MONOLITHIC POWER SYSTEMS INC
Form 10-Q
November 02, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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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, 2018

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)

4040 Lake Washington Blvd. NE, Suite 201, Kirkland, Washington 98033

(Address of principal executive offices)(Zip code)

(425) 296-9956

(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 every Interactive Data File required to be submitted 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 such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 42,412,000 shares of the registrant's common stock issued and outstanding as of October 29, 2018.

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MONOLITHIC POWER SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

(unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 131,094	$ 82,759
Short-term investments	216,754	216,331
Accounts receivable	59,887	38,037
Inventories	136,790	99,281
Other current assets	12,876	12,762
Total current assets	557,401	449,170
Property and equipment, net	147,497	144,636
Long-term investments	5,257	5,256
Goodwill	6,571	6,571
Acquisition-related intangible assets, net	308	951
Deferred tax assets, net	12,852	15,917
Other long-term assets	33,271	30,068
Total assets	$ 763,157	$ 652,569
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 27,603	$ 22,813
Accrued compensation and related benefits	22,996	15,597
Accrued liabilities	34,908	27,507
Total current liabilities	85,507	65,917
Income tax liabilities	31,173	31,621
Other long-term liabilities	36,313	33,024
Total liabilities	152,993	130,562
Commitments and contingencies		

Stockholders' equity:		
Common stock and additional paid-in capital, $0.001 par value; shares authorized: 150,000; shares issued and outstanding: 42,408 and 41,614, respectively	435,085	376,586
Retained earnings	180,819	143,608
Accumulated other comprehensive income (loss)	(5,740)	1,813
Total stockholders’ equity	610,164	522,007
Total liabilities and stockholders’ equity	$ 763,157	$ 652,569

See accompanying notes to unaudited condensed consolidated financial statements.

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MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per-share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Revenue	$159,975	$128,939	$428,885	$341,499
Cost of revenue	70,957	58,083	190,810	154,377
Gross profit	89,018	70,856	238,075	187,122
Operating expenses:				
Research and development	25,630	21,442	70,720	60,629
Selling, general and administrative	29,552	25,255	85,431	73,219
Litigation expense	343	327	1,513	903
Total operating expenses	55,525	47,024	157,664	134,751
Income from operations	33,493	23,832	80,411	52,371
Interest and other income, net	2,714	1,255	5,387	3,873
Income before income taxes	36,207	25,087	85,798	56,244
Income tax provision	4,639	1,445	8,168	3,112
Net income	$31,568	$23,642	$77,630	$53,132
Net income per share:				
Basic	$0.75	$0.57	$1.84	$1.29
Diluted	$0.71	$0.54	$1.75	$1.22
Weighted-average shares outstanding:				
Basic	42,362	41,458	42,173	41,276
Diluted	44,669	43,486	44,450	43,384
Cash dividends declared per common share	$0.30	$0.20	$0.90	$0.60

See accompanying notes to unaudited condensed consolidated financial statements.

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MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$31,568	$23,642	$77,630	$53,132
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(4,526)	1,500	(6,999)	3,992
Change in unrealized gain (loss) on available-for-sale securities, net of tax of $241, $0, $241, 0, respectively	491	222	(554)	565
Total other comprehensive income (loss), net of tax	(4,035)	1,722	(7,553)	4,557
Comprehensive income	$27,533	$25,364	$70,077	$57,689

See accompanying notes to unaudited condensed consolidated financial statements.

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MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2018	**2017**
Cash flows from operating activities:		
Net income	$77,630	$53,132
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of intangible assets	9,058	12,092
Amortization of premium on available-for-sale securities	1,122	1,494
Gain on deferred compensation plan investments	(949)	(1,902)
Stock-based compensation expense	45,765	40,759
Deferred taxes, net	3,169	-
Changes in operating assets and liabilities:		
Accounts receivable	(22,752)	(16,505)
Inventories	(37,496)	(28,384)
Other assets	(665)	1,696
Accounts payable	5,978	4,999
Accrued compensation and related benefits	7,838	4,542
Accrued liabilities	4,635	7,276
Income tax liabilities	528	1,249
Net cash provided by operating activities	93,861	80,448
Cash flows from investing activities:		
Property and equipment purchases	(18,057)	(25,108)
Purchases of short-term investments	(86,021)	(102,274)
Proceeds from maturities and sales of short-term investments	83,679	61,678
Contributions to deferred compensation plan, net	(1,396)	(2,124)
Net cash used in investing activities	(21,795)	(67,828)
Cash flows from financing activities:		
Property and equipment purchased on extended payment terms	-	(250)
Proceeds from exercise of stock options	59	129
Proceeds from vesting of restricted stock units	9,625	-
Proceeds from shares issued under the employee stock purchase plan	3,028	2,701
Dividends and dividend equivalents paid	(34,381)	(25,264)
Net cash used in financing activities	(21,669)	(22,684)
Effect of change in exchange rates	(2,062)	1,790
Net increase (decrease) in cash, cash equivalents and restricted cash	48,335	(8,274)
Cash, cash equivalents and restricted cash, beginning of period	82,874	112,813

Cash, cash equivalents and restricted cash, end of period	$131,209	$104,539
Supplemental disclosures:		
Cash paid for taxes and interest	$6,388	$1,855
Non-cash investing and financing activities:		
Liability accrued for property and equipment purchases	$1,563	$284
Liability accrued for dividends and dividend equivalents	$15,397	$10,131

See accompanying notes to unaudited condensed consolidated financial statements.

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MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by Monolithic Power Systems, Inc. (the "Company" or "MPS") in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted in accordance with these accounting principles, 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, 2017, filed with the SEC on March 1, 2018.

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, 2018 or for any other future periods.

Summary of Significant Accounting Policies

Except for the changes related to revenue recognition discussed in "Recently Adopted Accounting Pronouncements" and in Note 2 below, there have been no other changes to the Company's significant accounting policies during the three and nine months ended September 30, 2018 as compared to the significant accounting policies described in the Company's audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2017.

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* 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. The Company adopted the standard on January 1, 2018 using the modified retrospective method applied to those contracts which were not completed as of December 31, 2017. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior-period amounts have not been retrospectively adjusted and continue to be reported in accordance with Topic 605, *Revenue Recognition*.

The Company recorded a net increase to the opening balance of retained earnings of $0.4 million, net of tax, as of January 1, 2018 due to the cumulative effect of initially applying Topic 606, primarily related to the change in revenue recognition for three U.S.-based distributors. Sales to these distributors are transacted under the terms of agreements providing price adjustment rights. Prior to the adoption of Topic 606, revenue and costs related to these sales were deferred until the Company received notification from the distributors that the products had been sold to the end customers and the amount of price adjustments was fixed and finalized. Upon adoption of Topic 606, the transaction price takes into consideration the effect of variable consideration such as price adjustments, which are estimated and recorded at the time the promised goods are transferred to the distributors. Accordingly, effective January 1, 2018, the Company recognizes revenue at the time of shipment to the distributors, adjusted for an estimate of the price adjustments based on management's review of historical data and other information available at the time. See Note 2 for further discussion.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows - Restricted Cash (Topic 230),* which requires entities to show the changes in the total of cash, cash equivalents and restricted cash in the statement of cash flows. The Company adopted the standard on January 1, 2018 and applied the guidance retrospectively to all periods presented. See Note 9 for further discussion.

Recent Accounting Pronouncements Not Yet Adopted as of September 30, 2018

In August 2018, the SEC issued Final Rule Release No. 33-10532, *Disclosure Update and Simplification,* which amends certain disclosure requirements, including the presentation of changes in stockholders' equity and the dividend per share for interim periods. The final rule will be effective on November 5, 2018. The Company is evaluating the impact of the adoption on its disclosures.

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In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement,* which changes certain disclosure requirements, including those related to Level 3 fair value measurements. The standard will be effective for annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company is evaluating the impact of the adoption on its disclosures.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350),* which simplifies the accounting for goodwill impairment. The guidance removes step two of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. The standard will be applied prospectively, and will be effective for annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company is evaluating the impact of the adoption on its annual goodwill impairment test.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326),* which introduces a model based on expected losses to estimate credit losses for most financial assets and certain other instruments. In addition, for available-for-sale debt securities with unrealized losses, the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. The standard will be effective for annual reporting periods beginning after December 15, 2019, with early adoption permitted for annual reporting periods beginning after December 15, 2018. Entities will apply the standard by recording a cumulative-effect adjustment to retained earnings. The Company is evaluating the impact of the adoption on its consolidated financial position, results of operations, cash flows and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842),* which requires entities to recognize a right-of-use asset and a lease liability on the balance sheets for substantially all leases with a lease term greater than 12 months, including leases currently accounted for as operating leases. In addition, the standard applies to leases embedded in service or other arrangements. The standard requires modified retrospective adoption and will be effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted. The Company will adopt the standard on January 1, 2019. The Company is evaluating the impact of the adoption on its consolidated financial statements and disclosures, and expects to elect certain available transitional practical expedients. The Company anticipates recording assets and liabilities primarily related to its real estate leases on its Consolidated Balance Sheets, with no material impact to its Consolidated Statements of Operations.

2. REVENUE RECOGNITION

Revenue from Product Sales

The following table presents the Company’s revenue disaggregated by end market (in thousands, except for percentages):

	Three Months Ended September 30,						Nine Months Ended September 30,					
End Market	2018	% of Revenue		2017 (1)	% of Revenue		2018	% of Revenue		2017 (1)	% of Revenue	
Computing and storage	$47,658	29.8	%	$29,020	22.5	%	$115,584	27.0	%	$74,103	21.7	%
Automotive	19,785	12.4		12,857	10.0		57,857	13.5		38,042	11.1	
Industrial	24,869	15.5		16,348	12.7		61,544	14.3		46,736	13.7	
Communications	19,158	12.0		15,372	11.9		50,442	11.8		47,748	14.0	
Consumer	48,505	30.3		55,342	42.9		143,458	33.4		134,870	39.5	
Total	$159,975	100.0	%	$128,939	100.0	%	$428,885	100.0	%	$341,499	100.0	%

(1) 2017 amounts have not been adjusted under the modified retrospective method.

The Company generates revenue primarily from product sales, which include assembled and tested integrated circuits, as well as dies in wafer form. The Company also generates royalty revenue from licensing arrangements and revenue from wafer testing services performed for third parties, which have not been significant in all periods presented.

The Company sells its products primarily through third-party distributors, value-added resellers, original equipment manufacturers, original design manufacturers and electronic manufacturing service providers. For the three months ended September 30, 2018 and 2017, approximately 87% and 88%, respectively, of the Company’s sales were made through distribution arrangements. For the nine months ended September 30, 2018 and 2017, approximately 87% and 88%, respectively, of the Company’s sales were made through distribution arrangements. These distribution arrangements contain enforceable rights and obligations specific to those distributors and not the end customers. Purchase orders, which are generally governed by sales agreements or the Company's standard terms of sale, state the final terms for unit price, quantity, shipping and payment agreed by both parties. The Company considers purchase orders to be the contracts with customers. The unit price as stated on the purchase orders is considered the observable, stand-alone selling price for the arrangements.

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Under Topic 606, the Company recognizes revenue when it satisfies a performance obligation by transferring control of the promised goods or services to its customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. The Company excludes taxes assessed by government authorities, such as sales taxes, from revenue.

Product sales consist of a single performance obligation that the Company satisfies at a point in time. The Company recognizes product revenue from distributors and direct end customers when the following events have occurred: (a) the Company has transferred physical possession of the products, (b) the Company has a present right to payment, (c) the customer has legal title to the products, and (d) the customer bears significant risks and rewards of ownership of the products. In accordance with the shipping terms specified in the contracts, these criteria are generally met when the products are shipped from the Company's facilities (such as the "Ex Works" shipping term) or delivered to the customers' locations (such as the "Delivered Duty Paid" shipping term).

Under certain consignment agreements, revenue is not recognized when the products are held at customers' designated locations because the Company retains ownership and the customers do not have an unconditional obligation to pay. The Company recognizes revenue when the customers pull the products from the locations or after a 60-day period lapses, at which time control transfers to the customers and the Company invoices them for payment.

Variable Consideration

The Company records variable consideration as a reduction to revenue in the same period the revenue is recognized. Three U.S.-based distributors have price adjustment rights when they sell the Company's products to their end customers at a price that is lower than the distribution price invoiced by the Company. When the Company receives claims from the distributors that products have been sold to the end customers at the lower price, the Company issues the distributors credit memos for the price adjustments. The Company estimates the price adjustments based on analyses of historical claims, at both the distributor and product level, as well as an assessment of any known trends of product sales mix. Other U.S. distributors and non-U.S. distributors, which make up the majority of the Company's total sales to distributors, do not have price adjustment rights.

In addition, certain distributors have limited stock rotation rights that permit the return of a small percentage of the previous six months' purchases. The Company estimates the stock rotation returns based on analyses of historical returns, and the current level of inventory in the distribution channel. The Company recognizes an asset for product returns which represents the right to recover products from the customers related to stock rotations, with a corresponding reduction to cost of goods sold.

Contract Balances

The Company records a receivable when it has an unconditional right to receive consideration after the performance obligations are satisfied. As of September 30, 2018 and December 31, 2017, accounts receivable totaled $59.9 million and $38.0 million, respectively. To manage credit risk, management performs ongoing credit evaluations of its customers' financial condition. The Company did not recognize any impairment losses related to its receivables in any of the periods presented.

For certain customers located in Asia, the Company requires cash payments two weeks before the products are scheduled to be shipped to the customers. The Company records these payments received in advance of performance as customer prepayments within current accrued liabilities. As of September 30, 2018 and December 31, 2017, customer prepayments totaled $1.8 million and $4.7 million, respectively. The decrease in the customer prepayment balance for the nine months ended September 30, 2018 resulted from a decrease in unfulfilled customer orders for which the Company has received payments. For the nine months ended September 30, 2018, the Company recognized $4.7 million of revenue that was included in the customer prepayment balance as of December 31, 2017.

Contract Costs

The Company pays sales commissions based on the achievement of pre-determined product sales targets. As the Company recognizes product sales at a point in time, sales commissions are expensed as incurred.

Warranty

The Company generally provides one to two-year warranties against defects in materials and workmanship and will either repair the products, provide replacements at no charge to customers or issue a refund. As they are considered assurance-type warranties, the Company does not account for them as separate performance obligations. Warranty reserve requirements are generally based on a specific assessment of the products sold with warranties when a customer asserts a claim for warranty or a product defect.

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Practical Expedients

The Company's standard payment terms generally require customers to pay 30 to 60 days after the Company satisfies the performance obligations. For those customers who are required to pay in advance, the Company satisfies the performance obligations typically within one quarter. The Company has elected not to determine whether contacts with customers contain significant financing components.

As of September 30, 2018, the Company's unsatisfied performance obligations primarily included products held in consignment arrangements and customer purchase orders for products that the Company has not yet shipped. Because the Company expects to fulfill these performance obligations within one year, the Company has elected not to disclose the amount of these remaining performance obligations or the timing of recognition.

Changes to Financial Statement Line Items

The following tables compare the impact on the financial statement line items between the application of Topic 606 and Topic 605 as of September 30, 2018, and for the three and nine months ended September 30, 2018. The significant changes between the two standards are primarily attributable to the following:

Under Topic 606, the Company recognizes revenue for three U.S.-based distributors upon shipment of the products to them, net of an estimated amount for price adjustments. Under Topic 605, the Company would have deferred the recognition of revenue and related costs for these U.S. distributors until the Company received notification from the distributors that the products had been sold to the end customers and the amount of price adjustments was fixed and finalized.

Under Topic 606, the Company records assets for product returns within other current assets, which primarily represent the carrying value of inventory it expects to recover from customers related to stock rotation returns. Under Topic 605, such amounts would have been netted against the stock rotation reserve within current accrued liabilities.

Under Topic 606, the Company recorded a cumulative effect of initially applying the standard to retained earnings. Under Topic 605, the Company would not have recorded this adjustment.

Condensed Consolidated Balance Sheet (in thousands):

	September 30, 2018

Line Item	Topic 606 (As Reported)	Topic 605	Difference
Assets:			
Accounts receivable	$59,887	$61,430	$ (1,543)
Inventories	$136,790	$137,129	$ (339)
Other current assets	$12,876	$10,556	$ 2,320
Total current assets	$557,401	$556,963	$ 438
Deferred tax assets, net	$12,852	$12,953	$ (101)
Total assets	$763,157	$762,820	$ 337
Liabilities and Stockholders' Equity:			
Accrued liabilities	$34,908	$35,190	$ (282)
Total current liabilities	$85,507	$85,789	$ (282)
Total liabilities	$152,993	$153,275	$ (282)
Retained earnings	$180,819	$180,200	$ 619
Total stockholders' equity	$610,164	$609,545	$ 619
Total liabilities and stockholders' equity	$763,157	$762,820	$ 337

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Condensed Consolidated Statement of Operations (in thousands, except per-share amounts):

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
Line Item	**Topic 606 (As Reported)**	**Topic 605**	**Difference**	**Topic 606 (As Reported)**	**Topic 605**	**Difference**
Revenue	$159,975	$159,723	$ 252	$428,885	$428,440	$ 445
Cost of revenue	$70,957	$70,848	$ 109	$190,810	$190,668	$ 142
Gross profit	$89,018	$88,875	$ 143	$238,075	$237,772	$ 303
Income from operations	$33,493	$33,350	$ 143	$80,411	$80,108	$ 303
Income before income taxes	$36,207	$36,064	$ 143	$85,798	$85,495	$ 303
Income tax provision	$4,639	$4,609	$ 30	$8,168	$8,104	$ 64
Net income	$31,568	$31,455	$ 113	$77,630	$77,391	$ 239
Net income per share - basic	$0.75	$0.74	$ 0.01	$1.84	$1.84	$ -
Net income per share - diluted	$0.71	$0.70	$ 0.01	$1.75	$1.74	$ 0.01

Condensed Consolidated Statement of Comprehensive Income (in thousands):

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
Line Item	**Topic 606 (As Reported)**	**Topic 605**	**Difference**	**Topic 606 (As Reported)**	**Topic 605**	**Difference**
Net income	$31,568	$31,455	$ 113	$77,630	$77,391	$ 239
Comprehensive income	$27,533	$27,420	$ 113	$70,077	$69,838	$ 239

Condensed Consolidated Statement of Cash Flows (in thousands):

	Nine Months Ended September 30, 2018		
Line Item	**Topic 606 (As Reported)**	**Topic 605**	**Difference**
Cash flows from operating activities:			
Net income	$77,630	$77,391	$ 239
Changes in operating assets and liabilities:			

Accounts receivable	$(22,752)	$(23,394)	$ 642
Inventories	$(37,496)	$(37,835)	$ 339
Other assets	$(665)	$1,563	$ (2,228)
Accrued liabilities	$4,635	$3,691	$ 944
Income tax liabilities	$528	$464	$ 64

3. STOCK-BASED COMPENSATION

2014 Equity Incentive Plan (the "2014 Plan")

The Board of Directors adopted the 2014 Plan in April 2013, and the stockholders approved it in June 2013. In October 2014, the Board of Directors approved certain amendments to the 2014 Plan. The 2014 Plan, as amended, became effective on November 13, 2014 and provides for the issuance of up to 5.5 million shares. The 2014 Plan will expire on November 13, 2024. As of September 30, 2018, 2.7 million shares remained available for future issuance under the 2014 Plan.

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,**	
	2018	**2017**	**2018**	**2017**
Cost of revenue	$471	$453	$1,384	$1,264
Research and development	3,979	3,838	12,168	11,297
Selling, general and administrative	10,393	9,678	32,213	28,198
Total stock-based compensation expense	$14,843	$13,969	$45,765	$40,759
Tax benefit related to stock-based compensation	$764	$-	$2,723	$-

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Restricted Stock Units

The Company's restricted stock units ("RSUs") include time-based RSUs, RSUs with only performance conditions ("PSUs"), RSUs with both market and performance conditions ("MPSUs"), and RSUs with only market conditions ("MSUs"). Vesting of all awards requires continued service for the Company. In addition, vesting of awards with performance conditions or market conditions is subject to the achievement of pre-determined performance goals. A summary of RSU activity is presented in the table below (in thousands, except per-share amounts):

	Time-Based RSUs		PSUs and MPSUs		MSUs		Total	
	Number of Shares	Weighted-Average Grant Date Fair Value Per Share	Number of Shares	Weighted-Average Grant Date Fair Value Per Share	Number of Shares	Weighted-Average Grant Date Fair Value Per Share	Number of Shares	Weighted-Average Grant Date Fair Value Per Share
Outstanding at January 1, 2018	258	$ 66.30	2,266	$ 48.59	1,620	$ 23.57	4,144	$ 39.91
Granted	93	$ 116.01	595 (1)	$ 82.64	-	$ -	688	$ 87.16
Vested	(121)	$ 59.01	(636)	$ 40.78	-	$ -	(757)	$ 43.69
Forfeited	(14)	$ 82.08	(6)	$ 63.16	-	$ -	(20)	$ 76.57
Outstanding at September 30, 2018	216	$ 90.79	2,219	$ 59.92	1,620	$ 23.57	4,055	$ 47.04

(1) Amount reflects the number of PSUs and MPSUs that may ultimately be earned based on management's probability assessment of the achievement of performance conditions at each reporting period. In addition, MPSUs are subject to the achievement of market conditions.

The intrinsic value related to vested RSUs was $13.9 million and $12.5 million for the three months ended September 30, 2018 and 2017, respectively. The intrinsic value related to vested RSUs was $79.0 million and $61.3 million for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, the total intrinsic value of all outstanding RSUs was $465.9 million, based on the closing stock price of $125.53. As of September 30, 2018, unamortized compensation expense related to all outstanding RSUs was $89.3 million with a weighted-average remaining recognition period of approximately three years.

Cash proceeds from vested PSUs with a purchase price feature totaled $9.6 million for the nine months ended September 30, 2018. There were no proceeds for the nine months ended September 30, 2017.

Time-Based RSUs:

For the nine months ended September 30, 2018, the Compensation Committee of the Board of Directors (the "Compensation Committee") granted 93,000 RSUs with time-based vesting conditions to non-executive employees and non-employee directors. The RSUs vest over four years for employees and one year for directors, subject to continued service with the Company.

2018 PSUs:

In February 2018, the Compensation Committee granted 188,000 PSUs to the executive officers, which represent a target number of shares to be awarded based on the Company's average two-year (2018 and 2019) revenue growth rate compared against the analog industry's average two-year revenue growth rate as published by the Semiconductor Industry Association ("2018 Executive PSUs"). The maximum number of shares that an executive officer can earn is 300% of the target number of the 2018 Executive PSUs. 50% of the 2018 Executive PSUs will vest in the first quarter of 2020 if the pre-determined performance goals are met during the performance period and approved by the Compensation Committee. The remaining 2018 Executive PSUs will vest over the following two years on a quarterly basis. Vesting is subject to the employees' continued employment with the Company. Assuming the achievement of the highest level of performance goals, the total stock-based compensation cost for the 2018 Executive PSUs is $46.1 million.

In February 2018, the Compensation Committee granted 44,000 PSUs to certain non-executive employees, which represent a target number of shares to be awarded based on the Company's 2019 revenue goals for certain regions or product line divisions, or based on the Company's average two-year (2018 and 2019) revenue growth rate compared against the analog industry's average two-year revenue growth rate as published by the Semiconductor Industry Association ("2018 Non-Executive PSUs"). The maximum number of shares that an employee can earn is either 200% or 300% of the target number of the 2018 Non-Executive PSUs, depending on the job classification of the employee. 50% of the 2018 Non-Executive PSUs will vest in the first quarter of 2020 if the pre-determined performance goals are met during the performance period and approved by the Compensation Committee. The remaining 2018 Non-Executive PSUs will vest over the following two years on an annual or quarterly basis. Vesting is subject to the employees' continued employment with the Company. Assuming the achievement of the highest level of performance goals, the total stock-based compensation cost for the 2018 Non-Executive PSUs, excluding cancelled shares, is $8.8 million.

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The 2018 Executive PSUs and the 2018 Non-Executive PSUs contain a purchase price feature, which requires the employees to pay the Company $30 per share upon vesting of the shares. Shares that do not vest will not be subject to the purchase price payment. The Company determined the grant date fair value of the 2018 Executive PSUs and the 2018 Non-Executive PSUs using the Black-Scholes model with the following assumptions: stock price of $110.00, expected term of 2.6 years, expected volatility of 27.5% and risk-free interest rate of 2.3%.

2015 MPSUs:

On December 31, 2015, the Compensation Committee granted 86,000 MPSUs to the executive officers and 41,000 MPSUs to certain non-executive employees, which represent a target number of shares to be awarded upon achievement of both market conditions and performance conditions (“2015 MPSUs”). The maximum number of shares that an employee can earn is 500% of the target number of the 2015 MPSUs. The 2015 MPSUs consist of four separate tranches with various performance periods ending on December 31, 2019. The first tranche contains market conditions only, which require the achievement of five stock price targets ranging from $71.36 to $95.57 with a performance period from January 1, 2016 to December 31, 2019. As of September 30, 2017, all five stock price targets for the first tranche have been achieved and approved by the Compensation Committee.

The second, third and fourth tranches contain both market conditions and performance conditions. Each tranche requires the achievement of five stock price targets measured against a base price equal to the greater of: (1) the average closing stock price during the 20 consecutive trading days immediately before the start of the performance period for that tranche, or (2) the closing stock price immediately before the start of the performance period for that tranche. The stock price targets for the second tranche range from $89.56 to $106.81 with a performance period from January 1, 2017 to December 31, 2019. As of December 31, 2017, all five stock price targets for the second tranche have been achieved and approved by the Compensation Committee. The stock price targets for the third tranche range from $120.80 to $135.48 with a performance period from January 1, 2018 to December 31, 2019. As of September 30, 2018, all five stock price targets for the third tranche have been achieved and approved by the Compensation Committee. The stock price targets for the fourth tranche will be determined on December 31, 2018 with a performance period from January 1, 2019 to December 31, 2019.

In addition, each of the second, third and fourth tranches requires the achievement of one of following six operating metrics:

1. Successful implementation of full digital solutions for certain power products.
2. Successful implementation, and adoption by a key customer, of an integrated, software-based field-oriented control with sensors to motor drivers.
3. Successful implementation of certain advanced power analog processes.
4. Successful design wins and achievement of a specific level of revenue with a global networking customer.
5. Achievement of a specific level of revenue with a global electronics manufacturer.

6. Achievement of a specific level of market share with certain core power products.

As of October 30, 2018, the first and the second operating metrics have been achieved and the determination of achievement was approved by the Compensation Committee.

Subject to the employees' continued employment with the Company, the 2015 MPSUs will fully vest on January 1, 2020 if the pre-determined individual market and performance goals in each tranche are met during the performance periods and approved by the Compensation Committee. In addition, the 2015 MPSUs contain sales restrictions on the vested shares by employees for up to two years.

The Company determined the grant date fair value of the 2015 MPSUs using a Monte Carlo simulation model with the following weighted-average assumptions: stock price of $61.35, expected volatility of 33.2%, risk-free interest rate of 1.3%, and an illiquidity discount of 7.8% to account for the post-vesting sales restrictions. Assuming the achievement of all of the required market and performance goals, the total stock-based compensation cost for the 2015 MPSUs, excluding cancelled shares, is $24.6 million ($8.3 million for the first tranche, $4.5 million for the second tranche, $5.2 million for the third tranche, and $6.6 million for the fourth tranche).

For the first tranche, stock-based compensation expense is being recognized over the requisite service period. For the second, third and fourth tranches, stock-based compensation expense for each tranche is recognized if an operating metric has been achieved, or if management believes it is probable that an operating metric will be achieved during the performance periods in each reporting period. As of October 30, 2018, two operating metrics have been achieved, and based on management's quarterly assessment, one additional operating metric was considered probable of being achieved during the performance periods. Accordingly, stock-based compensation expense is being recognized for the second, third and fourth tranches over the requisite service period.

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Employee Stock Purchase Plan ("ESPP")

For the three months ended September 30, 2018 and 2017, 15,000 and 18,000 shares, respectively, were issued under the ESPP. For the nine months ended September 30, 2018 and 2017, 33,000 and 40,000 shares, respectively, were issued under the ESPP. As of September 30, 2018, 4.6 million shares were available for future issuance.

The intrinsic value of the shares issued was $0.6 million and $0.5 million for the three months ended September 30, 2018 and 2017, respectively. The intrinsic value of the shares issued was $1.1 million and $1.0 million for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, the unamortized expense was $0.4 million, which will be recognized through the first quarter of 2019. 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,**	
	2018	**2017**	**2018**	**2017**
Expected term (years)	0.5	0.5	0.5	0.5
Expected volatility	30.8%	23.5%	29.5%	23.5%
Risk-free interest rate	2.2 %	1.2 %	2.0 %	0.9 %
Dividend yield	0.9 %	0.8 %	1.0 %	0.9 %

Cash proceeds from the shares issued under the ESPP were $3.0 million and $2.7 million for the nine months ended September 30, 2018 and 2017, respectively.

4. BALANCE SHEET COMPONENTS

Inventories

Inventories consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Raw materials	$ 41,679	$ 20,573
Work in process	43,112	40,030
Finished goods	51,999	38,678
Total	$ 136,790	$ 99,281

Other Current Assets

Other current assets consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Prepaid wafer purchase	$ 4,297	$ 6,217
Other prepaid expense	3,813	2,742
Interest receivable	1,413	1,352
Assets for product returns	2,320	-
Value-added tax receivable	396	1,235
Other	637	1,216
Total	$ 12,876	$ 12,762

Under Topic 606, “assets for product returns” primarily represent the carrying value of inventory the Company expects to recover from customers related to stock rotation returns. Prior to the adoption of Topic 606, such amounts were netted against the stock rotation reserve within current accrued liabilities.

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Other Long-Term Assets

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

	September 30, 2018	December 31, 2017
Deferred compensation plan assets	$ 30,425	$ 28,080
Prepaid expense	1,588	897
Other	1,258	1,091
Total	$ 33,271	$ 30,068

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Dividends and dividend equivalents	$ 14,737	$ 9,248
Stock rotation and sales returns	7,464	2,647
Warranty	4,934	2,416
Income tax payable	1,911	2,861
Customer prepayments	1,818	4,742
Commissions	1,334	938
Sales rebate	380	1,036
Deferred income	-	1,845
Other	2,330	1,774
Total	$ 34,908	$ 27,507

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017

Balance at beginning of period	$3,951	$2,627	$2,416	$1,030
Warranty provision for product sales	3,840	129	5,654	2,431
Settlements made	(36)	(161)	(100)	(710)
Unused warranty provision	(2,821)	(88)	(3,036)	(244)
Balance at end of period	$4,934	$2,507	$4,934	$2,507

Other Long-Term Liabilities

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

	September 30, 2018	**December 31, 2017**
Deferred compensation plan liabilities	$ 30,412	$ 28,087
Dividend equivalents	5,818	4,881
Other	83	56
Total	$ 36,313	$ 33,024

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5. GOODWILL AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET

There have been no changes in the balance of goodwill during the three and nine months ended September 30, 2018.

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

	September 30, 2018		
	Gross Amount	Accumulated Amortization	Net Amount
Know-how	$1,018	$ (857)	$ 161
Developed technologies	6,466	(6,319)	147
Total	$7,484	$ (7,176)	$ 308

	December 31, 2017		
	Gross Amount	Accumulated Amortization	Net Amount
Know-how	$1,018	$ (704)	$ 314
Developed technologies	6,466	(5,829)	637
Total	$7,484	$ (6,533)	$ 951

Amortization expense is recorded in cost of revenue in the Condensed Consolidated Statements of Operations. For the three months ended September 30, 2018 and 2017, amortization expense totaled $0.2 million and $0.5 million, respectively. For the nine months ended September 30, 2018 and 2017, amortization expense totaled $0.6 million and $1.5 million, respectively.

As of September 30, 2018, the estimated future amortization expense was as follows (in thousands):

2018 (remaining three months)	$198
2019	110
Total	$308

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 shares, and calculated using the treasury stock method. Contingently issuable shares, including equity awards with performance conditions or market conditions, are considered outstanding common shares and included in the basic net income per share as of the date that all necessary conditions to earn the awards have been satisfied. Prior to the end of the contingency period, the number of contingently issuable shares included in the diluted net income per share is based on the number of shares, if any, that would be issuable under the terms of the arrangement at the end of the reporting period.

The Company's outstanding RSUs contain forfeitable rights to receive cash dividend equivalents, which are accumulated and paid to the employees when the underlying RSUs vest. Dividend equivalents accumulated on the underlying RSUs are forfeited if the employees do not fulfill their service requirement and the awards do not vest. 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,	
	2018	2017	2018	2017
Numerator:				
Net income	$31,568	$23,642	$77,630	$53,132
Denominator:				
Weighted-average outstanding shares used to compute basic net income per share	42,362	41,458	42,173	41,276
Effect of dilutive securities	2,307	2,028	2,277	2,108
Weighted-average outstanding shares used to compute diluted net income per share	44,669	43,486	44,450	43,384
Net income per share:				
Basic	$0.75	$0.57	$1.84	$1.29
Diluted	$0.71	$0.54	$1.75	$1.22

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7. SEGMENT AND GEOGRAPHIC INFORMATION

The Company operates in one reportable segment that includes the design, development, marketing and sale of high-performance analog solutions for the consumer, computing and storage, industrial, automotive and communications markets. The Company's chief operating decision maker is its Chief Executive Officer, who reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. 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 and 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 equal to or greater than 10% of the Company's total revenue, or with 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,
Customer	2018	2017	2018	2017	2018	2017
A (distributor)	23%	17 %	21 %	17 %	21 %	16 %
B (distributor)	10%	15 %	10 %	*	16 %	*
C (value-added reseller)	*	*	*	*	*	15 %

* Represents less than 10%.

The Company's agreements with these third-party distributors and value-added reseller were made in the ordinary course of business and may be terminated with or without cause by these customers 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 any of these customers 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 short period following the termination of the agreement with the customer.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Country or Region	**2018**	**2017**	**2018**	**2017**
China	$91,509	$66,645	$245,580	$185,054
Taiwan	20,774	27,387	55,315	59,548
Europe	12,579	10,726	36,696	28,227
Korea	11,406	9,279	30,046	25,594
Southeast Asia	11,259	7,179	28,261	20,476
Japan	6,895	4,813	18,994	14,584
United States	5,375	2,781	13,404	7,711
Other	178	129	589	305
Total	$159,975	$128,939	$428,885	$341,499

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Product Family	**2018**	**2017**	**2018**	**2017**
DC to DC	$147,727	$119,089	$394,492	$312,700
Lighting Control	12,248	9,850	34,393	28,799
Total	$159,975	$128,939	$428,885	$341,499

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

Country	September 30, 2018	December 31, 2017
China	$ 92,066	$ 89,472
United States	68,014	65,618
Taiwan	17,033	17,238
Bermuda	6,879	7,522
Other	810	388
Total	$ 184,802	$ 180,238

8. LITIGATION

The Company is a party to actions and proceedings in the ordinary course of business, including potential litigation initiated by its shareholders, challenges to the enforceability or validity of its intellectual property, claims that the Company's products infringe on the intellectual property rights of others, and employment matters. 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. As of September 30, 2018, there were no material pending legal proceedings to which the Company was a party.

9. CASH, CASH EQUIVALENTS, INVESTMENTS AND RESTRICTED CASH

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

	September 30, 2018	December 31, 2017
Cash, cash equivalents and investments:		
Cash	$ 105,859	$ 75,125
Money market funds	25,235	7,134
Corporate debt securities	190,924	203,807
U.S. treasuries and government agency bonds	24,230	13,024
Certificates of deposit	1,600	-

Auction-rate securities backed by student-loan notes	5,257	5,256
Total	$ 353,105	$ 304,346

	September 30, 2018	December 31, 2017
Reported as:		
Cash and cash equivalents	$ 131,094	$ 82,759
Short-term investments	216,754	216,331
Long-term investments	5,257	5,256
Total	$ 353,105	$ 304,346

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

	September 30, 2018	December 31, 2017
Due in less than 1 year	$ 111,908	$ 89,399
Due in 1 - 5 years	104,846	126,932
Due in greater than 5 years	5,257	5,256
Total	$ 222,011	$ 221,587

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The following tables summarize the unrealized gain and loss positions related to the Company's available-for sale investments (in thousands):

	September 30, 2018				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Total Fair Value	Fair Value of Investments in Unrealized Loss Position
Money market funds	$25,235	$ -	$ -	$25,235	$ -
Corporate debt securities	192,581	2	(1,659)	190,924	187,359
U.S. treasuries and government agency bonds	24,419	-	(189)	24,230	24,230
Certificates of deposit	1,600	-	-	1,600	-
Auction-rate securities backed by student-loan notes	5,570	-	(313)	5,257	5,257
Total	$249,405	$ 2	$ (2,161)	$247,246	$ 216,846

	December 31, 2017				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Total Fair Value	Fair Value of Investments in Unrealized Loss Position
Money market funds	$7,134	$ -	$ -	$7,134	$ -
Corporate debt securities	204,789	17	(999)	203,807	197,564
U.S. treasuries and government agency bonds	13,092	-	(68)	13,024	13,024
Auction-rate securities backed by student-loan notes	5,570	-	(314)	5,256	5,256
Total	$230,585	$ 17	$ (1,381)	$229,221	$ 215,844

Restricted Cash

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the Condensed Consolidated Balance Sheets to the amounts shown in the Condensed Consolidated Statements of Cash Flows:

	September 30, 2018	December 31, 2017
Cash and cash equivalents	$ 131,094	$ 82,759
Restricted cash included in other long-term assets	115	115
Total cash, cash equivalents and restricted cash shown in the Condensed Consolidated Statements of Cash Flows	$ 131,209	$ 82,874

Restricted cash includes a security deposit that is set aside in a bank account and cannot be withdrawn by the Company under the terms of a lease agreement. The restriction will end and any unused amount will be returned to the Company upon the expiration of the lease.

10. FAIR VALUE MEASUREMENTS

The following tables summarize the fair value measurement of the financial assets (in thousands):

	Fair Value Measurement at September 30, 2018			
	Total	Level 1	Level 2	Level 3
Money market funds	$25,235	$25,235	$-	$-
Corporate debt securities	190,924	-	190,924	-
U.S. treasuries and government agency bonds	24,230	-	24,230	-
Certificates of deposit	1,600	-	1,600	-
Auction-rate securities backed by student-loan notes	5,257	-	-	5,257
Mutual funds and money market funds under deferred compensation plan	16,284	16,284	-	-
Total	$263,530	$41,519	$216,754	$5,257

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	Fair Value Measurement at December 31, 2017			
	Total	**Level 1**	**Level 2**	**Level 3**
Money market funds	$7,134	$7,134	$-	$-
Corporate debt securities	203,807	-	203,807	-
U.S. treasuries and government agency bonds	13,024	-	13,024	-
Auction-rate securities backed by student-loan notes	5,256	-	-	5,256
Mutual funds and money market funds under deferred compensation plan	16,625	16,625	-	-
Total	$245,846	$23,759	$216,831	$5,256

Level 1—includes instruments with quoted prices in active markets for identical assets.
Level 2—includes instruments for which the valuations are based upon quoted market prices in active markets involving similar assets or inputs other than quoted prices that are observable for the assets. The market inputs used to value these instruments generally consist of market yields, recently executed transactions, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. Pricing sources may include industry standard data providers, security master files from large financial institutions, and other third-party sources used to determine a daily market value.
Level 3—includes instruments for which the valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

The Company’s level 3 assets consist of government-backed student loan auction-rate securities, which became illiquid in 2008. The Company determined the fair value of the auction-rate securities using a discounted cash flow model with the following assumptions:

	September 30, 2018	**December 31, 2017**
Time-to-liquidity (years)	2 -3	2 -3
Discount rate	5.4% - 10.5%	4.5% - 9.6%

11. DEFERRED COMPENSATION PLAN

The following table summarizes the deferred compensation plan balances in the Condensed Consolidated Balance Sheets (in thousands):

	September 30,	**December 31,**

	2018	2017
Deferred compensation plan asset components:		
Cash surrender value of corporate-owned life insurance policies	$ 14,141	$ 11,455
Fair value of mutual funds and money market funds	16,284	16,625
Total	$ 30,425	$ 28,080
Deferred compensation plan assets reported in:		
Other long-term assets	$ 30,425	$ 28,080
Deferred compensation plan liabilities reported in:		
Accrued compensation and related benefits (short-term)	$ 447	$ 356
Other long-term liabilities	30,412	28,087
Total	$ 30,859	$ 28,443

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12. INTEREST AND OTHER INCOME, NET

The components of interest and other income, net are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Interest income	$1,583	$1,346	$4,606	$3,938
Amortization of premium on available-for-sale securities	(314)	(490)	(1,122)	(1,494)
Gain on deferred compensation plan investments	717	636	949	1,902
Foreign currency exchange gain (loss)	700	(237)	915	(473)
Other	28	-	39	-
Total	$2,714	$1,255	$5,387	$3,873

13. INCOME TAXES

As of September 30, 2018, the Company has not adjusted its provisional tax estimates related to the U.S. Tax Cuts and Jobs Act enacted in December 2017 (the “2017 Tax Act”) that were recorded in the fourth quarter of 2017. These amounts remained as estimates and, as permitted by Staff Accounting Bulletin No. 118, they will be refined through December 2018 based on the Company’s ongoing analysis of data and tax positions along with new guidance from regulators and interpretation of the law.

The income tax provision for the three and nine months ended September 30, 2018 was $4.6 million, or 12.8% of pre-tax income, and $8.2 million, or 9.5% of pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by the Company’s subsidiaries in Bermuda and China was taxed at lower rates, and because of certain stock-based compensation deductions. In addition, the effective tax rate was impacted by the inclusion of the global intangible low-taxed income ("GILTI") under the 2017 Tax Act.

For the three and nine months ended September 30, 2018, the Company’s effective tax rate included the estimated impact of $18.4 million and $46.2 million, respectively, related to the GILTI provisions that was included as additional subpart F income, which was accounted for as a period cost. In addition, during the first quarter of 2018, the Company paid the 2018 installment of $1.9 million related to the deemed repatriation transition tax liability. As of September 30, 2018, $1.9 million of the transition tax liability was recorded in current accrued liabilities and $20.1 million was recorded in long-term income tax liabilities on the Condensed Consolidated Balance Sheet.

The income tax provision for the three and nine months ended September 30, 2017 was $1.4 million, or 5.8% of pre-tax income, and $3.1 million, or 5.5% of pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by the Company's subsidiaries in Bermuda and China was taxed at lower rates. In addition, the effective tax rate was impacted by changes in the valuation allowance primarily related to stock-based compensation.

As of September 30, 2018, the Company had $18.1 million of unrecognized tax benefits, $11.2 million of which would affect its effective tax rate if recognized after considering the valuation allowance. At December 31, 2017, the Company had $16.3 million of unrecognized tax benefits, $9.1 million of which would affect its effective tax rate if recognized after considering the valuation allowance.

Uncertain tax positions relate to the allocation of income and deductions between 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 increases or decreases in its unrecognized tax benefits. However, it is not possible to determine either the magnitude or the range of 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, 2018 and December 31, 2017, the Company has $0.8 million and $0.5 million, respectively, of accrued interest related to uncertain tax positions, which were recorded in long-term income tax liabilities in the Consolidated Balance Sheets.

In July 2018, the U.S. Ninth Circuit Court of Appeals overturned the U.S. Tax Court's unanimous 2015 decision in *Altera v. Commissioner*, holding that the Internal Revenue Service ("IRS") did not violate the rule-making procedures required by the Administrative Procedures Act. In the case, the taxpayer challenged IRS regulations that required participants in qualified cost sharing arrangements to share stock based compensation costs. The Tax Court had invalidated those regulations, in part because the Treasury Department failed to adequately consider significant taxpayer comments when adopting them. In August 2018, the U.S. Ninth Circuit Court of Appeals withdrew its July 2018 opinion. The Company will continue to monitor developments related to this case and the potential impact on its financial statements.

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14. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	Unrealized Losses on Available-for-Sale Securities	Foreign Currency Translation Adjustments	Total
Balance as of January 1, 2018	$ (1,364)	$ 3,177	$1,813
Other comprehensive income (loss) before reclassifications	(1,185)	4,389	3,204
Amounts reclassified from accumulated other comprehensive income (loss)	25	-	25
Net current period other comprehensive income (loss)	(1,160)	4,389	3,229
Balance as of March 31, 2018	(2,524)	7,566	5,042
Other comprehensive income (loss) before reclassifications	94	(6,862)	(6,768)
Amounts reclassified from accumulated other comprehensive income (loss)	21	-	21
Net current period other comprehensive income (loss)	115	(6,862)	(6,747)
Balance as of June 30, 2018	(2,409)	704	(1,705)
Other comprehensive income (loss) before reclassifications	242	(4,526)	(4,284)
Amounts reclassified from accumulated other comprehensive income (loss)	8	-	8
Tax effect	241	-	241
Net current period other comprehensive income (loss)	491	(4,526)	(4,035)
Balance as of September 30, 2018	$ (1,918)	$ (3,822)	$(5,740)

The amounts reclassified from accumulated other comprehensive income (loss) were recorded in interest and other income, net, in the Condensed Consolidated Statements of Operations.

15. DIVIDENDS AND DIVIDEND EQUIVALENTS

Cash Dividend Program

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. Based on the Company's historical practice, stockholders of record as of the last business day of the quarter are entitled to receive the quarterly cash dividends when and if declared by the Board of Directors, which are payable to the stockholders in the following month. The Board of Directors declared the following cash dividends (in thousands, except per-share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Dividend declared per share	$0.30	$0.20	$0.90	$0.60
Total amount	$12,722	$8,301	$38,052	$24,822

As of September 30, 2018 and December 31, 2017, accrued dividends totaled $12.7 million and $8.3 million, respectively.

The declaration of any future cash dividends is at the discretion of the Board of Directors and will depend on, among other things, the Company's financial condition, results of operations, capital requirements, business conditions, statutory requirements of Delaware law, and other factors that the Board of Directors may deem relevant, as well as a determination that cash dividends are in the best interests of the stockholders.

The Company anticipates that cash used for future dividend payments will come from its current domestic cash and cash generated from ongoing U.S. operations, as well as cash to be repatriated from its Bermuda subsidiary. Earnings from other foreign subsidiaries will continue to be indefinitely reinvested.

Cash Dividend Equivalent Rights

Under the Company's stock plans, outstanding RSUs contain rights to receive cash dividend equivalents, which entitle employees who hold RSUs to the same dividend value per share as holders of common stock. The dividend equivalents are accumulated and paid to the employees when the underlying RSUs vest. Dividend equivalents accumulated on the underlying RSUs are forfeited if the employees do not fulfill their service requirement and the awards do not vest. As of September 30, 2018 and December 31, 2017, accrued dividend equivalents totaled $7.8 million and $5.8 million, respectively.

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16. SUBSEQUENT EVENTS

Employee Equity Awards

2018 MSUs:

In October 2018, the Compensation Committee granted 60,000 MSUs to the executive officers and 60,000 MSUs to certain non-executive employees, which represent a target number of shares to be awarded upon achievement of stock price targets ("2018 MSUs"). The maximum number of shares that an employee can earn is 500% of the target number of the 2018 MSUs if the Company achieves five stock price targets ranging from $140 to $172. The performance period for the first two stock price targets is from October 26, 2018 to December 31, 2021, and the performance period for the last three price targets is from October 26, 2018 to December 31, 2023.

Subject to the employees' continued employment with the Company, the 2018 MSUs will fully vest on January 1, 2024 if the pre-determined stock price targets are met during the performance periods and approved by the Compensation Committee. In addition, the 2018 MSUs contain sales restrictions on the vested shares by employees for up to two years.

2019 PSUs:

In October 2018, the Compensation Committee granted 53,000 PSUs to certain non-executive employees, which represent a target number of shares to be awarded based on the Company's 2020 revenue goals for certain regions or product line divisions, or based on the Company's average two-year (2019 and 2020) revenue growth rate compared against the analog industry's average two-year revenue growth rate as published by the Semiconductor Industry Association ("2019 Non-Executive PSUs"). The maximum number of shares that an employee can earn is either 200% or 300% of the target number of the 2019 Non-Executive PSUs, depending on the job classification of the employee. 50% of the 2019 Non-Executive PSUs will vest in the first quarter of 2021 if the pre-determined performance goals are met during the performance period and approved by the Compensation Committee. The remaining 2019 Non-Executive PSUs will vest over the following two years on an annual or quarterly basis. Vesting is subject to the employees' continued employment with the Company.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that have been made pursuant to and in reliance on the provisions of the Private Securities Litigation Reform Act of 1995. These statements include, among others, statements concerning:

- 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 belief that we may incur significant legal expenses that vary with the level of activity in each of our current or future legal proceedings,
- the effect that liquidity of our investments has on our capital resources,
- the continuing application of our products in the consumer, computing and storage, industrial, automotive and communications markets,
- estimates of our future liquidity requirements,
- the cyclical nature of the semiconductor industry,
- protection of our proprietary technology,
- business outlook for the remainder of 2018 and beyond,
- the factors that we believe will impact our ability to achieve revenue growth,
- the percentage of our total revenue from various end markets,

- our ability to identify, acquire and integrate the companies, businesses and products that we acquire and achieve the anticipated benefits from such acquisitions,

- the impact of the U.S. Tax Cuts and Jobs Act enacted in December 2017 (the "2017 Tax Act") on our income tax provision and cash flows,

- our intention and ability to 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 “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.

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Overview

We are a leading semiconductor company that designs, develops and markets high-performance power solutions. Founded in 1997, MPS's core strengths include deep system-level and applications knowledge, strong analog design expertise and an innovative proprietary process technology. These combined strengths enable MPS to deliver highly integrated monolithic products that offer energy efficient, cost-effective, easy-to-use solutions for systems found in consumer, computing and storage, industrial, automotive and communications applications. Our mission is to reduce total energy consumption in our customers' systems with green, practical and compact solutions. 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 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 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 our products are incorporated into end-user products. Our revenue from direct or indirect sales to customers in Asia was 89% for both the three months ended September 30, 2018 and 2017, and 88% and 89% for the nine months ended September 30, 2018 and 2017, respectively. We derive a majority of our revenue from the sales of our DC to DC converter products which serve the consumer, computing and storage, industrial, automotive and communications 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 continue to secure manufacturing capacity.

Critical Accounting Policies and Estimates

Except for the changes related to revenue recognition discussed in Note 1 and Note 2 to Condensed Consolidated Financial Statements, there have been no other 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, 2018, as compared to those disclosed in the Annual Report on Form 10-K for the year ended December 31, 2017.

Results of Operations

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018		2017		2018		2017	
	(in thousands, except percentages)							
Revenue	$159,975	100.0%	$128,939	100.0%	$428,885	100.0%	$341,499	100.0%
Cost of revenue	70,957	44.4	58,083	45.0	190,810	44.5	154,377	45.2
Gross profit	89,018	55.6	70,856	55.0	238,075	55.5	187,122	54.8
Operating expenses:								
Research and development	25,630	16.0	21,442	16.6	70,720	16.5	60,629	17.8
Selling, general and administrative	29,552	18.5	25,255	19.6	85,431	19.9	73,219	21.4
Litigation expense	343	0.2	327	0.3	1,513	0.4	903	0.3
Total operating expenses	55,525	34.7	47,024	36.5	157,664	36.8	134,751	39.5
Income from operations	33,493	20.9	23,832	18.5	80,411	18.7	52,371	15.3
Interest and other income, net	2,714	1.7	1,255	1.0	5,387	1.3	3,873	1.2
Income before income taxes	36,207	22.6	25,087	19.5	85,798	20.0	56,244	16.5
Income tax provision	4,639	2.9	1,445	1.2	8,168	1.9	3,112	0.9
Net income	$31,568	19.7 %	$23,642	18.3 %	$77,630	18.1 %	$53,132	15.6 %

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Revenue

The following table summarizes our revenue by end market:

	Three Months Ended September 30,					Nine Months Ended September 30,				
End Market	**2018**	**% of Revenue**	**2017**	**% of Revenue**	**Change**	**2018**	**% of Revenue**	**2017**	**% of Revenue**	**Change**
	(in thousands, except percentages)									
Computing and storage	$47,658	29.8 %	$29,020	22.5 %	64.2 %	$115,584	27.0 %	$74,103	21.7 %	56.0%
Automotive	19,785	12.4	12,857	10.0	53.9 %	57,857	13.5	38,042	11.1	52.1%
Industrial	24,869	15.5	16,348	12.7	52.1 %	61,544	14.3	46,736	13.7	31.7%
Communications	19,158	12.0	15,372	11.9	24.6 %	50,442	11.8	47,748	14.0	5.6 %
Consumer	48,505	30.3	55,342	42.9	(12.4)%	143,458	33.4	134,870	39.5	6.4 %
Total	$159,975	100.0%	$128,939	100.0%	24.1 %	$428,885	100.0%	$341,499	100.0%	25.6%

Revenue for the three months ended September 30, 2018 was $160.0 million, an increase of $31.1 million, or 24.1%, from $128.9 million for the three months ended September 30, 2017. This increase was driven by higher sales in all of our end markets except for the consumer market. Overall unit shipments increased by 22% due to higher market demand, and average sales prices increased by 2% from the same period in 2017.

Revenue from the computing and storage market for the three months ended September 30, 2018 increased $18.6 million, or 64.2%, from the same period in 2017. This increase was primarily driven by strength in the solid-state drive storage, cloud computing and high-performance notebook markets. Revenue from the automotive market increased $6.9 million, or 53.9%, from the same period in 2017. This increase was primarily driven by higher sales of products for infotainment, safety and connectivity applications. Revenue from the industrial market increased $8.5 million, or 52.1%, from the same period in 2017. This increase was primarily driven by higher sales in power source, security and meter products. Revenue from the communications market increased $3.8 million, or 24.6%, from the same period in 2017. This increase was primarily driven by higher demand in networking applications. Revenue from the consumer market decreased $6.8 million, or 12.4%, from the same period in 2017. This decrease was primarily due to softness in demand for high volume consumer related products, particularly those sold in the greater China region. This decrease was partially offset by higher demand for products related to home appliance, specialty lighting and internet-of-things applications.

Revenue for the nine months ended September 30, 2018 was $428.9 million, an increase of $87.4 million, or 25.6%, from $341.5 million for the nine months ended September 30, 2017. This increase was driven by higher sales in all of our end markets. Overall unit shipments increased by 17% due to higher market demand, and average sales prices increased by 6% from the same period in 2017.

Revenue from the computing and storage market for the nine months ended September 30, 2018 increased $41.5 million, or 56.0%, from the same period in 2017. This increase was primarily driven by strength in the solid-state drive storage, cloud computing and high-performance notebook markets. Revenue from the automotive market increased $19.8 million, or 52.1%, from the same period in 2017. This increase was primarily driven by higher sales of products for infotainment, safety and connectivity applications. Revenue from the industrial market increased $14.8 million, or 31.7%, from the same period in 2017. This increase was primarily driven by higher sales in power source, security and meter products. Revenue from the communications market increased $2.7 million, or 5.6%, from the same period in 2017. This increase was primarily driven by higher demand in networking applications. Revenue from the consumer market increased $8.6 million, or 6.4%, from the same period in 2017. This increase was primarily driven by higher demand for products related to home appliance, specialty lighting and internet-of-things applications, partially offset by softness in demand for high volume consumer related products, particularly those sold in the greater China region.

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Cost of Revenue and Gross Margin

Cost of revenue primarily consists of costs incurred to manufacture, assemble and test our products, as well as warranty costs, inventory-related and other overhead costs, and stock-based compensation expenses. In addition, cost of revenue includes amortization for acquisition-related intangible assets.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(in thousands, except percentages)					
Cost of revenue	$70,957	$58,083	22.2 %	$190,810	$154,377	23.6 %
As a percentage of revenue	44.4 %	45.0 %		44.5 %	45.2 %	
Gross profit	$89,018	$70,856	25.6 %	$238,075	$187,122	27.2 %
Gross margin	55.6 %	55.0 %		55.5 %	54.8 %	

Cost of revenue was $71.0 million, or 44.4% of revenue, for the three months ended September 30, 2018, and $58.1 million, or 45.0% of revenue, for the three months ended September 30, 2017. The $12.9 million increase in cost of revenue was primarily due to a 22% increase in overall unit shipments, partially offset by a 4% decrease in the average direct cost of units shipped. The increase in cost of revenue was also driven by a $3.7 million increase in inventory write-downs and a $1.0 million net increase in warranty expenses.

Gross margin was 55.6% for the three months ended September 30, 2018, compared with 55.0% for the three months ended September 30, 2017. The increase in gross margin was primarily due to increased sales of higher margin products, lower labor and manufacturing overhead costs and lower amortization expense due to certain intangible assets being fully amortized, partially offset by higher inventory write-downs and net warranty expenses as a percentage of revenue.

Cost of revenue was $190.8 million, or 44.5% of revenue, for the nine months ended September 30, 2018, and $154.4 million, or 45.2% of revenue, for the nine months ended September 30, 2017. The $36.4 million increase in cost of revenue was primarily due to a 17% increase in overall unit shipments, coupled with a 2% increase in the average direct cost of units shipped. The increase in cost of revenue was also driven by an $8.7 million increase in inventory write-downs.

Gross margin was 55.5% for the nine months ended September 30, 2018, compared with 54.8% for the nine months ended September 30, 2017. The increase in gross margin was primarily due to increased sales of higher margin products, lower labor and manufacturing overhead costs and lower amortization expense due to certain intangible assets being fully amortized, partially offset by higher inventory write-downs as a percentage of revenue.

Research and Development

Research and development ("R&D") expenses primarily consist of salary and benefit expenses, bonuses, stock-based compensation and deferred compensation for design and product engineers, expenses related to new product development and supplies, and facility costs.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(in thousands, except percentages)					
R&D expenses	$25,630	$21,442	19.5 %	$70,720	$60,629	16.6 %
As a percentage of revenue	16.0 %	16.6 %		16.5 %	17.8 %	

R&D expenses were $25.6 million, or 16.0% of revenue, for the three months ended September 30, 2018, and $21.4 million, or 16.6% of revenue, for the three months ended September 30, 2017. The $4.2 million increase in R&D expenses was primarily due to an increase of $2.5 million in compensation expenses, which include salary, benefits and bonuses, an increase of $0.7 million in laboratory supplies, and an increase of $0.6 million in new product development expenses. Our R&D headcount was 692 employees as of September 30, 2018, compared with 624 employees as of September 30, 2017.

R&D expenses were $70.7 million, or 16.5% of revenue, for the nine months ended September 30, 2018, and $60.6 million, or 17.8% of revenue, for the nine months ended September 30, 2017. The $10.1 million increase in R&D expenses was primarily due to an increase of $5.2 million in compensation expenses, which include salary, benefits and bonuses, an increase of $1.9 million in new product development expenses, an increase of $1.7 million in laboratory supplies, and an increase of $0.9 million in stock-based compensation expenses mainly associated with the performance-based equity awards. These increases were partially offset by a $0.7 million decrease in depreciation.

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Selling, General and Administrative

Selling, general and administrative ("SG&A") expenses primarily include salary and benefit expenses, bonuses, stock-based compensation and deferred compensation for sales, marketing and administrative personnel, sales commissions, travel expenses, facilities costs, and professional service fees.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(in thousands, except percentages)					
SG&A expenses	$29,552	$25,255	17.0 %	$85,431	$73,219	16.7 %
As a percentage of revenue	18.5 %	19.6 %		19.9 %	21.4 %	

SG&A expenses were $29.6 million, or 18.5% of revenue, for the three months ended September 30, 2018, and $25.3 million, or 19.6% of revenue, for the three months ended September 30, 2017. The $4.3 million increase in SG&A expenses was primarily due to an increase of $2.0 million in compensation expenses, which include salary, benefits and bonuses, an increase of $0.9 million in commission expenses driven by higher revenue, and an increase of $0.7 million in stock-based compensation expenses mainly associated with the performance-based equity awards. Our SG&A headcount was 424 employees as of September 30, 2018, compared with 378 employees as of September 30, 2017.

SG&A expenses were $85.4 million, or 19.9% of revenue, for the nine months ended September 30, 2018, and $73.2 million, or 21.4% of revenue, for the nine months ended September 30, 2017. The $12.2 million increase in SG&A expenses was primarily due to an increase of $4.3 million in compensation expenses, which include salary, benefits and bonuses, an increase of $4.0 million in stock-based compensation expenses mainly associated with the performance-based equity awards, and an increase of $2.9 million in commission expenses driven by higher revenue.

Litigation Expense

Litigation expense was $0.3 million for both the three months ended September 30, 2018 and 2017. Litigation expense was $1.5 million for the nine months ended September 30, 2018, compared with $0.9 million for the nine months ended September 30, 2017. The increase was primarily due to increased expenses on our ongoing lawsuits.

Interest and Other Income, Net

Interest and other income, net, was $2.7 million for the three months ended September 30, 2018, compared with $1.3 million for the three months ended September 30, 2017. The increase was primarily due to an increase of $0.9 million in foreign currency exchange gain, an increase of $0.2 million in interest income as a result of higher investment balances and yields, and a decrease of $0.2 million in amortization of premium on available-for-sale securities.

Interest and other income, net, was $5.4 million for the nine months ended September 30, 2018, compared with $3.9 million for the nine months ended September 30, 2017. The increase was primarily due to an increase of $1.4 million in foreign currency exchange gain, an increase of $0.7 million in interest income as a result of higher investment balances and yields, and a decrease of $0.4 million in amortization of premium on available-for-sale securities, which was partially offset by a decrease of $1.0 million in income related to changes in the value of the deferred compensation plan investments.

Income Tax Provision

As of September 30, 2018, we have not adjusted our provisional tax estimates related to the 2017 Tax Act that were recorded in the fourth quarter of 2017. These amounts remained as estimates and, as permitted by Staff Accounting Bulletin No. 118, they will be refined through December 2018 based on our ongoing analysis of data and tax positions along with new guidance from regulators and interpretation of the law.

The income tax provision for the three and nine months ended September 30, 2018 was $4.6 million, or 12.8% of pre-tax income, and $8.2 million, or 9.5% of pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by our subsidiaries in Bermuda and China was taxed at lower rates, and because of certain stock-based compensation deductions. In addition, the effective tax rate was impacted by the inclusion of the global intangible low-taxed income ("GILTI") under the 2017 Tax Act.

For the three and nine months ended September 30, 2018, our effective tax rate included the estimated impact of $18.4 million and $46.2 million, respectively, related to the GILTI provisions that was included as additional subpart F income, which was accounted for as a period cost. In addition, during the first quarter of 2018, we paid the 2018 installment of $1.9 million related to the deemed repatriation transition tax liability. As of September 30, 2018, $1.9 million of the transition tax liability was recorded in current accrued liabilities and $20.1 million was recorded in long-term income tax liabilities on the Condensed Consolidated Balance Sheet.

The income tax provision for the three and nine months ended September 30, 2017 was $1.4 million, or 5.8% of pre-tax income, and $3.1 million, or 5.5% of pre-tax income, respectively. The effective tax rate differed from the federal statutory rate primarily because foreign income generated by our subsidiaries in Bermuda and China was taxed at lower rates. In addition, the effective tax rate was impacted by changes in the valuation allowance primarily related to stock-based compensation.

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Liquidity and Capital Resources

	September 30, 2018	December 31, 2017
	(in thousands, except percentages)	
Cash and cash equivalents	$131,094	$82,759
Short-term investments	216,754	216,331
Total cash, cash equivalents and short-term investments	$347,848	$299,090
Percentage of total assets	45.6 %	45.8 %
Total current assets	$557,401	$449,170
Total current liabilities	(85,507)	(65,917)
Working capital	$471,894	$383,253

As of September 30, 2018, we had cash and cash equivalents of $131.1 million and short-term investments of $216.8 million, compared with cash and cash equivalents of $82.8 million and short-term investments of $216.3 million as of December 31, 2017. As of September 30, 2018, $100.6 million of cash and cash equivalents and $108.0 million of short-term investments were held by our international subsidiaries. As a result of the enactment of the 2017 Tax Act, we currently plan to repatriate cash from our Bermuda subsidiary to fund our future expenditures in the U.S. Earnings from other foreign subsidiaries will continue to be indefinitely reinvested.

The significant components of our working capital are cash and cash equivalents, short-term investments, accounts receivable, inventories and other current assets, reduced by accounts payable, accrued compensation and related benefits, and other accrued liabilities. As of September 30, 2018, we had working capital of $471.9 million, compared with working capital of $383.3 million as of December 31, 2017. The $88.6 million increase in working capital was due to a $108.2 million increase in current assets, partially offset by a $19.6 million increase in current liabilities. The increase in current assets was primarily due to an increase in cash and cash equivalents, accounts receivable and inventories. The increase in current liabilities was primarily due to an increase in accounts payable, accrued compensation and related benefits, and other accrued liabilities.

Summary of Cash Flows

The following table summarizes our cash flow activities:

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Net cash provided by operating activities	$93,861	$80,448
Net cash used in investing activities	(21,795)	(67,828)
Net cash used in financing activities	(21,669)	(22,684)
Effect of change in exchange rates	(2,062)	1,790
Net increase (decrease) in cash, cash equivalents and restricted cash	$48,335	$(8,274)

For the nine month ended September 30, 2018, net cash provided by operating activities was $93.9 million, primarily due to our net income adjusted for certain non-cash items, including depreciation and amortization and stock-based compensation, and a net decrease of $41.9 million from the changes in our operating assets and liabilities. The increase in accounts receivable was primarily driven by increased sales and the timing of shipments in the last month of the quarter. The increase in inventories was primarily driven by an increase in strategic wafer and die inventories as well as an increase in finished goods to meet current demand and future growth. The increase in accounts payable was primarily driven by increased inventory and capital asset purchases to meet future demand. For the nine months ended September 30, 2017, net cash provided by operating activities was $80.4 million, primarily due to our net income adjusted for certain non-cash items, including depreciation and amortization and stock-based compensation, and a net decrease of $25.1 million from the changes in our operating assets and liabilities. The increase in accounts receivable was primarily driven by higher sales and outstanding balances with certain customers with longer payment terms. The increase in inventories was primarily driven by an increase in strategic wafer and die inventories as well as an increase in finished goods to meet current demand and future growth. The increase in accounts payable was primarily driven by increased inventory and capital asset purchases to meet future demand. The increase in accrued liabilities was primarily driven by an increase in employee contributions to the deferred compensation plan and warranty expenses.

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For the nine months ended September 30, 2018, net cash used in investing activities was $21.8 million, primarily due to purchases of property and equipment of $18.1 million, net purchases of short-term investments of $2.3 million, and net contributions to the deferred compensation plan of $1.4 million. For the nine months ended September 30, 2017, net cash used in investing activities was $67.8 million, primarily due to net purchases of short-term investments of $40.6 million, purchases of property and equipment of $25.1 million, and net contributions to the deferred compensation plan of $2.1 million.

For the nine months ended September 30, 2018, net cash used in financing activities was $21.7 million, primarily reflecting $34.4 million used to pay dividends to our stockholders and dividend equivalents to our employees who hold RSUs, partially offset by $12.7 million of cash proceeds from vesting of RSUs and issuance of shares through our employee stock purchase plan. For the nine months ended September 30, 2017, net cash used in financing activities was $22.7 million, primarily reflecting $25.3 million used to pay dividends to our stockholders and dividend equivalents to our employees who hold RSUs, partially offset by $2.8 million of cash proceeds from stock option exercises and issuance of shares through our employee stock purchase plan.

We have a dividend program pursuant to which we intend to pay quarterly cash dividends on our common stock. In addition, outstanding 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 accumulated and paid to the employees when the underlying RSUs vest. Dividend equivalents accumulated on the underlying RSUs are forfeited if the employees do not fulfill their service requirement and the awards do not vest. For the nine months ended September 30, 2018, we paid dividends and dividend equivalents totaling $34.4 million. For the nine months ended September 30, 2017, we paid dividends and dividend equivalents totaling $25.3 million.

In February 2018, our Board of Directors approved an increase in our quarterly cash dividends from $0.20 per share to $0.30 per share, effective for the dividends declared in the first quarter of 2018.

We anticipate that cash used for future dividends and dividend equivalent payments, as well as payments for the one-time deemed repatriation transition tax and other expenditures, will come from our current domestic cash and cash generated from ongoing U.S. operations, as well as cash to be repatriated from our Bermuda subsidiary. Earnings from other foreign subsidiaries will continue to be indefinitely reinvested.

Although cash requirements will fluctuate based on the timing and extent of many factors such as those discussed above, we believe that cash generated from operations, together with the liquidity provided by existing cash balances and short-term investments, will be sufficient to satisfy our liquidity requirements for the next 12 months.

In the future, in order to strengthen our financial position, respond to changes in our circumstance or unforeseen events or conditions, or fund our growth, we may need to discontinue paying dividends and dividend equivalents, and may need to raise additional funds by any one or a combination of the following: issuing equity securities, issuing debt or convertible debt securities, incurring indebtedness secured by our assets, or selling certain product lines and/or portions of our business. Accordingly, we cannot ensure that we will continue to pay dividends and dividend equivalents in the future, and there can be no guarantee that we will be able to raise additional funds on terms acceptable to us, or at all.

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

Contractual Obligations

Our outstanding purchase commitments primarily consist of wafer purchases from our foundries, assembly services and license arrangements. As of September 30, 2018, the outstanding balance under our purchase commitments was $67.7 million, compared with $52.6 million as of December 31, 2017.

Under the 2017 Tax Act, we have a transition tax liability which represents a one-time, mandatory deemed repatriation tax imposed on previously deferred foreign earnings. As permitted by the 2017 Tax Act, we elected to pay the tax liability in installment over eight years through 2025. During the first quarter of 2018, we paid the 2018 installment of $1.9 million. As of September 30, 2018, the outstanding liability was $22.0 million.

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Other long-term obligations include long-term liabilities reflected in our Condensed Consolidated Balance Sheets, which primarily consist of the deferred compensation plan liabilities and accrued dividend equivalents. As of September 30, 2018, the outstanding obligations were $36.3 million, compared with $33.0 million as of December 31, 2017.

Our other contractual obligations have not changed significantly from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For a discussion of market risks, refer to Item 7A, “Quantitative and Qualitative Disclosures about Market Risk” in our Annual Report on Form 10-K for the year ended December 31, 2017. During the three and nine months ended September 30, 2018, there were no material changes or developments that would materially alter the market risk assessment performed as of December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2018, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

Effective January 1, 2018, we adopted Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. We have implemented additional business processes and control activities, primarily related to variable consideration estimates and presentation and disclosure, in order to monitor and maintain appropriate controls over financial reporting. There were no other changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating 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.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are a party to actions and proceedings in the ordinary course of business, including potential litigation initiated by our shareholders, challenges to the enforceability or validity of our intellectual property, claims that our products infringe on the intellectual property rights of others, and employment matters. These proceedings often involve complex questions of fact and law and may require the expenditure of significant funds and the diversion of other resources to prosecute and defend. We defend ourselves vigorously against any such claims. As of September 30, 2018, there were no material pending legal proceedings to which we were a party.

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ITEM 1A. RISK FACTORS

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

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

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

- our results of operations and financial performance;
- general economic, industry and market conditions worldwide;
- our ability to outperform the market, and outperform at a level that meets or exceeds our investors' expectations;
- whether our guidance meets the expectations of our investors;
- the depth and liquidity of the market for our common stock;
- developments generally affecting the semiconductor industry;
- commencement of or developments relating to our involvement in litigation;
- investor perceptions of us and our business strategies;
- changes in securities analysts' expectations or our failure to meet those expectations;
- actions by institutional or other large stockholders;
- terrorist acts or acts of war;

•actual or anticipated fluctuations in our results of operations;

•actual or anticipated manufacturing capacity limitations;

•developments with respect to intellectual property rights;

•introduction of new products by us or our competitors;

•our sale of common stock or other securities in the future;

•conditions and trends in technology industries;

•our loss of key customers;

•changes in market valuation or earnings of our competitors;

•any mergers, acquisitions or divestitures of assets undertaken by us;

•government debt default;

•government policies and regulations on corporate taxes, including the impact of the 2017 Tax Act;

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- government policies and regulations on international trade policies and restrictions, including tariffs on imports of foreign goods;
- our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity;
- our ability to increase our gross margins;
- market reactions to guidance from other semiconductor companies or third-party research groups;
- market reactions to merger and acquisition activities in the semiconductor industry, and rumors or expectations of further consolidation in the industry;
- investments in sales and marketing resources to enter new markets;
- costs of increasing wafer capacity and qualifying additional third-party wafer fabrication facilities;
- our ability to pay quarterly cash dividends to stockholders; and,
- changes in the estimation of the future size and growth rate of our markets.

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

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

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

- changes in general demand for electronic products as a result of worldwide macroeconomic conditions;
- changes in business conditions at our distributors, value-added resellers and/or end-customers;
- changes in general economic conditions in the countries where our products are sold or used;
- the timing of developments and related expenses in our litigation matters;
-

the loss of key customers or our inability to attract new customers due to customer and prospective customer concerns about being litigation targets;

- continued dependence on turns business (orders received and shipped within the same fiscal quarter);
- continued dependence on the Asian markets for our customer base;
- increases in assembly costs due to commodity price increases, such as the price of gold;
- the timing of new product introductions by us and our competitors;
- changes in our revenue mix between original equipment manufacturers ("OEMs"), original design manufacturers ("ODMs"), distributors and value-added resellers;
- changes in product mix, product returns, and actual and potential product liability;
- the acceptance of our new products in the marketplace;

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- our ability to develop new process technologies and achieve volume production;
- our ability to meet customer product demand in a timely manner;
- the scheduling, rescheduling, or cancellation of orders by our customers;
- the cyclical nature of demand for our customers' products;
- fluctuations in our estimate for stock rotation reserves;
- our ability to manage our inventory levels, including the levels of inventory held by our distributors;
- product obsolescence;
- seasonality and variability in the consumer, computing and storage, industrial, automotive and communications markets;
- the availability of adequate manufacturing capacity from our outside suppliers;
- increases in prices for finished wafers due to general capacity shortages;
- the potential loss of future business resulting from capacity issues;
- changes in manufacturing yields;
- movements in foreign exchange rates, interest rates or tax rates;
- the impact of the 2017 Tax Act on our income tax provision and cash flows;
- the impact of tariffs on imports of foreign goods; and,
- stock-based compensation charges primarily resulting from performance and market-based equity awards granted to our employees.

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

Our business has been and may be significantly impacted by worldwide economic conditions.

In recent years, global credit and financial markets experienced disruptions, and may experience disruptions in the future, including diminished liquidity and credit availability, declines in consumer confidence, declines in economic

growth, increases in unemployment rates, and uncertainty about economic stability. Economic uncertainty affects businesses such as ours in a number of ways, making it difficult to accurately forecast and plan our future business activities. The tightening of credit in financial markets may lead consumers and businesses to postpone spending, which may cause our customers to cancel, decrease or delay their existing and future orders with us. In addition, financial difficulties experienced by our suppliers or distributors could result in product delays, increased accounts receivable defaults and inventory challenges. Volatility in the credit markets could severely diminish liquidity and capital availability. Demand for our products is a function of the health of the economies in the United States, Europe, China and the rest of the world. We cannot predict the timing, strength or duration of any economic disruption or subsequent economic recovery worldwide, in the United States, in our industry, or in the different markets that we serve. These and other economic factors have had, and may in the future have, a material adverse effect on demand for our products and on our financial condition and operating results.

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Rising concern of international tariffs, including tariffs applied to goods traded between the United States and China, could materially and adversely affect our business and results of operations.

Since the beginning of 2018, there has been increasing rhetoric, in some cases coupled with legislative or executive action, from several U.S. and foreign leaders regarding tariffs against foreign imports of certain materials. More specifically, there have been three rounds of U.S. tariffs on Chinese goods taking effect in July, August and September 2018 (some of which prompted retaliatory Chinese tariffs on U.S. goods) and with an additional U.S. tariff rate increase scheduled to take effect in January 2019. The institution of trade tariffs both globally and between the U.S. and China specifically carries the risk of negatively affecting China's overall economic condition, which could have a negative impact on us as we have significant operations in China. Furthermore, imposition of tariffs could cause a decrease in the sales of our products to customers located in China or other customers selling to Chinese end users, which would directly impact our business and operating results.

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

Our profitability is dependent on many factors, including:

- our sales, which because of our turns business, are difficult to accurately forecast;
- the cancellation or rescheduling of our customers' orders, which may occur without significant penalty to our customers;
- changes in general demand for electronic products as a result of worldwide macroeconomic conditions;
- changes in revenue mix between OEMs, ODMs, distributors and value-added resellers;
- changes in product mix, and actual and potential product liability;
- changes in revenue mix between end market segments (i.e. consumer, computing and storage, industrial, automotive and communications);
- our competition, which could adversely impact our selling prices and our potential sales;
- our manufacturing costs, including our ability to negotiate with our vendors and our ability to efficiently run our test facility in China;
- manufacturing capacity constraints;
- level of activity in our legal proceedings, which could result in significant legal expenses;

- the impact of the 2017 Tax Act on our income tax provision and cash flows;
- the impact of tariffs on imports between the U.S. and China;
- stock-based compensation charges primarily resulting from performance and market-based equity awards granted to our employees; and,
- our operating expenses, including general and administrative expenses, selling and marketing expenses, and research and development expenses relating to products that will not be introduced and will not generate revenue until later periods, if at all.

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

We may not experience growth rates comparable to past years.

In the past, our revenue increased significantly in certain years due to increased sales of certain of our products. We are subject to numerous risks and factors that could cause a decrease in our growth rates compared to past periods, including increased competition, loss of certain of our customers, unfavorable changes in our operations, reduced global electronics demand, end-customer market downturn, market acceptance and penetration of our current and future products and litigation. A material decrease in our growth rates could adversely affect our stock price and results of operations.

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

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

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

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

Industry consolidation may lead to increased competition and may harm our operating results.

In recent years, there has been a trend toward semiconductor industry consolidation. We expect this trend to continue as companies attempt to improve the leverage of growing research and development costs, strengthen or hold their market positions in an evolving industry, or become unable to continue operations unless they find an acquirer or consolidate with another company. In addition, companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe that semiconductor industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, operating results and financial condition.

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

We believe that the application of our products in the consumer, computing and storage, industrial, automotive 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 and our results of operations and financial condition would be materially and adversely affected. In addition, as technology evolves, the ability to integrate the functionalities of various components, including our discrete semiconductor products, onto a single chip and/or onto other components of systems containing our products increases. Should our customers require integrated solutions that we do not offer, demand for our products could decrease, and our business and results of operations would be materially and adversely affected.

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

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

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

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

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

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

We may face competition from customers developing products internally.

Our customers generally have substantial technological capabilities and financial resources. Some customers have traditionally used these resources to develop their own products internally. The future prospects for our products in these markets are dependent in part upon our customers' acceptance of our products as an alternative to their internally developed products. Future sales prospects also are dependent upon acceptance of third-party sourcing for products as an alternative to in-house development. Customers may in the future continue to use internally developed components. They also may decide to develop or acquire components, technologies or products that are similar to, or that may be substituted for, our products. If our customers fail to accept our products as an alternative, if they develop or acquire the technology to develop such components internally rather than purchase our products, or if we are otherwise unable to develop or maintain strong relationships with them, our business, financial condition and results of operations could be materially and adversely affected.

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

We derive most of our revenue from customers located in Asia through direct sales or indirect sales through distribution arrangements and value-added reseller agreements with parties located in Asia. As a result, we are subject to increased risks due to this geographic concentration of business and operations. For the three and nine months ended September 30, 2018, 89% and 88% of our revenue, respectively, was from customers in Asia. There are risks inherent in doing business in Asia, and internationally in general, including:

- changes in, or impositions of, legislative or regulatory requirements, including tax laws in the U.S. and in the countries in which we manufacture or sell our products;
- trade restrictions, including restrictions imposed by the United States on trading with parties in foreign countries;
- currency exchange rate fluctuations impacting intra-company transactions;
- the fluctuations in the value of the U.S. Dollar relative to other foreign currencies, which could affect the competitiveness of our products;
- transportation delays;
- changes in tax regulations in China that may impact our tax status in Chengdu, Hangzhou and other regions where we have significant operations;
- tariffs imposed by China that may impact our sales;
- multi-tiered distribution channels that lack visibility to end customer pricing and purchase patterns;
- international political relationships and threats of war;

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- terrorism and threats of terrorism;
- epidemics and illnesses;
- work stoppages and infrastructure problems due to adverse weather conditions or natural disasters;
- work stoppages related to employee dissatisfaction;
- economic, social and political instability;
- longer accounts receivable collection cycles and difficulties in collecting accounts receivables;
- enforcing contracts generally; and,
- less effective protection of intellectual property and contractual arrangements.

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

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

Historically, we have generated most of our revenue from a limited number of customers, including distributors. For example, sales to our largest distributor accounted for 23% and 21% of our total revenue for the three and nine months ended September 30, 2018, respectively. We continue to rely on a limited number of customers for a significant portion of our revenue. Because we rely on a limited number of customers for significant percentages of our revenue, a decrease in demand or significant pricing pressure for our products from any of our major customers for any reason (including due to competition, market conditions, catastrophic events or otherwise) could have a materially adverse impact on our financial conditions and results of operations.

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

We are subject to the FCPA, which generally prohibits companies and their intermediaries from making improper payments to foreign officials for the purpose of obtaining or keeping business and/or other benefits, along with various other anti-corruption laws. Although we have implemented policies and procedures designed to ensure that

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

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

We market our products through distribution arrangements and value-added resellers and through our direct sales and applications support organization to customers that include OEMs, ODMs and electronic manufacturing service providers ("EMSs"). Receivables from our customers are generally not secured by any type of collateral and are subject to the risk of being uncollectible. Sales to our largest distributor accounted for 23% and 21% of our total revenue for the three and nine months ended September 30, 2018, respectively. Significant deterioration in the liquidity or financial condition of any of our major customers or any group of our customers could have a material adverse impact on the collectability of our accounts receivable and our future operating results. We primarily conduct our sales on a purchase order basis, and we do not have any long-term supply commitments.

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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 an OEM's significant program or product could reduce our revenue and adversely affect our results of operations and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

- the costs and expense associated with such activities;
- the availability of modern foundries to be developed, acquired, leased or otherwise made available to us or our third-party suppliers;
- the ability of foundries and our third-party suppliers to obtain the advanced equipment used in the production of our products;
- delays in bringing new foundry operations online to meet increased product demand; and
- unforeseen environmental, engineering or manufacturing qualification problems relating to existing or new foundry facilities, including delays in qualification of new foundries by our customers.

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

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

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

The 2017 Tax Act is expected to have significant effects on our income tax expense, which could result in a material adverse impact on our results of operations, financial condition and cash flows.

In December 2017, the 2017 Tax Act was enacted and includes a broad range of tax reforms, including changes to corporate tax rates, business deductions and international tax provisions. Many of these provisions significantly differ from prior U.S. tax law, resulting in material tax accounting implications for us. Some of the significant new requirements include, but are not limited to, a one-time mandatory deemed repatriation transition tax on previously deferred foreign earnings, a remeasurement of our deferred taxes due to the change in the corporate tax rate, taxation of certain global intangible low-taxed income under the international tax provisions, and limitations on the deductibility of performance-based compensation for officers. As we continue to evaluate the potential implications of the 2017 Tax Act on our financial statements, any increase in our income tax expense in future periods could have a material negative impact on our results of operations. In addition, the deemed repatriation transition tax liability, which is payable over eight years, will adversely impact our cash flows and financial condition in future periods. Any changes to our corporate tax planning and strategies as a result of the 2017 Tax Act may not result in a favorable impact on our income tax expense in future periods.

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The calculation of the tax impact and exposures under the 2017 Tax Act is complex. It requires the collection of information not regularly produced by us, the use of estimates and the exercise of significant judgment in determining our tax provision. As regulations and guidance evolve with respect to the 2017 Tax Act, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our financial position. Furthermore, we will need to evaluate whether changes to our existing processes and controls are necessary to address the financial reporting effects. If we fail to correctly interpret the tax law or implement effective internal controls on gathering, analyzing and reviewing data used in our calculations, our income tax provision could be misstated, which could have a material adverse impact on our results of operations and financial condition.

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

Due to the complexity associated with the calculation of our tax provision, including the effects of the 2017 Tax Act, we engage third-party tax advisors to assist us in the calculation. If we or our tax advisors fail to resolve or fully understand certain issues that we may have had in the past and issues that may arise in the future, we could be subject to errors, which, if material, would result in us having to restate our financial statements. Restatements are generally costly and could adversely impact our results of operations, damage our reputation, and/or have a negative impact on the trading price of our common stock.

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 such as the 2017 Tax Act, regulations, accounting principles or interpretations thereof and discrete items such as future exercises or dispositions of stock options and restricted stock releases. In addition, we are subject to potential future examinations of our income tax returns by the Internal Revenue Service (“IRS”) and other tax authorities. For example, our U.S. federal income tax returns for the years ended December 31, 2005 through December 31, 2007 were examined by the IRS. We reached a resolution with the IRS in April 2015 and recorded a one-time net charge of $2.7 million to our income tax provision in the second quarter of 2015. We 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 any examinations will not have an adverse effect on our operating results and financial condition.

Implementation of an enterprise resource planning (“ERP”) or other information technology systems could result in significant disruptions to our operations.

From time to time, we may implement new ERP software solutions or upgrade existing systems. Implementation of these solutions and systems is highly dependent on coordination of system providers and internal business teams. We may experience difficulties as we transition to these new or upgraded systems and processes, including loss or corruption of financial, business or customer data. In addition, transitioning to these new systems requires significant capital investments and personnel resources. Difficulties in implementing new or upgraded information systems or significant system failures could disrupt our operations, which could have a material adverse effect on our capital resources, financial condition or results of operations.

System security risks, data protection or privacy breaches, cyber attacks and systems integration issues could disrupt our internal operations and/or harm our reputation, and any such disruption or harm could cause a reduction in our expected revenue, increase our expenses, negatively impact our results of operation or otherwise adversely affect our stock price.

Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate or compromise our confidential and proprietary information, create system disruptions or cause shutdowns. The costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions and delays that may impede our sales, manufacturing, distribution or other critical functions.

In the ordinary course of business, we store sensitive data on our internal systems, network and servers, such as proprietary business and financial information, and confidential data pertaining to our customers, suppliers and business partners. The secure maintenance of sensitive information on our networks and the protection features of our solutions are both critical to our operations and business strategy. We devote significant resources to network security, data encryption, and other security measures to protect our systems and data. However, these security measures cannot provide absolute security. Although we make significant efforts to maintain the security and integrity of our systems and solutions, any destructive or intrusive breach could compromise our networks, creating system disruptions or slowdowns, and the information stored on our networks could be accessed, publicly disclosed, lost or stolen. If any of these types of security breaches were to occur and we were unable to protect sensitive data, our relationships with our business partners and customers could be materially damaged, our reputation could be materially harmed, and we could be exposed to a risk of litigation and possible significant liability.

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Portions of our IT infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and our remediation efforts may be expensive, time consuming, disruptive and resource-intensive. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes. Delayed sales or lost customers resulting from these disruptions could adversely affect our financial results, stock price and reputation.

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

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

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

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

Future legal proceedings may divert our financial and management resources.

The semiconductor industry is characterized by frequent claims of infringement and litigation regarding patent and other intellectual property rights. Patent infringement is an ongoing risk, in part because other companies in our

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

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 technologies or products, or to obtain and use information that we regard as proprietary. We intend to continue to protect our proprietary technologies, 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 materially harm our business.

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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 became illiquid in 2008. Since 2008, we have redeemed 87% of the original portfolio of our auction-rate securities at par and continue to hold $5.6 million in principal amount as of September 30, 2018. The underlying maturity of these auction-rate securities is up to 30 years. We have historically recorded temporary and other-than-temporary impairment charges on these investments. The valuation is subject to fluctuations in the future, which will depend on many factors, including the quality of underlying collateral, estimated time for liquidity including potential to be called or restructured, underlying final maturity, insurance guaranty and market conditions, among others. Should there be further deterioration in the market for auction-rate securities, the value of our portfolio may decline, which may have an adverse impact on our cash position and our earnings. If the accounting rules for these securities change, there may be an adverse impact on our earnings.

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

Effective internal control over financial reporting is necessary for us to provide reliable and accurate financial reports. If we cannot provide reliable financial reports or prevent fraud or other financial misconduct, our business and operating results could be harmed. Our failure to implement and maintain effective internal control over financial reporting could result in a material misstatement of our financial statements or otherwise cause us to fail to meet our financial reporting obligations. This, in turn, could result in a loss of investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our results of operations and/or have a negative impact on the trading price of our common stock, and could subject us to stockholder litigation. In addition, we cannot assure you that we will not in the future identify material weaknesses in our internal control over financial reporting that we have not discovered to date, which may impact the reliability of our financial reporting and financial statements.

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

Our customers generally establish demanding specifications for quality, performance, and reliability that our products must meet. ICs as complex as ours often encounter development delays and may contain undetected defects or failures when first introduced or after commencement of commercial shipments, which might require product replacement or recall. Further, our third-party manufacturing processes or changes thereof, or raw material used in the manufacturing processes may cause our products to fail. We have from time to time in the past experienced product quality, performance or reliability problems. Our standard warranty period is generally one to two years, which exposes us 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, cancellations or

rescheduling of orders or shipments, and product returns or discounts, any of which would harm our operating results.

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

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

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

Fluctuations in the value of the U.S. Dollar relative to other foreign currencies, including the Renminbi, may adversely affect results of operations.

Our manufacturing and packaging suppliers are and will continue to be primarily located in China for the foreseeable future. If the value of the Renminbi rises against the U.S. Dollar, there could be an increase in our manufacturing costs relative to competitors who have manufacturing facilities located in the U.S., which could adversely affect our operations. In addition, our sales are primarily denominated in the U.S. Dollar. If the value of the U.S Dollar rises against other currencies, it may adversely affect the demand for our products in international markets, which could negatively impact our business and results of operations.

We incur foreign currency exchange gains or losses related to the timing of payments for transactions between the U.S. and our foreign subsidiaries, which are reported in interest and other income in the statements of operations. Fluctuations in the value of the U.S. Dollar relative to the foreign currencies could increase the amount of foreign currency exchange losses we record, which could have an adverse impact on our results of operations.

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Our business is subject to various governmental laws and regulations, and compliance with these regulations may impact our revenue and cause us to incur significant expense. If we fail to maintain compliance with applicable regulations or obtain government licenses and approvals for our desired international trading activities or technology transfers, we may be forced to recall products and cease their distribution, and we could be subject to civil or criminal penalties.

Our business is subject to various significant laws and other legal requirements imposed by the U.S. and other countries we conduct business with, including export control laws such as the Export Administration Act, the Export Administration Regulations ("EAR") and other laws, regulations and requirements governing international trade and technology transfer. These laws and regulations are complex, change frequently and have generally become more stringent over time. We may be required to incur significant expense to comply with these regulations or to remedy violations of these regulations. In addition, if our customers fail to comply with these regulations, we may be required to suspend sales to these customers, which could negatively impact our results of operations. We must conform the manufacture and distribution of our products to various laws and adapt to regulatory requirements in many countries as these requirements change. If we fail to comply with these requirements in the manufacture or distribution of our products, we could be required to pay civil penalties, face criminal prosecution and, in some cases, be prohibited from distributing our products commercially until the products are brought into compliance.

Environmental laws and regulations could cause a disruption in our business and operations.

We are subject to various state, federal and international laws and regulations governing the environment, including those restricting the presence of certain substances in electronic products and making manufacturers of those products financially responsible for the collection, treatment, recycling and disposal of certain products. Such laws and regulations have been passed in several jurisdictions in which we operate, including various European Union member countries and countries in Asia. There can be no assurance that similar laws and regulations will not be implemented in other jurisdictions resulting in additional costs, possible delays in delivering products, and even the discontinuance of existing and planned future product replacements if the cost were to become prohibitive.

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.

We have manufacturing and testing facilities in China and most of our manufacturing partners are located in China. The Chinese government has broad discretion and authority to regulate the technology industry in China. Additionally, China’s government has implemented policies from time to time to regulate economic expansion in China. It 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.

Personal privacy, cyber security, and data protection are becoming increasingly significant issues in China. To address these issues, the Standing Committee of the National People's Congress promulgated the Cyber Security Law of the People's Republic of China (the "Cyber Security Law"), which took effect on June 1, 2017. The Cyber Security Law sets forth various requirements relating to the collection, use, storage, disclosure and security of data, among other things. Various Chinese agencies are expected to issue additional regulations in the future to define these requirements more precisely. These requirements may increase our costs of compliance. We cannot assure you that we will be able to comply with all of these regulatory requirements. Any failure to comply with the Cyber Security Law and the relevant regulations and policies could result in further cost and liability to us and could adversely affect our business and results of operations. Additionally, increased costs to comply with, and other burdens imposed by, the Cyber Security Law and relevant regulations and policies that are applicable to the businesses of our suppliers, vendors and other service providers, as well as our customers, could adversely affect our business and results of operations.

Any additional new regulations or the amendment or modification 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.

The Chinese government and provincial and local governments also 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 facilities 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.

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

We have manufacturing and testing facilities in China. We face the following risks, among others, with respect to our operations in China:

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

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

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

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

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

The introduction of new products presents significant business challenges because product development plans and expenditures may be made up to two years or more in advance of any sales. It generally takes us up to 12 months or more to design and manufacture a new product prototype. Only after we have a prototype do we introduce the product to the market and begin selling efforts in an attempt to achieve design wins. This sales process requires us to expend

significant sales and marketing resources without any assurance of success. Volume production of products that use our ICs, if any, may not be achieved for an additional period of time after an initial sale. Sales cycles for our products are lengthy for a number of reasons, including:

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

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

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

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

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

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

Our future success depends upon our ability to attract and retain highly qualified technical and managerial personnel. We are particularly dependent on the continued services of our key executives, including Michael Hsing, our President and Chief Executive Officer, who founded our company and developed our proprietary process technology. In addition, personnel with highly skilled analog and mixed-signal design engineering expertise are scarce and competition for personnel with these skills is intense. There can be no assurance that we will be able to retain existing key employees or that we will be successful in attracting, integrating or retaining other highly qualified personnel with critical capabilities in the future. If we are unable to retain the services of existing key employees or are unsuccessful in attracting new highly qualified employees quickly enough to meet the demands of our business, including design cycles, our business could be harmed. Furthermore, if we lose key personnel, the search for a qualified replacement and the transition could interrupt our operations as the search could take us longer than expected and divert management resources, and the newly hired employee could take longer than expected to integrate into the team.

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

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

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

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

We may not realize the anticipated benefits of any company or business that we acquire. In addition, acquisitions could result in diluting the ownership interests of our stockholders, reduce our cash balances, and cause us to incur debt or to assume contingent liabilities, which could adversely affect our business. We may also be the target of strategic transactions, which could divert our management's attention and otherwise disrupt our operations and 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. As a result of completing acquisitions, we could use a significant portion of our available cash, cash equivalents and short-term investments, issue equity securities that would dilute current stockholders' percentage ownership, incur substantial debt or contingent liabilities, or incur impairment charges related to goodwill or other acquisition-related intangibles. Such actions could impact our operating results and the price of our common stock.

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In addition, we may be unable to identify or complete prospective acquisitions for various reasons, including competition from other companies in the semiconductor industry, the valuation expectations of acquisition candidates and applicable antitrust laws or related regulations. If we are unable to identify and complete acquisitions, we may not be able to successfully expand our business and product offerings.

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

- unexpected losses of key employees or customers of the acquired companies or businesses;
- conforming the acquired company's standards, processes, procedures and controls with our operations;
- coordinating new product and process development;
- hiring additional management and other critical personnel;
- increasing the scope, geographic diversity and complexity of our operations;
- difficulties in consolidating facilities and transferring processes and know-how;
- difficulties in the assimilation of acquired operations, technologies or products;
- the risk of undisclosed liabilities of the acquired businesses and potential legal disputes with founders or stockholders of acquired companies;
- our inability to commercialize acquired technologies;
- the risk that the future business potential as projected is not realized and as a result, we may be required to take a charge to earnings that would impact our profitability;
- the need to take impairment charges or write-downs with respect to acquired assets and technologies;
- difficulties in assessing the fair value of earn-out arrangements;
- diversion of management's attention from other business concerns; and
- adverse effects on existing business relationships with customers.

In addition, third parties may be interested in acquiring us. We will consider and discuss such transactions as we deem appropriate. Such potential transactions may diver the attention of management, and cause us to incur various costs and expenses in investigating and evaluating such transactions, whether or not they are consummated.

If we issue additional shares of stock in the future, it may have a dilutive effect on our stockholders.

We may issue additional shares of common stock in the future in order to raise additional capital to fund our global operations or in connection with an acquisition. We also issue restricted stock units to employees, which convert into shares of common stock upon vesting. Any issuance of our common stock may result in immediate dilution to our stockholders. In addition, the issuance of a significant amount of our common stock may result in additional regulatory requirements, such as stockholder approval.

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

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

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

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

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

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

In June 2014, the Board of Directors approved a dividend program pursuant to which we intend to pay quarterly cash dividends on our common stock. The declaration of any future cash dividends is at the discretion of our Board of Directors and will depend on, among other things, our financial condition, results of operations, capital requirements, business conditions, statutory requirements of Delaware law, and other factors that our Board of Directors may deem relevant, as well as a determination that cash dividends are in the best interests of our stockholders. Our dividend payments may change from time to time, and we cannot provide assurance that we will continue to declare dividends at all or in any particular amounts. A reduction in or elimination of our dividend payments could have a negative effect on the price of our common stock.

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

Our corporate headquarters, the production facilities of our third-party wafer suppliers, our IC testing and manufacturing facilities, 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, particularly in China. Such concentration increases the risk that other natural disasters, labor strikes, terrorism, war, political unrest, epidemics, and/or health advisories could disrupt our operations. In addition, we rely heavily on our internal information and communications systems and on systems or support services from third parties to manage our operations efficiently and effectively. Any of these are subject to failure due to a natural disaster or other disruption. System-wide or local failures that affect our information processing could have material adverse effects on our business, financial condition, operating results and cash flows.

ITEM 6. EXHIBITS

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation
101.DEF	XBRL Taxonomy Extension Definition
101.LAB	XBRL Taxonomy Extension Labels
101.PRE	XBRL Taxonomy Extension Presentation

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

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MONOLITHIC POWER SYSTEMS, INC

SIGNATURES

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

MONOLITHIC POWER SYSTEMS, INC.

Dated: November 2, 2018 /s/ T. Bernie Blegen

T. Bernie Blegen
Chief Financial Officer
(Duly Authorized Officer and Principal Financial and Accounting Officer)