

MONOLITHIC POWER SYSTEMS INC
Form 10-Q
May 08, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware
(State or other jurisdiction of
incorporation or organization)

77-0466789
(I.R.S. Employer
Identification Number)

79 Great Oaks Boulevard, San Jose, CA 95119 (408) 826-0600
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE AND TELEPHONE NUMBER)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

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

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

There were 34,556,346 shares of the registrant’s common stock issued and outstanding as of April 30, 2012.

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 and share amounts)
 (Unaudited)

	March 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 78,731	\$ 96,371
Short-term investments	102,197	77,827
Accounts receivable, net of allowances of \$5 in 2012 and 2011	19,947	15,097
Inventories	21,547	20,104
Deferred income tax assets, net - current	646	421
Prepaid expenses and other current assets	2,352	1,685
Total current assets	225,420	211,505
Property and equipment, net	51,437	47,794
Long-term investments	13,665	13,675
Deferred income tax assets, net - long-term	19	239
Other assets	639	654
Total assets	\$ 291,180	\$ 273,867
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 14,573	\$ 8,904
Accrued compensation and related benefits	6,746	9,321
Accrued liabilities	10,150	7,845
Total current liabilities	31,469	26,070
Non-current income tax liabilities	4,930	4,920
Total liabilities	36,399	30,990
Stockholders' equity:		
Common stock, \$0.001 par value, \$34 in 2012 and 2011; shares authorized: 150,000,000; shares issued and outstanding: 34,410,896 and 33,826,032 in 2012 and 2011, respectively	167,773	159,336
Retained earnings	82,943	79,948
Accumulated other comprehensive income	4,065	3,593
Total stockholders' equity	254,781	242,877
Total liabilities and stockholders' equity	\$ 291,180	\$ 273,867

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended March 31,	
	2012	2011
Revenue	\$50,484	\$44,468
Cost of revenue (1)	24,074	22,163
Gross profit	26,410	22,305
Operating expenses:		
Research and development (2)	11,118	10,086
Selling, general and administrative (3)	11,966	9,490
Litigation expense	128	813
Total operating expenses	23,212	20,389
Income from operations	3,198	1,916
Other income (expense):		
Interest and other income	157	271
Interest and other expense	(51)	(88)
Total other income, net	106	183
Income before income taxes	3,304	2,099
Income tax provision	309	206
Net income	\$2,995	\$1,893
Basic net income per share	\$0.09	\$0.05
Diluted net income per share	\$0.08	\$0.05
Weighted average common shares outstanding:		
Basic	34,105	35,024
Diluted	35,538	36,105
(1) Includes stock-based compensation expense	\$95	\$63
(2) Includes stock-based compensation expense	1,266	1,427
(3) Includes stock-based compensation expense	1,954	1,497
Total stock-based compensation expense	\$3,315	\$2,987

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended March 31,	
	2012	2011
Net income	\$2,995	\$1,893
Other comprehensive income (loss):		
Auction-rate securities valuation reserve adjustment	90	140
Unrealized gain/ (loss) on available-for-sale securities	(16)	(7)
Foreign currency translation adjustments	398	154
Comprehensive income	\$3,467	\$2,180

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income	\$2,995	\$1,893
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,184	2,270
Loss on disposal of property and equipment	74	-
Amortization and realized gain on debt instruments	28	183
Deferred income tax assets	(2)	-
Tax benefit from stock option transactions	649	1,472
Excess tax benefit from stock option transactions	(100)	(435)
Stock-based compensation	3,315	2,987
Changes in operating assets and liabilities:		
Accounts receivable	(4,849)	705
Inventories	(1,443)	2,679
Prepaid expenses and other current assets	97	(345)
Accounts payable	4,098	1,299
Accrued and other long-term liabilities	2,207	(347)
Accrued income taxes payable and noncurrent tax liabilities	(432)	(1,037)
Accrued compensation and related benefits	(2,602)	(3,094)
Net cash provided by operating activities	6,219	8,230
Cash flows from investing activities:		
Property and equipment purchases	(4,875)	(3,056)
Purchases of short-term investments	(49,415)	(15,968)
Proceeds from sale of short-term investments	25,000	43,530
Proceeds from sale of long-term investments	100	2,050
Net cash provided by (used in) investing activities	(29,190)	26,556
Cash flows from financing activities:		
Proceeds from issuance of common stock	3,985	3,527
Proceeds from employee stock purchase plan	1,036	928
Repurchase of common stock	-	(13,710)
Excess tax benefits from stock option transactions	100	435
Net cash provided by (used in) financing activities	5,121	(8,820)
Effect of change in exchange rates	210	86
Net increase (decrease) in cash and cash equivalents	(17,640)	26,052
Cash and cash equivalents, beginning of period	96,371	48,010
Cash and cash equivalents, end of period	\$78,731	\$74,062
Supplemental disclosures for cash flow information:		
Cash paid for taxes	\$125	\$100

Supplemental disclosures of non-cash investing and financing activities:

Liability accrued for equipment purchases	\$3,099	\$3,464
Temporary impairment reversal of auction-rate securities	\$(90) \$(140

See accompanying notes to condensed consolidated financial statements.

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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 its Form 10-K filed with the SEC on March 12, 2012.

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, 2012 or for any other future period.

Recently Adopted Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820) – Fair Value Measurement (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. The ASU is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2011 and should be applied prospectively. The Company adopted this standard effective January 1, 2012.

In June 2011, the FASB issued ASU No. 2011-05 relating to Comprehensive Income (Topic 220) – Presentation of Comprehensive Income (ASU 2011-05), which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The ASU is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2011 and must be applied retrospectively. The Company adopted this standard effective January 1, 2012.

2. Stock-Based Compensation — The Company has two stock option plans and an employee stock purchase plan—the 1998 Stock Option Plan, the 2004 Equity Incentive Plan and the 2004 Employee Stock Purchase Plan. The Company recognized stock-based compensation expenses for the three months ended March 31, 2012 and 2011, as follows (in thousands):

	Three months ended March 31,	
	2012	2011
Non-Employee	\$ 5	\$ 4
ESPP	211	152
Restricted Stock	2,180	1,163
Stock Options	919	1,668
TOTAL	\$ 3,315	\$ 2,987

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued) (Unaudited)

2004 Equity Incentive Plan

The Company's Board of Directors adopted the Company's 2004 Equity Incentive Plan in March 2004, and the Company's stockholders approved it in November 2004. Options granted under the 2004 Plan have a maximum term of ten years. New hire grants generally vest over four years at the rate of 25 percent one year from the date of grant and 1/48th monthly thereafter. Refresh grants generally vest over four years at the rate of 50 percent two years from the date of grant and 1/48th monthly thereafter. There were 800,000 shares initially reserved for issuance under the 2004 Plan. The 2004 Plan provides for annual increases in the number of shares available for issuance beginning on January 1, 2005 equal to the least of: 5% of the outstanding shares of common stock on the first day of the year, 2,400,000 shares, or a number of shares determined by the Board of Directors. The following is a summary of the 2004 Plan, which includes stock options and restricted stock awards and units:

Available for Grant as of December 31, 2011	4,291,737
2012 Additions to Plan	1,641,301
2012 Grants	(462,781)
2012 Cancellations	31,210
Available for Grant as of March 31, 2012	5,501,467

A summary of the status of the Company's stock option plans at March 31, 2012 and changes during the three months then ended is presented in the table below:

	Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2011 (4,202,786 options exercisable at a weighted-average exercise price of \$15.05 per share)	4,863,239	\$15.31	3.44	\$8,817,049
Options granted (weighted-average fair value of \$6.69 per share)	7,000	15.96		
Options exercised	(367,100)	10.86		
Options forfeited and expired	(10,435)	19.75		
Outstanding at March 31, 2012	4,492,704	15.67	3.24	20,443,562
Options exercisable at March 31, 2012 and expected to become exercisable	4,457,906	15.66	3.22	20,307,960
Options vested and exercisable at March 31, 2012	3,979,612	\$15.53	3.04	\$18,590,366

The total fair value of options that vested during the three months ended March 31, 2012 and 2011 was \$0.9 million and \$1.7 million, respectively. The total intrinsic value of options exercised during the three months ended March 31, 2012 and 2011 was \$2.8 million and \$4.7 million, respectively. Net cash proceeds from the exercise of stock options were \$4.0 million for the three months ended March 31, 2012 and \$3.5 million for the three months ended March 31, 2011. At March 31, 2012, unamortized compensation expense related to unvested options was approximately \$3.3 million, net of estimated forfeitures. The weighted average period over which compensation expense related to these

options will be recognized is approximately 1.8 years.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued) (Unaudited)

The employee stock-based compensation expense recognized under Accounting Standards Codification (“ASC”) 718-10-30 Compensation – Stock Compensation – Overall - Initial Measurement, was determined using the Black-Scholes option pricing model. Option pricing models require the input of subjective assumptions and these assumptions can vary over time. The Company used the following weighted-average assumptions to determine the fair values of stock option awards granted during the three months ended March 31, 2012 and 2011:

	Three months ended March 31,	
	2012	2011
Expected term (years)	4.1	4.1
Expected volatility	53.4 %	52.9 %
Risk-free interest rate	0.6 %	1.7 %
Dividend yield	-	-

In estimating the expected term, the Company considers its historical stock option exercise experience, post vesting cancellations and remaining contractual term of the options outstanding. In estimating the expected volatility, the Company uses its own historical data to determine its estimated expected volatility. The Company uses the U.S. Treasury constant maturity yield based on the expected term for its risk-free interest rate and a dividend yield of zero as it does not issue dividends. The Company applies a forfeiture rate that is based on options that have been forfeited historically.

Restricted Stock

The Company grants restricted stock units, which vest generally over four years as determined by the Company’s Compensation Committee, and are issued upon vesting. Before vesting, these restricted stock units are not eligible for dividends, if and when declared. A summary of the restricted stock units is presented in the table below:

	Restricted Stock Units	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Recognition Period (Years)
Outstanding at December 31, 2011	1,299,556	\$ 16.87	2.71
Awards granted	455,781	17.53	
Awards released	(120,517)	17.38	
Awards forfeited	(20,775)	18.17	
Outstanding at March 31, 2012	1,614,045	\$ 17.00	2.45

The total fair value of restricted stock units that vested was \$2.2 million for the three months ended March 31, 2012 and \$2.5 million for the three months ended March 31, 2011. The intrinsic value related to restricted stock units released for the three months ended March 31, 2012 and 2011 was \$2.0 million and \$1.6 million, respectively. The intrinsic value related to restricted stock units outstanding at March 31, 2012 and 2011 was \$31.7 million and \$26.8 million, respectively. At March 31, 2012, the unamortized compensation expense related to unvested restricted stock units was approximately \$18.9 million, net of estimated forfeitures, with a weighted average remaining recognition period of 2.5 years.

On February 25, 2010, the Board granted 416,000 performance units to the Company's executive officers. These performance units generally vest over four years, with a graded acceleration feature that allows all or a portion of these awards to be accelerated if certain performance conditions are satisfied. The amount of shares to be accelerated is based on achieving certain performance targets, with the minimal acceleration occurring if performance exceeds at least 110% of non-GAAP earnings per share as set forth in the Company's annual operating plan approved by the Board, as determined by the Compensation Committee in its sole discretion. The Compensation Committee has the discretion not to accelerate any shares, if it so chooses, even if the performance targets are met. To date, none of the shares have been accelerated.

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On February 14, 2012, the Board granted 413,000 Restricted Stock Units (“RSUs”) to the Company’s executive officers. Fifty percent of RSUs granted to Company’s executive officers will vest over two years on a quarterly basis (“Time-based RSUs”) and 50% of their units will be a target number of RSUs awarded upon achievement of a pre-determined target for the Company’s revenue in 2013 (“Performance-based RSUs”). Half of Performance-based RSUs will vest when earned with the remainder vesting during the following two years on a quarterly basis. The Performance-based RSUs earned will be reduced in the event that the Company’s total shareholder return (“TSR”), defined as the cumulative change in share price plus dividends, as compared to the Company’s compensation peer group is below a specified percentile for calendar years 2012 and 2013.

2004 Employee Stock Purchase Plan

Under the 2004 Employee Stock Purchase Plan (the Purchase Plan), eligible employees may purchase common stock through payroll deductions. Participants may not purchase more than 2,000 shares in a six-month offering period or stock having a value greater than \$25,000 in any calendar year as measured at the beginning of the offering period in accordance with the Internal Revenue Code and applicable Treasury Regulations. A total of 200,000 shares of common stock were reserved for issuance under the Purchase Plan. The Purchase Plan provides for an automatic annual increase beginning on January 1, 2005 by an amount equal to the least of: 1,000,000 shares, 2% of the outstanding shares of common stock on the first day of the year, or a number of shares as determined by the Board of Directors. For the three months ended March 31, 2012 and 2011, 97,247 shares and 70,685 shares, respectively, were issued under the Purchase Plan. The following is a summary of the Purchase Plan and changes during the three months ended March 31, 2012:

Available Shares as of December 31, 2011	3,693,210
2012 Additions to Plan	676,520
2012 Purchases	(97,247)
Available Shares as of March 31, 2012	4,272,483

The Purchase Plan is considered compensatory under ASC 718-50-25, Compensation – Stock Compensation - Employee Share Purchase Plans - Recognition, and is accounted for in accordance with ASC 718-50-30 Compensation – Stock Compensation - Employee Share Purchase Plans - Initial Measurement - Look-Back Plans. The intrinsic value for stock purchased was \$0.7 million and \$0.2 million for each of the three months ended March 31, 2012 and 2011, respectively. The unamortized expense as of March 31, 2012 was \$0.3 million, which will be recognized over 0.4 years. The Black-Scholes option pricing model was used to value the employee stock purchase rights. For the three months ended March 31, 2012 and 2011, the following weighted average assumptions were used in the valuation of the stock purchase rights:

	Three months ended March 31,			
	2012		2011	
Expected term (years)	0.5		0.5	
Expected volatility	50.7	%	37.5	%
Risk-free interest rate	0.1	%	0.2	%
Dividend yield	-		-	

Cash proceeds from employee stock purchases for each of the three months ended March 31, 2012 and 2011 was \$1.0 million and \$0.9 million, respectively.

3. Inventories - Inventories consist of the following (in thousands):

March 31, 2012 December 31, 2011

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Work in progress	\$	14,595	\$	11,596
Finished goods		6,952		8,508
Total inventories	\$	21,547	\$	20,104

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued) (Unaudited)

4. Accrued Liabilities- Accrued liabilities consist of the following (in thousands):

	March 31, 2012	December 31, 2011
Deferred revenue and customer prepayments	\$ 5,625	\$ 3,603
Stock rotation reserve	1,573	1,086
Legal expenses and settlement costs	723	911
Warranty	573	561
Other	1,656	1,684
Total accrued liabilities	\$ 10,150	\$ 7,845

A roll-forward of the warranty reserve for the three months ended March 31, 2012 and 2011 is as follows (in thousands):

	Three months ended March 31, 2012	2011
Balance at beginning of year	\$ 561	\$ 764
Warranty costs	(6)	(296)
Unused warranty provision	(83)	(121)
Warranty provision for product sales	101	116
Balance at end of period	\$ 573	\$ 463

5. Net Income per Share — Basic net income per share excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share is calculated using the treasury stock method and reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock. For the three months ended March 31, 2012 and 2011, the Company had securities outstanding, which could potentially dilute basic net income per share in the future, but were excluded from the computation of diluted net income per share in the periods presented, as their effect would have been anti-dilutive. The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three months ended March 31, 2012	2011
Numerator:		
Net income	\$ 2,995	\$ 1,893
Denominator:		
Weighted average outstanding shares used to compute basic net income per share	34,105	35,024
Effect of dilutive securities	1,433	1,081
Weighted average outstanding shares used to compute diluted net income per share	35,538	36,105
Net income per share - basic	\$ 0.09	\$ 0.05
Net income per share - diluted	\$ 0.08	\$ 0.05

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued) (Unaudited)

For the three months ended March 31, 2012 and 2011, approximately 2.1 million and 4.7 million common stock equivalents, respectively, were excluded from the calculation of diluted net income per share because their inclusion would have been anti-dilutive.

6. Segment Information

As defined by the requirements of ASC 280-10-50 Segment Reporting – Overall - Disclosure, 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, computing, consumer, and industrial markets. Geographic revenue is based on the location to which customer shipments are delivered. For the three months ended March 31, 2012 and 2011, the Company derived substantially all of its revenue from sales to customers located outside North America. The following is a list of customers whose sales exceeded 10% of revenue for the three months ended March 31, 2012 and 2011.

Customers	Three months ended March 31,			
	2012		2011	
A	15	%	16	%
B	14	%	*	

(*) represents less than 10%

The following is a summary of revenue by geographic region based on customer ship-to location (in thousands):

Country	Three months ended March 31,	
	2012	2011
China	\$ 29,093	\$ 23,677
Taiwan	6,415	5,129
Korea	1,959	4,427
Europe	4,190	3,475
Japan	2,306	2,978
USA	1,112	1,106
Other	5,409	3,676
Total	\$ 50,484	\$ 44,468

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

Product Family	Three months ended March 31,	
	2012	2011
DC to DC Converters	\$ 44,342	\$ 38,580
Lighting Control Products	6,142	5,888
Total	\$ 50,484	\$ 44,468

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued) (Unaudited)

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

	March 31, 2012	December 31, 2011
China	\$ 32,333	\$ 32,566
United States	19,533	15,662
Taiwan	98	98
Japan	64	70
Other	48	51
TOTAL	\$ 52,076	\$ 48,447

On July 8, 2011, the Company purchased the property located at 79 Great Oaks Boulevard in San Jose, California, to be used as its new headquarters and sales offices. The property consists of an approximately 106,262 square foot office building and approximately 5.5 acres of land. The \$11.0 million purchase price for the property was allocated based on an independent third party valuation with \$5.0 million attributable to the building and \$6.0 million attributable to the land. The Company will begin to depreciate the building when it takes occupancy in May 2012. The increase of \$3.9 million in the long-lived assets for the three months ended March 31, 2012 for the United States was primarily related to the building improvements at this new location. Buildings and building improvements have a depreciation life of up to 40 years.

7. Litigation

On September 16, 2011 and September 29, 2011, two nearly identical shareholder derivative actions were filed in the United States District Court for the Northern District of California and the California Superior Court for Santa Clara County, naming as defendants certain of the Company's current and former directors and officers and the Company's compensation advisory firm. The complaints assert claims for, among other things, breach of fiduciary duty in connection with the directors' approval of compensation for the Company's executive officers during 2010. The complaints each seek an award of damages in favor of the Company, equitable relief, costs and attorney's fees. On March 2, 2012, the parties in the state court action stipulated to the dismissal without prejudice of that action. On April 3, 2012, a hearing was held in the United States District Court on the defendants' motions to dismiss the case. The court has not yet ruled on the motions. The matters are at a preliminary stage at the United States District Court; the defendants have not yet responded to the complaint and no discovery has taken place. In management's opinion, the resolution of the derivative action filed in the United States District Court is uncertain and estimate of its effect cannot be made on our consolidated financial condition, results of operations or liquidity.

The Company and certain of its subsidiaries are parties to actions and proceedings incident to the Company's business in the ordinary course of business, including litigation regarding 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. In December 2011, the Company entered into a settlement and license agreement with a third-party company for infringement of the Company's patent whereby the Company will receive \$2 million which will be paid in equal installments of \$300,000 in each quarter of 2012 and the remainder will be paid in two equal installments in first two quarters of 2013. For the three months ended March 31, 2012, the Company received the first \$300,000 payment which was recorded as a credit to the litigation expenses in the Condensed Consolidated Statements of Operations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued) (Unaudited)

8. Fair Value Measurements

The following is a schedule of Company's cash and cash equivalents, short-term investments and long-term investments as of March 31, 2012 and December 31, 2011 (in thousands):

	Estimated Fair Market Value as of	
	March 31, 2012	December 31, 2011
	(In thousands)	
Cash, Cash Equivalents and Investments		
Cash in Banks	\$ 49,899	\$ 43,305
Money Market Funds	28,832	51,066
Government Agencies/ Treasuries	102,197	79,827
Auction-Rate Securities backed by Student-Loan Notes	13,665	13,675
Total Cash, Cash Equivalents and Investments	\$ 194,593	\$ 187,873

Reported as:

Cash and Cash Equivalents	\$ 78,731	\$ 96,371
Short-term Investments	102,197	77,827
Long-term Investments	13,665	13,675
Total Cash, Cash Equivalents and Investments	\$ 194,593	\$ 187,873

The contractual maturities of the Company's investments classified as available-for-sale as of March 31, 2012 and December 31, 2011 is as follows (in thousands):

	March 31, 2012	December 31, 2011
Less than 1 year	\$ 21,510	\$ 45,133
1 - 5 years	80,687	32,694
Greater than 5 years	13,665	13,675
	\$ 115,862	\$ 91,502

The following table details the fair value measurements as of March 31, 2012 and December 31, 2011 within the fair value hierarchy of the financial assets that are required to be recorded at fair value (in thousands):

Fair Value Measurements at March 31, 2012 Using				
		Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Money Market Funds	\$ 28,832	\$ 28,832	\$ -	\$ -
	102,197	-	102,197	-

US Treasuries and US Government

Agency Bonds

Auction-rate securities backed by students loan	13,665	-	-	13,665
	\$ 144,694	\$ 28,832	\$ 102,197	\$ 13,665

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Fair Value Measurements at December 31, 2011 Using				
	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	\$ 51,066	\$ 51,066	\$ -	\$ -
US Treasuries and US Government Agency Bonds	79,827	-	79,827	-
Long-term available-for-sale auction-rate securities	13,675	-	-	13,675
	\$ 144,568	\$ 51,066	\$ 79,827	\$ 13,675

At March 31, 2012, fixed income available-for-sale securities included \$102.2 million in US government agencies and treasuries, all of which was classified as short-term investments. The Company also had \$28.8 million invested in money market funds. From these investments, there was \$27,000 in unrealized losses. The impact of gross unrealized gains and losses was not material. At March 31, 2012, the Company also had \$14.3 million in face value of auction-rate securities, all of which are classified as long-term available-for-sale investments.

At December 31, 2011, fixed income available-for-sale securities include securities issued by government agencies and treasuries, \$77.8 million of which are classified as short-term investments and \$2.0 million which are classified as cash equivalents. The Company also had \$51.1 million invested in money market funds. At December 31, 2011, there was \$17,000 in unrealized losses from these investments. The impact of gross unrealized gains and losses was not material. At December 31, 2011, the Company also had \$14.4 million in face value of auction-rate securities, all of which are classified as long-term available-for-sale investments.

Temporary impairment charges are recorded in accumulated other comprehensive income (loss) within stockholders' equity and has no impact on net income. Other-than-temporary impairment exists when the entity has the intent to sell the security or it will more likely than not be required to sell the security before anticipated recovery or it does not expect to recover the entire amortized cost basis of the security. Other-than-temporary impairment charges are recorded in other income (expense) in the Condensed Consolidated Statement of Operations.

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

As of March 31, 2012				Fair Value of Investments in Unrealized Loss Position
	Adjusted Cost	Unrealized Gains or Losses	Total Fair Value	
Money Market Funds	\$28,832	\$-	\$28,832	\$ -
US Treasuries and US Government Agency Bonds	102,216	(19)	102,197	59,808

Auction-rate securities backed by Student-Loan Notes	14,205	(540)	13,665	13,665
	\$145,253	\$(559)	\$144,694	\$73,473

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	As of December 31, 2011			
	Adjusted Cost	Unrealized Gains or Losses	Total Fair Value	Fair Value of Investments in Unrealized Loss Position
Money Market Funds	\$51,066	\$-	\$51,066	\$ -
US Treasuries and US Government Agency Bonds	79,830	(3)	79,827	25,281
Auction-rate securities backed by Student-Loan Notes	14,305	(630)	13,675	13,675
	\$145,201	\$(633)	\$144,568	\$38,956

The Company's level 2 assets consist of U.S. treasuries, U.S. government agency bonds, corporate notes and commercial paper. 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 beginning and ending balances for the assets measured at fair value using significant unobservable inputs (Level 3) (in thousands):

	Auction-Rate Securities
Ending balances at December 31, 2011	\$ 13,675
Sales and Settlement at Par	(100)
Unrealized Gain	90
Ending balances at March 31, 2012	\$ 13,665

At March 31, 2012, the Company's investment portfolio included \$13.7 million in government-backed student loan auction-rate securities, net of impairment charges of \$0.6 million; of which, \$0.5 million was temporary and \$0.1 million was recorded other-than-temporary. This compares to an investment balance of auction-rate securities as of December 31, 2011 of \$13.7 million net of impairment charges of \$0.7 million; of which, \$0.6 million was temporary and \$0.1 million was recorded as other-than-temporary. The underlying maturity of these auction-rate securities is up to 36 years. As of March 31, 2012 and December 31, 2011 the portion of the impairment classified as temporary was based on the following analysis:

The decline in the fair value of these securities is not largely attributable to adverse conditions specifically related to these securities or to specific conditions in an industry or in a geographic area;

Management possesses both the intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value;

Management believes that it is more likely than not that the Company will not have to sell these securities before recovery of its cost basis;

Except for the credit loss of \$70,000 recognized during the year ended December 31, 2009 for the Company's holdings in auction rate securities described below, the Company does not believe that there is any additional credit loss associated with other auction-rate securities because the Company expects to recover the entire amortized cost basis;

The majority of the securities remain AAA rated, with \$6.3 million of the auction rate securities having been downgraded by Moody's to A3-Baa3, during the year ended December 31, 2009 and there have been no downgrades since;

All scheduled interest payments have been made pursuant to the reset terms and conditions; and All redemptions of auction-rate securities representing 63% of the original portfolio purchased by the Company in February 2008 have been at par.

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Based on the guidance of ASC 320-10-35 and ASC 320-10-50, the Company evaluated the potential credit loss of each of the auction-rate securities that are currently held by the Company. Based on such analysis, the Company determined that those securities that are not 100% Federal Family Education Loan Programs (“FFELPS”) guaranteed are potentially subject to credit risks based on the extent to which the underlying debt is collateralized and the security-specific student-loan default rates. The Company’s portfolio includes two such securities. The senior parity ratio for the two securities is approximately 106%. If, therefore, the student-loan default rate and borrowing rate for these issuers increases, the remaining balance in these trusts may not be sufficient to cover the senior debt. The Company therefore concluded that there is potential credit risk for these two securities and as such, used the discounted cash flow model to determine the amount of credit loss to be recorded. In valuing the potential credit loss, the following parameters were used: 20 year expected term, cash flows based on the 90 day t-bill rates for 20 year forwards and a risk premium of 5.9%, the amount of interest that the Company was receiving on these securities when the market was last active. As of March 31, 2012 and December 31, 2011, the potential credit loss associated with these securities was \$70,000, which the Company deemed other-than-temporary and had recorded in other expense in its Condensed Consolidated Statement of Operations during 2009. There have been no such losses since.

Unless a rights offering or other similar offer is made to redeem at par and accepted by the Company, the Company intends to hold the balance of these investments through successful auctions at par, which the Company believes could take approximately 2.0 years.

Determining the fair value of the auction-rate securities requires significant management judgment regarding projected future cash flows which will depend on many factors, including the quality of the underlying collateral, estimated time for liquidity including potential to be called or restructured, underlying final maturity, insurance guaranty and market conditions, among others. To determine the fair value of the auction-rate securities at December 31, 2011 and March 31, 2012, the Company used a discounted cash flow model, for which there are four unobservable inputs: estimated time-to-liquidity, discount rate, credit quality of the issuer and expected interest receipts. A significant increase in the time-to-liquidity or the discount rate inputs or a significant decrease in the credit quality of the issuer or the expected interest receipts inputs in isolation would result in a significantly lower fair value measurement.

The following are the values used in the discounted cash flow model:

	March 31, 2012	December 31, 2011
Time-to-Liquidity	24 months	24 months
Expected Return (Based on the requisite treasury rate, plus a contractual penalty rate)	1.8%	1.8%
Discount Rate (Based on the requisite LIBOR, the cost of debt and a liquidity risk premium)	2.8% - 7.6%, depending on the credit-rating of the security	3.1% - 7.9%, depending on the credit-rating of the security

If the auctions continue to fail, the liquidity of the Company’s investment portfolio may be negatively impacted and the value of its investment portfolio could decline.

9. Income Taxes

The income tax provision for the three months ended March 31, 2012 was \$0.3 million or 9.4% of the Company’s income before income taxes. This differs from the federal statutory rate of 34% primarily because the Company’s foreign income was taxed at lower rates and because of the benefit that the Company realized as a result of stock

option exercises and restricted units vested.

The income tax provision for the three months ended March 31, 2011 was \$0.2 million or 9.8% of the Company's income before income taxes. This differs from the federal statutory rate of 34% 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 the disqualifying disposition of incentive stock options and employee stock plan purchases.

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We are subject to examination of our income tax returns by the Internal Revenue Service ("IRS") and other tax authorities. Our U.S. Federal income tax returns for the years ended December 31, 2000 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 the Company and its international subsidiaries in 2004. In the NOPA, the IRS objected to the Company's allocation of certain litigation expenses between the Company and our international subsidiaries and the amount of "buy-in payments" made by our international subsidiaries to the Company in connection with the cost-sharing agreement, and proposed to increase our U.S. taxable income according to a few alternative methodologies. The methodology resulting in the largest potential adjustment could, if the IRS were to prevail on all matters in dispute, increase our potential federal and state income tax liabilities by up to \$37.0 million, plus interest and penalties, if any. In February 2012, the Company received a revised NOPA from the IRS (Revised NOPA). In this revised NOPA, the largest potential adjustment, if the IRS were to prevail on all matters in dispute, has decreased to \$10.5 million, plus interest and penalties, if any. On March 20, 2012, the Company received an examination report from IRS, commonly referred to as a "30-day letter", formally proposing adjustments to the taxable years 2005, 2006 and 2007. After receiving 30-day extension, the Company has until May 19, 2012, to respond to the 30-day letter. The IRS also audited the research and development credits generated in the years 2000 through 2007, and the carry forward of these credits to subsequent years. We received a NOPA from the IRS in February 2011, proposing to reduce the research and development credits generated in years 2000 through 2007, which would also reduce the value of such credits carried forward to subsequent tax years. We are currently reviewing these proposed adjustments as well. We regularly assess the likelihood of an adverse outcome resulting from such examinations to determine the adequacy of our provision for income taxes. We believe that the IRS's position in the NOPA is incorrect and that our tax returns for those years were correct as filed. We expect to contest these proposed adjustments vigorously. As of March 31, 2012, based on the technical merits of our tax return filing positions, we believe that it is more-likely-than-not that the benefit of such positions will be sustained upon the resolution of our audits resulting in no significant impact on our consolidated financial position and the results of operations and cash flows.

10. Stock Repurchase Program

On July 27, 2010, the Board of Directors approved a stock repurchase program that authorized MPS to repurchase up to \$50.0 million in the aggregate of its common stock between August 2, 2010 and December 31, 2011. In February 2011, the Board of Directors approved an increase from \$50.0 million to \$70.0 million. From August 2010 through June 2011, the Company repurchased 4,385,289 shares for a total of \$70.0 million. During the three months ended March 31, 2011, the following shares have been repurchased through the open market and subsequently retired:

Three months ended March 31, 2011				
	Shares Repurchased	Average Price per Share		Value (in thousands)
February 2011	817,500	\$	15.47	\$ 12,648
March 2011	75,000	\$	14.17	\$ 1,062
	892,500			\$ 13,710

11. Subsequent Events

On May 3, 2012, the United States District Court for the Northern District of California 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 is in addition to the approximately \$340,000 in taxable costs that the Court had earlier ordered O2 Micro to pay to the Company in connection with the same lawsuit.

O2 Micro filed complaints against the Company in both the United States International Trade Commission ("ITC") and the Northern District of California, alleging that the Company infringed four O2 Micro patents but then voluntarily dismissed three patents. In June 2010, the ITC found that the Company's products did not infringe O2 Micro's patent. Subsequently, O2 Micro unilaterally dismissed its infringement claims with prejudice, and granted the Company and its customers broad covenants not to sue in the district court case.

On March 3, 2011, the Court ordered O2 Micro to pay the Company \$339,315.13 in costs. The Court also found that "O2 Micro engaged in a vexatious litigation strategy and litigation misconduct," entitling the Company to its reasonable attorneys' fees. O2 Micro's vexatious litigation strategy consisted of filing lawsuits against the Company and its customers; only to dismiss them after substantial litigation had taken place. This allowed O2 Micro to damage the Company's business while avoiding trials at which the validity of its patents would be challenged.

Since that time, the Company submitted the documentation for its attorneys' fees and non-taxable costs. O2 Micro challenged those fees on various grounds. On May 3, 2012, the Court accepted the Company's figures and entered an order awarding \$8,419,429 in attorneys' fees, and \$663,151 in non-taxable costs, plus interest. The Court then entered judgment for the Company.

The Company anticipates that O2 Micro will appeal the Court's orders and the final judgment. These amounts will be recognized in the Consolidated Financial Statements of the company when all related appeals have been exhausted and collectibility is probable.

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 introduce additional new products within our existing product families as well as in new product categories and families,

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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 auction-rate securities on our liquidity and capital resources,

the application of our products in the Communications, Computing, Consumer and Industrial markets continuing to account for a majority of 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 2012,

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

the outcome of the IRS audit of our tax return for the tax years ended December 31, 2000 through 2007,

the percentage of our total revenue from various market segments, and

the factors that differentiate us from our competitors.

In some cases, words such as "would," "could," "may," "should," "predict," "potential," "targets," "continue," "anticipate," "expect," "intend," "plan," "believe," "seek," "estimate," "project," "forecast," "will," the negative of these terms or other variations of such terms and similar expressions relating to the future identify forward-looking statements. All forward-looking statements are based on our current outlook, expectations, estimates, projections, beliefs and plans or objectives about our business and our industry. These statements are not guarantees of future performance and are subject to risks and uncertainties. Actual events or results could differ materially and adversely from those expressed in any such forward-looking statements. Risks and uncertainties that could cause actual results to differ materially include those set forth throughout this quarterly report on Form 10-Q and, in particular, in the section entitled "Part II. Other Information; item 1A. Risk Factors". Except as required by law, we disclaim any duty to and undertake no obligation to update any forward-looking statements, whether as a result of new information relating to existing conditions, future events or otherwise or to release publicly the results of any future revisions we may make to forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are cautioned not to place undue reliance on such statements, which speak only as of the date of this quarterly report on Form 10-Q. Readers should carefully review future reports and documents that we file from time to time with the Securities and Exchange Commission, such as our annual reports on Form 10-K and any current reports on Form 8-K. The following management's discussion and analysis should be read in connection with the information presented in our unaudited condensed consolidated financial statements and related notes for the three months ended March 31, 2012 included in this report and our audited consolidated financial statements and related notes for the year ended December 31, 2011 included in our Annual Report on Form 10-K filed on March 12, 2012 with the Securities and Exchange Commission.

Overview

We are a fabless semiconductor company that designs, develops, and markets proprietary, advanced analog and mixed-signal semiconductors. We offer products that serve multiple markets, including flat panel televisions, wireless communications, telecommunications equipment, general consumer products, notebook computers, and set top boxes, among others. 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 to achieve revenue and volume production is usually achieved several months after we receive an initial customer order for a new product. 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.

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We derive most of our revenue from sales through distribution arrangements, or direct sales to customers in Asia, where the components we produce are incorporated into end-user product. Out of our total revenue, 89% of our revenue for both the quarters ended March 31, 2012 and 2011 was attributable to direct or indirect sales to customers in Asia. We derive a majority of our revenue from the sales of our DC to DC converter product family which services the Communications, Computing, Consumer and Industrial markets. We believe our ability to achieve revenue growth will depend, in part, on our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity.

Critical Accounting Policies and Estimates

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

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

Revenue Recognition. We recognize revenue in accordance with Financial Accounting Standards Board (“FASB”) – Accounting Standards Codification (“ASC”) 605-10-S25 Revenue Recognition – Overall – Recognition. ASC 605-10-S25 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectability is reasonably assured. Determination of criteria (3) and (4) are based on management’s judgment regarding the fixed nature of the fee charged for products delivered and the collectability of those fees. The application of these criteria has resulted in our generally recognizing revenue upon shipment (when title passes) to customers. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely impacted.

Approximately 80% of our sales for the three months ended March 31, 2012 are made through distributors with formal distribution agreements. These arrangements do not include any special payment terms (our normal payment terms are 30-45 days for our distributors), price protection or exchange rights. Returns are limited to our standard product warranty. Certain of our large distributors have contracts that include limited stock rotation rights that permit the return of a small percentage of the previous six months’ purchases in return for a compensating new order of equal or greater dollar value.

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

We maintain a sales reserve for stock rotation rights, which is based on historical experience of actual stock rotation returns on a per distributor basis, where available, and information related to products in the distribution channel. This

reserve is recorded at the time of sale. In the future, if we are unable to estimate our stock rotation returns accurately, we may not be able to recognize revenue from sales to our distributors based on when we sell inventory to our distributors. Instead, we may have to recognize revenue when the distributor sells through such inventory to an end-customer.

We generally recognize revenue upon shipment of products to the distributor for the following reasons (based on ASC 605-15-25-1 Revenue Recognition – Products – Recognition – Sales of Products When Right of Return Exists):

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

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If we enter into arrangements that have rights of return that are not estimable, we recognize revenue under such arrangements only after the distributor has sold our products to an end customer.

Approximately 8% of our sales for the three months ended March 31, 2012 are made through value-added resellers based on purchase orders rather than formal distribution arrangements. These value-added resellers do not receive any stock rotation rights and, as such, hold very little inventory, if any. We do not have a history of accepting returns from these value-added resellers.

The terms in a majority of our distribution agreements include the non-exclusive right to sell, and the agreement to use best efforts to promote and develop a market for, our products in certain regions of the world and the ability to terminate the distribution agreement by either party with up to three months notice. We provide a one year warranty against defects in materials and workmanship. Under this warranty, we will repair the goods, provide replacements at no charge, or, under certain circumstances, provide a refund to the customer for defective products. Estimated warranty returns and warranty costs are based on historical experience and are recorded at the time product revenue is recognized.

Two of the Company's U.S. distributors have distribution agreements where revenue is recognized upon sale by these distributors to their end customers because these distributors have certain rights of return which management believes are not estimable. The deferred revenue balance from these two distributors as of March 31, 2012 and December 31, 2011 was \$1.5 million and \$1.0 million, respectively.

Warranty Reserves. We currently provide a 12-month warranty against defects in materials and workmanship and will either repair the goods or provide replacement products at no charge to the customer for defective products. We record estimated warranty costs by product, which are based on historical experience over the preceding 12 months, at the time we recognize product revenue. Reserve requirements are recorded in the period of sale and are based on an assessment of the products sold with warranty and historical warranty costs incurred. As the complexity of our products increases, we could experience higher warranty claims relative to sales than we have previously experienced, and we may need to increase these estimated warranty reserves.

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

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

Our calculation of current and deferred tax assets and liabilities is based on certain estimates and judgments and involves dealing with uncertainties in the application of complex tax laws. Our estimates of current and deferred tax assets and liabilities may change based, in part, on added certainty or finality or uncertainty to an anticipated outcome, changes in accounting or tax laws in the U.S., or foreign jurisdictions where we operate, or changes in other facts or

circumstances. In addition, we recognize liabilities for potential U.S. and foreign income tax for uncertain income tax positions taken on our tax returns if it has less than a 50% likelihood of being sustained. If we determine that payment of these amounts is unnecessary or if the recorded tax liability is less than our current assessment, we may be required to recognize an income tax benefit or additional income tax expense in our financial statements in the period such determination is made. We have calculated our uncertain tax positions which were attributable to certain estimates and judgments primarily related to transfer pricing, cost sharing and our international tax structure exposure.

As of both March 31, 2012 and December 31, 2011, we had a valuation allowance of \$14.6 million attributable to management's determination that it is more likely than not that none of the deferred tax assets in the United States will be realized, except for certain deferred tax assets related to uncertain income tax positions. Should it be determined that all or part of the net deferred tax asset will not be realized in the future, an adjustment to increase the deferred tax asset valuation allowance will be charged to income in the period such determination is made. Likewise, in the event we were to determine that it is more likely than not that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the valuation allowance for the deferred tax asset would increase income in the period such determination was made.

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Contingencies. We and certain of our subsidiaries are parties to actions and proceedings incident to our business in the ordinary course of business, including litigation regarding our intellectual property, challenges to the enforceability or validity of our intellectual property and claims that our products infringe on the intellectual property rights of others. The pending proceedings involve complex questions of fact and law and will require the expenditure of significant funds and the diversion of other resources to prosecute and defend. In addition, from time to time, we become aware that we are subject to other contingent liabilities. When this occurs, we will evaluate the appropriate accounting for the potential contingent liabilities using ASC 450-20-25-2 Contingencies – Loss Contingencies - Recognition to determine whether a contingent liability should be recorded. In making this determination, management may, depending on the nature of the matter, consult with internal and external legal counsel and technical experts. Based on the facts and circumstances in each matter, we use our judgment to determine whether it is probable that a contingent loss has occurred and whether the amount of such loss can be estimated. If we determine a loss is probable and estimable, we record a contingent loss in accordance with ASC 450-20-25-2. In determining the amount of a contingent loss, we take into account advice received from experts for each specific matter regarding the status of legal proceedings, settlement negotiations (which may be ongoing), prior case history and other factors. Should the judgments and estimates made by management need to be adjusted as additional information becomes available, we may need to record additional contingent losses that could materially and adversely impact our results of operations. Alternatively, if the judgments and estimates made by management are adjusted, for example, if a particular contingent loss does not occur, the contingent loss recorded would be reversed which could result in a favorable impact on our results of operations.

Accounting for Stock-Based Compensation. We account for stock-based compensation under the provisions of ASC 718-10-30 Compensation – Stock Compensation – Overall – Initial Measurement. This standard requires us to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). We currently use the Black-Scholes option-pricing model to estimate the fair value of our share-based payments. The Black-Scholes option-pricing model is based on a number of assumptions, including historical volatility, expected life, risk-free interest rate and expected dividends. The amount of stock-based compensation that we recognize is also based on an expected forfeiture rate. If there is a difference between the forfeiture assumptions used in determining stock-based compensation costs and the actual forfeitures which become known over time, we may change the forfeiture rate, which could have a significant impact on our stock-based compensation expense.

Fair Value Instruments. ASC 820-10 Fair Value Measurements and Disclosures – Overall defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles in the United States of America, and requires that assets and liabilities carried at fair value be classified and disclosed in one of the three categories, as follows:

- a. Level 1: Quoted prices in active markets for identical assets;
- b. Level 2: Significant other observable inputs; and
- c. Level 3: Significant unobservable inputs.

ASC 820-10-35-51 Fair Value Measurement and Disclosure – Overall – Subsequent Measurement – Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly provides additional guidance for estimating fair value in accordance with ASC 820-10 Fair Value Measurements and Disclosures – Overall, when the volume and level of activity for the asset or liability have significantly decreased.

Our financial instruments include cash and cash equivalents and short-term and long-term investments. Cash equivalents are stated at cost, which approximates fair market value. Short-term and long-term investments are stated

at their fair market value.

The face value of our holdings in auction rate securities is \$14.3 million, all of which is classified as long-term available-for-sale investments.

Investments in available-for-sale securities are recorded at fair value, and unrealized gains or losses (that are deemed to be temporary) are recognized through shareholders' equity, as a component of accumulated other comprehensive income in our condensed consolidated balance sheet. We record an impairment charge to earnings when an available-for-sale investment has experienced a decline in value that is deemed to be other-than-temporary. Investments in trading securities are recorded at fair value and unrealized gains and losses are recognized in other income (expense) in our condensed consolidated statement of operations.

We adopted the provisions of ASC 320-10-35 Investments – Debt and Equity Securities – Overall – Subsequent Measurement and ASC 320-10-50 Investments – Debt and Equity Securities – Overall - Disclosure, effective April 1, 2009 and used the guidelines therein to determine whether the impairment is temporary or other-than temporary. Other-than-temporary impairment charges exist when the entity has the intent to sell the security or it will more likely than not be required to sell the security before anticipated recovery. During the year ended December 31, 2009, we recognized a credit loss of \$70,000, which was deemed to be other-than-temporary in other income (expense) in our Condensed Consolidated Statement of Operations. There have been no such losses since.

Based on certain assumptions described in Note 8, “Fair Value Measurements”, to our condensed consolidated financial statements and the Liquidity and Capital Resources section of “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this quarterly report on Form 10-Q, we recorded impairment charges on our holdings in auction-rate securities. The valuation of these securities is subject to fluctuations in the future, which will depend on many factors, including the collateral quality, potential to be called or restructured, underlying final maturity, insurance guaranty, liquidity and market conditions, among others.

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Results of Operations

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

	Three months ended March 31,			
	2012		2011	
Revenue	100.0	%	100.0	%
Cost of revenue	47.7	%	49.8	%
Gross profit	52.3	%	50.2	%
Operating expenses:				
Research and development	22.0	%	22.7	%
Selling, general and administrative	23.7	%	21.4	%
Litigation expense	0.3	%	1.8	%
Total operating expenses	46.0	%	45.9	%
Income from operations	6.3	%	4.3	%
Other income (expense):				
Interest and other income	0.3	%	0.6	%
Interest and other expense	(0.1	%)	(0.2	%)
Total other income, net	0.2	%	0.4	%
Income before income taxes	6.5	%	4.7	%
Income tax provision / (benefit)	0.6	%	0.4	%
Net income	5.9	%	4.3	%

Revenue.

	Three months ended March 31,			
	2012		2011	
	(in thousands)		Change	
Revenue	\$ 50,484		\$ 44,468	13.5 %

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Revenue for the three months ended March 31, 2012 was \$50.5 million, an increase of \$6.0 million, or 13.5%, from \$44.5 million for the three months ended March 31, 2011. This increase was primarily due to increased demand for our DC to DC converters. The revenue from our DC to DC converters was \$44.3 million, an increase of \$5.8 million, or 14.9% compared to the same period in 2011 primarily due to the increase in unit product shipment. The higher unit shipments in our DC to DC converter product line were primarily driven by an increase in demand for our DCDC and MNSTR products. Sales of our lighting control products were up 4% period over period. The following table illustrates changes in our revenue by product family:

	Three months ended March 31, 2012			2011				
	(in thousands) Amount	% of Revenue		(in thousands) Amount	% of Revenue		Change	
DC to DC Converters	\$ 44,342	87.8	%	\$ 38,580	86.8	%	14.9	%
Lighting Control Products	6,142	12.2	%	5,888	13.2	%	4.3	%
	\$ 50,484	100.0	%	\$ 44,468	100.0	%	13.5	%

Cost of Revenue and Gross Margin.

	Three months ended March 31, 2012			2011				
	(in thousands)						Change	
Cost of Revenue (1)	\$ 24,074			\$ 22,163			8.6	%
Cost of revenue as a percentage of revenue	47.7	%		49.8	%			
Gross Profit	\$ 26,410			\$ 22,305			18.4	%
Gross Profit Margin	52.3	%		50.2	%			
(1) Includes stock-based compensation expense	\$ 95			\$ 63				

Cost of revenue consists primarily of costs incurred to manufacture, assemble and test our products, as well as other overhead costs relating to the aforementioned costs including stock-based compensation expense. Gross Profit as a percentage of revenue, or gross profit margin, was 52.3% for the three months ended March 31, 2012 and 50.2% for the three months ended March 31, 2011. The 2.1 percentage point increase in gross profit margin was primarily due to higher absorption of in-house test manufacturing overhead on higher revenue in the three months ended March 31, 2012 as compared to the same period in 2011.

Research and Development.

	Three months ended March 31, 2012			2011				
	(in thousands)						Change	
Research and development ("R&D") (1)	\$ 11,118			\$ 10,086			10.2	%
R&D as a percentage of revenue	22.0	%		22.7	%			
(1) Includes stock-based compensation expense	\$ 1,266			\$ 1,427				

Research and development (R&D) expenses consist of salary and benefit expenses for design and product engineers, expenses related to new product development, and related facility costs. R&D expenses for the three months ended March 31, 2012 increased by \$1.0 million, or 10.2% compared to the R&D expenses incurred during the same period in 2011. This increase was primarily attributable to an increase in compensation related expenses. Our R&D head count as of March 31, 2012 was 387 employees as compared to 350 employees as of March 31, 2011.

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Selling, General and Administrative.

	Three months ended March 31,			
	2012		2011	
	(in thousands)		Change	
Selling, general and administrative ("SG&A")				
(1)	\$ 11,966		\$ 9,490	26.1 %
SG&A as a percentage of revenue	23.7	%	21.4	%
(1) Includes stock-based compensation expense	\$ 1,954		\$ 1,497	

Selling, general and administrative (SG&A) expenses include salary and benefit expenses for sales, marketing and administrative personnel, sales commissions, travel expenses, related facilities costs, outside legal and accounting fees, and fees associated with Sarbanes-Oxley compliance requirements. SG&A expense for the three months ended March 31, 2012 increased by \$2.5 million or 26.1% compared to the SG&A expense incurred during the same period in 2011. This increase was primarily attributable to the increased compensation related expenses including stock-based compensation expense, higher professional fees and increased sales commissions as a result of increase in revenue during three months ended March 31, 2012 as compared to the same period in 2011. Our SG&A head count as of March 31, 2012 was 242 employees as compared to 231 employees as of March 31, 2011.

Litigation Expense.

	Three months ended March 31,			
	2012		2011	
	(in thousands)		Change	
Litigation expense	\$ 128		\$ 813	(84.3) %
Litigation expense as a percentage of revenue	0.3	%	1.8	%

Litigation expenses decreased by \$0.7 million for the three months ended March 31, 2012, compared to the same period in 2011. This decrease was primarily due to lower litigation spending in the quarter plus the benefit of a \$0.3 million payment received under a settlement and license agreement. In December 2011, the Company entered into a settlement and license agreement with a third-party company for infringement of the Company's patent whereby the Company will receive \$2 million which will be paid in equal installments of \$300,000 in each quarter of 2012 and the remainder will be paid in two equal installments in the first two quarters of 2013. For the three months ended March 31, 2012, the Company received the first \$300,000 payment which was recorded as a credit to the litigation expenses in the Condensed Consolidated Statements of Operations. During the three months ended March 31, 2011, we incurred legal expenses primarily to recover attorneys' fees from O2Micro. Overall, our litigation expense has decreased as a result of us being party to fewer material litigations.

Income Tax Provision. The income tax provision for the three months ended March 31, 2012 was \$0.3 million or 9.4% of the Company's income before income taxes. This differs from the federal statutory rate of 34% primarily because the Company's foreign income was taxed at lower rates and because of the benefit that the Company realized as a result of stock option exercises and restricted units vested.

The income tax provision for the three months ended March 31, 2011 was \$0.2 million or 9.8% of the Company's income before income taxes. This differs from the federal statutory rate of 34% 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 the disqualifying disposition of incentive stock options and employee stock plan purchases.

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Liquidity and Capital Resources.

	March 31, 2012 (in thousands)	December 31, 2011
Cash and cash equivalents	\$ 78,731	\$ 96,371
Short-term investments	102,197	77,827
Total cash, cash equivalents and short-term investments	\$ 180,928	\$ 174,198
Percentage of total assets	62.1 %	63.6 %
Total current assets	\$ 225,420	\$ 211,505
Total current liabilities	31,469	26,070
Working Capital	\$ 193,951	\$ 185,435

As of March 31, 2012, we had working capital of \$194.0 million, including cash and cash equivalents of \$78.7 million and short-term investments of \$102.2 million, compared to working capital of \$185.4 million, including cash and cash equivalents of \$96.4 million and short-term investments of \$77.8 million as of December 31, 2011. For the three months ended March 31, 2012, cash and cash equivalents decreased by \$17.6 million primarily due to investment in short-term securities and due to building improvements at our new headquarters located in San Jose, California. We have financed our operations primarily with proceeds from cash generated from operating activities, proceeds from the exercise of stock options and proceeds from the issuance of shares through the Company's employee stock purchase plan.

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

The working capital at March 31, 2012, increased by \$8.5 million compared to the working capital at December 31, 2011 primarily due to a \$13.9 million net increase in current assets offset by a \$5.4 million net increase in current liabilities. The increase in current assets was primarily due to investment in short-term securities. In addition, accounts receivable increased reflecting a change in the timing of shipments during the quarter relative to the fourth quarter of 2011. The increase in current liabilities was primarily due to an increase in accounts payable.

Summary of Cash Flows. The table below summarizes the cash and cash equivalents provided by (used in) in our operating, investing and financing activities (in thousands) for the periods presented:

	Three months ended March 31, 2012 (in thousands)	2011
Cash provided by operating activities	\$ 6,219	\$ 8,230
Cash provided by (used in) investing activities	(29,190)	26,556
Cash provided by (used in) financing activities	5,121	(8,820)
Effect of exchange rate changes on cash and cash equivalents	210	86
Net increase (decrease) in cash and cash equivalents	\$ (17,640)	\$ 26,052

For the three months ended March 31, 2012, net cash provided by operating activities was \$6.2 million, primarily due to strong operating results and an increase in accounts payable related to building improvements for our new

headquarters and for inventory purchases to meet customer demands. This was partially offset by an increase in accounts receivable, primarily from the timing of shipments relative to the fourth quarter of 2011 for which the collections have not been made. For the three months ended March 31, 2011, net cash provided by operating activities was \$8.2 million primarily due to strong operating results and an increase in accounts payable for inventory purchases. This was partially offset by an increase in inventory to meet the anticipated second quarter demand and an increase in accounts receivable resulting from shipments at the end of the quarter for which the collections have not been made. As of March 31, 2012, \$46.9 million of the \$78.7 million of cash and cash equivalents was held by our foreign 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.

For the three months ended March 31, 2012, net cash used by investing activities was \$29.2 million, primarily related to the investment in short-term securities and investment in building improvements at our new headquarters located in San Jose, California. For the three months ended March 31, 2011, net cash provided by investing activities was \$26.6 million, primarily related to the redemption of short-term investments to fund our stock repurchase program.

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We use professional investment management firms to manage the majority of our invested cash. Our fixed income portfolio is primarily invested in US government securities, auction-rate securities and highly rated corporate notes and commercial paper. The balance of the fixed income portfolio is managed internally and invested primarily in money market securities for working capital purposes.

We adopted the provisions of ASC 320-10-35 Investments – Debt and Equity Securities – Overall – Subsequent Measurement and ASC 320-10-50 Investments – Debt and Equity Securities – Overall - Disclosure, effective April 1, 2009 and used the guidelines therein to determine whether the impairment is temporary or other-than temporary. Temporary impairment charges are recorded in accumulated other comprehensive income (loss) within equity and have no impact on net income. Other-than-temporary impairment charges exist when the entity has the intent to sell the security, it will more likely than not be required to sell the security before anticipated recovery, or it does not expect to recover the entire amortized cost basis of the security. Other-than-temporary impairment charges are recorded in other income (expenses) in the Condensed Consolidated Statement of Operations.

At March 31, 2012, the Company's investment portfolio included \$13.7 million in government-backed student loan auction-rate securities, net of impairment charges of \$0.6 million; of which, \$0.5 million was temporary and \$0.1 million was recorded other-than-temporary. This compares to an investment balance of auction-rate securities as of December 31, 2011 of \$13.7 million, net of impairment charges of \$0.7 million; of which, \$0.6 million was temporary and \$0.1 million was recorded as other-than-temporary. The underlying maturity of these auction-rate securities is up to 36 years. As of March 31, 2012 and December 31, 2011 the portion of the impairment classified as temporary was based on the following analysis:

1. The decline in the fair value of these securities is not attributable to adverse conditions specifically related to these securities or to specific conditions in an industry or in a geographic area;
2. Management possesses both the intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value;
3. Management believes that it is more likely than not that the Company will not have to sell these securities before recovery of its cost basis;
4. Except for the credit loss of \$70,000 recognized in year ended December 31, 2009 for the Company's holdings in auction rate securities described below, the Company does not believe that there is any additional credit loss associated with other auction-rate securities because the Company expects to recover the entire amortized cost basis;
5. The majority of the securities remain AAA rated, with \$6.3 million of the auction rate securities having been downgraded by Moody's to A3-Baa3 during the year ended December 31, 2009, and there have been no downgrades since; and
6. All scheduled interest payments have been made pursuant to the reset terms and conditions; and
7. All redemptions of auction-rate securities representing 63% of the original portfolio purchased by the Company in February 2008 have been at par.

Based on the guidance of ASC 320-10-35 and ASC 320-10-50, the Company evaluated the potential credit loss of each of the auction-rate securities that are currently held by the Company. Based on such analysis, the Company determined that those securities that are not 100% FFELPS guaranteed are potentially subject to credit risks based on the extent to which the underlying debt is collateralized and the security-specific student-loan default rates. The Company's portfolio includes two such securities. The senior parity ratio for the two securities is approximately 106%. If, therefore, the student-loan default rate and borrowing rate increases for these issuers, the remaining balance in these trusts may not be sufficient to cover the senior debt. The Company therefore concluded that there is potential credit risk for these two securities and as such, used the discounted cash flow model to determine the amount of credit loss to be recorded. In valuing the potential credit loss, the following parameters were used: 20 year expected term,

cash flows based on the 90-day t-bill rates for 20 year forwards and a risk premium of 5.9%, the amount of interest that the Company was receiving on these securities when the market was last active. During the year ended December 31, 2009, the potential credit loss associated with these securities was \$70,000, which the Company deemed other-than-temporary and recorded in other expense in its Consolidated Statement of Operations during 2009. There have been no such losses since.

Unless a rights offering or other similar offer is made to redeem at par and accepted by us, we intend to hold the balance of these investments through successful auctions at par, which we believe could take approximately 2.0 years.

Determining the fair value of the auction-rate securities requires significant management judgment regarding projected future cash flows which will depend on many factors, including the quality of the underlying collateral, estimated time for liquidity including potential to be called or restructured, underlying final maturity, insurance guaranty and market conditions, among others. To determine the fair value of the auction-rate securities at December 31, 2011 and March 31, 2012, the Company used a discounted cash flow model, for which there are four unobservable inputs: estimated time-to-liquidity, discount rate, credit quality of the issuer and expected interest receipts. A significant increase in the time-to-liquidity or the discount rate inputs or a significant decrease in the credit quality of the issuer or the expected interest receipts inputs in isolation would result in a significantly lower fair value measurement. The following are the values used in the discounted cash flow model:

	March 31, 2012	December 31, 2011
Time-to-Liquidity	24 months	24 months
Expected Return (Based on the requisite treasury rate, plus a contractual penalty rate)	1.8%	1.8%
Discount Rate (Based on the requisite LIBOR, the cost of debt and a liquidity risk premium)	2.8% - 7.6%, depending on the credit-rating of the security	3.1% - 7.9%, depending on the credit-rating of the security

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From the fourth quarter of 2011 to the first quarter of 2012, we kept the time-to-liquidity constant at 2.0 years. We sold \$0.1 million in auction-rate securities at par and reversed the impairment related to these securities in the amount of \$0.1 million. This reduced the overall impairment from \$0.7 million at December 31, 2011 to \$0.6 million at March 31, 2012.

Net cash provided by financing activities for the three months ended March 31, 2012 was \$5.1 million, primarily from the proceeds from the exercise of stock options in the amount of \$4.0 million and proceeds from the employee stock purchase plan of \$1.0 million. Net cash used in financing activities for the three months ended March 31, 2011 was \$8.8 million, primarily from stock repurchases in the amount of 13.7 million, which was partially offset by the proceeds from the exercise of stock options in the amount of \$3.5 million and proceeds from the employee stock purchase plan of \$0.9 million.

On July 27, 2010, we announced that our Board of Directors approved a stock repurchase program that authorized the Company to repurchase up to \$50.0 million of its common stock between August 2, 2010 and December 31, 2011. From August 2010 through June 2011, we repurchased 4,385,289 shares for a total of \$70.0 million. In February 2011, our Board of Directors approved an increase from \$50.0 million to \$70.0 million. During the three months ended March 31, 2011, the following shares have been repurchased through the open market and subsequently retired:

Three months ended March 31, 2011				
	Shares Repurchased	Average Price per Share		Value (in thousands)
February 2011	817,500	\$	15.47	\$ 12,648
March 2011	75,000	\$	14.17	\$ 1,062
	892,500			\$ 13,710

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 and cash equivalents and short-term investments, will be sufficient to satisfy our liquidity requirements for at least the next 12 months. For further details regarding our operating, investing and financing activities, see our Condensed Consolidated Statements of Cash Flows.

Contractual Obligations and Off Balance Sheet Arrangements.

As of March 31, 2012 we continued to lease our headquarters and sales offices in San Jose, California. We moved to our Company-owned headquarters also located in San Jose, California in May 2012.

Certain of our facility leases provide for periodic rent increases. In September 2004, we signed an agreement with the Chinese local authority to construct a facility in Chengdu, China. We have the option to acquire this facility in Chengdu after a five-year lease term, which option became exercisable in March 2011. We will likely exercise our purchase option and enter into a purchase agreement for this facility in the future. We constructed a 150,000 square foot research and development facility in Chengdu, China which was put into operation in October 2010.

We also lease our sales offices in Japan, China, Taiwan, Singapore and Korea and our research and development facilities in Finland.

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As of March 31, 2012, our total outstanding purchase commitments with vendors were \$25.5 million, which includes wafer purchases from our three foundries and the purchase of assembly services primarily from multiple contractors in Asia. This compares to purchase commitments of \$18.6 million as of December 31, 2011.

Our other contractual obligations have not changed significantly from that disclosed in our annual report on Form 10-K filed with the SEC on March 12, 2012.

As of March 31, 2012, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of the Securities and Exchange Commission's Regulation S-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For a discussion of market risks at December 31, 2011, refer to Item 7A, "Quantitative and Qualitative Disclosures about Market Risk" in our annual report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC on March 12, 2012. During the three months ended March 31, 2012, there were no material changes or developments that would materially alter the market risk assessment performed as of December 31, 2011.

During the quarter ended September 30, 2011, S&P downgraded the credit rating for U.S. long-term sovereign debt. We will continue to monitor the situation and potentially rebalance our investment portfolio, as needed. Currently, we do not believe that there is any impairment, temporary or otherwise, related to our investments in U.S. Treasuries and U.S. Agencies and as such, we have not recorded any such impairment.

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 under the Securities Exchange Act of 1934 as of the end of the period covered by this quarterly report on Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our chief executive officer and chief financial officer concluded that 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 Securities and Exchange Commission 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 period covered by this quarterly report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On September 16, 2011 and September 29, 2011, two nearly identical shareholder derivative actions were filed in the United States District Court for the Northern District of California and the California Superior Court for Santa Clara County, naming as defendants certain of our current and former directors and officers and our compensation advisory firm. The complaints assert claims for, among other things, breach of fiduciary duty in connection with the directors' approval of compensation for our executive officers during 2010. The complaints each seek an award of damages in favor of the Company, equitable relief, costs and attorney's fees. On March 2, 2012, the parties in the state court action stipulated to the dismissal without prejudice of that action. On April 3, 2012, a hearing was held in the United States District Court on the defendants' motions to dismiss the case. The court has not yet ruled on the motions. The matters are at a preliminary stage at the United States District Court; the defendants have not yet responded to the complaint and no discovery has taken place. In management's opinion, the resolution of the derivative action filed in the United States District Court is uncertain and estimate of its effect cannot be made on our consolidated financial condition, results of operations or liquidity.

On May 3, 2012, the United States District Court for the Northern District of California 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 is in addition to the approximately \$340,000 in taxable costs that the Court had earlier ordered O2 Micro to pay to the Company in connection with the same lawsuit.

O2 Micro filed complaints against the Company in both the United States International Trade Commission ("ITC") and the Northern District of California, alleging that the Company infringed four O2 Micro patents but then voluntarily dismissed three patents. In June 2010, the ITC found that the Company's products did not infringe O2 Micro's patent. Subsequently, O2 Micro unilaterally dismissed its infringement claims with prejudice, and granted the Company and its customers broad covenants not to sue in the district court case.

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On March 3, 2011, the Court ordered O2 Micro to pay the Company \$339,315.13 in costs. The Court also found that "O2 Micro engaged in a vexatious litigation strategy and litigation misconduct," entitling the Company to its reasonable attorneys' fees. O2 Micro's vexatious litigation strategy consisted of filing lawsuits against the Company and its customers; only to dismiss them after substantial litigation had taken place. This allowed O2 Micro to damage the Company's business while avoiding trials at which the validity of its patents would be challenged.

Since that time, the Company submitted the documentation for its attorneys' fees and non-taxable costs. O2 Micro challenged those fees on various grounds. On May 3, 2012, the Court accepted the Company's figures and entered an order awarding \$8,419,429 in attorneys' fees, and \$663,151 in non-taxable costs, plus interest. The Court then entered judgment for the Company.

The Company anticipates that O2 Micro will appeal the Court's orders and the final judgment. These amounts will be recognized in the Consolidated Financial Statements of the company when all related appeals have been exhausted and collectibility is probable.

We and certain of our subsidiaries are parties to actions and proceedings incident to our business in the ordinary course of business, including litigation regarding our intellectual property, challenges to the enforceability or validity of our intellectual property and claims that our products infringe on the intellectual property rights of others. These proceedings often involve complex questions of fact and law and will require the expenditure of significant funds and the diversion of other resources to prosecute and defend. We defend ourselves vigorously against any such claims. In December 2011, the Company entered into a settlement and license agreement with a third-party company for infringement of the Company's patent whereby the Company will receive \$2 million which will be paid in equal installments of \$300,000 in each quarter of 2012 and the remainder will be paid in two equal installments in the first two quarters of 2013. For the three months ended March 31, 2012, the Company received the first \$300,000 payment which was recorded as a credit to the litigation expenses in the Condensed Consolidated Statement of Operations.

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 our 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, which have been updated from the risk factors previously disclosed in our Annual Report on Form 10-K 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 price in response to various factors, many of which are beyond our control, including:

- our results of operations and financial performance;

- general economic, industry and global market conditions;

- 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;

announcements of technological innovations or significant contracts by us or our competitors;

introduction of new products by us or our competitors;

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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;

our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity;

our ability to increase our gross margins; and

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

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

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

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

a deterioration in general demand for electronic products as a result of worldwide financial crises and associated macro-economic slowdowns;

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

adverse 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 additional lost business as a result of customer and prospective customer concerns about adverse outcomes in our litigations or about being litigation targets;

continued dependence on our turns business (orders received and shipped within the same fiscal quarter);

increases in assembly costs due to commodity price increases, such as the price of gold;