, 43,000 and 65,000 shares, respectively, were issued under the ESPP. As of June 30, 2014, 4.8 million shares were available for future issuance.

The intrinsic value of stock purchased was \$0.5 million for both the six months ended June 30, 2014 and 2013. As of June 30, 2014, the unamortized expense was \$75,000, which will be recognized through the third quarter of 2014. The Black-Scholes model was used to value the employee stock purchase rights with the following assumptions:

	Six Months Ended June 30, 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 six months ended June 30, 2014 and 2013 were \$1.1 million and \$1.2 million, respectively.

3. Balance Sheet Components

Inventories

Inventories consist of the following (in thousands):

	June 30, 2014	December 31, 2013
Work in process	\$25,156	\$ 26,605
Finished goods	16,042	13,132
Total inventories	\$41,198	\$ 39,737

Other Long-Term Assets

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

	June 30,	December 31,
	2014	2013
Deferred compensation plan assets	\$3,053	\$ 607
Prepaid expense	1,561	57
Other	972	980
Total other long-term assets	\$5,586	\$ 1,644

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	June 30,	December 31,
	2014	2013
Deferred proceeds from litigation	\$-	\$ 9,489
Dividends and dividend equivalents	5,893	-
Deferred revenue and customer prepayments	4,204	2,523
Commissions	1,234	931
Stock rotation reserve	1,224	1,459
Sales rebate	1,154	900
Warranty	290	451
Other	1,606	1,623
Total accrued liabilities	\$15,605	\$ 17,376

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance at beginning of period	\$334	\$275	\$451	\$331
Warranty provision for product sales	68	113	128	215
Settlements made	-	(3)	(74)	(95)
Unused warranty provision	(112)	(51)	(215)	(117)
Balance at end of period	\$290	\$334	\$290	\$334

Other Long-Term Liabilities

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

	June 30,	December 31,
	2014	2013
Deferred compensation plan liabilities	\$3,078	\$ 628
Other	1,220	850
Total other long-term liabilities	\$4,298	\$ 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 Company's outstanding RSUs contain forfeitable rights to receive dividend equivalents, which are accrued quarterly during the vesting periods of the RSUs and paid to the employees when the awards vest. Dividend equivalents accrued on the RSUs are forfeited if the employees do not fulfill their service requirement during the vesting periods. Accordingly, these awards are not treated as participating securities in the net income per share

calculation.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income	\$6,397	\$5,489	\$15,415	\$7,989
Denominator:				
Weighted average outstanding shares used to compute basic net income per share	38,684	37,053	38,577	36,657
Effect of dilutive securities	924	1,186	986	1,362
Weighted average outstanding shares used to compute diluted net income per share	39,608	38,239	39,563	38,019
Net income per share - basic	\$0.17	\$0.15	\$0.40	\$0.22
Net income per share - diluted	\$0.16	\$0.14	\$0.39	\$0.21

For the three and six months ended June 30, 2014, there were no anti-dilutive common stock equivalents. For the three and six months ended June 30, 2013, approximately 123,000 and 115,000 common stock equivalents, respectively, 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 two customers (both distributors) with sales greater than 10% of the Company's total revenue:

Customer	Three Months Ended June 30,		Six Months Ended June 30	
	2014	2013	2014	2013
A	26%	31 %	26%	32 %
B	*	11 %	10%	*

*Represents less than 10%.

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

Customer	June 30,		December 31,	
	2014	2013	2014	2013
A	33 %	32 %		
B	11 %	17 %		

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

Country and Region	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
China	\$43,931	\$34,743	\$80,789	\$61,522
Taiwan	9,638	8,321	18,701	15,840
Europe	4,574	3,327	9,165	7,277
Korea	3,890	2,408	6,626	4,826
United States	3,231	1,839	5,834	3,740
Japan	1,713	1,640	3,854	3,161
Southeast Asia	1,407	5,385	3,421	12,714
Other	52	51	107	104
Total	\$68,436	\$57,714	\$128,497	\$109,184

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

Product Family	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
DC to DC products	\$61,173	\$50,536	\$115,108	\$96,978
Lighting control products	7,263	7,178	13,389	12,206
Total	\$68,436	\$57,714	\$128,497	\$109,184

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

Country	June 30,	December 31,
	2014	2013
China	\$38,248	\$41,557
United States	31,578	24,719
Other	207	205
Total	\$70,033	\$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, the Company could have been liable to return a portion or all of the \$9.5 million to O2 Micro. Accordingly, the Company recorded the \$9.5 million as a current liability as of December 31, 2013.

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

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	
	June 30,	December 31,
	2014	2013
Cash, cash equivalents and investments:		
Cash	\$76,899	\$ 62,625
Money market funds	30,964	35,588
U.S. treasuries and government agency bonds	133,012	128,126
Auction-rate securities backed by student-loan notes	9,848	9,860
Total cash, cash equivalents and investments	\$250,723	\$ 236,199

	June 30,	December 31,
	2014	2013
Reported as:		
Cash and cash equivalents	\$107,863	\$ 101,213
Short-term investments	133,012	125,126
Long-term investments	9,848	9,860
Total cash, cash equivalents and investments	\$250,723	\$ 236,199

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

	June 30, 2014	December 31, 2013
Due in less than 1 year	\$86,825	\$95,509
Due in 1 - 5 years	46,187	29,617
Due in greater than 5 years	9,848	9,860
	\$142,860	\$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 June 30, 2014

	Adjusted Cost	Unrealized Gains	Unrealized Losses	Total Fair Value	Fair Value of Investments in Unrealized Loss Position
Money market funds	\$30,964	\$ -	\$ -	\$30,964	\$ -
U.S. treasuries and government agency bonds	132,996	31	(15)	133,012	39,607
Auction-rate securities backed by student-loan notes	10,220	-	(372)	9,848	9,848
	\$174,180	\$ 31	\$ (387)	\$173,824	\$ 49,455

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 June 30, 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	\$30,964	\$ 30,964	\$ -	\$ -
U.S. treasuries and government agency bonds	133,012	-	133,012	-
Auction-rate securities backed by student-loan notes	9,848	-	-	9,848
	\$173,824	\$ 30,964	\$ 133,012	\$ 9,848

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
Change in unrealized loss included in other comprehensive income	(17)
Ending balance at March 31, 2014	9,843
Change in unrealized loss included in other comprehensive income	5
Ending balance at June 30, 2014	\$9,848

As of June 30, 2014, the Company's investment portfolio included \$9.8 million in government-backed student loan auction-rate securities, net of impairment charges of \$402,000, of which \$372,000 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. To determine the fair value of the auction-rate securities, the Company used a discounted cash flow model with the following assumptions:

	June 30,		December 31,	
	2014		2013	
Time-to-liquidity (months)	24		24	
Expected return	2.7%		2.5%	
Discount rate	3.5%	- 8.3%	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 June 30, 2014 and December 31, 2013, the plan assets totaled \$3.1 million and \$0.6 million, and the plan liabilities totaled \$3.1 million and \$0.6 million, respectively.

8. *Income Taxes*

The income tax provision for the three and six months ended June 30, 2014 was \$0.5 million, or 7.3% of pre-tax income, and \$0.8 million, or 4.7% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates, and because of the benefit that the Company realized as a result of stock options exercises and the releases of RSUs and changes in the valuation allowance.

The income tax benefit for the three and six months ended June 30, 2013 was \$(0.4) million, or (7.0%) of the pre-tax income, and \$(0.6) million, or (7.6%) of the pre-tax income, respectively. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates, and because of the benefit that the Company realized from the release of an income tax reserve where the statute of limitations expired and from stock option exercises and releases of RSUs.

Unrecognized Tax Benefits

As of June 30, 2014 and December 31, 2013, the Company had unrecognized tax benefits of approximately \$15.5 million and \$14.9 million, respectively. As of June 30, 2014 and December 31, 2013, the Company had unrecognized tax benefits of approximately \$5.3 million and \$5.0 million, respectively, that would result in an adjustment to the Company's effective tax rate if recognized after considering the valuation allowance.

Uncertain tax positions relate to the allocation of income and deductions among the Company's global entities and to the determination of the research and development tax credit. 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 of June 30, 2014 and December 31, 2013, the Company had \$0.9 million and \$0.8 million, respectively, of accrued interest related to uncertain tax positions.

Income Tax Audits

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

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

The Company reviewed and responded to the above proposed adjustments. The Company regularly assesses the likelihood of an adverse outcome resulting from such examinations to determine the adequacy of its provision for income taxes. As of June 30, 2014, based on the technical merits of its tax return filing positions and the interactions

to date with the IRS, the Company believes that it is more-likely-than-not that the resolution of the audits will not have a material impact on the Company's consolidated financial position, results of operations and cash flows.

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
Other comprehensive income before reclassifications	5	8	176	189
Amounts reclassified from accumulated other comprehensive income	-	(1)	-	(1)
Net current period other comprehensive income	5	7	176	188
Balance as of June 30, 2014	\$ (372)	\$ 16	\$ 6,196	\$5,840

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	Total Amount (in thousands)
Cumulative balance at January 1, 2014	663,802	\$ 31.06	\$ 20,615
Repurchases	323,789	\$ 35.08	11,358
Cumulative balance at March 31, 2014	987,591	\$ 32.38	31,973
Repurchases	321,764	\$ 38.65	12,438
Cumulative balance at June 30, 2014	1,309,355	\$ 33.92	\$ 44,411

As of June 30, 2014, \$55.6 million remained available for future repurchases under the program.

11. Dividends and Dividend Equivalents

In June 2014, the Board of Directors approved a dividend program pursuant to which the Company intends to pay quarterly cash dividends on its common stock. Stockholders of record as of the last day of the quarter are entitled to receive the quarterly cash dividends declared by the Board of Directors, which are payable on the 15th of the following month. For the second quarter of 2014, the Board of Directors declared a cash dividend of \$0.15 per share for a total of \$5.8 million, which was accrued in other current liabilities as of June 30, 2014.

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

Under the 2004 Equity Plan, RSU awards contain rights to receive dividend equivalents, which entitle employees who hold RSUs to the same dividend value per share as holders of common stock. The dividend equivalents are accrued quarterly during the vesting periods of the RSUs and paid to the employees when the awards vest. Dividend equivalents accrued on the RSUs are forfeited if the employees do not fulfill their service requirement during the vesting periods. As of June 30, 2014, the Company accrued \$0.3 million of dividend equivalents.

12. *Subsequent Event*

Acquisition

In July 2014, the Company completed the acquisition of Sensima Technology SA (“Sensima”), a company located in Switzerland that develops magnetic sensors for angle measurements as well as three-dimensional magnetic field sensing. The purchase consideration consists of an upfront cash payment of \$11.7 million and a cash earn-out payment of up to \$8.9 million that is contingent upon Sensima achieving certain new product development and revenue goals through 2016. In addition, key employees are eligible to receive \$1.7 million of time-based RSUs and up to \$8.0 million of performance-based RSUs in connection with the transaction.

The initial accounting for the acquisition is still ongoing as of the date this Quarterly Report on Form 10-Q is issued. It is expected that intangible assets and goodwill will be recorded on the consolidated balance sheets; however, as the initial accounting for the acquisition has not been completed at the time of the issuance of these consolidated financial statements, further details have not yet been disclosed.

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

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

• the above-average industry growth of product and market areas that we have targeted,

- our plan to increase our revenue through the introduction of new products within our existing product families as well as in new product categories and families,

• our intention to exercise our purchase option with respect to our manufacturing facility in Chengdu, China,

• our belief that we will continue to incur significant legal expenses that vary with the level of activity in each of our legal proceedings,

• the effect of liquidity of our investments on our capital resources,

• the application of our products in the communications, storage and computing, consumer and industrial markets continuing to account for our revenue,

• estimates of our future liquidity requirements,

• the cyclical nature of the semiconductor industry,

• protection of our proprietary technology,

• near term business outlook for 2014 and beyond,

• the factors that we believe will impact our ability to achieve revenue growth,

- the outcome of the IRS audit of our tax returns,
- the percentage of our total revenue from various market segments,
- our intention and ability to continue the stock repurchase program and pay future cash dividends, and
- the factors that differentiate us from our competitors.

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

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

Overview

We are a fabless semiconductor company that designs, develops, and markets proprietary, advanced analog and mixed-signal semiconductors. Our products are used extensively in storage and computing products, network communications products, 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. Our revenue from direct or indirect sales to customers in Asia was 89% and 88% for the three and six months ended June 30, 2014, respectively. We derive a majority of our revenue from the sales of our DC to DC converter product family which services the communications, storage and computing, consumer and industrial markets. We believe our ability to achieve revenue growth will depend, in part, on our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity.

In July 2014, we completed the acquisition of Sensima Technology SA (“Sensima”), a company located in Switzerland that develops magnetic sensors for angle measurements as well as three-dimensional magnetic field sensing. The purchase consideration consists of an upfront cash payment of \$11.7 million and a cash earn-out payment of up to \$8.9 million that is contingent upon Sensima achieving certain new product development and revenue goals through 2016. In addition, key employees are eligible to receive \$1.7 million of time-based restricted stock units and up to \$8.0 million of performance-based restricted stock units in connection with the transaction. As our acquisition of Sensima closed in July 2014, the results of operations reported in this Quarterly Report on Form 10-Q did not include the results of operations of Sensima.

Critical Accounting Policies and Estimates

There have been no significant changes in our critical accounting policies and estimates used in the preparation of our financial statements during the three and six months ended June 30, 2014, as compared to those disclosed in the Annual Report on Form 10-K for the year ended December 31, 2013.

Results of Operations

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
	(in thousands, except percentages)				(in thousands, except percentages)			
Revenue	\$68,436	100.0%	\$57,714	100.0%	\$128,497	100.0%	\$109,184	100.0%
Cost of revenue	31,337	45.8	26,786	46.4	59,301	46.1	50,871	46.6
Gross profit	37,099	54.2	30,928	53.6	69,196	53.9	58,313	53.4
Operating expenses:								
Research and development	13,368	19.6	12,478	21.6	28,971	22.6	24,601	22.5
Selling, general and administrative	16,853	24.6	13,793	23.9	32,962	25.7	27,051	24.8
Litigation expense (benefit), net	274	0.4	(257)	(0.4)	(8,426)	(6.6)	(558)	(0.5)
Total operating expenses	30,495	44.6	26,014	45.1	53,507	41.7	51,094	46.8
Income from operations	6,604	9.6	4,914	8.5	15,689	12.2	7,219	6.6
Interest and other income, net	295	0.5	218	0.4	485	0.4	208	0.2
Income before income taxes	6,899	10.1	5,132	8.9	16,174	12.6	7,427	6.8
Income tax provision (benefit)	502	0.8	(357)	(0.6)	759	0.6	(562)	(0.5)
Net income	\$6,397	9.3 %	\$5,489	9.5 %	\$15,415	12.0 %	\$7,989	7.3 %

Revenue

The following table shows our revenue by product family:

Product Family	Three Months Ended June 30,					Six Months Ended June 30,				
	2014	% of Revenue	2013	% of Revenue	Change	2014	% of Revenue	2013	% of Revenue	Change
	(In thousands, except percentages)					(In thousands, except percentages)				
DC to DC products	\$61,173	89.4 %	\$50,536	87.6 %	21.0 %	\$115,108	89.6 %	\$96,978	88.8 %	18.7 %
Lighting control products	7,263	10.6 %	7,178	12.4 %	1.2 %	13,389	10.4 %	12,206	11.2 %	9.7 %
Total	\$68,436	100.0 %	\$57,714	100.0 %	18.6 %	\$128,497	100.0 %	\$109,184	100.0 %	17.7 %

Revenue for the three months ended June 30, 2014 was \$68.4 million, an increase of \$10.7 million, or 18.6%, from \$57.7 million for the three months ended June 30, 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 \$61.2 million for the three months ended June 30, 2014, an increase of \$10.6 million, or 21.0%, from the same period in 2013. This increase was primarily due to higher sales of our DC to DC converters and battery charger products, offset in part by lower sales of our Mini-Monsters products. Revenue from our lighting control products was \$7.3 million for the three months ended June 30, 2014, an increase of \$85,000, or 1.2%, compared with the same period in 2013.

Revenue for the six months ended June 30, 2014 was \$128.5 million, an increase of \$19.3 million, or 17.7%, from \$109.2 million for the six months ended June 30, 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 \$115.1 million for the six months ended June 30, 2014, an increase of \$18.1 million, or 18.7%, from the same period in 2013. This increase was primarily due to higher sales of our DC to DC converters and battery charger products, offset in part by lower sales of our Mini-Monsters products. Revenue from our lighting control products was \$13.4 million for the six months ended June 30, 2014, an increase of \$1.2 million, or 9.7%, compared with the same period in 2013. This increase was primarily due to higher sales of our LED lighting 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 warranty costs, inventory-related expenses and other overhead costs and stock-based compensation expenses.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	2013	Change	2014	2013	Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Cost of revenue	\$31,337	\$26,786	17.0 %	\$59,301	\$50,871	16.6 %
Cost of revenue as a percentage of revenue	45.8 %	46.4 %		46.1 %	46.6 %	
Gross profit	\$37,099	\$30,928	20.0 %	\$69,196	\$58,313	18.7 %
Gross margin	54.2 %	53.6 %		53.9 %	53.4 %	

Gross profit as a percentage of revenue, or gross margin, was 54.2% for the three months ended June 30, 2014, compared to 53.6% for the three months ended June 30, 2013. The increase in gross margin was primarily due to higher absorption of in-house test manufacturing overhead, compared to the same period in 2013. This increase was partially offset by a higher provision for inventory reserve.

Gross margin was 53.9% for the six months ended June 30, 2014, compared to 53.4% for the six months ended June 30, 2013. The increase in gross margin was primarily due to cost improvements and increased sales of higher margin products, compared to the same period in 2013. This increase was partially offset by a higher provision for inventory reserve.

Research and Development

Research and development expenses 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 June 30,			Six Months Ended June 30,		
	2014	2013	Change	2014	2013	Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Research and development ("R&D")	\$13,368	\$12,478	7.1 %	\$28,971	\$24,601	17.8 %
R&D as a percentage of revenue	19.6 %	21.6 %		22.6 %	22.5 %	

R&D expenses were \$13.4 million, or 19.6% of revenue, for the three months ended June 30, 2014 and \$12.5 million, or 21.6% of revenue, for the three months ended June 30, 2013. The increase in R&D expenses was primarily due to an increase in stock-based compensation expenses associated with the performance-based and market-based equity awards, higher salary and benefits expenses, and an increase in new product development expenses. This increase was partially offset by a decrease in accrued bonuses. Our R&D headcount was 463 employees as of June 30, 2014, compared with 438 employees as of June 30, 2013.

R&D expenses were \$29.0 million, or 22.6% of revenue, for the six months ended June 30, 2014 and \$24.6 million, or 22.5% of revenue, for the six months ended June 30, 2013. The increase in R&D 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 the year-over-year accrued bonuses, higher salary and benefits expenses, and an increase in new product development expenses.

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 June 30,			Six Months Ended June 30,		
	2014	2013	Change	2014	2013	Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Selling, general and administrative ("SG&A")	\$16,853	\$13,793	22.2 %	\$32,962	\$27,051	21.9 %
SG&A as a percentage of revenue	24.6 %	23.9 %		25.7 %	24.8 %	

SG&A expenses were \$16.9 million, or 24.6% of revenue, for the three months ended June 30, 2014 and \$13.8 million, or 23.9% of revenue, for the three months ended June 30, 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 commission expenses due to higher revenue, an increase in professional service fees primarily due to the acquisition of Sensima, and higher salary and benefits expenses. This increase was partially offset by a decrease in accrued bonuses. Our SG&A headcount was 256 employees as of June 30, 2014, compared with 251 employees as of June 30, 2013.

SG&A expenses were \$33.0 million, or 25.7% of revenue, for the six months ended June 30, 2014 and \$27.1 million, or 24.8% of revenue, for the six months ended June 30, 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 accrued bonuses, an increase in professional service fees primarily due to the acquisition of Sensima, and an increase in commission expenses due to higher revenue.

Litigation Expense (Benefit), Net

Net litigation expense was \$0.3 million for the three months ended June 30, 2014, compared to net litigation benefit of \$(0.3) million for the three months ended June 30, 2013. Net litigation benefit for the three months ended June 30, 2013 included \$0.4 million of proceeds received in connection with the settlement from Silergy Corporation. In addition, we incurred higher expenses in other litigation matters for the three months ended June 30, 2014 compared to the three months ended June 30, 2013.

Net litigation benefit was \$(8.4) million for the six months ended June 30, 2014, compared to net litigation benefit of \$(0.6) million for the six months ended June 30, 2013. The increase in net litigation benefit was primarily due to the recognition of the \$9.5 million award from the O2 Micro litigation, partially offset by \$0.5 million of additional legal fees incurred in connection with the final resolution of the litigation for the six months ended June 30, 2014. Net litigation benefit for the six months ended June 30, 2013 included \$0.8 million of proceeds received in connection with the settlement from Silergy Corporation. The increase in net litigation benefit for the six months ended June 30, 2014 was partially offset by higher expenses we incurred in other litigation matters, compared to the six months ended June 30, 2013.

Interest and Other Income, Net

For the three months ended June 30, 2014, interest and other income, net, was \$0.3 million, compared with \$0.2 million for the three months ended June 30, 2013. The increase in interest and other income, net, was primarily due to higher foreign exchange gains and interest income.

For the six months ended June 30, 2014, interest and other income, net, was \$0.5 million, compared with \$0.2 million for the six months ended June 30, 2013. The increase in interest and other income, net, was primarily due to higher foreign exchange gains and interest income.

Income Tax Provision (Benefit)

The income tax provision for the three and six months ended June 30, 2014 was \$0.5 million, or 7.3% of pre-tax income, and \$0.8 million, or 4.7% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because our foreign income was taxed at lower rates, and because of the benefit that we realized 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 and six months ended June 30, 2013 was \$(0.4) million, or (7.0%) of the pre-tax income, and \$(0.6) million, or (7.6%) of the pre-tax income, respectively. This differs from the federal statutory rate primarily because our foreign income was taxed at lower rates, and because of the benefit that we realized from the release of an income tax reserve where the statute of limitations expired and from stock option exercises and releases of RSUs.

Liquidity and Capital Resources

	June 30, 2014		December 31, 2013	
	(In thousands)			
Cash and cash equivalents	\$ 107,863		\$ 101,213	
Short-term investments	133,012		125,126	
Total cash, cash equivalents and short-term investments	\$ 240,875		\$ 226,339	
Percentage of total assets	62.3	%	61.4	%
Total current assets	\$ 306,297		\$ 292,086	
Total current liabilities	(41,970)		(38,489)	
Working capital	\$ 264,327		\$ 253,597	

As of June 30, 2014, we had cash and cash equivalents of \$107.9 million and short-term investments of \$133.0 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 June 30, 2014, \$74.5 million of cash and cash equivalents and \$17.0 million of short-term investments were held by our international subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to indefinitely reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

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

As of June 30, 2014, we had working capital of \$264.3 million, compared with working capital of \$253.6 million as of December 31, 2013. The \$10.7 million increase in working capital was due to a \$14.2 million increase in current assets, partially offset by a \$3.5 million increase in current liabilities. The increase in current assets was primarily due to an increase in cash and short-term investments, partially offset by a decrease in accounts receivable. The increase in current liabilities was primarily due to an increase in accounts payable and accrued compensation and related benefits, partially offset by a decrease in accrued liabilities.

Summary of Cash Flows

The following table summarizes our cash flow activities:

	Six Months Ended	
	June 30,	
	2014	2013
	(In thousands)	
Net cash provided by operating activities	\$37,588	\$22,217
Net cash used in investing activities	(16,410)	(13,361)
Net cash provided by (used in) financing activities	(14,370)	17,351
Effect of exchange rate changes on cash and cash equivalents	(158)	424
Net increase in cash and cash equivalents	\$6,650	\$26,631

For the six months ended June 30, 2014, net cash provided by operating activities was \$37.6 million, primarily due to our net income adjusted for certain non-cash items, including depreciation and amortization and stock-based compensation, and a decrease of \$0.3 million from the changes in our operating assets and liabilities. The decrease in accounts receivable was primarily attributable to timing of product shipments and cash collections. The increase in accounts payable was primarily driven by increased inventory purchases to meet anticipated future demand. The decrease in accrued liabilities was primarily driven by the release of the liability related to the O2 Micro litigation, partially offset by an increase in employee contributions to the deferred compensation plan. For the six months ended June 30, 2013, net cash provided by operating activities was \$22.2 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 product shipments and the timing of those shipments. The increase in inventories was primarily due to an increase in strategic wafer and die bank inventories as well as an increase in finished goods necessary to meet anticipated future demand.

For the six months ended June 30, 2014, net cash used in investing activities was \$16.4 million, primarily reflecting net purchases of short-term investments of \$8.1 million and purchases of property and equipment of \$6.0 million. For the six months ended June 30, 2013, net cash used in investing activities was \$13.4 million, reflecting \$10.8 million of equipment and software purchases and \$2.6 million of net purchases of short-term investments.

As of June 30, 2014, our investment portfolio included \$9.8 million in government-backed student loan auction-rate securities, net of impairment charges of \$402,000, of which \$372,000 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 six months ended June 30, 2014 and 2013, we redeemed \$0 and \$25,000 of auction-rate securities at par.

For the six months ended June 30, 2014, net cash used in financing activities was \$14.4 million, primarily reflecting \$23.8 million used in the repurchases of our common stock, partially offset by \$9.7 million of cash proceeds from stock option exercises and stock purchases through our employee stock purchase plan. Net cash provided by financing activities for the six months ended June 30, 2013 was \$17.4 million, primarily reflecting \$16.2 million of cash received from the exercise of stock options and \$1.2 million of cash received from 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 six months ended June 30, 2014, we repurchased a total of 646,000 shares for \$23.8 million, at an average price of \$36.86 per share. As of June 30, 2014, \$55.6 million remained available for future repurchases under the program.

In June 2014, the Board of Directors approved a dividend program pursuant to which we intend to pay quarterly cash dividends on our common stock. For the second quarter of 2014, the Board of Directors declared a cash dividend of \$0.15 per share for a total of \$5.8 million, which was accrued in other current liabilities as of June 30, 2014 and paid on July 15, 2014.

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

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

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

Contractual Obligations

We lease our research and development and sales offices in the United States, 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 June 30, 2014, the outstanding balance was \$26.5 million, compared with \$12.4 million as of December 31, 2013.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of June 30, 2014, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 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, we could have been liable to return a portion or all of the \$9.5 million to O2 Micro. Accordingly, we recorded the \$9.5 million as a current liability as of December 31, 2013.

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

ITEM 1A. RISK FACTORS

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

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

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

- our results of operations and financial performance;
- general economic, industry and market conditions worldwide;
- our ability to outperform the market, and outperform at a level that meets or exceeds our investors' expectations;
- whether our forward guidance meets the expectations of our investors;

- the depth and liquidity of the market for our common stock;
- developments generally affecting the semiconductor industry;
- commencement of or developments relating to our involvement in litigation;
- investor perceptions of us and our business strategies;
- changes in securities analysts' expectations or our failure to meet those expectations;
- actions by institutional or other large stockholders;
- terrorist acts or acts of war;
- actual or anticipated fluctuations in our results of operations;
- developments with respect to intellectual property rights;
- introduction of new products by us or our competitors;
- our sale of common stock or other securities in the future;
- conditions and trends in technology industries;
- changes in market valuation or earnings of our competitors;
- any mergers, acquisitions or divestitures of assets undertaken by us;
- government debt default;
- our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity;

our ability to increase our gross margins;

our ability to continue the stock repurchase program and pay quarterly cash dividends to stockholders; and

changes in the estimation of the future size and growth rate of our markets.

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

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

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

changes in general demand for electronic products as a result of worldwide macro-economic conditions;

changes in business conditions at our distributors, value-added resellers and/or end-customers;

changes in general economic conditions in the countries where our products are sold or used;

the timing of developments and related expenses in our litigation matters;

the possibility of lost business as a result of customer and prospective customer concerns about being litigation targets;

continued dependence on 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;

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;

• changes in general demand for electronic products as a result of worldwide macro-economic conditions;

- changes in revenue mix between OEMs, ODMs, distributors and value-added resellers;

• changes in product mix and actual and potential product liability;

• changes in revenue mix between end market segments (i.e. communication, storage and computing, consumer and industrial);

• our competition, which could adversely impact our selling prices and our potential sales;

• our manufacturing costs, including our ability to negotiate with our vendors and our ability to efficiently run our test facility in China;

• manufacturing capacity constraints;

• settlements of tax audits;

• stock-based compensation accounting charges; and

• our operating expenses, including general and administrative expenses, selling and marketing expenses, and research and development expenses relating to products that will not be introduced and will not generate revenue until later periods, if at all.

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

We may not experience growth rates comparable to past years.

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

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

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

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

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

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

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

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

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

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

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

- timely and efficient completion of process design and device structure improvements;

- timely and efficient implementation of manufacturing, assembly, and test processes;

- the ability to secure and effectively utilize fabrication capacity in different geometries;

- product performance;

- product availability;

- product quality and reliability; and

- effective marketing, sales and service.

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

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

We derive most of our revenue from customers located in Asia through direct sales or indirect sales through distribution arrangements and value-added reseller agreements with parties located in Asia. As a result, we are subject to increased risks due to this geographic concentration of business and operations. For the three months ended June 30, 2014, approximately 89% of our revenue was from customers in Asia. There are risks inherent in doing business in Asia, and internationally in general, including:

- changes in, or impositions of, legislative or regulatory requirements, including tax laws in the United States and in the countries in which we manufacture or sell our products;

- trade restrictions, including restrictions imposed by the United States on trading with parties in foreign countries;

- currency exchange rate fluctuations impacting intra-company transactions;

- transportation delays;

- changes in tax regulations in China that may impact our tax status in Chengdu;

- multi-tiered distribution channels that lack visibility to end customer pricing and purchase patterns;

- international political relationships and threats of war;

- terrorism and threats of terrorism;

- epidemics and illnesses;

- work stoppages and infrastructure problems due to adverse weather conditions or natural disasters;
- work stoppages related to employee dissatisfaction;
- economic, social and political instability;
- changes in import/export regulations, tariffs, and freight rates;
- longer accounts receivable collection cycles and difficulties in collecting accounts receivables;
- enforcing contracts generally; and
- less effective protection of intellectual property and contractual arrangements.

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

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

Historically, we have generated most of our revenue from a limited number of customers. For example, as a result of consolidations in recent years among distributors, sales to our two largest distributors accounted for approximately 26% and 9% of our total revenue for the three months ended June 30, 2014. We continue to rely on a limited number of customers for a significant portion of our revenue. Because we rely on a limited number of customers for significant percentages of our revenue, a decrease in demand for our products from any of our major customers for any reason (including due to market conditions, catastrophic events or otherwise) could have a materially adverse impact on our financial conditions and results of operations.

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

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

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

We market our products through distribution arrangements and value-added resellers and through our direct sales and applications support organization to customers that include OEMs, ODMs and EMSs. Receivables from our customers are generally not secured by any type of collateral and are subject to the risk of being uncollectible. As a result of consolidations in recent years among distributors, sales to our two largest distributors accounted for approximately 26% and 9% of our total revenue for the three months ended June 30, 2014. Significant deterioration in the liquidity or financial condition of any of our major customers or any group of our customers could have a material adverse impact on the collectability of our accounts receivable and our future operating results. We primarily conduct our sales on a purchase order basis, and we do not have any long-term supply commitments.

Moreover, we believe a high percentage of our products are eventually sold to a number of OEMs. Although we communicate with OEMs in an attempt to achieve “design wins,” which are decisions by OEMs and/or ODMs to incorporate our products, we do not have purchase commitments from these end users. Therefore, there can be no assurance that the OEMs and/or ODMs will continue to incorporate our ICs into their products. OEM technical specifications and requirements can change rapidly, and we may not have products that fit new specifications from an end-customer for whom we have had previous design wins. We cannot be certain that we will continue to achieve design wins from large OEMs, that our direct customers will continue to be successful in selling to the OEMs, or that

the OEMs will be successful in selling products which incorporate our ICs. The loss of any significant customer, any material reduction in orders by any of our significant customers or by their OEM customers, the cancellation of a significant customer order, or the cancellation or delay of a customer's or OEM's significant program or product could reduce our revenue and adversely affect our operations and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

- the costs and expense associated with such activities;

- the availability of modern foundries to be developed, acquired, leased or otherwise made available to us or our third-party suppliers;

- the ability of foundries and our third-party suppliers to obtain the advanced equipment used in the production of our products;

- delays in bringing new foundry operations online to meet increased product demand; and

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

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

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

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

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

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

The IRS also audited the research and development credits carried forward into year 2005 and the credits generated in the years 2005 through 2007. We received a NOPA from the IRS in February 2011, proposing to reduce the research

and development credits generated in year 2005 through 2007 and the carryforwards, which would then reduce the value of such credits carried forward to subsequent tax years.

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

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

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

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

Due to the complexity associated with the calculation of our tax provision, we have hired independent tax advisors to assist us in the calculation. If we or our independent tax advisors fail to resolve or fully understand certain issues that we may have had in the past and issues that may arise in the future, we could be subject to errors, which would result in us having to restate our financial statements. For example, because of the complexity of our tax structure, we have had errors in our financial statements in the calculation of our tax provision that previously resulted in restatements of our 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

June 30, 2014, \$10.3 million of our auction-rate security investments have failed to reset through successful auctions and it is unclear as to when these investments will regain their liquidity. The underlying maturity of these auction-rate securities is up to 34 years.

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

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

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

Effective internal control over financial reporting is necessary for us to provide reliable and accurate financial reports. If we cannot provide reliable financial reports or prevent fraud or other financial misconduct, our business and operating results could be harmed. Our failure to implement and maintain effective internal control over financial reporting could result in a material misstatement of our financial statements or otherwise cause us to fail to meet our financial reporting obligations. This, in turn, could result in a loss of investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our results of operations and/or have a negative impact on the trading price of our common stock, and could subject us to stockholder litigation. For example, because of the complexity of our tax structure, 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. If the value of the renminbi rises against the U.S. Dollar, there could be an increase in our manufacturing costs relative to competitors who have manufacturing facilities located in the U.S., which could adversely affect our operations. In addition, because we collect payments from all customers in U.S. dollars, fluctuations in the value of foreign currencies could have an adverse impact on our customers' business, which could negatively impact our business and results of operations.

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

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

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

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

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

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

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

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

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

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

The introduction of new products presents significant business challenges because product development plans and expenditures must be made up to two years or more in advance of any sales. It takes us up to 12 months or more to

design and manufacture a new product prototype. Only after we have a prototype do we introduce the product to the market and begin selling efforts in an attempt to achieve design wins. This sales process requires us to expend significant sales and marketing resources without any assurance of success. Volume production of products that use our ICs, if any, may not be achieved for an additional period of time after an initial sale. Sales cycles for our products are lengthy for a number of reasons, including:

- our customers usually complete an in-depth technical evaluation of our products before they place a purchase order;

- the commercial adoption of our products by OEMs and ODMs is typically limited during the initial release of their product to evaluate product performance and consumer demand;

- our products must be designed into our customers' products or systems; and

- the development and commercial introduction of our customers' products incorporating new technologies frequently are delayed.

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

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

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

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

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

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

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

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

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

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

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

As a part of our business strategy, from time to time we review acquisition prospects that would complement our current product offerings, enhance our design capability or offer other competitive opportunities. For example, we completed our acquisition of Sensima Technology SA in July 2014 that will further our diversification strategy and create new opportunities with key customers. In the event of 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, such as the Sensima acquisition, 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.

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

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

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

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

Issuer Purchases of Equity Securities

Stock repurchase activities during the three months ended June 30, 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)
April 1 - April 30	111,899	\$ 37.12	111,899	
May 1 - May 31	109,890	\$ 37.81	109,890	
June 1 - June 30	99,975	\$ 41.30	99,975	
Total	321,764	\$ 38.65	321,764	\$ 55,589

(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

10.1 2004 Equity Incentive Plan (as Amended June 2014).

31.1

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Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

SIGNATURES

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

MONOLITHIC POWER SYSTEMS, INC.

Dated: July 29, 2014

/s/ MEERA RAO

Meera Rao

Chief Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting Officer)

EXHIBIT INDEX

10.1 2004 Equity Incentive Plan (as Amended June 2014).

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

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