# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended September 30, 2009**

**OR**

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

**Commission file number: 000-51026**

# Monolithic Power Systems, Inc.

**(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)**

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

**6409 Guadalupe Mines Road, San Jose, CA 95120 (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 x No ¨

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

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

Large accelerated filer ¨ Accelerated filer x 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 x

There were 34,901,371 shares of the registrant s common stock issued and outstanding as of October 15, 2009.

Table of Contents

**MONOLITHIC POWER SYSTEMS, INC.**

**TABLE OF CONTENTS**



2

**Table of Contents**

**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)

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 51,993 | $ 83,266 |
| Short-term investments | 97,763 | 21,922 |
| Accounts receivable, net of allowances of $7 and $0 in 2009 and 2008, respectively | 19,493 | 9,115 |
| Inventories | 20,358 | 18,887 |
| Deferred income tax assets, net - current | 76 | 75 |
| Prepaid expenses and other current assets | 2,790 | 2,622 |
| Restricted cash | | 7,360 |
| Total current assets | 192,473 | 143,247 |
| Property and equipment, net | 17,012 | 14,163 |
| Long-term investments | 19,465 | 37,425 |
| Deferred income tax assets, net - long-term | 19 | 19 |
| Other assets | 431 | 438 |
| Restricted assets | 7 | 7 |
| Total assets | $ 229,407 | $ 195,299 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 8,867 | $ 4,674 |
| Accrued compensation and related benefits | 6,351 | 7,848 |
| Accrued liabilities | 8,041 | 13,360 |
| Total current liabilities | 23,259 | 25,882 |
| Non-current income tax liability | 4,798 | 4,762 |
| Other long-term liabilities | 8 | 10 |
| Total liabilities | 28,065 | 30,654 |
| Stockholders equity: | | |
| Common stock, $0.001 par value, $35 and $34 in 2009 and 2008, respectively; shares authorized: 150,000,000; shares issued and outstanding: 34,841,371 and 33,646,821 in 2009 and 2008, respectively | 168,472 | 147,298 |

| | | | | |
|---|---|---|---|---|
| Retained earnings | | 32,431 | | 17,411 |
| Accumulated other comprehensive income (loss) | | 439 | | (64) |
| Total stockholders equity | | 201,342 | | 164,645 |
| Total liabilities and stockholders equity | $ | 229,407 | $ | 195,299 |

See accompanying notes to condensed consolidated financial statements.

**Table of Contents**

**MONOLITHIC POWER SYSTEMS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(Unaudited)

| | Three months ended September 30, 2009 | Three months ended September 30, 2008 | Nine months ended September 30, 2009 | Nine months ended September 30, 2008 |
|---|---|---|---|---|
| Revenue | $ 47,966 | $ 48,891 | $ 118,461 | $ 125,802 |
| Cost of revenue | 18,868 | 18,201 | 48,122 | 46,620 |
| Gross profit | 29,098 | 30,690 | 70,339 | 79,182 |
| Operating expenses: | | | | |
| Research and development | 10,080 | 9,420 | 27,929 | 25,594 |
| Selling, general and administrative | 9,438 | 9,560 | 26,567 | 27,200 |
| Litigation expense | 2,811 | 1,090 | 7,090 | 6,120 |
| Litigation provision reversal, net | (6,356) | | (6,356) | |
| Total operating expenses | 15,973 | 20,070 | 55,230 | 58,914 |
| Income from operations | 13,125 | 10,620 | 15,109 | 20,268 |
| Other income (expense): | | | | |
| Interest and other income | 161 | 684 | 827 | 2,928 |
| Interest and other expense | (76) | (389) | (355) | (507) |
| Total other income, net | 85 | 295 | 472 | 2,421 |
| Income before income taxes | 13,210 | 10,915 | 15,581 | 22,689 |
| Income tax provision | 648 | 458 | 561 | 1,697 |
| Net income | $ 12,562 | $ 10,457 | $ 15,020 | $ 20,992 |
| Basic net income per share | $ 0.36 | $ 0.31 | $ 0.44 | $ 0.63 |
| Diluted net income per share | $ 0.34 | $ 0.29 | $ 0.41 | $ 0.58 |
| Weighted average common shares outstanding | 34,552 | 33,869 | 34,082 | 33,482 |
| Stock options and restricted stock | 2,695 | 2,733 | 2,273 | 2,850 |
| Diluted weighted-average common equivalent shares outstanding | 37,247 | 36,602 | 36,355 | 36,332 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**MONOLITHIC POWER SYSTEMS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(Unaudited)

| | Nine months ended September 30, 2009 | Nine months ended September 30, 2008 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 15,020 | $ 20,992 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,867 | 4,211 |
| Loss on disposal of property and equipment | 17 | 4 |
| Accretion of purchase discounts on debt instruments | 263 | |
| Credit loss on auction-rate securities | 70 | |
| Tax benefit from stock option transactions | 1,837 | 1,833 |
| Excess tax benefit from stock option transactions | (534) | (583) |
| Stock-based compensation | 10,431 | 9,464 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (10,378) | (10,541) |
| Inventories | (1,468) | (4,776) |
| Prepaid expenses and other current assets | (152) | 817 |
| Accounts payable | 3,798 | 1,732 |
| Accrued and long-term liabilities | (5,117) | (889) |
| Accrued income taxes payable and noncurrent tax liabilities | (1,265) | (1,253) |
| Accrued compensation and related benefits | (1,555) | (1,953) |
| Deferred rent | (204) | (196) |
| Net cash provided by operating activities | 15,630 | 18,862 |
| **Cash flows from investing activities:** | | |
| Property and equipment purchases | (7,328) | (3,623) |
| Purchase of short-term investments | (105,026) | (17,370) |
| Purchase of long-term investments | | (28,050) |
| Proceeds from sale of short-term investments | 45,886 | 24,910 |
| Proceeds from sale of long-term investments | 1,300 | 725 |
| Changes in restricted assets | 7,360 | 2,296 |
| Net cash used in investing activities | (57,808) | (21,112) |
| **Cash flows from financing activities:** | | |
| Proceeds from issuance of common stock | 8,414 | 12,627 |
| Proceeds from employee stock purchase plan | 1,794 | 1,778 |
| Repurchase of common stock | | (20,022) |
| Excess tax benefits from stock option transactions | 534 | 583 |
| Net cash provided by (used in) financing activities | 10,742 | (5,034) |
| Effect of change in exchange rates on cash | 163 | 87 |

| | | | | |
|---|---|---|---|---|
| **Net decrease in cash and cash equivalents** | | **(31,273)** | | **(7,197)** |
| Cash and cash equivalents, beginning of period | | 83,266 | | 83,114 |
| Cash and cash equivalents, end of period | $ | 51,993 | $ | 75,917 |
| Supplemental disclosures of cash flow information: | | | | |
| Cash paid for taxes | $ | 429 | $ | 472 |
| Supplemental disclosures of non-cash investing and financing activities: | | | | |
| Liability accrued for equipment purchases | $ | 393 | $ | 241 |
| Impairment (market value adjustment) of auction-rate securities | $ | (360) | $ | 2,000 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**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 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 February 27, 2009.

The Company has performed a review of subsequent events as of October 20, 2009, which is the date the financial statements were available for issuance.

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, 2009 or for any other future period.

*Recent Accounting Pronouncements*

In September 2009, the Financial Accounting Standards Board ( FASB ) ratified final Emerging Issues Task Force ( EITF ) consensus on the following Issue: EITF Issue No. 08-1, *Revenue Arrangements with Multiple Deliverables* ( EITF 08-1 ). EITF 08-1 supersedes EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* ( EITF 00-21 ). EITF 08-1 retains the criteria from EITF 00-21 for when delivered items in a multiple-deliverable arrangement should be considered separate units of accounting, but removes the previous separation criterion under EITF 00-21 that objective and reliable evidence of fair value of any undelivered items must exist for the delivered items to be considered a separate unit or separate units of accounting. EITF 08-1 is effective for fiscal years beginning on or after June 15, 2010. The Company is currently evaluating EITF 08-1 and the impact, if any, that it may have on its results of operations or financial position.

In April 2009, the FASB issued transition guidance Accounting Standards Codification ( ASC ) 820-10-65-4 *Fair Value Measurements and Disclosures Overall Transition Guidance,* the provisions of which have been incorporated in ASC 820-10-50-2 *Fair Value Measurements and Disclosures Overall Disclosures.* ASC 820-10-50-2 requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This guidance is effective for interim and annual periods ending after June 15, 2009. The Company adopted this standard effective April 1, 2009, the results of which are disclosed in Note 8 Fair Value Measurements.

In April 2009, the FASB issued transition guidance ASC 320-10-65-1 *Transition Related to FASB Staff Position (* FSP *) SFAS No. 115-2 and SFAS No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments,* the provisions of which have been incorporated in ASC 320-10-35 *Investments Debt and Equity Securities Overall Subsequent Measurement* and ASC 320-10-50 *Investments Debt and Equity Securities Overall Disclosure*. The objective of an other-than-temporary impairment analysis under existing U.S. generally accepted accounting principles (GAAP) is to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale) should recognize a loss in earnings when the investment is impaired. An investment is impaired if the fair value of the investment is less than its amortized cost basis. ASC 320-10-35 and ASC 320-10-50 amend the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. ASC 320-10-35 and ASC 320-10-50 do not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This guidance is effective for interim and annual periods ending after June 15, 2009. In response to this guidance, in April 2009, the SEC published ASC 320-10-S99-1 *Investments Debt and Equity Securities Overall SEC Materials Staff Accounting Bulletin ( SAB ) Topic 5M, Other than Temporary Impairment of Certain Investments in Equity Securities*. ASC 320-10-S99-1 maintains the staff s previous views related to equity securities and excludes debt securities from its scope. The Company adopted this standard effective April 1, 2009, the results of which are disclosed in Note 8 Fair Value Measurements.

6

Table of Contents

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

In April 2009, the FASB issued transition guidance ASC 820-10-65-4 *Fair Value Measurement and Disclosure Overall Transition Related to FASB FSP SFAS No. 157-4*, *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,* the provisions of which have been incorporated in 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.* ASC 820-10-35-51 provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased and includes guidance on identifying circumstances that indicate a transaction is not orderly. ASC 820-10-35-51 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. This guidance is effective for interim and annual periods ending after June 15, 2009. The Company adopted this standard effective April 1, 2009, the results of which are disclosed in Note 8 Fair Value Measurements.

In December 2007, the FASB issued transition guidance ASC 805-10-65-1 *Business Combinations Overall Transition Related to* SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141(R)) and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Review Bulletin ( ARB ) No. 51* (SFAS 160), the provisions of which have been incorporated in ASC 805-10 *Business Combinations Overall* and ASC 805-20 *Business Combinations Identifiable Assets and Liabilities, and Any Noncontrolling Interest*. ASC 805-10 will significantly change current practices regarding business combinations. Among the more significant changes, ASC 805-10 expands the definition of a business and a business combination; requires the acquirer to recognize the assets acquired, liabilities assumed and noncontrolling interests (including goodwill), measured at fair value at the acquisition date; requires acquisition-related expenses and restructuring costs to be recognized separately from the business combination; requires assets acquired and liabilities assumed from contractual and non-contractual contingencies to be recognized at their acquisition -date fair values with subsequent changes recognized in earnings; and requires in-process research and development to be capitalized at fair value as an indefinite-lived intangible asset. ASC 805-20 will change the accounting and reporting for minority interests, reporting them as equity separate from the parent entity s equity, as well as requiring expanded disclosures. ASC 805-10 and ASC 805-20 are effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of ASC 805-10 and ASC 805-20 did not have a significant impact on the Company s consolidated financial statements or financial position, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions, if any, the Company consummates after the effective date.

In May 2009, the FASB issued ASC 855, *Subsequent Events.* The objective of this guidance is to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, this guidance sets forth:

1. The period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements;

2. The circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and

3. The disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

In accordance with this guidance, an entity should apply the requirements to interim or annual financial periods ending after June 15, 2009. The Company adopted this standard effective April 1, 2009 and has and will make the appropriate disclosures, as required.

**Table of Contents**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

In June 2009, the FASB issued SFAS 167, Amendments to FASB Interpretation No. 46(R). The objective in issuing this Statement is to improve financial reporting by enterprises involved with variable interest entities. The Board undertook this project to address (1) the effects on certain provisions of ASC 810-10, Consolidation Overall, as a result of the elimination of the qualifying special-purpose entity concept in FASB Statement No. 166, Accounting for Transfers of Financial Assets, and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provide timely and useful information about an enterprise s involvement in a variable interest entity. The issuance of this Statement will have an impact on the guidance in ASC 810-10 *Consolidation Overall.* This Statement shall be effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company is currently evaluating the impact this provision will have on its consolidated financial statements.

In June 2009, the FASB issued transition guidance ASC 105-10-65-1, *Transition Related to SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, the guidance of which was incorporated in ASC 105-10 *Generally Accepted Accounting Principles ( GAAP ) Overall*. The FASB Accounting Standards Codification™ (Codification) will become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this guidance, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. This guidance is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted this standard effective July 1, 2009, and has incorporated the current codification in this Form 10-Q.

**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 and nine months ended September 30, 2009 and 2008, as follows (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| Non-Employee | $ 11 | $ 15 | $ 112 | $ 43 |
| ESPP | 104 | 160 | 501 | 480 |
| Restricted Stock | 642 | 801 | 2,033 | 2,162 |
| Stock Options | 2,409 | 2,358 | 7,785 | 6,779 |
| TOTAL | $ 3,166 | $ 3,334 | $ 10,431 | $ 9,464 |

***Stock Options***

**1998 Stock Option Plan**

Under the Company s 1998 Stock Option Plan (the 1998 Plan), the Company reserved 11,807,024 shares of common stock for issuance to the Company s employees, directors and consultants. Options granted under the 1998 Plan have a maximum term of ten years and generally vest over four years at the rate of 25 percent one year from the date of grant and 1/48th monthly thereafter. On November 19, 2004, the effective date of the Company s initial public offering, the 1998 Plan was terminated for future grants and the remaining 1,392,750 shares available for grant were moved to the Company s 2004 Equity Incentive Plan (the 2004 Plan). In addition, shares underlying options from the 1998 Plan that were cancelled (for example, upon termination of service) were transferred to the 2004 Plan based on the number of cancellations that occurred throughout the year.

Table of Contents

**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 1/48$^{th}$ monthly thereafter. Refresh grants generally vest over four years at the rate of 50 percent two years from the date of grant and 1/48$^{th}$ 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, 2008 | 813,601 |
| 2009 Additions to Plan | 1,682,341 |
| 2009 Grants | (682,700) |
| 2009 Cancellations | 188,383 |
| Available for Grant as of September 30, 2009 | 2,001,625 |

A summary of the status of the Company s stock option plans at September 30, 2009 and changes during the nine 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, 2008 (7,506,407 options exercisable at a weighted-average exercise price of $12.31 per share) | 8,196,637 | $ 12.62 | 5.91 | $ 20,193,958 |
| Options granted (weighted-average fair value of $8.29 per option) | 655,000 | 17.19 | | |
| Options exercised | (906,952) | 9.28 | | |
| Options forfeited and expired | (177,633) | 18.04 | | |
| Outstanding at September 30, 2009 | 7,767,052 | $ 13.28 | 5.25 | $ 79,329,642 |
| Options exercisable at September 30, 2009 and expected to become exercisable | 7,231,924 | $ 13.03 | 5.22 | $ 75,600,276 |
| Options vested and exercisable at September 30, 2009 | 4,149,517 | $ 10.45 | 4.87 | $ 54,050,254 |

Table of Contents

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

The total fair value of options that vested during each of the three months ended September 30, 2009 and 2008 was $2.4 million and the total fair value of options that vested during the nine months ended September 30, 2009 and 2008 was $7.8 million and $6.8 million, respectively. The total intrinsic value of options exercised during the three months ended September 30, 2009 and 2008 was $7.1 million and $7.3 million, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2009 and 2008 was $13.4 million and $20.4 million, respectively. Net cash proceeds from the exercise of stock options was $4.7 million for the three months ended September 30, 2009 and $4.8 million for the three months ended September 30, 2008. Net cash proceeds from the exercise of stock options was $8.4 million for the nine months ended September 30, 2009 and $12.6 million for the nine months ended September 30, 2008. At September 30, 2009, unamortized compensation expense related to unvested options was approximately $17.8 million. The weighted average period over which compensation expense related to these options will be recognized is approximately 2.5 years.

The employee stock-based compensation expense recognized under 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 and nine months ended September 30, 2009 and 2008:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Expected term (years) | 4.1 | 4.1 | 4.1 | 4.2 |
| Expected volatility | 60.6% | 40.2% | 60.8% | 40.4% |
| Risk-free interest rate | 2.0% | 3.1% | 1.8% | 2.8% |
| 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 for grants prior to December 31, 2008, the Company used the historical stock prices of MPS and companies similar to MPS, as the Company did not have sufficient historical data as a public company regarding its own volatility. MPS considered companies of similar size, industry and financial structure to devise its estimate. For grants after January 1, 2009, the Company, having a long enough history as a public company, uses its own historical data to determine its estimated expected volatility. The Company uses the U.S. Treasury yield 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***

A portion of the Company s shares of common stock were issued under restricted stock purchase agreements. Under these agreements, in the event of a termination of an employee, the Company has the right to repurchase the common stock at the original issuance price of $0.001 per share. The repurchase right expires over a 48 month period. A summary of the Company s restricted stock awards is presented in the table below:

| | Restricted Stock Awards | Weighted Average Grant Date Fair Value Per Share | Weighted Average Remaining Recognition Period (Years) |
|---|---|---|---|
| Outstanding at December 31, 2008 | 70,377 | $ 11.55 | 0.48 |
| Awards granted | | | |
| Awards released | (47,577) | 10.71 | |
| Awards forfeited | (6,250) | 8.64 | |

| | | | |
|---|---|---|---|
| Outstanding at September 30, 2009 | 16,550 | $ 15.08 | 0.23 |

Table of Contents

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

The Company also grants restricted stock units, which vest generally over two to four years as determined by the Company s Compensation Committee, and are issued upon vesting. Before vesting, these 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) |
|---|---|---|---|
| Total granted through December 31, 2008 | 389,643 | $ 18.11 | 2.72 |
| Awards granted | 27,700 | 19.74 | |
| Awards released | (132,822) | 18.14 | |
| Awards forfeited | (4,500) | 15.75 | |
| Outstanding at September 30, 2009 | 280,021 | $ 18.30 | 2.31 |

The total fair value of restricted stock awards and units that vested was $0.6 million for the three months ended September 30, 2009 and $0.8 million for the three months ended September 30, 2008, respectively. The total fair value of restricted stock awards and units that vested was $2.0 million for the nine months ended September 30, 2009 and $2.2 million for the nine months ended September 30 2008, respectively. The intrinsic value related to restricted stock awards and units released for the three months ended September 30, 2009 and 2008 was $1.7 million and $1.4 million, respectively, and the intrinsic value related to restricted stock awards and units released for the nine months ended September 30, 2009 and 2008 was $3.3 million and $2.7 million, respectively. The intrinsic value related to restricted stock awards and units outstanding at September 30, 2009 and 2008 was $7.0 million and $8.7 million, respectively. At September 30, 2009, the unamortized compensation expense related to unvested restricted stock awards and units was approximately $3.6 million with a weighted average remaining recognition period of 2.2 years.

***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 September 30, 2009 and 2008, 77,600 shares and 65,117 shares, respectively, were issued under the Purchase Plan. For the nine months ended September 30, 2009 and 2008, 161,026 shares and 125,207 shares, respectively, were issued under the Purchase Plan. The following is a summary of the Purchase Plan and changes during the nine months ended September 30, 2009:

| | |
|---|---|
| Available Shares as of December 31, 2008 | 2,041,102 |
| 2009 Additions to Plan | 672,936 |
| 2009 Purchases | (161,026) |
| Available Shares as of September 30, 2009 | 2,553,012 |

Table of Contents

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

The Purchase Plan is considered compensatory under ASC 718-50-25-2, *Compensation Stock Compensation Employee Share Purchase Plans Recognition,* and is accounted for in accordance with ASC 718-50-30-2 *Compensation Stock Compensation Employee Share Purchase Plans Initial Measurement Look-Back Plans*. The intrinsic value for stock purchased was $0.9 million and $0.7 million for the three months ended September 30, 2009 and 2008, respectively. The intrinsic value for stock purchased was $1.0 million and $0.8 million for the nine months ended September 30, 2009 and 2008, respectively. The unamortized expense as of September 30, 2009 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 nine months ended September 30, 2009 and 2008, the following weighted average assumptions were used in the valuation of the stock purchase rights:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Expected term (years) | 0.5 | 0.5 | 0.5 | 0.5 |
| Expected volatility | 61.0% | 45.4% | 79.8% | 48.3% |
| Risk-free interest rate | 0.3% | 1.9% | 0.4% | 2.0% |
| Dividend yield | | | | |

Cash proceeds from employee stock purchases for each of the three months ended September 30, 2009 and 2008 was $0.9 million. Cash proceeds from employee stock purchases for each of the nine months ended September 30, 2009 and 2008 was $1.8 million, respectively.

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

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Work in progress | $ 13,432 | $ 10,653 |
| Finished goods | 6,926 | 8,234 |
| Total inventories | $ 20,358 | $ 18,887 |

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

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Legal expenses and settlement costs | $ 2,479 | $ 8,791 |
| Deferred revenue | 2,091 | 841 |
| Warranty | 586 | 764 |
| Professional fees | 233 | 66 |
| Other | 2,652 | 2,898 |
| Total accrued liabilities | $ 8,041 | $ 13,360 |

Table of Contents

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

***5. Net Income per Share and Comprehensive Income*** 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 and nine months ended September 30, 2009 and 2008, 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 shows the number of shares of common stock issuable upon conversion or exercise of such outstanding stock options:

| Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|
| 2009 | 2008 | 2009 | 2008 |
| 1,096,555 | 1,660,852 | 3,446,134 | 1,853,954 |

For the three and nine months ended September 30, 2009, the Company s comprehensive income consists of reversals of temporary impairment of the Company s holdings in auction-rate securities, market adjustments on available-for-sale investments and favorable fluctuations of the Chinese Yuan. For the three and nine months ended September 30, 2008, the Company s comprehensive income consisted primarily of temporary impairment of the Company s holdings in auction-rate securities, offset by favorable fluctuations of the Chinese Yuan. The following table sets forth the components of other comprehensive income, net of income tax effect (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Net income | $ 12,562 | $ 10,457 | $ 15,020 | $ 20,992 |
| Other comprehensive income (loss): | | | | |
| Change in value of temporary impairment of auction-rate securities | 30 | (1,590) | 360 | (2,000) |
| Unrealized gain (loss) on available-for-sale investments | 31 | (52) | 15 | (53) |
| Foreign currency translation adjustments | 74 | (79) | 129 | 843 |
| Comprehensive income | $ 12,697 | $ 8,736 | $ 15,524 | $ 19,782 |

**6.** ***Segment Information***

As defined by the requirements of ASC 280-10-50 *Segment Reporting Overall Disclosure*, the Company operates in one reportable segment: the design, development, marketing and sale of high-performance, mixed-signal analog semiconductors for the communications, computing, consumer, and industrial and automotive markets. Geographic revenue is based on the location to which customer shipments are delivered. For the three and nine months ended September 30, 2009, 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 and nine months ended September 30, 2009 and 2008.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| **Customers** | **2009** | **2008** | **2009** | **2008** |
| A | 12% | 18% | 14% | 20% |

| | | | | |
|---|---|---|---|---|
| B | 12% | 14% | 10% | 10% |
| C | 11% | | 11% | |
| D | | 10% | | 10% |

-

(-) represents less than 10%

13

Table of Contents

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| **Country** | **2009** | **2008** | **2009** | **2008** |
| China | $ 20,703 | $ 20,556 | $ 48,257 | $ 56,529 |
| Korea | 8,038 | 8,963 | 24,237 | 20,903 |
| Taiwan | 5,812 | 7,990 | 15,207 | 17,656 |
| Europe | 5,843 | 3,125 | 13,825 | 8,593 |
| Japan | 3,498 | 4,612 | 8,268 | 12,356 |
| USA | 1,779 | 1,137 | 4,306 | 3,224 |
| Other | 2,293 | 2,508 | 4,361 | 6,541 |
| Total | $ 47,966 | $ 48,891 | $ 118,461 | $ 125,802 |

During the first quarter of 2009, the Company reclassified certain of its products from DC to DC Converters to Lighting Control Products. The product information for the three and nine months ended September 30, 2008 has been reclassified to conform to the current presentation. The following is a summary of revenue by product family (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| **Product Family** | **2009** | **2008** | **2009** | **2008** |
| DC to DC Converters | $ 36,723 | $ 31,705 | $ 87,576 | $ 82,637 |
| Lighting Control Products | 8,511 | 12,761 | 20,544 | 32,540 |
| Audio Amplifiers | 2,732 | 4,425 | 10,341 | 10,625 |
| Total | $ 47,966 | $ 48,891 | $ 118,461 | $ 125,802 |

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

| | **September 30, 2009** | **December 31, 2008** |
|---|---|---|
| China | $ 14,221 | $ 10,470 |
| United States | 2,777 | 3,646 |
| Taiwan | 77 | 103 |
| Japan | 32 | 31 |
| Other | 36 | 41 |
| TOTAL | $ 17,143 | $ 14,291 |

**7.** ***Litigation***

**O2Micro**

The Company has been engaged in a number of legal proceedings involving patent infringement claims with O2Micro, Inc. and its parent corporation, O2Micro International Limited (referred to hereinafter as O2Micro ). Currently there are two proceedings pending, both involving O2 Micro s U.S. Patent No. 7,417,382 ( 382 patent). One proceeding is pending in the International Trade Commission. The other is pending in the United States District Court for the Northern District of California. O2 Micro alleges that certain of the Company s CCFL backlight inverter products infringe its patents. The Company alleges that it does not infringe and the patent is invalid. The ITC Investigation hearing is scheduled to begin on October 19, 2009. Trial in the Northern District of California case is scheduled for August 2, 2010. The Company is not able to reasonably estimate the probability of loss or the range of possible loss in this case.

Table of Contents

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

**Taiwan Sumida Electronics**

During the quarter ended September 30, 2009, the Company completed the litigation process with respect to lawsuit related to Taiwan Sumida Electronics ( TSE ), a customer. The conclusion of this lawsuit resulted in recording a reversal of a litigation provision of approximately $7.4 million during the quarter ended September 30, 2009. This provision was recorded as a litigation provision in the second quarter of 2007 and the reversal of this provision in the current quarter is reflected in the Litigation Provision Reversal, net item in the Condensed Consolidated Statement of Operations. In connection with the completion of this lawsuit, the Company also jointly terminated an escrow agreement with TSE and retrieved the deposit of $7.4 million.

**Linear Technology Corporation**

On July 1, 2008, the United States District Court for the District of Delaware held as a matter of law that the Company did not breach its October 1, 2005 Settlement and License Agreement with Linear Technology Corporation ( Linear ). Based upon that ruling, the Company anticipates filing a motion to seek recovery of its attorney fees when the final judgment is entered. The court has not issued its final judgment concerning the patent infringement, validity, and enforceability issues.

**Chip Advanced Technology Inc.**

On December 12, 2007, the Company filed a patent infringement lawsuit in the U.S. District Court for the Central District of California against Chip Advanced Technology Inc. ( CAT ), asserting that CAT willfully infringed a MPS patent that enables efficient low voltage, low current power conversions, such as DC-DC step down converters. CAT was subsequently acquired by ITE Technology ( ITE ), a successor in interest of CAT. On July 28, 2009, the Company entered into a license agreement and a settlement agreement with ITE in which the parties agreed to mutually release and dismiss the complaints.

**8.** ***Fair Value Measurements***

The Company adopted the provisions of ASC 820-10 *Fair Value Measurements and Disclosures Overall,* which 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 noted below. The Company also adopted the provisions of 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*, effective April 1, 2009, which 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.

The following table details the fair value measurements as of September 30, 2009 within the fair value hierarchy of the financial assets that are required to be recorded at fair value (in thousands):

| | | Fair Value Measurements at September 30, 2009 Using | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| Cash and cash equivalents | $ 51,993 | $ 51,993 | $ | $ |
| Fixed income available-for-sale securities | 80,813 | 80,813 | | |
| Long-term available-for-sale auction-rate securities | 19,465 | | | 19,465 |
| Short-term trading auction-rate securities | 16,230 | | | 16,230 |
| Put right | 720 | | | 720 |

| | | | | | | |
|---|---|---|---|---|---|---|
| $ 169,221 | $ | 132,806 | $ | | $ | 36,415 |

Fixed income available-for-sale securities includes securities issued by government agencies and treasuries and commercial paper, $80.8 million of which are classified as short-term on the Condensed Consolidated Balance Sheet. At September 30, 2009, the Company had $25.1 million invested in money market funds. At September 30, 2009, there was an insignificant amount of unrealized gross gains and losses from these investments.

**Table of Contents**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

The face value of our holdings in auction rate securities is $37.5 million, of which $20.6 million is currently classified as long-term available-for-sale investments and $16.9 million is classified as short-term trading investments. The securities that are classified as short-term trading securities have been classified as such because the Company intends to exercise its put option to sell these securities to UBS in June of 2010 (see below). These investments are accounted for in accordance with ASC 320-10, *Investments Debt and Equity Securities Overall.*

The Company 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 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. Other-than-temporary impairment charges are recorded in other income (expense) in the Condensed Consolidated Statement of Operations.

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 | Put Right | Total |
|---|---|---|---|
| Beginning balances as of January 1, 2009 | $ 36,175 | $ 1,250 | $ 37,425 |
| Unrealized loss | (35) | | (35) |
| Unrealized loss resulting from the valuation of the UBS put right | | (50) | (50) |
| Ending balances at March 31, 2009 | 36,140 | 1,200 | 37,340 |
| Sales and Settlement | (50) | | (50) |
| Unrealized gain | 345 | | 345 |
| Gain (loss) from UBS auction rate securities and put right | 315 | (315) | |
| Ending balances at June 30, 2009 | 36,750 | 885 | 37,635 |
| Sales and Settlement | (1,250) | | (1,250) |
| Unrealized gain | 30 | | 30 |
| Gain (loss) from UBS auction rate securities and put right | 165 | (165) | |
| Ending balances at September 30, 2009 | $ 35,695 | $ 720 | $ 36,415 |

The Company s Level 3 assets consist of government-backed student loan auction-rate securities and the UBS put right described below. The market for auction-rate securities, with interest rates that reset through a Dutch auction every 7 to 35 days became illiquid in 2008. As of September 30, 2009, the Company s investment portfolio included $35.7 million, net of impairment charges of $1.8 million, in government-backed student loan auction-rate securities. The portfolio also included a UBS auction-rate put right, which was valued at $0.7 million in accordance with the fair value measurement provisions of ASC 825-10-25 *Financial Instruments Overall Recognition*. During the nine months ended September 30, 2009, auction rate securities with a face value of $1.3 million were sold at par through successful auctions. However, the remaining auction rate securities in the portfolio with a face value of approximately $37.5 million have failed to reset through successful auctions and it is unclear as to when these investments will regain their liquidity. The underlying maturity of these auction-rate securities is up to 38 years and the underlying credit quality of these instruments in which the Company has invested remain generally AAA rated, with $12.2 million in auction rate securities having been downgraded by Moody s to Aa1-Baa3 during the nine months ended September 30, 2009.

In October 2008, the Company accepted an offer to participate in an auction-rate security rights offering from UBS to sell up to $18.2 million in face value of eligible auction-rate securities commencing in June 2010. In 2009, $1.3 million of these auction-rate securities were called at par, leaving $16.9 million in eligible auction-rate securities remaining at UBS. The offer gives the Company the right but not the obligation to sell these securities at par to UBS and allows the Company to borrow up to $16.9 million, if needed, beginning October 7, 2008. In accepting the offer, the Company also entered into a release of claims in favor of UBS.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued) (Unaudited)**

Since the Company accepted this put right from UBS in October 2008, the Company intends to sell these auction-rate securities at par to UBS commencing in June 2010. The cumulative impairment related to these auction-rate securities of $0.7 million was therefore considered to be other-than-temporary in accordance with the provisions of ASC 320-10-35 and ASC 320-10-50 and has been recorded in other income (expense) in the Condensed Consolidated Statement of Operations.

Having accepted UBS rights offering and elected the fair value option under ASC 820-10-35, the Company valued the resulting put right at fair value which was estimated to be equal to the par value of the auction-rate securities less their fair value as determined by management. The value of the put right was $0.7 million, the effect of which has been recorded by the Company in other income (expense) in the Condensed Consolidated Statement of Operations.

For the remaining auction-rate securities for which the put right (described above) does not apply, and which have a face value of $20.6 million, management concluded that as of September 30, 2009, the cumulative impairment of $1.1 million was temporary 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 nine months ended September 30, 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 $9.0 million in auction rate securities having been downgraded by Moody s to A3-Baa3 during the nine months ended September 30, 2009 and there have been no downgrades in the three months ended September 30, 2009; and

- All scheduled interest payments have been made pursuant to the reset terms and conditions.

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 for which a put right was not provided. 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. MPS portfolio includes three such securities, one of which has a senior parity ratio of approximately 115%, which is substantially above the expected student-loan default rate for that security. Conversely, the senior parity ratio for the other two securities is approximately 105%. 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. The potential credit loss associated with these securities was $70,000, which the Company deemed other-than-temporarily impaired and recorded in other expense in its Condensed Consolidated Statement of Operations during the nine months ended September 30, 2009.

Unless another rights offering or other similar offers are 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.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

The valuation of the auction-rate 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. To determine the fair value of the auction-rate securities at September 30, 2009, June 30, 2009, March 31, 2009 and December 31, 2008, the Company used a discounted cash flow model, for which there are three valuation parameters, including time-to-liquidity, discount rate and expected return. The following are the values used in the discounted cash flow model:

| | December 31, 2008 | March 31, 2009 | June 30, 2009 | September 30, 2009 |
|---|---|---|---|---|
| Time-to-Liquidity | 18 months | 24 months | 21 months | 24 months |
| Expected Return (Based on the 2-year treasury rate, plus a contractual penalty rate) | 2.3% | 1.6% | 2.1% | 2.1% |
| Discount Rate (Based on the 2-year LIBOR, the cost of debt and a liquidity risk premium) | 6.8% | 5.5% - 8.5%, depending on the credit-rating of the security | 5.3% -10.1%, depending on the credit-rating of the security | 4.8% - 9.6%, depending on the credit-rating of the security |

The gross accumulated impairment charge was $1.8 million as of September 30, 2009, of which $1.1 million was recorded as temporary and the remaining $0.7 million was recorded as other-than-temporary.

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 and nine months ended September 30, 2009 was $0.6 million or 4.9% of our income before income taxes and $0.6 million or 3.6% of the pre-tax income, respectively. These differ from the federal statutory rate of 34% primarily because our foreign income is taxed at lower rates and because of the benefit that we realized as a result of stock options exercised and restricted units released. The income tax provision for the three and nine months ended September 30, 2008 was $0.5 million or 4.2% of our income before income taxes and $1.7 million or 7.5% of our income before income taxes, respectively. These differ from the federal statutory rate of 34% primarily because our foreign income is taxed at lower rates and because of the benefit that we realized as a result of stock options exercised and restricted stock released.

**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,*

*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 impact of our outstanding litigation and changing market conditions on the revenue we derive from our CCFL product line,*

*the effect of auction-rate securities on our liquidity and capital resources,* *the application of our products in the computer, consumer electronics, and communications 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 2009,*

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

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

*the factors that differentiate ourselves from our competitors.*

*You can identify forward-looking statements by terms such as would, could, may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, potential, targets, seek, or continue, the negative of these terms or other variations of such terms. These statements are only predictions based upon assumptions that we believe to be reasonable at the time made, and are subject to risks and uncertainties. Therefore, actual events or results may differ materially and adversely from those expressed in any forward-looking statement. In evaluating these statements, you should specifically consider the risks described below in the section entitled Risk Factors. These factors may cause our actual results to differ materially from any forward-looking statements. Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

***Overview***

We are a fabless semiconductor company that designs, develops, and markets proprietary, advanced analog and mixed-signal semiconductors. We currently offer products that serve multiple markets, including flat panel televisions, wireless communications, telecommunications equipment, general consumer products, notebook computers, cellular handsets, 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 additional new products within our existing product families, as well as in new product categories.

We operate in the cyclical semiconductor industry where there is seasonal demand for certain of our 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 over the long term.

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

Following the introduction of a product, our sales cycle generally takes six to twelve months to achieve revenue. Volume production is usually achieved in three to six months after we receive an initial customer order for a new product. Typical lead times for orders are fewer than 90 days. These factors, combined with the fact that orders in the semiconductor industry can typically be cancelled or rescheduled without significant penalty to the customer, make the forecasting of our orders and revenue difficult.

We derive most of our revenue from sales through distribution arrangements or direct sales to customers in Asia, where the components we produce are incorporated into an end-user product. 84% of our revenue for the three months ended September 30, 2009 and 91% of our revenue for the three months ended September 30, 2008 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 consumer electronics, communications and computing 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

**Table of Contents**

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 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) collectibility 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 collectibility 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 distributor sales are made through distribution arrangements with third parties. These arrangements do not include any special payment terms (our normal payment terms are 30-45 days), 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.

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 rather than 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.

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 20% of our distributor sales are made through small distributors based on purchase orders rather than formal distribution arrangements. These distributors 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 distributors.

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.

Table of Contents

In 2006, we signed a distribution agreement with a U.S. distributor. Revenue from this distributor is recognized upon sale by the distributor to the end customer because the distributor has certain rights of return which management believes are not estimable. The deferred revenue balance from this distributor as of September 30, 2009 and December 31, 2008 was $0.6 million and $0.5 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.

***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 derecognition, 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 September 30, 2009 and December 31, 2008, we had a valuation allowance of $14.4 million and $14.4 million, respectively, attributable to management s determination that none of the deferred tax assets 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 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.

***Contingencies*****.** We are engaged in legal proceedings resulting from several patent infringement actions against us. 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 adopted the provisions of ASC 718-10-30 *Compensation Stock Compensation Overall Initial Measurement*, under the modified prospective method. ASC 718-10-30 eliminates the alternative of applying the intrinsic value measurement to stock compensation awards issued to employees. Rather, the 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. If these assumptions change, stock-based compensation may differ significantly from what we have recorded in the past. 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.*** We adopted the provisions of ASC 820-10 *Fair Value Measurements and Disclosures Overall,* effective January 1, 2008. This Statement 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.

We also adopted the provisions of 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*, effective April 1, 2009. This FSP 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 based on quoted market prices. Short-term and long-term investments are stated at their fair market value.

The face value of our holdings in auction rate securities is $37.5 million, of which $20.6 million is currently classified as long-term available-for-sale investments and $16.9 million is classified as short-term trading investments. The securities that are classified as short-term trading securities have been classified as such because the Company intends to exercise its put option to sell these securities to UBS in June of 2010. These investments are accounted for in accordance with ASC 320-10, *Investments Debt and Equity Securities Overall.* 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 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. In the nine months ended September 30, 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.

**Table of Contents**

The UBS put right is accounted for in accordance with ASC 820-10-35 *Fair Value Measurement and Disclosures Overall Subsequent Measurement.* We value the UBS put right at fair value, which is estimated to be equal to the par value of the auction-rate securities less their fair value as determined by management. Refer to Note 8, Fair Value Measurements for further information.

Based on certain assumptions described in Note 8 to our condensed consolidated financial statements and the Liquidity and Capital Resources section of Part I, Item 2 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.

***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 September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| Revenue | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of revenue | 39.3% | 37.2% | 40.6% | 37.0% |
| Gross profit | 60.7% | 62.8% | 59.4% | 63.0% |
| Operating expenses: | | | | |
| Research and development | 21.0% | 19.3% | 23.6% | 20.3% |
| Selling, general and administrative | 19.7% | 19.6% | 22.4% | 21.6% |
| Litigation expense | 5.9% | 2.2% | 6.0% | 4.9% |
| Litigation provision reversal, net | (13.3)% | 0.0% | (5.4)% | 0.0% |
| Total operating expenses | 33.3% | 41.1% | 46.6% | 46.8% |
| Income from operations | 27.4% | 21.7% | 12.8% | 16.2% |
| Other income (expense): | | | | |
| Interest and other income | 0.3% | 1.4% | 0.7% | 2.3% |
| Interest and other expense | (0.2)% | (0.8)% | (0.3)% | (0.5)% |
| Total other income, net | 0.1% | 0.6% | 0.4% | 1.8% |
| Income before income taxes | 27.5% | 22.3% | 13.2% | 18.0% |
| Income tax provision | 1.3% | 0.9% | 0.5% | 1.3% |
| Net income | 26.2% | 21.4% | 12.7% | 16.7% |

***Revenue.***

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | | **2009** | **2008** | |
| | **(in thousands)** | | **Change** | **(in thousands)** | | **Change** |
| Revenue | $ 47,966 | $ 48,891 | -1.9% | $ 118,461 | $ 125,802 | -5.8% |

Revenue for the three months ended September 30, 2009 was $48.0 million, a decrease of $0.9 million, or 1.9%, from $48.9 million for the three months ended September 30, 2008. The decrease in revenue reflects the continuing shift of notebook backlighting from CCFL solutions to WLED solutions. We also experienced a decline in the sales of our audio products during the three months ended September 30, 2009. The decrease in sales of our lighting control and audio products for the three months ended September 30, 2009 was offset by an increase in the sales of our DC to DC products resulting from an increase in demand for electronic products in the consumer and communications markets. Revenue for the nine months ended September 30, 2009 was $118.5 million, a decrease of $7.3 million, or 5.8%, from $125.8 million for the nine months ended September 30, 2008. The decrease in revenue for the nine months ended September 30, 2009 was primarily due to weak overall sales in the first quarter of 2009, primarily from the deterioration in the general demand for electronic products as a result of the

**Table of Contents**

worldwide financial crises and associated macro-economic slowdowns. We also experienced a decrease in the sales of our lighting control products as a result of the continuing shift of notebook backlighting from CCFL solutions to WLED solutions. These declines were partially offset by strong sales of our DC to DC products resulting from an increase in demand for electronic products in the consumer and communications markets. Sales for our audio products for the nine months ended September 30, 2009 remained flat year over year.

During the first quarter of 2009, the Company reclassified certain of its products from DC to DC Converters to Lighting Control Products. The product information for the three and nine months ended September 30, 2008 has been reclassified to conform to the current presentation. The following table illustrates changes in our revenue by product family:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| Product Family | | | | |
| DC to DC Converters | $ 36,723 | $ 31,705 | $ 87,576 | $ 82,637 |
| Lighting Control Products | 8,511 | 12,761 | 20,544 | 32,540 |
| Audio Amplifiers | 2,732 | 4,425 | 10,341 | 10,625 |
| Total | $ 47,966 | $ 48,891 | $ 118,461 | $ 125,802 |

***Gross Profit.*** Gross profit as a percentage of revenue, or gross margin, was 60.7% for the three months ended September 30, 2009 and 62.8% for the three months ended September 30, 2008. Gross profit as a percentage of revenue was 59.4% for the nine months ended September 30, 2009 and 63.0% for the nine months ended September 30, 2008. For the three and nine months ended September 30, 2009 and 2008, gross margin declined year-over-year as a result of increasing price pressure and therefore declining average selling prices and an increase in inventory reserves resulting from a decrease in the general demand for certain of our lighting control products.

***Research and Development.***

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | | **2009** | **2008** | |
| | **(in thousands)** | | **Change** | **(in thousands)** | | **Change** |
| Revenue | $ 47,966 | $ 48,891 | -1.9% | $ 118,461 | $ 125,802 | -5.8% |
| Research and development ( R&D ) (including stock-based compensation of $1,409 and $1,471 for the three months ended September 30, 2009 and 2008, respectively, and $4,656 and $4,074 for the nine months ended September 30, 2009 and 2008, respectively) | 10,080 | 9,420 | 7.0% | 27,929 | 25,594 | 9.1% |
| R&D as a percentage of revenue | 21.0% | 19.3% | | 23.6% | 20.3% | |

R&D expenses were $10.1 million, or 21.0% of revenue, for the three months ended September 30, 2009 and $9.4 million, or 19.3% of revenue, for the three months ended September 30, 2008. The year-over-year increase was primarily due to an increase in personnel and new product introduction expenses to support new product development activities. R&D expenses were $27.9 million, or 23.6% of revenue, for the nine months ended September 30, 2009 and $25.6 million, or 20.3% of revenue, for the nine months ended September 30, 2008. The year-over-year increase was primarily due to an increase in personnel and new product introduction expenses to support new product development activities and increased stock-based compensation expenses.

Table of Contents

***Selling, General and Administrative.***

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | | 2009 | 2008 | |
| | (in thousands) | | Change | (in thousands) | | Change |
| Revenue | $ 47,966 | $ 48,891 | -1.9% | $ 118,461 | $ 125,802 | -5.8% |
| Selling, general and administrative ( SG&A ) (including stock-based compensation of $1,688 and $1,787 for the three months ended September 30, 2009 and 2008, respectively, and $5,558 and $5,141 for the nine months ended September 30, 2009 and 2008, respectively) | 9,438 | 9,560 | -1.3% | 26,567 | 27,200 | -2.3% |
| SG&A as a percentage of revenue | 19.7% | 19.6% | | 22.4% | 21.6% | |

SG&A expenses were $9.4 million, or 19.7% of revenue, for the three months ended September 30, 2009 and $9.6 million, or 19.6% of revenue, for the three months ended September 30, 2008. SG&A expenses were relatively flat for the three months ended September 30, 2009 and 2008. SG&A expenses were $26.6 million, or 22.4% of revenue, for the nine months ended September 30, 2009 and $27.2 million, or 21.6% of revenue, for the nine months ended September 30, 2008. For the nine months ended September 30, 2009, SG&A expenses declined compared to the corresponding period in the prior year due to administrative efficiencies and a decrease in sales and sales-related expenses.

***Litigation Expense, excluding Litigation Provision Reversal, net.***

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | | 2009 | 2008 | |
| | (in thousands) | | Change | (in thousands) | | Change |
| Revenue | $ 47,966 | $ 48,891 | -1.9% | $ 118,461 | $ 125,802 | -5.8% |
| Litigation expense, excluding litigation provision reversal, net | 2,811 | 1,090 | 157.9% | 7,090 | 6,120 | 15.8% |
| Litigation expense, excluding litigation provision reversal, net as a percentage of revenue | 5.9% | 2.2% | | 6.0% | 4.9% | |

Litigation expenses were $2.8 million, or 5.9% of revenue, for the three months ended September 30, 2009 as compared to $1.1 million, or 2.2% of revenue, for the three months ended September 30, 2008. Litigation expenses were $7.1 million, or 6.0% of revenue, for the nine months ended September 30, 2009 as compared to $6.1 million, or 4.9% of revenue, for the nine months ended September 30, 2008. During the three and nine months ended September 30, 2009, we incurred significant legal expenses to defend our lawsuit against O2Micro. During the three and nine months ended September 30, 2008, we incurred significant legal expenses to defend our lawsuit against Linear.

***Litigation Provision Reversal, net.*** Litigation provision reversal, net was $6.4 million for the three and nine months ended September 30, 2009. During the quarter ended September 30, 2009, we completed the litigation process with respect to lawsuit related to TSE, a customer. The conclusion of this lawsuit resulted in recording a reversal of a litigation provision of approximately $7.4 million during the quarter ended September 30, 2009. This provision was recorded as a litigation provision in the second quarter of 2007 and the reversal of this provision in the current quarter is reflected in the Litigation Provision Reversal, net item in the Condensed Consolidated Statement of Operations. In connection with the completion of this lawsuit, the Company also jointly terminated an escrow agreement with TSE and retrieved the deposit of $7.4 million. This recovery was reduced by certain litigation stipulations for other parties involved in the case in the amount of $1.0 million.

***Income Tax Provision.*** The income tax provision for the three and nine months ended September 30, 2009 was $0.6 million or 4.9% of our income before income taxes and $0.6 million or 3.6% of the pre-tax income, respectively. These differ from the federal statutory rate of 34% primarily because our foreign income is taxed at lower rates and because of the benefit that we realized as a result of stock options exercised and restricted units released. The income tax provision for the three and nine months ended September 30, 2008 was $0.5 million or 4.2% of our income before income taxes and $1.7 million or 7.5% of our income before income taxes, respectively. These differ from the federal statutory rate of 34% primarily because our foreign income is taxed at lower rates and because of the benefit that we realized as a result of stock options exercised and restricted stock released.

**Liquidity and Capital Resources.**

As of September 30, 2009, we had working capital of $169.2 million, including cash and cash equivalents of $52.0 million and short-term investments of $97.8 million compared to working capital of $117.4 million, including cash and cash equivalents of $83.3 million and short-term investments of $21.9 million as of December 31, 2008. We have financed our growth primarily with proceeds from cash generated from operating activities, proceeds from the purchase of shares through the Company s employee stock purchase plan and the exercise of stock options.

For the nine months ended September 30, 2009, net cash provided by operating activities was $15.6 million. Net cash increased primarily due to strong sales during the third quarter of 2009 and an increase in accounts payable, primarily for inventory purchased during the third quarter. This was offset by an increase in accounts receivable as a result of increased shipments at the end of the quarter ended September 30, 2009 for which collections have not yet been made. Net cash provided by operating activities was $18.9 million for the nine months ended September 30, 2008, primarily due to strong sales during the third quarter of 2008. Accounts receivable increased due to increased sales in the third quarter of 2008. Inventory increased due to anticipated future demand for our products.

For the nine months ended September 30, 2009, net cash used in investing activities was $57.8 million, primarily related to the purchase of short-term investments. For the nine months ended September 30, 2008, net cash used in investing activities was $21.1 million, primarily related to the purchase of auction-rate securities which the Company was not able to sell during the period and the purchase of $3.6 million in capital equipment.

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

The market for auction-rate securities with interest rates that reset through a Dutch auction every 7 to 35 days, became illiquid in 2008. As of September 30, 2009, our investment portfolio included $35.7 million, net of impairment charges of $1.8 million, in government-backed student loan auction-rate securities. The portfolio also included a UBS auction-rate put right, which was valued at $0.7 million in accordance with the fair value measurement provisions of ASC 820-10-35. During the nine months ended September 30, 2009, auction rate securities with a face value of $1.3 million were sold at par through successful auctions. However, the remaining auction rate securities in the portfolio with a face value of approximately $37.5 million have failed to reset through successful auctions and it is unclear as to when these investments will regain their liquidity. The underlying maturity of these auction-rate securities is up to 38 years and the underlying credit quality of these instruments in which we have invested remain generally AAA rated, with $12.2 million in auction rate securities having been downgraded by Moody s during the nine months ended September 30, 2009.

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 or it will more likely than not be required to sell the security before anticipated recovery. Other-than-temporary impairment charges are recorded in other income (expenses) in the Condensed Consolidated Statement of Operations.

In October 2008, we accepted an offer to participate in an auction-rate security rights offering from UBS to sell up to $18.2 million in face value amount of eligible auction-rate securities commencing in June 2010. In 2009, $1.3 million of these auction-rate securities were called at par, leaving $16.9 million in eligible auction-rate securities remaining at UBS. The offer gives us the right but not the obligation to sell these securities at par to UBS and allows us to borrow up to $16.9 million beginning October 7, 2008. In accepting the offer, we also entered into a release of claims in favor of UBS.

Since we accepted this put right from UBS, we intend to sell these auction-rate securities at par to UBS commencing in June 2010. These securities have been reclassified as trading securities and the cumulative impairment related to these auction-rate securities is $0.7 million. Therefore, the impairment related to these securities has been recorded in other income (expense) in the Condensed Consolidated Statement of Operations.

Having accepted UBS rights offering, we valued the put right at fair value, which was estimated to be equal to the par value of the auction-rate securities less their fair value as determined by management. The value of the put right was $0.7 million, the effect of which has been recorded by the Company in other income in the Condensed Consolidated Statement of Operations. The UBS rights offering is being accounted for as a fair-value instrument under ASC 820-10-35 and as such, all future changes in the fair value of these instruments will be recognized in other income (expense) in the Condensed Consolidated Statement of Operations.

**Table of Contents**

For the remaining auction-rate securities for which the rights offering (described above) does not apply, and which have a face value of $20.6 million, management concluded that as of September 30, 2009, the cumulative impairment was temporary 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 the nine months ended September 30, 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 $9.0 million in auction rate securities having been downgraded by Moody s to A3-Baa3 during the nine months ended September 30, 2009 and there have been no downgrades in the three months ended September 30, 2009; and

6. All scheduled interest payments have been made pursuant to the reset terms and conditions.

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 for which a put right was not provided. 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. MPS portfolio includes three such securities, one of which has a senior parity ratio of approximately 115%, which is substantially above the expected student-loan default rate for that security. Conversely, the senior parity ratio for the other two securities is approximately 105%. 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. The potential credit loss associated with these securities was $70,000, which the Company recorded in other expense in its Condensed Consolidated Statement of Operations during the nine months ended September 30, 2009.

Unless another rights offering or other similar offers are 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.

The valuation of the auction-rate 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. To determine the fair value of the auction-rate securities at September 30, 2009, June 30, 2009, March 31, 2009 and December 31, 2008, we used a discounted cash flow model, for which there are three valuation parameters, including time-to-liquidity, discount rate and expected return. The following are the values used in the discounted cash flow model:

| | December 31, 2008 | March 31, 2009 | June 30, 2009 | September 30, 2009 |
|---|---|---|---|---|
| Time-to-Liquidity | 18 months | 24 months | 21 months | 24 months |

| | | | | |
|---|---|---|---|---|
| Expected Return (Based on the 2-year treasury rate, plus a contractual penalty rate) | 2.3% | 1.6% | 2.1% | 2.1% |
| Discount Rate (Based on the 2-year LIBOR, the cost of debt and a liquidity risk premium) | 6.8% | 5.5% - 8.5%, depending on the credit-rating of the security | 5.3% - 10.1%, depending on the credit-rating of the security | 4.8% - 9.6%, depending on the credit-rating of the security |

From the fourth quarter of 2008 to the first quarter of 2009, we increased the time-to-liquidity from 1.5 years to 2.0 years, as we do not believe that liquidity will return to the market until then. We also experienced a downgrade in certain of our auction-rate securities by Moody s. These changes increased the impairment of these securities. However, there was a decrease in the FFELPs-guaranteed student-loan credit default swap spread from 325 basis points at the end of the fourth quarter of 2008 to 150 basis points at the end of the first quarter of 2009, which significantly reduced the impairment of these securities. As a result of offsetting charges, the total cumulative impairment charge of $2.7 million did not change from December 31, 2008. However, the temporary impairment charge increased from $1.4 million at the end of 2008 to $1.5 million at the end of the first quarter of 2009. Other-than-temporary impairment charges decreased from $1.3 million at the end of 2008 to $1.2 million at the end of the first quarter of 2009.

From the first quarter of 2009 to the second quarter of 2009, we decreased the time to liquidity from 2.0 years to 1.8 years, as three months have elapsed between periods. We also experienced a decrease in the FFELPS-guaranteed student-loan credit default swap spread from 150 basis points at the end of the first quarter of 2009 to 80 basis points at the end of the second quarter of 2009. Based on the quarterly change in the parameters used in the discounted cash flow model, the total cumulative impairment charge decreased from $2.7 million at the end of the first quarter of 2009 to $2.0 million at the end of the second quarter of 2009. Temporary impairment charges decreased from $1.5 million at the end of the first quarter of 2009 to $1.1 million at the end of the second quarter of 2009. We also recognized $70,000 in credit losses in other income (expense) in the Condensed Consolidated Statement of Operations as detailed in Note 8 Fair Value Measurements.

From the second quarter of 2009 to the third quarter of 2009, we increased the time to liquidity from 1.8 years to two years even though $1.3 million of our holdings in auction rate securities were called at par. The credit markets for these types of securities remain tight and it is unclear as to when the markets will regain its liquidity. We also experienced a decrease in the FFELPs-guaranteed student loan credit default swap spread from 80 basis points at the end of the second quarter of 2009 to 30 basis points at the end of the third quarter of 2009. Based on the quarterly change in the parameters used in the discounted cash flow model, the cumulative impairment decreased from $2.0 million at the end of the second quarter to $1.8 million at the end of the third quarter. Temporary impairment charges remained relatively constant between quarters. However, we experienced a $0.2 million decrease in other-than-temporary impairment charges related to the auction-rate securities held at UBS, which was fully offset by the change in the value of the UBS put right.

Net cash provided by financing activities for the nine months ended September 30, 2009 was $10.7 million, primarily from the issuance of common stock in the amount of $10.2 million. Net cash used in financing activities for the nine months ended September 30, 2008 was $5.0 million, primarily from the repurchase of $20.0 million of our common stock of which our Board approved a repurchase of up to $25.0 million. This was partially offset by the proceeds related to the issuance of common stock in the amount of $14.4 million and excess tax benefits related to the exercise of options of $0.6 million.

Although cash requirements will fluctuate based on the timing and extent of many factors such as those discussed above, we believe that cash generated from operations, together with the liquidity provided by existing cash 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.***

We lease our headquarters and sales offices in San Jose, California under a non-cancelable operating lease which expires in October 2016. 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 becomes available to us in March 2011. We also lease our sales offices in Japan, China, Taiwan and Korea.

As of September 30, 2009, our total outstanding purchase commitments with vendors were $16.7 million, which includes wafer purchases from our two foundries and the purchase of assembly services primarily from multiple contractors in Asia. This compares to purchase commitments of $10.3 million as of December 31, 2008.

Our contractual obligations have not changed significantly from that disclosed in our annual report on Form 10-K filed with the SEC on February 27, 2009.

As of September 30, 2009, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of the Securities and Exchange Commission s Regulation S-K.

Table of Contents

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

For a discussion of market risks at December 31, 2008, 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, 2008 filed with the SEC on February 27, 2009. During the three and nine months ended September 30, 2009, there were no material changes or developments that would materially alter the market risk assessment performed as of December 31, 2008.

**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**

***O2Micro***

We have been engaged in a number of legal proceedings involving patent infringement claims with O2Micro, Inc. and its parent corporation, O2Micro. Currently, there are two proceedings pending, both involving O2 Micro s U.S. Patent No. 7,417,382 ( 382 patent). One proceeding is pending in the International Trade Commission. The other is pending in the United States District Court for the Northern District of California. O2 Micro alleges that certain of our CCFL backlight inverter products infringe its patents. We allege that we do not infringe and the patent is invalid. The ITC Investigation hearing is scheduled to begin on October 19, 2009. Trial in the Northern District of California case is scheduled for August 2, 2010. We are not able to reasonably estimate the probability of loss or the range of possible loss in this case.

***Taiwan Sumida Electronics***

During the quarter ended September 30, 2009, we completed the litigation process with respect to lawsuit related to TSE, a customer. The conclusion of this lawsuit resulted in recording a reversal of a litigation provision of approximately $7.4 million during the quarter ended September 30, 2009. This provision was recorded as a litigation provision in the second quarter of 2007 and the reversal of this provision in the current quarter is reflected in the Litigation Provision Reversal, net item in the Condensed Consolidated Statement of Operations. In connection with the completion of this lawsuit, the Company also jointly terminated an escrow agreement with TSE and retrieved the deposit of $7.4 million.

***Linear Technology Corporation***

On July 1, 2008, the United States District Court for the District of Delaware held as a matter of law that we did not breach our October 1, 2005 Settlement and License Agreement with Linear. Based upon that ruling, we anticipate filing a motion to seek recovery of our attorney fees when the final judgment is entered. The court has not issued its final judgment concerning the patent infringement, validity, and enforceability issues.

Table of Contents

***Chip Advanced Technology Inc.***

On December 12, 2007, we filed a patent infringement lawsuit in the U.S. District Court for the Central District of California against CAT, asserting that CAT willfully infringed a MPS patent that enables efficient low voltage, low current power conversions, such as DC-DC step down converters. CAT was subsequently acquired by ITE Technology ( ITE ), a successor in interest of CAT. On July 28, 2009, we entered into a license agreement and a settlement agreement with ITE in which the parties agreed to mutually release and dismiss the complaints.

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

**If we are unsuccessful in any of the legal proceedings involving us and O2Micro, we could be prevented from selling many of our products and/or be required to pay substantial damages. An unfavorable outcome or an additional award of damages, attorneys fees or an injunction could cause our revenue to decline significantly and could severely harm our business and operating results.**

We are engaged in legal proceedings with O2Micro. These proceedings involve various claims and counterclaims alleging, among other things, patent infringement. O2Micro has also in the past taken legal action against certain of our customers, which we were obligated to indemnify. Other new or existing customers may request similar indemnity from us because of continued legal actions between us and O2Micro. See the section entitled Part II Item 1. Legal Proceedings of this quarterly report on Form 10-Q for more information.

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

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

Until our legal proceedings with O2Micro and Linear are resolved, we will continue to incur significant legal expenses that vary with the level of activity in each of these proceedings. This level of activity is not entirely within our control as we may need to respond to legal actions by the opposing parties or scheduling decisions by the judges. Consequently, it is difficult for us to forecast our legal expenses for any given quarter, which adversely affects our ability to forecast our expected results of operations in general. If we fail to meet the expectations of securities or industry analysts as a result of unexpected changes in our legal expenses, our stock price could be impacted.

**Our ongoing legal proceedings and the potential for additional legal proceedings have diverted, and may continue to divert, financial and management resources.**

The semiconductor industry is characterized by frequent claims of infringement and litigation regarding patent and other intellectual property rights, such as our litigation matters with O2Micro and Linear. Patent infringement is an ongoing risk, in part because other companies in our industry could have patent rights that may not be identifiable when we initiate development efforts. Litigation may be necessary to enforce our intellectual property rights, and we may have to defend

Table of Contents

ourselves against additional infringement claims. Such litigation is very costly. In the event any third party makes a new infringement claim against us or our customers, we could incur additional ongoing legal expenses. Our management team may also be required to devote a great deal of time, effort and energy to these legal proceedings, which could adversely affect our business.

**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.**

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 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 with O2Micro and Linear and any future litigation;
- 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;
- the timing of new product introductions by us and our competitors;
- the acceptance of our new products in the marketplace;
- our ability to develop new process technologies and achieve volume production;
- the scheduling, rescheduling, or cancellation of orders by our customers;
- the cyclical nature of demand for our customers products;
- inventory levels and product obsolescence;

- seasonality and variability in the computer, consumer electronics, and communications markets;

- the availability of adequate manufacturing capacity from our outside suppliers;

- changes in manufacturing yields; and

- movements in exchange rates, interest rates or tax rates.

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

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

The market for government-backed student loan auction-rate securities with interest rates that reset through a Dutch auction every 7 to 35 days, became illiquid in 2008. As of September 30, 2009, the Company s investment portfolio included $35.7 million, net of impairment charges of $1.8 million, in government-backed student loan auction-rate securities. As of that date, $37.5 million, the face value of our auction-rate security investments, have failed to reset through successful auctions and it is unclear as to when these investments will regain their liquidity. The underlying maturity of these auction-rate securities is up to 38 years.

Based on certain assumptions described in Note 8 to our consolidated financial statements and the Liquidity and Capital Resources section of Part I, Item 2 of this quarterly report on Form 10-Q, we recorded impairment charges on these investments. The valuation 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. We experienced our first failed auction in mid-February 2008. Although we accepted an offer to participate in an auction-rate securities rights offering from UBS in October 2008 to sell up to $16.9 million in eligible auction-rate

Table of Contents

securities held by us at par to UBS commencing in June 2010, if UBS does not follow through on its commitment to purchase the auction-rate securities at par or the auctions continue to fail, the liquidity of our investment portfolio may be negatively impacted and the value of our investment portfolio could decline.

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

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

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

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

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

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

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

**If demand for our products declines in the major end markets that we serve, our revenue will decrease.**

We believe that the application of our products in the computer, consumer electronics and communications markets will continue to account for the majority of our revenue. If the demand for our products declines in the major end markets that we serve, our revenue will decrease. In the fourth quarter of 2008 and continuing into 2009, the semiconductor industry as a whole saw and may continue to see dramatic declines in overall demand, which affects MPS. In addition, as technology evolves, the ability to integrate the functionalities of various components, including our discrete semiconductor products, onto a single chip and/or onto other components of systems containing our products increases. Should our customers require integrated solutions that we do not offer, demand for our products could decrease, and our business and results of operations could be adversely affected.

**Certain of our products contain mercury, which is the subject of environmental concerns.**

Our CCFL tubes contain mercury, which is the subject of environmental concerns, particularly in Europe. Should environmental issues impair the widespread use of our CCFL-based products, and should we be unable to produce replacement products based on LED lighting fast enough to compensate for the loss of our CCFL-related business, our business and results of operations could be adversely affected.

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

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

Table of Contents

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

Our profitability is dependent on many factors, including:

- our sales, which because of our turns business (i.e., orders received and shipped within the same fiscal quarter), is difficult to accurately forecast;
- consumer electronic sales, which has experienced and may continue to experience a downturn as a result of the worldwide economic crisis;
- our competition, which could adversely impact our selling prices and our potential sales;
- our manufacturing costs, including our ability to negotiate with our vendors and our ability to efficiently run our test facility in China; and
- our operating expenses, including general and administrative expenses, selling and marketing expenses, stock-based compensation expenses, litigation expenses, which we expect to be significant due to the litigation in which we are involved, and research and development expenses relating to products that will not be introduced and will not generate revenue until later periods, if at all.

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

**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;
- 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, including the O2Micro and Linear;
- investor perceptions of us and our business;

- 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;
- 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; 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.

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

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

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

Due to the complexity associated with the calculation of our tax provision, we have hired independent tax advisors to assist us in the calculation. If we or our independent tax advisors fail to resolve or fully understand certain issues, we could be subject to errors, which would result in us having to restate our financial statements. Restatements are generally costly and could adversely impact our results of operations and/or have a negative impact on the trading price of our common stock.

**We face risks in connection with our internal control over financial reporting related to income taxes.**

Because of the complexity of our tax structure, we have had errors in our financial statements in the calculation of our tax provision that previously resulted in restatements of our prior year financial results. Although we believe that we have implemented appropriate internal control over financial reporting related to the computation of our income tax provision, we cannot be certain that any measures we have taken or may take in the future will ensure that we implement and maintain adequate internal control over financial reporting and that we will avoid any material weakness in the future. In addition, we cannot assure you that we will not in the future identify further material weaknesses in our internal control over financial reporting related to the calculation of our income tax provision that we have not discovered to date, which may impact the reliability of our financial reporting and financial statements.

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

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

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

We market our products through distribution arrangements and through our direct sales and applications support organization to customers that include OEMs, ODMs and electronic manufacturing service providers. Receivables from our customers are generally not secured by any type of collateral and are subject to the risk of being uncollectible. For the three months ended September 30, 2009, sales to our three largest distributors and/or customers accounted for approximately 35% of our total revenue. Significant deterioration in the liquidity or financial condition of any of our major customers or any group of our customers could have a material adverse impact on the collectibility of our accounts receivable and our future operating results. We primarily conduct our sales on a purchase order basis, and we do not have any long-term supply contracts.

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

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

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

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

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

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

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

We have a supply arrangement with two suppliers for the production of wafers. Should any of our suppliers become insolvent, we many not be able to fulfill our customer orders, which would likely cause a decline in our revenue. In the past, many wafer foundries in the semiconductor industry were operating well below normal capacity, including the two suppliers to MPS, and consequently our suppliers ability to meet their financial obligations were potentially impaired.

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

Although we provide our suppliers with rolling forecasts of our production requirements, their ability to provide wafers to us is limited by the available capacity, particularly capacity in the geometries we require, at the facilities in which they manufacture wafers for us. An increased need for capacity to meet internal demands or demands of other customers could cause our suppliers to reduce capacity available to us. Our suppliers may also require us to pay amounts in excess of contracted or anticipated amounts for wafer deliveries or require us to make other concessions in order to acquire the wafer supply necessary to meet our customer requirements. If our suppliers extend lead times, limit supplies or the types of capacity we require, or increase prices due to capacity constraints or other factors, our revenue and gross margin may decline.

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

Table of Contents

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

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

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

We derive most of our revenue from customers located in Asia through direct or indirect sales through distribution arrangements with parties located in Asia. As a result, we are subject to increased risks due to this geographic concentration of business and operations. For the three months ended September 30, 2009, approximately 84% of our revenue was from customers in Asia. There are risks inherent in doing business internationally, including:

- changes in, or impositions of, legislative or regulatory requirements, including tax laws in the United States and in the countries in which we manufacture or sell our products;
- trade restrictions, including restrictions imposed by the United States government on trading with parties in foreign countries;
- currency exchange rate fluctuations impacting intra-company transactions;
- transportation delays;
- changes in tax regulations in China that may impact our tax status in Chengdu;
- multi-tiered distribution channels that lack visibility to end customer pricing and purchase patterns;
- international political relationships and threats of war;
- terrorism and threats of terrorism;
- epidemics and illnesses;
- work stoppages and infrastructure problems due to adverse weather conditions or natural disasters;
- economic and political instability;

- changes in import/export regulations, tariffs, and freight rates;
- longer accounts receivable collection cycles and difficulties in collecting accounts receivables;
- enforcing contracts generally; and
- less effective protection of intellectual property and contractual arrangements.

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

Our products incorporate commodities such as gold, platinum, copper and silicon. The price and availability of these commodities and other like commodities that we use could negatively impact our business and results of operations.

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

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

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

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

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

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

We have a testing facility in China that began operations in 2006. In addition to the risks discussed elsewhere in this quarterly report, we face the following risks, among others:

- inability to maintain appropriate and acceptable manufacturing controls; and

- higher than anticipated overhead and other costs of operation.

If we are unable to continue a fully operational status with appropriate controls, we may incur higher costs than our current expense levels, which would affect our gross margins. In addition, if capacity restraints result in significant delays in product shipments, our business and results of operations would be adversely affected.

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

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

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

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

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

As a fabless semiconductor company, we purchase our inventory from a third party manufacturer in advance of selling our product. We place orders with our manufacturer based on existing and expected orders from our customers for particular

Table of Contents

products. While our contracts with our customers and distributors include lead time requirements and cancellation penalties that are designed to protect us from misalignment between customer orders and inventory levels, we must nonetheless make some predictions when we place orders with our manufacturer. In the event that our predictions are inaccurate due to unexpected increases in orders or unavailability of product within the time frame that is required, we may have insufficient inventory to meet our customer demands. In the event that we order products that we are unable to sell due to a decrease in orders, unexpected order cancellations, injunctions due to patent litigations, or product returns, we may have excess inventory which, if not sold, may need to be disposed of. If any of these situations were to arise, it could have a material impact on our business and financial position.

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

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

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

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

- our products must be designed into a customer s product or system; and

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

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

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

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

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

Since 2006, we significantly increased the quantity and quality of our sales, applications, financial and legal staff. However, if we fail to continue to adequately staff these areas, maintain or upgrade our business systems and maintain internal controls that meet the demands of our business, our ability to operate effectively will suffer. The operation of our business also depends upon our ability to retain these employees, as these employees hold a significant amount of institutional knowledge about us and our products, and, if they were to terminate their employment, our sales and internal control over financial reporting could be adversely affected.

Table of Contents

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

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

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

As a part of our business strategy, from time to time we review acquisition prospects that would complement our current product offerings, enhance our design capability or offer other competitive opportunities. In the event of future acquisitions, we could use a significant portion of our available cash, cash equivalents and short-term investments, issue equity securities which would dilute current stockholders percentage ownership, and/or incur substantial debt or contingent liabilities. Such actions by us could impact our operating results and/or the price of our common stock. In addition, if we are unsuccessful in integrating any acquired company into our operations or if integration is more difficult than anticipated, we may experience disruptions that could harm our business.

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

The analog and mixed-signal semiconductor industry is highly competitive, and we expect competitive pressures to continue. Our ability to compete effectively and to expand our business will depend on our ability to continue to recruit applications and design talent, our ability to introduce new products, and our ability to maintain the rate at which we introduce these new products. We compete with domestic and non-domestic semiconductor companies, many of which have substantially greater financial and other resources with which to pursue engineering, manufacturing, marketing, and distribution of their products. We are in direct and active competition, with respect to one or more of our product lines, with at least 10 manufacturers of such products, of varying size and financial strength. The number of our competitors has grown due to the expansion of the market segments in which we participate. We consider our competitors to include, but not be limited to: Analog Devices, Fairchild Semiconductor, Intersil, Linear, Maxim Integrated Products, Micrel, Microsemi, National Semiconductor, O2Micro, RichTech, Semtech, STMicroelectronic and Texas Instruments. We expect continued competition from existing competitors as well as competition from new entrants in the semiconductor market.

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

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

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

**Because of their significant stock ownership, our officers and directors will be able to exert significant influence over our future direction.**

Executive officers, directors, and affiliated entities beneficially owned in aggregate, approximately 14% of our outstanding common stock as of September 30, 2009. These stockholders, if acting together, would be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions.

Table of Contents

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

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

Our facilities in Chengdu, China are located in a seismically active area, as evidenced by the May 2008 earthquake that was centered in the Sichuan Province of China. Although there was no damage to our facilities as a result of that earthquake, should there be additional earthquakes in the area, we may incur losses and our business, financial condition and/or operating results may suffer.

**ITEM 6. EXHIBITS**

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| 3.1(1) | Amended and Restated Certificate of Incorporation |
| 3.2(2) | Amended and Restated Bylaws |
| 31.1 | Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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

(1) Incorporated by reference to Exhibit 3.2 of the Registrant s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.

(2) Incorporated by reference to Exhibit 3.4 of the Registrant s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.

Table of Contents

**MONOLITHIC POWER SYSTEMS, INC**

**SIGNATURE**

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

MONOLITHIC POWER SYSTEMS, INC.

Dated: October 22, 2009

/s/ C. RICHARD NEELY, JR.
**C. Richard Neely, Jr.**
**Chief Financial Officer**
**(Principal Financial and Accounting Officer)**

41

**Table of Contents**

EXHIBIT INDEX

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