MONOLITHIC POWER SYSTEMS INC
Form 10-Q
October 31, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.

(Exact name of registrant as specified in its charter)

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

79 Great Oaks Boulevard, San Jose, CA 95119

(Address of principal executive offices)(Zip code)

(408) 826-0600

(Registrant’s telephone number, including area code)

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

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

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

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

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

There were 38,745,011 shares of the registrant’s common stock issued and outstanding as of October 24, 2014.

MONOLITHIC POWER SYSTEMS, INC.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

(Unaudited)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 101,812	$ 101,213
Short-term investments	126,849	125,126
Accounts receivable, net	24,274	23,730
Inventories	41,587	39,737
Prepaid expenses and other current assets	2,788	2,280
Total current assets	297,310	292,086
Property and equipment, net	63,428	64,837
Long-term investments	9,795	9,860
Goodwill	6,571	-
Acquisition-related intangible assets, net	7,178	-
Deferred income tax assets, net	477	481
Other long-term assets	7,940	1,644
Total assets	$ 392,699	$ 368,908
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 14,793	$ 10,694
Accrued compensation and related benefits	6,607	10,419
Accrued liabilities	15,528	17,376
Total current liabilities	36,928	38,489
Income tax liabilities	4,746	5,542
Other long-term liabilities	9,364	1,478
Total liabilities	51,038	45,509

Commitments and contingencies (Notes 8 and 12)		
Stockholders' equity:		
Common stock, $0.001 par value; shares authorized: 150,000; shares issued and outstanding: 38,804 and 38,291 as of September 30, 2014 and December 31, 2013, respectively	238,602	234,201
Retained earnings	97,398	82,938
Accumulated other comprehensive income	5,661	6,260
Total stockholders' equity	341,661	323,399
Total liabilities and stockholders' equity	$ 392,699	$ 368,908

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Revenue	$78,335	$65,347	$206,832	$174,531
Cost of revenue	35,872	30,053	95,173	80,924
Gross profit	42,463	35,294	111,659	93,607
Operating expenses:				
Research and development	14,679	12,643	43,649	37,246
Selling, general and administrative	17,006	13,891	49,968	40,941
Litigation expense (benefit), net	332	104	(8,093)	(455)
Total operating expenses	32,017	26,638	85,524	77,732
Income from operations	10,446	8,656	26,135	15,875
Interest and other income (expense), net	202	(59)	686	149
Income before income taxes	10,648	8,597	26,821	16,024
Income tax provision (benefit)	(573)	1,187	186	625
Net income	$11,221	$7,410	$26,635	$15,399
Net income per share:				
Basic	$0.29	$0.20	$0.69	$0.42
Diluted	$0.28	$0.19	$0.67	$0.40
Weighted-average shares outstanding:				
Basic	38,785	37,910	38,646	37,079
Diluted	39,727	39,009	39,618	38,419
Cash dividends declared per common share	$0.15	$-	$0.30	$-

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Net income	$11,221	$7,410	$26,635	$15,399
Other comprehensive income (loss), net of tax:				
Change in unrealized gains (losses) on auction-rate securities, net of $0 tax for the three and nine months ended September 30, 2014 and 2013	(53)	149	(65)	117
Change in unrealized gains (losses) on other available-for-sale securities, net of $0 tax for the three and nine months ended September 30, 2014 and 2013	(28)	34	(16)	12
Foreign currency translation adjustments	(98)	431	(518)	1,595
Total other comprehensive income (loss), net of tax	(179)	614	(599)	1,724
Comprehensive income	$11,042	$8,024	$26,036	$17,123

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2014	**2013**
Cash flows from operating activities:		
Net income	$26,635	$15,399
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,688	8,960
Amortization and realized gain/loss on investments	197	320
Stock-based compensation	24,872	15,081
Changes in operating assets and liabilities, net of effects of an acquisition:		
Accounts receivable	(516)	(2,573)
Inventories	(1,800)	(10,851)
Prepaid expenses and other assets	(1,868)	463
Accounts payable	3,864	1,164
Accrued liabilities	(2,885)	3,492
Accrued income taxes payable and noncurrent tax liabilities	(801)	(215)
Accrued compensation and related benefits	(3,789)	(1,002)
Net cash provided by operating activities	53,597	30,238
Cash flows from investing activities:		
Property and equipment purchases	(7,730)	(15,424)
Purchases of short-term investments	(100,706)	(62,374)
Proceeds from sale of short-term investments	98,752	55,700
Proceeds from sale of long-term investments	-	25
Investments related to deferred compensation plan	(4,860)	(309)
Cash paid for an acquisition, net of cash acquired	(11,590)	-
Net cash used in investing activities	(26,134)	(22,382)
Cash flows from financing activities:		
Property and equipment purchased on extended payment terms	(250)	-
Proceeds from issuance of common shares	10,403	32,654
Proceeds from employee stock purchase plan	2,078	2,145
Repurchases of common shares	(32,976)	(7,973)
Dividends and dividend equivalents paid	(5,817)	-
Net cash provided by (used in) financing activities	(26,562)	26,826
Effect of change in exchange rates	(302)	660

Net increase in cash and cash equivalents	599	35,342
Cash and cash equivalents, beginning of period	101,213	75,104
Cash and cash equivalents, end of period	$101,812	$110,446
Supplemental disclosures for cash flow information:		
Cash paid for taxes	$981	$847
Supplemental disclosures of non-cash investing and financing activities:		
Liability accrued for property and equipment purchases	783	2,081
Liability accrued for dividends and dividend equivalents	6,359	-
Fair value of contingent consideration related to an acquisition	2,507	-

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

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

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

Summary of Significant Accounting Policies

Other than the adoption of the following new significant accounting policies, there have been no changes to the Company's significant accounting policies during the three and nine months ended September 30, 2014 as compared to those described in the Company's audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2013.

Goodwill and Acquisition-Related Intangible Assets – Goodwill represents the excess of the fair value of purchase consideration over the fair value of net tangible and identified intangible assets as of the date of acquisition. In-process research and development ("IPR&D") assets represent the fair value of incomplete R&D projects that had not reached technological feasibility as of the date of acquisition. The IPR&D assets are initially capitalized at fair value as intangible assets with indefinite lives. When the IPR&D projects are completed, they are reclassified as amortizable intangible assets and are amortized over their estimated useful lives. Alternatively, if the IPR&D projects are abandoned, they are impaired and expensed to research and development. Acquisition-related intangible assets with finite lives consist of know-how and developed technologies. These assets are amortized on a straight-line basis over estimated useful lives ranging from three to five years and the amortization expense is recorded in cost of revenue in the Condensed Consolidated Statements of Operations.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The standard gives guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists, with the purpose of reducing diversity in practice. This new standard requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. The Company adopted this standard in the first quarter of 2014 prospectively and the adoption did not have an impact on its consolidated financial position, results of operations or cash flows.

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

- Identify the contract with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognize revenue when the entity satisfies a performance obligation

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

2. STOCK-BASED COMPENSATION

Stock Plans

As of September 30, 2014, approximately 4.4 million shares were available for future issuance under the 2004 Equity Incentive Plan (the "2004 Plan"). The 2004 Plan will expire on November 12, 2014. Once the 2004 Plan expires, the Company will no longer be able to grant equity awards under the 2004 Plan, and any shares otherwise remaining available for future grants under the 2004 Plan will no longer be available for issuance.

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

Stock-Based Compensation Expense

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Cost of revenue	$246	$163	$669	$465
Research and development	2,388	1,491	6,638	4,557
Selling, general and administrative	6,225	3,577	17,565	10,059
Tax benefit	-	(80)	-	(175)
Total stock-based compensation expense	$8,859	$5,151	$24,872	$14,906

Restricted Stock

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

	Time-Based RSUs	Weighted-Average Grant Date Fair Value Per Share	PSUs		Weighted-Average Grant Date Fair Value Per Share	MSUs	Weighted-Average Grant Date Fair Value Per Share	Total	Weighted-Average Grant Date Fair Value Per Share
Outstanding at January 1, 2014	754,306	$ 19.41	1,027,782		$ 23.02	1,800,000	$ 23.57	3,582,088	$ 22.53
Awards granted	312,697	36.52	1,091,001	(1)	34.23	-	-	1,403,698	34.74
Performance adjustment	-	-	(141,626)	(2)	31.54	-	-	(141,626)	31.54
Awards released	(378,142)	19.76	(276,512)		18.12	-	-	(654,654)	19.07
Awards forfeited	(24,039)	19.81	(17,097)		19.79	-	-	(41,136)	19.80
Outstanding at September 30, 2014	664,822	27.25	1,683,548		27.87	1,800,000	23.57	4,148,370	25.90

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

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

The intrinsic value related to awards released for the three months ended September 30, 2014 and 2013 was $5.3 million and $3.2 million, respectively. The intrinsic value related to awards released for the nine months ended September 30, 2014 and 2013 was $23.8 million and $14.8 million, respectively. As of September 30, 2014, the total intrinsic value of outstanding awards was $182.7 million, based on the closing stock price of $44.05. As of September 30, 2014, unamortized compensation expense related to outstanding awards was approximately $79.5 million with a weighted-average remaining recognition period of approximately six years.

2014 PSUs and Time-Based RSUs:

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

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

Based on the Company’s revenue forecast as of September 30, 2014, the Company has determined that it is probable that it will be able to achieve or exceed the pre-determined revenue targets set for the 2014 Executive PSUs and the majority of the 2014 Non-Executive PSUs. The Company continues to evaluate the expected performance against the pre-determined goals and will adjust stock-based compensation expense based on this assessment accordingly.

In connection with the acquisition of Sensima Technology SA (“Sensima”) in July 2014, the Board of Directors granted time-based RSUs and PSUs to key Sensima employees who became employees of the Company. See Note 3 for further discussion.

Stock Options

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

	Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2014	1,356,446	$ 15.86	1.9	$25,505,753
Options exercised	(638,018)	16.30		
Options forfeited and expired	(8,397)	11.22		
Outstanding at September 30, 2014	710,031	15.51	1.3	20,265,815
Options exercisable at September 30, 2014 and expected to vest	709,524	15.52	1.3	20,245,815
Options exercisable at September 30, 2014	677,985	15.63	1.2	19,268,944

Total intrinsic value of options exercised was $2.3 million and $11.3 million for the three months ended September 30, 2014 and 2013, respectively. Total intrinsic value of options exercised was $14.1 million and $22.2 million for the nine months ended September 30, 2014 and 2013, respectively. The net cash proceeds from the exercise of stock options were $10.4 million and $32.7 million for the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, unamortized compensation expense related to unvested options was approximately $0.2 million with a weighted-average remaining recognition period of approximately one year.

Employee Stock Purchase Plan ("ESPP")

For the three months ended September 30, 2014 and 2013, 34,000 and 46,000 shares, respectively, were issued under the ESPP. For the nine months ended September 30, 2014 and 2013, 78,000 and 111,000 shares, respectively, were issued under the ESPP. As of September 30, 2014, 4.7 million shares were available for future issuance.

The intrinsic value of stock purchased was $0.5 million and $0.3 million for the three months ended September 30, 2014 and 2013, respectively. The intrinsic value of stock purchased was $0.9 million and $0.8 million for the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, the unamortized expense was $0.2 million, which will be recognized through the first quarter of 2015. The Black-Scholes model was used to value the employee stock purchase rights with the following weighted-average assumptions:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2014	**2013**	**2014**	**2013**
Expected term (years)	0.5	0.5	0.5	0.5
Expected volatility	25.1%	27.5%	29.5%	28.0%
Risk-free interest rate	0.1 %	0.1 %	0.1 %	0.1 %
Dividend yield	1.4 %	-	0.7 %	-

Cash proceeds from employee stock purchases were $2.1 million for both the nine months ended September 30, 2014 and 2013.

3. ACQUISITION

On July 22, 2014 (the "Acquisition Date"), the Company acquired 100% of the outstanding capital stock of Sensima, a company based in Switzerland that develops magnetic sensor technologies for angle measurements as well as three-dimensional magnetic field sensing. The acquisition is expected to create new opportunities with customers by offering enhanced solutions in power management for key industries such as automotive, industrial and cloud computing. Subsequent to the Acquisition Date, Sensima became a subsidiary of the Company and its results of operations have been included in the Company's consolidated financial statements.

Purchase Consideration

The fair value of the purchase consideration consists of the following (in thousands):

Cash paid at the Acquisition Date	$11,735
Contingent consideration	2,507
Total	$14,242

Cash paid at the Acquisition Date included $1.2 million that is being held at an escrow account for a one-year period for Sensima's satisfaction of certain representations and warranties.

The contingent consideration arrangement requires the Company to pay up to an additional $8.9 million to certain former Sensima shareholders if Sensima achieves a new product introduction as well as certain product revenue and direct margin targets in 2016. The fair value of the contingent consideration at the Acquisition Date was $2.5 million, which was estimated based on a probability-weighted analysis of possible future cash flow outcomes. The fair value of the contingent consideration is recorded in other long-term liability in the Condensed Consolidated Balance Sheets and is remeasured at the end of each reporting period, with any changes in fair value recorded in operating expense in the Condensed Consolidated Statements of Operations. Actual amounts that will ultimately be paid may differ from the obligations recorded.

The Company incurred $0.6 million of transaction costs that were expensed as incurred and included in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

Preliminary Purchase Consideration Allocation

The estimated fair value of assets acquired and liabilities assumed is as follows (in thousands):

Cash	$ 145
Other tangible assets acquired, net of liabilities assumed	42
Intangible assets:	
Know-how	1,018
Developed technologies	4,421
IPR&D	2,045
Total identifiable net assets acquired	7,671
Goodwill	6,571
Total net assets acquired	$ 14,242

Intangible assets with finite lives include know-how and developed technologies with estimated useful lives of three to five years. The fair value of know-how was determined using the relief from royalty method, and the fair value of the developed technologies was determined using the income approach. Intangible assets with indefinite lives include IPR&D, which consists of incomplete R&D projects that had not reached technological feasibility as of the Acquisition Date. The fair value of the IPR&D assets was determined using the income approach.

The goodwill arising from the acquisition was primarily attributed to synergies which will enable the Company to develop advanced solutions in power management combining with Sensima's magnetic sensor technologies. The goodwill is not expected to be deductible for tax purposes.

The purchase price allocation is considered preliminary and dependent upon the finalization of the valuation of assets acquired and liabilities assumed, primarily related to deferred taxes. The Company is currently determining if the acquisition qualifies as a tax-free reorganization within the meaning of Swiss tax rules pursuant to the tax holiday granted to Sensima by the Swiss tax authorities. Final determination of the valuation could result in an adjustment to the preliminary purchase price allocation, with an offsetting adjustment to goodwill.

Equity Awards

On the Acquisition Date, the Board of Directors granted $1.7 million of time-based RSUs (or 40,000 shares) to key Sensima employees who became employees of the Company. These awards vest over four years. In addition, the Board of Directors granted $2.0 million of PSUs (or 47,000 shares) to these employees, with the right to earn up to a maximum of $8.0 million based on the achievement of certain cumulative Sensima product revenue targets during the performance period from the Acquisition Date to July 22, 2019. One half of the awards subject to each revenue goal will vest immediately when the pre-determined revenue goal is met and approved by the Compensation Committee, and the remaining 50% will vest over the following two years. The vesting is subject to continued employment with the Company. These equity awards are considered arrangements for post-acquisition services and the related compensation expense is being recognized over the requisite service period.

Pro Forma Information (Unaudited)

Supplemental information on a pro forma basis, as if the Sensima acquisition had been consummated on January 1, 2013, is presented as follows (in thousands):

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2014	**2013**	**2014**	**2013**
Revenue	$78,336	$65,357	$206,882	$174,589
Net income	$11,025	$6,801	$24,886	$13,351
Diluted net income per share	$0.28	$0.17	$0.63	$0.35

These pro forma results are not necessarily indicative of the Company's consolidated results of operations in future periods or the results that actually would have been realized had the Company acquired Sensima during the periods presented. The pro forma results include adjustments primarily related to Sensima's results of operations, amortization of intangible assets and stock-based compensation expense.

4. BALANCE SHEET COMPONENTS

Inventories

Inventories consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Work in process	$ 25,594	$ 26,605
Finished goods	15,993	13,132
Total	$ 41,587	$ 39,737

Other Long-Term Assets

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

	September 30, 2014	December 31, 2013
Deferred compensation plan assets	$ 5,490	$ 607
Prepaid expense	1,490	57
Other	960	980
Total	$ 7,940	$ 1,644

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2014	**December 31, 2013**
Deferred proceeds from litigation	$ -	$ 9,489
Dividends and dividend equivalents	5,994	-
Deferred revenue and customer prepayments	4,110	2,523
Stock rotation reserve	2,095	1,459
Commissions	1,228	931
Sales rebate	451	900
Warranty	240	451
Other	1,410	1,623
Total	$ 15,528	$ 17,376

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Balance at beginning of period	$290	$334	$451	$331
Warranty provision for product sales	78	130	207	349
Settlements made	-	(3)	(74)	(98)
Unused warranty provision	(128)	(78)	(344)	(199)
Balance at end of period	$240	$383	$240	$383

Other Long-Term Liabilities

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

	September 30, 2014	December 31, 2013
Deferred compensation plan liabilities	$ 5,433	$ 628
Contingent consideration	2,507	-
Other	1,424	850
Total	$ 9,364	$ 1,478

5. GOODWILL AND ACQUISITION-RELATED INTANIGIBLE ASSETS, NET

There have been no changes in the balance of goodwill from the Acquisition Date to September 30, 2014.

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

	As of September 30, 2014
	Accumulated

	Gross Amount	Amortization	Net Amount
Subject to amortization:			
Know-how	$1,018	$ (43)	$ 975
Developed technologies	4,421	(263)	4,158
Not subject to amortization:			
IPR&D	2,045	-	2,045
Total	$7,484	$ (306)	$ 7,178

Amortization expense was recorded in cost of revenue in the Condensed Consolidated Statements of Operations and totaled $0.3 million for the three and nine months ended September 30, 2014.

The estimated future amortization expense as of September 30, 2014 is as follows (in thousands):

Remainder of 2014	$366
2015	1,467
2016	1,467
2017	1,467
2018 and thereafter	366
Total	$5,133

6. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock, and calculated using the treasury stock method.

The Company's outstanding RSUs contain forfeitable rights to receive dividend equivalents, which are accrued quarterly during the vesting periods of the RSUs and paid to the employees when the awards vest. Dividend equivalents accrued on the RSUs are forfeited if the employees do not fulfill their service requirement during the vesting periods. Accordingly, these awards are not treated as participating securities in the net income per share calculation.

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2014	**2013**	**2014**	**2013**
Numerator:				
Net income	$11,221	$7,410	$26,635	$15,399
Denominator:				
Weighted average outstanding shares used to compute basic net income per share	38,785	37,910	38,646	37,079
Effect of dilutive securities	942	1,099	972	1,340
Weighted average outstanding shares used to compute diluted net income per share	39,727	39,009	39,618	38,419
Net income per share - basic	$0.29	$0.20	$0.69	$0.42
Net income per share - diluted	$0.28	$0.19	$0.67	$0.40

For the three and nine months ended September 30, 2014, there were no anti-dilutive common stock equivalents. For the three and nine months ended September 30, 2013, approximately 1,000 and 7,000 common stock equivalents, respectively, were excluded from the calculation of diluted net income per share because their inclusion would have been anti-dilutive.

7. SEGMENT AND GEOGRAPHIC INFORMATION

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

The Company sells its products primarily through third-party distributors, value-added resellers and directly to original equipment manufacturers, original design manufacturers, and electronic manufacturing service providers. The following table summarizes those customers with sales greater than 10% of the Company's total revenue or accounts receivable balances greater than 10% of the Company's total accounts receivable:

	Revenue				Accounts Receivable	
	Three Months Ended September 30,		Nine Months Ended September 30,		September 30,	December 31,
Customers	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Distributor A	26%	33%	26%	32%	25%	32%
Distributor B	10%	*	10%	*	13%	17%

* Represents less than 10%.

Both of the customers are third-party distributors. The Company's agreements with these distributors were made in the ordinary course of business and may be terminated with or without cause by either party with advance notice. Although the Company may experience a short-term disruption in the distribution of its products and a short-term decline in revenue if its agreement with either of these distributors was terminated, the Company believes that such termination would not have a material adverse effect on its financial statements because it would be able to engage alternative distributors, resellers and other distribution channels to deliver its products to end customers within a few quarters following the termination of any agreement with a distributor.

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
Country and Region	**2014**	**2013**	**2014**	**2013**
China	$51,796	$40,577	$132,585	$102,099
Taiwan	9,379	8,886	28,080	24,726
Europe	5,212	3,949	14,377	11,226
Korea	4,067	2,599	10,693	7,425
United States	4,079	1,812	9,913	5,552
Japan	2,221	2,285	6,075	5,446
Southeast Asia	1,534	5,103	4,955	17,817
Other	47	136	154	240
Total	$78,335	$65,347	$206,832	$174,531

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
Product Family	**2014**	**2013**	**2014**	**2013**
DC to DC products	$70,196	$57,823	$185,304	$154,801
Lighting control products	8,139	7,524	21,528	19,730
Total	$78,335	$65,347	$206,832	$174,531

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

Country	**September 30, 2014**	**December 31, 2013**
China	$ 37,450	$ 41,557
United States	33,695	24,719
Bermuda	13,749	-
Other	223	205
Total	$ 85,117	$ 66,481

8. LITIGATION

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

O2 Micro

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

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

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

9. CASH, CASH EQUIVALENTS AND INVESTMENTS

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

	September 30, 2014	December 31, 2013
Cash, cash equivalents and investments:		
Cash	$ 72,709	$ 62,625
Money market funds	29,103	35,588
U.S. treasuries and government agency bonds	126,849	128,126
Auction-rate securities backed by student-loan notes	9,795	9,860
Total	$ 238,456	$ 236,199

	September 30, 2014	December 31, 2013
Reported as:		
Cash and cash equivalents	$ 101,812	$ 101,213
Short-term investments	126,849	125,126
Long-term investments	9,795	9,860
Total	$ 238,456	$ 236,199

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

	September 30, 2014	December 31, 2013
Due in less than 1 year	$ 79,562	$ 95,509
Due in 1 - 5 years	47,287	29,617
Due in greater than 5 years	9,795	9,860

Total	$ 136,644	$ 134,986

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

	As of September 30, 2014				
	Adjusted Cost	**Unrealized Gains**	**Unrealized Losses**	**Total Fair Value**	**Fair Value of Investments in Unrealized Loss Position**
Money market funds	$29,103	$ -	$ -	$29,103	$ -
U.S. treasuries and government agency bonds	126,861	37	(49)	126,849	37,455
Auction-rate securities backed by student-loan notes	10,220	-	(425)	9,795	9,795
Total	$166,184	$ 37	$ (474)	$165,747	$ 47,250

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

10. DEFERRED COMPENSATION PLAN

The Company has a non-qualified, unfunded deferred compensation plan, which became effective in July 2013 and provides certain key employees, including our executive management, with the ability to defer the receipt of compensation in order to accumulate funds for retirement on a tax deferred basis. The Company does not make contributions to the plan or guarantee returns on the investments. The Company is responsible for the plan's administrative expenses. Participant deferrals and investment gains and losses remain as the Company's liabilities and the underlying assets are subject to claims of general creditors. As of September 30, 2014 and December 31, 2013, the plan assets totaled $5.5 million and $0.6 million, and the plan liabilities totaled $5.4 million and $0.6 million, respectively.

11. FAIR VALUE MEASURMENTS

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

	Fair Value Measurement at September 30, 2014		
	Quoted Prices in	Significant Other Observable Inputs	Significant Unobservable Inputs

	Total	Active Markets for Identical Assets Level 1	Level 2	Level 3
Assets:				
Money market funds	$29,103	$29,103	$ -	$ -
U.S. treasuries and government agency bonds	126,849	-	126,849	-
Auction-rate securities backed by student-loan notes	9,795	-	-	9,795
Total	$165,747	$29,103	$ 126,849	$ 9,795
Liabilities:				
Contingent consideration	$2,507	$ -	$ -	$ 2,507
Total	$2,507	$ -	$ -	$ 2,507

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

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

Balance at January 1, 2014	$9,860
Change in unrealized loss included in other comprehensive income	(65)
Ending balance at September 30, 2014	$9,795

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

	September 30, 2014	**December 31, 2013**
Time-to-liquidity (months)	24	24
Expected return	2.9%	2.5%
Discount rate	4.1% - 7.1%	3.3% - 8.1%

The Company's level 3 liabilities consist of the contingent consideration related to the acquisition of Sensima in July 2014. The arrangement requires the Company to pay up to $8.9 million to certain former Sensima shareholders if Sensima achieves a new product introduction as well as certain product revenue and direct margin targets in 2016. The fair value of the contingent consideration at the Acquisition Date was $2.5 million, which was estimated based on a probability-weighted analysis of possible future cash flow outcomes. There were no significant changes in the fair value of the contingent consideration from the Acquisition Date to September 30, 2014. The fair value is calculated using the following assumptions:

	September 30, 2014
Project revenue in 2016 (in millions)	$2.1 - $3.8
Discount rate	9.0%
Probability of occurrence	20% - 50%

12. INCOME TAXES

The income tax provision (benefit) for the three and nine months ended September 30, 2014 was $(0.6) million, or (5.4)% of pre-tax income, and $0.2 million, or 0.7% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates, and because of the benefit that the Company realized from the release of a reserve where the statute of limitations expired and the benefit realized as a result of stock option exercises and releases of restricted stock.

The income tax expense for the three and nine months ended September 30, 2013 was $1.2 million, or 13.8% of the pre-tax income, and $0.6 million, or 3.9% of the pre-tax income, respectively. This differs from the federal statutory rate primarily because the Company's foreign income was taxed at lower rates, and because of the benefit that the Company realized from the release of a reserve where the statute of limitations expired.

Unrecognized Tax Benefits

As of September 30, 2014 and December 31, 2013, the Company had unrecognized tax benefits of approximately $15.1 million and $14.9 million, respectively. As of September 30, 2014 and December 31, 2013, the Company had unrecognized tax benefits of approximately $4.2 million and $5.0 million, respectively that would result in an adjustment to the Company's effective tax rate if recognized after considering the valuation allowance.

Uncertain tax positions relate to the allocation of income and deductions among the Company's global entities and to the determination of the research and development tax credit. It is reasonably possible that over the next twelve-month period, the Company may experience other increases or decreases in its unrecognized tax benefits. However, it is not possible to determine either the magnitude or the range of other increases or decreases at this time.

The Company recognizes interest and penalties, if any, related to uncertain tax positions in its income tax provision. As of September 30, 2014 and December 31, 2013, the Company had $0.4 million and $0.8 million, respectively, of accrued interest related to uncertain tax positions.

Income Tax Audits

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

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

The Company reviewed and responded to the above proposed adjustments. The Company regularly assesses the likelihood of an adverse outcome resulting from such examinations to determine the adequacy of its provision for income taxes. As of September 30, 2014, based on the technical merits of its tax return filing positions and the interactions to date with the IRS, the Company believes that it is more-likely-than-not that the resolution of the audits will not have a material impact on the Company's consolidated financial position, results of operations and cash flows.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME

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

	Unrealized Losses	Unrealized Gains	Foreign Currency	Total

	on Auction-Rate Securities	(Losses) on Other Available-for-Sale Securities	Translation Adjustments	
Balance as of January 1, 2014	$ (360)	$ 4	$ 6,616	$6,260
Other comprehensive income (loss) before reclassifications	(17)	5	(596)	(608)
Amounts reclassified from accumulated other comprehensive income	-	-	-	-
Net current period other comprehensive income (loss)	(17)	5	(596)	(608)
Balance as of March 31, 2014	(377)	9	6,020	5,652
Other comprehensive income before reclassifications	5	8	176	189
Amounts reclassified from accumulated other comprehensive income	-	(1)	-	(1)
Net current period other comprehensive income	5	7	176	188
Balance as of June 30, 2014	(372)	16	6,196	5,840
Other comprehensive loss before reclassifications	(53)	(28)	(98)	(179)
Amounts reclassified from accumulated other comprehensive income	-	-	-	-
Net current period other comprehensive loss	(53)	(28)	(98)	(179)
Balance as of September 30, 2014	$ (425)	$ (12)	$ 6,098	$5,661

14. STOCK REPURCHASE PROGRAM

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

	Shares Repurchased	Average Price Per Share	Total Amount (in thousands)
Cumulative balance at January 1, 2014	663,802	$ 31.06	$ 20,615
Repurchases	323,789	$ 35.08	11,358
Cumulative balance at March 31, 2014	987,591	$ 32.38	31,973
Repurchases	321,764	$ 38.65	12,438
Cumulative balance at June 30, 2014	1,309,355	$ 33.92	44,411
Repurchases	212,035	$ 43.29	9,180
Cumulative balance at September 30, 2014	1,521,390	$ 35.22	$ 53,591

As of September 30, 2014, $46.4 million remained available for future repurchases under the program.

15. DIVIDENDS AND DIVIDEND EQUIVALENTS

In June 2014, the Board of Directors approved a dividend program pursuant to which the Company intends to pay quarterly cash dividends on its common stock. Stockholders of record as of the last day of the quarter are entitled to receive the quarterly cash dividends declared by the Board of Directors, which are payable on the 15th of the following month. The Board of Directors declared the following dividends in 2014:

2014	**Dividend Declared per Share**	**Total Amount** (in thousands)
Second quarter	$ 0.15	$ 5,817

Third quarter	0.15	5,823

As of September 30, 2014, accrued dividends totaled $5.8 million, which was paid to stockholders on October 15, 2014.

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

Under the 2004 Plan, RSU awards contain rights to receive dividend equivalents, which entitle employees who hold RSUs to the same dividend value per share as holders of common stock. The dividend equivalents are accrued quarterly during the vesting periods of the RSUs and paid to the employees when the awards vest. Dividend equivalents accrued on the RSUs are forfeited if the employees do not fulfill their service requirement during the vesting periods. As of September 30, 2014, accrued dividend equivalents totaled $0.5 million.

16. SUBSEQUENT EVENT

Equity Awards

In October 2014, the Board of Directors approved 337,000 shares of PSUs to non-executive employees with five consecutive two-year performance periods that will begin from 2015 and end in 2020. In addition, the Board of Directors approved 218,000 shares of PSUs to executive officers with a two-year performance period that will begin in 2015. The performance metrics for all of the PSUs will be determined by the Board of Directors prior to the inception of each performance period.

The Company reserved these shares from the 2004 Plan. In addition, the Company will determine the grant date fair value of these awards and begin recognizing the related expense when the performance criteria are approved by the Board of Directors and communicated to employees prior to the inception of each performance period.

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

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

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

- the percentage of our total revenue from various market segments,
- our ability to integrate Sensima successfully and achieve the anticipated benefits from the acquisition,
- our ability to identify, acquire and integrate future acquisitions and achieve the anticipated benefits from such acquisitions,
- our intention and ability to continue the stock repurchase program and pay future cash dividends, and
- the factors that differentiate us from our competitors.

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

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

Overview

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

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

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

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

We derive most of our revenue from sales through distribution arrangements and direct sales to customers in Asia, where the products we produce are incorporated into end-user products. Our revenue from direct or indirect sales to customers in Asia was 88% for both the three and nine months ended September 30, 2014. We derive a majority of our revenue from the sales of our DC to DC converter product family which services the communications, storage and computing, consumer and industrial markets. We believe our ability to achieve revenue growth will depend, in part, on our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity.

In July 2014, we completed the acquisition of Sensima Technology SA ("Sensima"), a company located in Switzerland that develops magnetic sensors for angle measurements as well as three-dimensional magnetic field sensing. The acquisition is expected to create new opportunities with customers by offering enhanced solutions in power management for key industries such as automotive, industrial and cloud computing. The purchase consideration consisted of an upfront cash payment of $11.7 million and additional consideration that is contingent upon Sensima achieving a new product introduction and certain revenue and direct margin goals in 2016, with a fair value of $2.5 million at the date of acquisition. In addition, key employees received $1.7 million of time-based restricted stock units and up to $8.0 million of performance-based restricted stock units in connection with the transaction. These equity awards are considered arrangements for post-acquisition services and the related compensation expense is being recognized over the requisite service period. The results of operations of Sensima have been included in our consolidated financial statements subsequent to the acquisition date.

Critical Accounting Policies and Estimates

Other than the adoption of the following new significant accounting policies, there have been no significant changes in our critical accounting policies and estimates used in the preparation of our financial statements during the three and nine months ended September 30, 2014, as compared to those disclosed in the Annual Report on Form 10-K for the year ended December 31, 2013.

Valuation of Goodwill and Acquisition-Related Intangible Assets**.** We evaluate intangible assets with finite lives for impairment whenever events or changes in circumstances indicate that an impairment may exist. We perform an annual impairment assessment for goodwill and intangible assets with indefinite lives in the fourth quarter, or more frequently if indicators of potential impairment exist. Impairment of intangible assets is recognized based on the difference between the fair value of the assets and their carrying value. Impairments for goodwill occur if the fair value of a reporting unit including goodwill is less than its carrying value and are recognized based on the difference between the implied fair value of the reporting unit's goodwill and the carrying value of the goodwill. The assumptions and estimates used to determine future values of goodwill and intangible assets are complex and subjective. They can be affected by various factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and revenue forecasts. If there is a significant adverse change in our business in the future, including macroeconomic and market conditions, we may be required to record impairment charges on our goodwill and acquisition-related intangible assets.

Results of Operations

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

	Three Months Ended September 30,						**Nine Months Ended September 30,**				
	2014			**2013**			**2014**			**2013**	
	(in thousands, except percentages)						(in thousands, except percentages)				
Revenue	$ 78,335	100.0	%	$ 65,347	100.0	%	$ 206,832	100.0	%	$ 174,531	100.0