

MONOLITHIC POWER SYSTEMS INC  
Form 10-K  
March 04, 2011

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2010

or

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

6409 Guadalupe Mines Road, San Jose, CA 95120 (408) 826-0600  
(Address of principal executive offices, including zip code and telephone number)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
Common Stock, \$0.001 Par Value

Name of each exchange on which registered  
The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.  Yes  No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"). Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The number of shares of the registrant’s stock outstanding as of June 30, 2010 was 36,545,581. The closing price of the registrant’s common stock on the Nasdaq Global Select Market as of June 30, 2010 was \$17.86. The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant based upon the closing price of the Common Stock on the Nasdaq Global Select Market on June 30, 2010 was \$373,041,070.\*

There were 35,315,748 shares of the registrant’s common stock issued and outstanding as of February 22, 2011.

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#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s Proxy Statement for the registrant’s 2011 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K to the extent stated herein. The Proxy Statement will be filed within 120 days of the registrant’s fiscal year ended December 31, 2010.

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\*Excludes 15,658,623 shares of the registrant’s common stock held by executive officers, directors and stockholders whose ownership exceeds 5% (“affiliates”) of the Common Stock outstanding at June 30, 2010. Exclusion of such shares should not be construed to indicate that any such person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the registrant or that such person is controlled by or under common control with the registrant.

MONOLITHIC POWER SYSTEMS, INC.  
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Except as the context otherwise requires, the terms “Monolithic Power Systems”, “MPS”, “Registrant”, “Company”, “we”, “us” and “our” as used herein are references to Monolithic Power Systems, Inc. and its consolidated subsidiaries.

## FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K and the documents incorporated herein by reference contain 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 other things, statements concerning:

- the above-average industry growth of product and market areas that we have targeted,
- our plan to introduce additional new products within our existing product families as well as in new product categories and families,
- our belief that we will continue to incur significant legal expenses that vary with the level of activity in each of our legal proceedings,
- the impact of our outstanding litigation and changing market conditions on the revenue we derive from our CCFL product line,
- the effect of auction-rate securities on our liquidity and capital resources,
- the application of our products in the computer, consumer electronics, and communications markets continuing to account for a majority of our revenue,
- estimates of our future liquidity requirements,
- the cyclical nature of the semiconductor industry,
- protection of our proprietary technology,
- near term business outlook for 2011,
- the factors that we believe will impact our ability to achieve revenue growth,
- the outcome of the IRS audit of our tax return for the tax years ended December 31, 2006 and 2007,
- the percentage of our total revenue from various market segments, and
- the factors that differentiate us from our competitors.

In some cases, words such as “would,” “could,” “may,” “should,” “predict,” “potential,” “targets,” “continue,” “anticipate,” “expect,” “intend,” “plan,” “believe,” “seek,” “estimate,” “project,” “forecast,” “will,” the negative of these terms or other variations of such terms and similar expressions relating to the future identify forward-looking statements.

All forward-looking statements are based on our current outlook, expectations, estimates, projections, beliefs and plans or objectives about our business and our industry. These statements are not guarantees of future performance and are subject to risks and uncertainties. Actual events or results could differ materially and adversely from those expressed in any such forward-looking statements.

Risks and uncertainties that could cause actual results to differ materially include those set forth throughout this annual report on Form 10-K 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 annual report on Form 10-K. Readers should carefully review future reports and documents that we file from time to time with the Securities and Exchange Commission, such as our quarterly reports on Form 10-Q and any current reports on Form 8-K.



## PART I

### ITEM 1. BUSINESS

#### General

Monolithic Power Systems is a fabless semiconductor company that designs, develops and markets proprietary, advanced analog and mixed-signal semiconductors. We combine advanced process technology with our highly experienced analog designers to produce high-performance power management integrated circuits (ICs) for DC to DC converters, LED drivers, Cold Cathode Fluorescent Lamp (CCFL) backlight controllers, Class-D audio amplifiers, and other Linear ICs. Our products are used extensively in computing and network communications products, flat panel TVs, set top boxes and a wide variety of consumer and portable electronics products. We partner with world-class manufacturing organizations to deliver top quality, ultra-compact, high-performance solutions through productive, cost-efficient channels. Founded in 1997 and headquartered in San Jose, California, we have expanded our global presence with offices in Taiwan, China, Korea, Japan, and Europe, which operate under MPS International, Ltd.

#### Industry Overview

Semiconductors comprise the basic building blocks of electronic systems and equipment. Within the semiconductor industry, components can be classified either as discrete devices, such as individual transistors, or as ICs, in which a number of transistors and other elements are combined to form a more complicated electronic circuit. ICs can be further divided into three primary categories: digital, analog, and mixed-signal. Digital ICs, such as memory devices and microprocessors, can store or perform arithmetic functions on data that is represented by a series of ones and zeroes. Analog ICs, in contrast, handle real world signals such as temperature, pressure, light, sound, or speed. In addition, analog ICs also perform power management functions, such as regulating or converting voltages, for electronic devices. Mixed-signal ICs combine digital and analog functions onto a single chip and play an important role in bridging real world phenomena to digital systems.

**Analog and Mixed-Signal Markets.** We focus on the market for 'high performance' analog and mixed-signal ICs. 'High performance' products generally are differentiated by functionality and performance factors which include integration of higher levels of functionality onto a single chip, greater precision, higher speed and lower heat and noise. There are several key factors that distinguish analog and mixed-signal IC markets from digital IC markets and in particular the high performance portion of the analog and mixed signal IC market. These factors include longer product life cycles, numerous market segments, technology that is difficult to replicate, relative complexity of design and process technology, importance of experienced design engineers, lower capital requirements and diversity of end markets. We have, however, targeted product and market areas that we believe have the ability to offer above average industry growth over the long term.

#### Products and Applications

We currently have three primary product families that address multiple applications within the computing, consumer electronics, communications, and industrial/automotive markets. Our products are differentiated with respect to their high degree of integration and strong levels of accuracy and efficiency, making them cost-effective relative to many competing solutions. These product families include:

**Direct Current (DC) to DC Converters.** DC to DC converter ICs are used to convert and control voltages within a broad range of electronic systems, such as portable electronic devices, wireless LAN access points, computers, set top boxes, TVs and monitors, automobiles and medical equipment. We believe that our DC to DC converters are differentiated in the market, particularly with respect to their high degree of integration, high voltage operation, high

load current, and high switching speed in a small footprint. These features are important to our customers as they result in fewer components, a smaller form factor, more accurate regulation of voltages, and, ultimately, lower system cost and increased reliability through the elimination of many discrete components and power devices.

Lighting Control Products and AC/DC Offline Solutions. Lighting control ICs are used in backlighting and general illumination products. Lighting control ICs for backlighting are used in systems that provide the light source for LCD panels typically found in notebook computers, LCD monitors, car navigational systems, and LCD televisions. Backlighting solutions are typically either WLED lighting sources or cold cathode fluorescent lamps (CCFL). WLED lighting control ICs step-up or step-down a DC voltage, or convert from an AC line voltage supplied by the utility company (also called AC/DC Offline) and provide efficient precision power and protection to a LED string or to multiple LED strings. The CCFL ICs function by converting low-voltage direct current (DC) or battery voltage to high-voltage alternating current (AC). We believe our CCFL ICs were the first to utilize a full bridge resonant topology that allows for high efficiency, extended lifetimes for cold cathode fluorescent lamps (CCFLs), and lower signal interference with adjacent components. The full bridge topology is now the industry standard for these products.

In addition to AC/DC offline solutions for lighting illumination applications, MPS also offers AC/DC power conversion solutions for a diverse number of end products that plug into a wall outlet.



Audio Amplifiers. Audio amplifier ICs are used to amplify sound produced by audio processors. We currently offer Class-D audio amplifiers, which are well-suited for applications that require both a small form factor and high power efficiency, such as plasma televisions, LCD televisions and DVD players. With today's systems becoming smaller and utilizing larger amounts of power, solution sizes and the management of heat dissipation are becoming increasingly important to the overall system design. The high degree of power efficiency and small form factor provided by our Class-D audio amplifiers allows system vendors to significantly reduce heat dissipation, eliminating the costly and sizable fans and heat sinks traditionally required by audio amplifier ICs. These features enable our customers to achieve their design and cost objectives without sacrificing sound quality.

We currently target our products at the consumer electronics, communications and computing markets, with the consumer market representing the largest portion of our revenue.

The following is a brief summary of our product family solutions for various applications. For each of these applications, we are currently shipping product or have design wins, which are decisions by original equipment manufacturers, or OEMs, or original design manufacturers, or ODMs, to use our ICs:

| Application                                    | WLED Lighting Illumination (non-backlight) | LCD Backlight (Inverters or WLED) | DC to DC Converters (Buck & Boost) | µP Reset & Supervisory | Audio Amplifiers | AC/DC Offline | Chargers (Switching & Linear) | Current Limit Switches |
|--|--|-----------------------------------|------------------------------------|------------------------|------------------|---------------|-------------------------------|------------------------|
| <b>Computing</b>                               |  |                                   |                                    |                        |                  |               |                               |                        |
| Computers and PDA devices                      |  | X                                 | X                                  | X                      | X                | X             | X                             | X                      |
| LCD Monitors                                   |  | X                                 | X                                  | X                      | X                |               |                               |                        |
| Disk Drives/ Storage Networks                  |  |                                   | X                                  |                        |                  |               |                               | X                      |
| <b>Consumer Electronics</b>                    |  |                                   |                                    |                        |                  | X             |                               |                        |
| LCD TV Displays                                |  | X                                 | X                                  | X                      | X                |               |                               | X                      |
| Plasma TV Displays                             |  | X                                 | X                                  | X                      | X                |               |                               | X                      |
| Set Top Boxes                                  |  |                                   | X                                  | X                      | X                | X             |                               | X                      |
| Blu-Ray & DVD Players                          |  | X                                 | X                                  | X                      | X                |               |                               |                        |
| Digital Still Cameras                          |  |                                   | X                                  | X                      | X                |               | X                             |                        |
| Commercial & Industrial Bulb & CFL Replacement | X  |                                   |                                    |                        |                  | X             |                               |                        |
| GPS and Infotainment systems                   |  | X                                 | X                                  | X                      | X                |               |                               | X                      |
| <b>Communications</b>                          |  |                                   |                                    |                        |                  | X             |                               |                        |
| Cellular Handsets                              |  |                                   | X                                  |                        | X                | X             | X                             |                        |
| Networking Infrastructure                      |  |                                   | X                                  | X                      |                  | X             |                               |                        |
| VOIP   |  |                                   | X                                  | X                      |                  |               |                               |                        |
| Wireless Access Points                         |  |                                   | X                                  | X                      |                  |               |                               |                        |

We derive a majority of our revenue from the sales of our DC to DC converter IC product family to the computing, consumer electronics and communications markets. In the future, we will continue to introduce additional new products within our existing product families, such as high current, high voltage, small form factor switching voltage regulators, as well as expand our newer product families in battery chargers, voltage references and low dropout regulators. Our ability to achieve revenue growth will depend in part upon our ability to enter new market segments, gain market share, grow in regions outside of Greater China, expand our customer base and successfully secure manufacturing capacity.

Please refer to the table showing our revenue by product family in the section entitled “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations”.

## Customers, Sales, and Marketing

We sell our products through third party distributors, value-added resellers and directly to OEMs, ODMs, and electronic manufacturing service (EMS) providers. Our third party distributors are subject to distribution agreements with us which allow the distributor to sell our products to end customers and other resellers. Distributors may distribute our products to end customers which include OEMs, ODMs or EMS providers. Our value-added resellers may second source our products and provide other services to customers. ODMs typically design and manufacture electronic products on behalf of OEMs, and EMS providers typically provide manufacturing services for OEMs and other electronic product suppliers. The following is a summary for the years ended December 31, 2010, 2009 and 2008 of those customers that accounted for more than 10% of our total revenue in one or more of these years:

| Customer | Revenue<br>Year ended December 31, |   |      |   |      |   |
|----------|------------------------------------|---|------|---|------|---|
|          | 2010                               |   | 2009 |   | 2008 |   |
| A        | 14                                 | % | 13   | % | 20   | % |
| B        | *                                  |   | 10   | % | 10   | % |
| C        | *                                  |   | 10   | % | *    |   |
| D        | *                                  |   | *    |   |      | * |

Current distribution agreements with several of our major distributors provide that each distributor shall have the non-exclusive right to sell and use its best efforts to promote and develop a market for our products in several countries in Asia. These agreements may be terminated by either us or the distributor on up to three months' notice. These agreements provide that payment for purchases from us will generally occur within 30 to 45 days from the date of invoice. In addition, we allow for limited stock rotation in certain agreements.

We have sales offices located in the United States, Taiwan, China, Korea and Japan and have marketing representatives in Europe. Our products typically require a highly technical sales and applications engineering effort where we assist our customers in the design and use of our products in their application. We maintain a staff of applications engineers who work directly with our customers' engineers in the development of their systems electronics containing our products.

Because our sales are billed and payable in United States dollars, our sales are not directly subject to fluctuating currency exchange rates. However, because 87% of our revenue in 2010 was attributable to direct or indirect sales to customers in Asia, changes in the relative value of the dollar may create pricing pressures for our products.

Our sales are made primarily pursuant to standard individual purchase orders. Our manufacturing lead times are generally 4 to 12 weeks and we often build inventory in advance of customer orders based on our forecast of future customer orders. This subjects us to certain risks, most notably the possibility that sales will not meet our forecast, which could lead to inventories in excess of demand. If excess inventory exists, it may be necessary for us to sell it at a substantial discount or dispose of it altogether, either of which would negatively affect our profit margins.

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

## Research and Development

We have assembled a qualified team of engineers in the United States, China and Europe with core competencies in analog and mixed-signal design. Through our research and development efforts, we have developed a collection of

intellectual property and know-how that we are able to leverage across our products and markets. These include the development of high efficiency power devices, the design of precision analog circuits, expertise in mixed-signal integration and the development of proprietary semiconductor process technologies.

Our research and development efforts are generally targeted at three areas: systems architecture, circuit design and implementation, and process technology. In the area of systems architecture, we are exploring new ways of solving our customers' system design challenges and are investing in the development of systems expertise in new markets and applications that align well with our core capabilities. In the area of circuit design and implementation, our initiatives include expanding our portfolio of products and adding new features to our products.

Please refer to the discussion of the amount spent on research and development during each of the last three fiscal years in the section entitled "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations – Research and Development". In the area of process technology, we are investing research and development resources to provide leading-edge analog power processes for our next generation of integrated circuits. Process technology is a key strategic component to our future growth.

## Patents and Intellectual Property Matters

We rely on our proprietary technologies, which include both our proprietary circuit designs for our products and our proprietary manufacturing process technologies. Our future success and competitive position depend in part upon our ability to obtain and maintain protection of our proprietary technologies.

In general, we have elected to pursue patent protection for aspects of our circuit designs that we believe are patentable and to protect our manufacturing process technologies by maintaining those process technologies as trade secrets. As of January 18, 2011 we had approximately 84 patents issued and pending, of which 68 have been issued in the United States. Our U.S. issued patents are scheduled to expire at various times through October 2028 and our other issued patents are scheduled to expire at various times through August 2027. Our patents are material to our business, but we do not rely on any one particular patent for our success. 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. We have entered into a patent license agreement with another integrated circuit company, which is a value-added reseller, pursuant to which we have granted this company a license (with certain limited sublicense rights) under certain of our patents to make, use, and sell certain of this company's own integrated circuit products for a period of two years ending in 2011, and for which this company is obligated to pay us royalties based on sales of those products. We also seek to register certain of our trademarks as we deem appropriate. We have not registered any of our copyrights and do not believe registration of copyrights is material to our business. Despite precautions that we take, it may be possible for unauthorized third parties to copy aspects of our current or future technology or products or to obtain and use information that we regard as proprietary. There can be no assurance that the steps we take will be adequate to protect our proprietary rights, that our patent applications will lead to issued patents, that others will not develop or patent similar or superior products or technologies, or that our patents will not be challenged, invalidated, or circumvented by others. Furthermore, the laws of the countries in which our products are or may be developed, manufactured or sold may not protect our products and intellectual property rights to the same extent as laws in the United States. Our failure to adequately protect our proprietary technologies could harm our business.

The semiconductor industry is characterized by frequent claims of infringement and litigation regarding patent and other intellectual property rights. For a more complete description of our legal matters, please read the section entitled Item 3. Legal Proceedings and Note 10 to our consolidated financial statements. 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 infringement claims. Any such litigation could be very costly and may divert our management resources. Further, we have agreed to indemnify certain of our customers and a supplier in some circumstances against liability from infringement by our products. In the event any third party were to make an infringement claim against us or our customers, we could be enjoined from selling selected products or could be required to indemnify our customers or supplier or pay royalties or other damages to third parties. If any of our products is found to infringe and we are unable to obtain necessary licenses or other rights on acceptable terms, we would either have to change our product so that it does not infringe or stop making the infringing product, which could have a material adverse effect on our operating results, financial condition, and cash flows.

## Manufacturing

We utilize a fabless business model, working with third parties to manufacture and assemble our integrated circuits. This fabless approach allows us to focus our engineering and design resources on our strengths and to reduce our fixed costs and capital expenditures. In contrast to many fabless semiconductor companies, who utilize standard process technologies and design rules established by their foundry partners, we have developed our own proprietary process technology and collaborate with our foundry partners to install our technology on their equipment in their facilities for

use solely on our behalf. This close collaboration and control over the manufacturing process has historically resulted in favorable yields and product performance for our integrated circuits.

We currently contract with two suppliers to manufacture our wafers in foundries located in China. Once our silicon wafers have been produced, they are shipped to our facility in Chengdu, China for wafer sort. Our semiconductor products are then assembled and packaged by independent subcontractors in Malaysia and China. The assembled ICs are then sent for final testing at our Chengdu facility prior to shipping to our customers.

In September 2004, we signed an agreement with a Chinese local authority to construct a facility in Chengdu, China, initially for the testing of our ICs. Pursuant to this agreement, we agreed to contribute capital in the form of cash, in-kind assets, and/or intellectual property, of at least \$5.0 million to our wholly-owned Chinese subsidiary as the registered capital for the subsidiary and have exercised the option to purchase land use rights for the facility for approximately \$0.2 million. We also have the option to acquire the facility after a five-year lease term for the original construction cost less rents paid, which is currently estimated at \$1.9 million and, which becomes exercisable in March 2011. We will likely enter into a purchase agreement for this facility at a date to be determined and as the opportunity necessitates. The facility has been fully operational since 2006 and we have benefitted from shorter manufacturing cycle times and lower labor and overhead costs. Furthermore, we are continuing to expand our product testing capabilities in our China facility and are able to take advantage of the rich pool of local engineering talent to expand our manufacturing support and engineering operations.

## Key Personnel and Employees

Our performance is substantially dependent on the performance of our executive officers and key employees. Due to the relative complexity of the design of our analog and mixed-signal ICs, our engineers generally have more years of experience and greater circuit design aptitude than the more prevalent digital circuit design engineer. Analog engineers with advanced skills are limited in number and difficult to replace. The loss of the services of key officers, managers, engineers and other technical personnel would harm the business. Our future success will depend, in part, on our ability to attract, train, retain, and motivate highly qualified technical and managerial personnel. We may not be successful in attracting and retaining such personnel. Our employees are not represented by a collective bargaining organization, and we have never experienced a work stoppage or strike. Our management considers employee relations to be good. As of December 31, 2010, we employed 889 employees located in the United States, Taiwan, China, Japan, Korea and Europe.

## Competition

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 both applications engineering and design engineering personnel, our ability to introduce new products, and our ability to maintain the rate at which we introduce these new products. Our industry is characterized by decreasing unit selling prices over the life of a product. We compete with domestic and international semiconductor companies, many of which have substantially greater financial and other resources with which to pursue engineering, manufacturing, marketing, and distribution of their products. We are in direct and active competition, with respect to one or more of our product lines, with at least 10 manufacturers of such products, of varying size and financial strength. The number of our competitors has grown due to expansion of the market segments in which we participate. We consider our primary competitors to include Fairchild Semiconductor International, Intersil Corporation, Linear Technology, Maxim Integrated Products, Micrel Inc., Microsemi Corporation, National Semiconductor Corporation, O2Micro International, Richtek Technology Corporation, Rohm Co., Ltd., Semtech Corporation, STMicroelectronics N.V., Texas Instruments Incorporated and Volterra.

We expect continued competition from existing competitors as well as competition from new entrants into the semiconductor market. We believe that we are competitive with respect to these factors, particularly because our ICs typically are smaller in size, are highly integrated, possess higher levels of power management functionalities and achieve high performance specifications at lower price points than most of our competition. However, 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.

## Geographical and Segment Information

Please refer to the geographical and segment information for each of the last three fiscal years in Note 13 to our consolidated financial statements.

Please refer to the discussion of risks attendant to our foreign operations in the section entitled "Item 1A: Risk Factors".

## Available Information

We were incorporated in California in 1997 and reincorporated in Delaware in November 2004. Our executive offices are located at 6409 Guadalupe Mines Road, San Jose, CA 95120. Our telephone number is (408) 826-0600. Our e-mail address is [investors@monolithicpower.com](mailto:investors@monolithicpower.com), and our website is [www.monolithicpower.com](http://www.monolithicpower.com). Our annual reports

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on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge. These may be obtained from our website, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission, or at the SEC website at [www.sec.gov](http://www.sec.gov). Information contained on our website is not a part of this Form 10-K.



## Executive Officers of the Registrant

The executive officers of the Company, and their ages as of March 4, 2011 are as follows:

| Name             | Age | Position   |
|------------------|-----|--|
| Michael R. Hsing | 51  | President, Chief Executive Officer, and Director       |
| Meera P. Rao     | 50  | CFO and Principal Financial and Accounting Officer     |
| Deming Xiao      | 48  | President of MPS Asia Operations                       |
| Maurice Sciammas | 51  | Senior Vice President of Worldwide Sales and Marketing |
| Paul Ueunten     | 56  | Senior Vice President of Engineering                   |
| Saria Tseng      | 40  | Vice President, General Counsel                        |

Michael R. Hsing has served on our board of directors and has served as our President and Chief Executive Officer since founding Monolithic Power Systems in August 1997. Before founding our company, Mr. Hsing held senior technical positions at companies such as Supertex, Inc. and Micrel, Inc. Mr. Hsing is an inventor on numerous patents related to the process development of bipolar mixed-signal semiconductor manufacturing. Mr. Hsing holds a B.S.E.E. from the University of Florida.

Meera P. Rao has served as our Chief Financial Officer since January 2011. Ms. Rao joined us in January 2009 and served as our Vice President of Finance and Corporate Controller. Prior to joining MPS, she was the principal in her own consulting practice, working with various semiconductor companies, including MPS, where she set up our business operations in Chengdu, China in 2006. Ms. Rao has more than 20 years of experience with semiconductor and high technology companies and has held various senior executive positions, including the CFO of Integration Associates, Vice President of Finance and Interim CFO at Atrica, Vice President of Finance at Raza Foundries, Corporate Controller and Interim CFO at nVIDIA, as well as various positions at Advanced Micro Devices (AMD). Ms. Rao is a CPA and holds an MBA from the University of Rochester.

Maurice Sciammas currently serves as our Senior Vice President of Worldwide Sales and Marketing, a position he has had since 2007. Mr. Sciammas joined the Company in July 1999 and served as Vice President of Products and Vice President of Sales (excluding greater China) until he was appointed to his current position. Before joining the Company, he was Director of IC Products at Supertex from 1990 to 1999. He has also held positions at Micrel, Inc. He holds a B.S.E.E. degree from San Jose State University.

Deming Xiao has served as our President of our Asia Operations since January 2008. Since joining us in May 2001, Mr. Xiao has held several executive positions, including Foundry Manager and Senior Vice President of Operations. Before joining us, from June 2000 to May 2001, Mr. Xiao was Engineering Account Manager at Chartered Semiconductor Manufacturing, Inc. Prior to that, Mr. Xiao spent 6 years as the Manager of Process Integration Engineering at Fairchild Imaging Sensors. Mr. Xiao holds a B.S. in Semiconductor Physics from Sichuan University, Chengdu, China and a M.S.E.E. from Wayne State University.

Paul Ueunten has served as our Senior Vice President of Design Engineering since October 2007. Mr. Ueunten joined us in May 1998 and held several senior level positions, including Vice President of Design Engineering, prior to his appointment as our Senior Vice President of Design Engineering. Before joining us, Mr. Ueunten held positions at National Semiconductor, Signetics Corporation and Sperry Flight Systems. Mr. Ueunten holds a MS in Electrical Engineering from the University of Santa Clara, a BS in Electrical Engineering from the University of Washington and a BS in Engineering-Physics from Pacific Lutheran University. Mr. Ueunten is credited with a number of patents

and is a Member of the Institute of Electrical and Electronics Engineers.

Saria Tseng has served as our Vice President and General Counsel since November 2004. Ms. Tseng joined the Company from MaXXan Systems, Inc., a privately held provider of intelligent storage networking solutions, where she was also Vice President and General Counsel from January 2001 to November 2004. Prior to her corporate experience, Ms. Tseng was an attorney at Gray Cary Ware & Freidenrich, LLP from July 1999 to January 2001. Previously, she practiced law at Wang & Wang and Jones Day, Reavis & Pogue. Ms. Tseng is a member of the state bar in both California and New York and is a member of the bar association of the Republic of China (Taiwan). She holds Masters of Law degrees from Boalt Hall, University of California at Berkeley and the Chinese Culture University in Taipei.

#### ITEM 1A. RISK FACTORS

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

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

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

- our results of operations and financial performance;
- general economic, industry and global market conditions;
- whether our forward guidance meets the expectations of our investors;
- the depth and liquidity of the market for our common stock;
- developments generally affecting the semiconductor industry;
- commencement of or developments relating to our involvement in litigation;
- investor perceptions of us and our business strategies;
- changes in securities analysts' expectations or our failure to meet those expectations;
  - actions by institutional or other large stockholders;
  - terrorist acts or acts of war;
- actual or anticipated fluctuations in our results of operations;
- developments with respect to intellectual property rights;
- announcements of technological innovations or significant contracts by us or our competitors;
  - introduction of new products by us or our competitors;
  - our sale of common stock or other securities in the future;
  - conditions and trends in technology industries;
  - changes in market valuation or earnings of our competitors;
- our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity;
  - our ability to increase our gross margins; and
- changes in the estimation of the future size and growth rate of our markets.

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

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

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

- a deterioration in general demand for electronic products as a result of worldwide financial crises and associated macro-economic slowdowns;
  - a deterioration in business conditions at our distributors, value-added resellers and/or end-customers;
  - adverse general economic conditions in the countries where our products are sold or used;
  - the timing of developments and related expenses in our litigation matters;
- the possibility of additional lost business as a result of customer and prospective customer concerns about adverse outcomes in our litigations or about being litigation targets;
  - continued dependence on our turns business (orders received and shipped within the same fiscal quarter);
    - increases in assembly costs due to commodity price increases, such as the price of gold;
    - the timing of new product introductions by us and our competitors;
    - the acceptance of our new products in the marketplace;

- our ability to develop new process technologies and achieve volume production;
- 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;
- an increase in stock rotation reserves;
- our ability to manage our inventory levels, including the levels of inventory held by our distributors;
  - inventory levels and product obsolescence;
- seasonality and variability in the computer, consumer electronics, and communications markets;
  - the availability of adequate manufacturing capacity from our outside suppliers;
  - increases in prices for finished wafers due to general capacity shortages;
  - the potential loss of future business resulting from current capacity issues;
  - changes in manufacturing yields; and
  - movements in exchange rates, interest rates or tax rates.

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

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

Our profitability is dependent on many factors, including:

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

We may not achieve profitability on a quarterly or annual basis in the future. Unfavorable changes in 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 revenues increased significantly in certain years due to increased sales of certain of our products. Due to various factors, including increased competition, loss of certain of our customer install base, unfavorable changes in our operations, reduced global electronics demand, end-customer market downturn, market acceptance and penetration of our current and future products and ongoing litigation, we may not experience growth rates comparable to past periods, which could materially and adversely affect our stock price and results of operations.

Due to product shortages early in 2010, several major customers in Korea sought alternative suppliers, which impacted our revenue in the fourth quarter of 2010 and may continue to impact our revenue in future periods. If we are unable to fill this revenue gap, our growth rate may be impacted, which could materially and adversely affect our stock price and results of operations.

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

Our success depends on products that are differentiated in the market, which result in gross margins that have historically been above the industry averages. During 2010, our gross margins decreased materially as compared to 2009. Should we fail to improve our gross margin in future years, and accordingly develop and introduce sufficiently differentiated products that result in higher gross margins than industry averages, our financial condition could be materially adversely affected.

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

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

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

We believe that the application of our products in the computer, consumer electronics and communications markets will continue to account for the majority of our revenue. If the demand for our products declines in the major end markets that we serve, our revenue will decrease 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 derive most of our revenue from direct or indirect sales to customers in Asia and have significant operations in Asia, which may expose us to political, cultural, regulatory, economic, foreign exchange, and operational risks.

We derive most of our revenue from customers located in Asia through direct or indirect sales through distribution arrangements with parties located in Asia. As a result, we are subject to increased risks due to this geographic concentration of business and operations. For the year ended December 31, 2010, approximately 87% of our revenue was from customers in Asia. There are risks inherent in doing business in Asia, and internationally in general, including:

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

- enforcing contracts generally; and
- less effective protection of intellectual property and contractual arrangements.

If we fail to expand our customer base and significantly reduce the geographical 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 receive a significant portion of our revenue from our distribution channel, and the loss of any one of these distributors or value-added resellers 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. Receivables from our customers are generally not secured by any type of collateral and are subject to the risk of being uncollectible. For the year ended December 31, 2010, sales to our largest distributor accounted for approximately 14% of our total revenue. Significant deterioration in the liquidity or financial condition of any of our major customers or any group of our customers could have a material adverse impact on the 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 contracts.



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

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. Specifically, in the fourth quarter of 2010, demand was lower because distributors used up inventory that was shipped in the third quarter. 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 revenues is currently 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 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.

Due to lack of capacity, which resulted in product shortages in early 2010, several major customers in Korea sought alternative suppliers, which impacted our revenue in the fourth quarter of 2010 and may continue to impact our revenue in future periods. If we are faced with capacity issues similar to what we experienced in 2010, our product sales and revenue may be further impacted, which could materially and adversely affect our business and results of operations.

We currently depend on two 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 two suppliers for the production of wafers. Should any of our suppliers become insolvent or capacity constrained, we may not be able to fulfill our customer orders, which would likely cause a decline in our revenue.

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

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

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

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

There may be unanticipated costs associated with adding to or supplementing our third-party supplier's 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, or testing facilities for our products. In order to facilitate such growth, we may need to enter into strategic transactions, investments and other activities. Such activities are subject to a number of risks, including:

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

These and other risks may affect the ultimate cost and timing of any expansion of our third-party supplier's 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 a third party manufacturer in advance of selling our product. We place orders with our manufacturer based on existing and expected orders from our customers for particular products. While our contracts with our customers and distributors include lead time requirements and cancellation penalties that are designed to protect us from misalignment between customer orders and inventory levels, we must nonetheless make some predictions when we place orders with our manufacturer. In the event that our predictions are inaccurate due to unexpected increases in orders or unavailability of product within the time frame that is required, we may have insufficient inventory to meet our customer demands. In the event that we order products that we are unable to sell due to a decrease in orders, unexpected order cancellations, injunctions due to patent litigations, or product returns, we may have excess inventory which, if not sold, may need to be disposed of or would result in a decrease in our revenues 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.

If we are unsuccessful in any of the legal proceedings involving us and any of our competitors, 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.

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

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

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

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

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

We will continue to vigorously defend and enforce our intellectual property rights around the world, especially as it relates to patent litigation. We will take the appropriate action in various courts throughout the world and may be required to post bonds to defend such intellectual property in certain countries for an indefinite period of time, until such dispute is resolved. If we are not successful in defending our intellectual property, we could lose revenue and the business could be harmed.

From time to time, we are faced with having to defend our intellectual property rights throughout the world. Should we become engaged in such proceedings, it could divert management's attention from focusing on and implementing the business strategy. Further, should we not be successful in any of our intellectual property defenses, the revenue may be affected and the business could be harmed.

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

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

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

The market for government-backed student loan auction-rate securities with interest rates that reset through a Dutch auction every 7 to 35 days, became illiquid in 2008. At December 31, 2010, the Company's investment portfolio included \$19.2 million, net of impairment charges of \$1.0 million, in government-backed student loan auction-rate securities. As of that date, \$20.2 million, the face value of our auction-rate security investments, have failed to reset through successful auctions and it is unclear as to when these investments will regain their liquidity. The underlying maturity of these auction-rate securities is up to 37 years.

Based on certain assumptions described in Note 2, "Fair Value Measurements", to our consolidated financial statements and the Liquidity and Capital Resources section of "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" of this annual report on Form 10-K, we recorded temporary and other-than-temporary impairment charges on these investments. The valuation is subject to fluctuations in the future, which will depend on many factors, including the collateral quality, potential to be called or restructured, underlying final maturity, insurance guaranty, liquidity and market conditions, among others. We experienced our first failed auction in mid-February 2008.

Should there be further deterioration in the market for auction-rate securities or if the accounting rules for these securities change, the value of our portfolio may decline, which may have an adverse impact on our cash position and our earnings. In addition, it is unlikely that we will be able to liquidate our auction-rate securities in the short term.

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

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

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

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

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

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

Certain of our CCFL products are used to drive fluorescent lighting products which contain small amount of mercury.

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

We have a testing facility in China that began operations in 2006. In addition to the risks discussed elsewhere in this annual report on Form 10-K, we face the following risks, among others:

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

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

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

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

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

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

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

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

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

Our future success depends upon our ability to attract and retain highly qualified technical and managerial personnel. We are particularly dependent on the continued services of our key executives, including Michael Hsing, our President and Chief Executive Officer, who founded our company and developed our proprietary process technology. In addition, personnel with highly skilled analog and mixed-signal design engineering expertise are scarce and competition for personnel with these skills is intense. There can be no assurance that we will be able to retain existing

key employees or that we will be successful in attracting, integrating or retaining other highly qualified personnel with critical capabilities in the future. If we are unable to retain the services of existing key employees or are unsuccessful in attracting new highly qualified employees quickly enough to meet the demands of our business, including design cycles, our business could be harmed.

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

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

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

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

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

As a part of our business strategy, from time to time we review acquisition prospects that would complement our current product offerings, enhance our design capability or offer other competitive opportunities. In the event of future acquisitions, we could use a significant portion of our available cash, cash equivalents and short-term investments, issue equity securities which would dilute current stockholders' percentage ownership, incur substantial debt or contingent liabilities, and/or incur impairment charges related to goodwill or other intangibles. Such actions by us could impact our operating results and/or the price of our common stock.

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

To the extent we are successful in completing strategic acquisitions, if we are unsuccessful in integrating any acquired company into our operations or if integration is more difficult than anticipated, we may experience disruptions that could harm our business and not realize the anticipated benefits of the acquisitions. Some of the risks that may adversely affect our ability to integrate or realize any anticipated benefits from the acquired companies, businesses or assets include those associated with:

- § unexpected losses of key employees or customers of the acquired companies or businesses;
- § conforming the acquired company's standards, processes, procedures and controls with our operations;
- § coordinating new product and process development;
- § hiring additional management and other critical personnel;
- § increasing the scope, geographic diversity and complexity of our operations;
- § difficulties in consolidating facilities and transferring processes and know-how;
- § other difficulties in the assimilation of acquired operations, technologies or products;
- § diversion of management's attention from other business concerns; and
- § adverse effects on existing business relationships with customers.

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

The analog and mixed-signal semiconductor industry is highly competitive, and we expect competitive pressures to continue. Our ability to compete effectively and to expand our business will depend on our ability to continue to recruit applications and design talent, our ability to introduce new products, and our ability to maintain the rate at which we introduce these new products. We compete with domestic and non-domestic semiconductor companies, many of which have substantially greater financial and other resources with which to pursue engineering,

manufacturing, marketing, and distribution of their products. We are in direct and active competition, with respect to one or more of our product lines, with at least 10 manufacturers of such products, of varying size and financial strength. The number of our competitors has grown due to the expansion of the market segments in which we participate. We consider our competitors to include, but not be limited to: Fairchild Semiconductor, Intersil, Linear, Maxim Integrated Products, Micrel, Microsemi, National Semiconductor, O2Micro, RichTek, Rohm, Semtech, STMicroelectronic, Texas Instruments and Volterra. We expect continued competition from existing competitors as well as competition from new entrants in the semiconductor market.

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

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

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

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

Executive officers, directors, and affiliated entities beneficially owned in aggregate, approximately 17% of our outstanding common stock as of December 31, 2010. These stockholders, if acting together, would be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions.

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

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

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

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

#### ITEM 2. PROPERTIES

Our primary operating locations are currently in San Jose, California and Chengdu, Sichuan, China. We currently lease approximately 55,110 square feet in San Jose, which serves as our corporate headquarters, sales and research and development center. Certain test procedures and manufacturing also take place in our San Jose facility. The San Jose facility was sold and the new landlord has exercised their right to terminate the lease, effective April 18, 2012.

We lease approximately 56,000 square feet in Chengdu which serves as our test facility and manufacturing hub and we constructed a 150,000 square foot research and development facility in Chengdu, which was put into operation in October 2010. We also lease sales and research and development offices in the United States, Japan, China, Taiwan

and Korea. We believe that our existing facilities are adequate for our current operations.

ITEM 3. LEGAL PROCEEDINGS

O2Micro

We have been engaged in a number of legal proceedings involving patent infringement claims with O2Micro, Inc. and its parent corporation, O2Micro International Limited (referred to hereinafter as "O2Micro"). There are two proceedings, both involving O2Micro's U.S. Patent No. 7,417,382 ('382 patent). On June 18, 2010, the U.S. International Trade Commission issued a final determination finding of no violation of Section 337 by us or our customers in an action brought by O2Micro International, Ltd. in 2008. An International Trade Commission ("ITC") administrative law judge had previously issued an initial determination on April 20, 2010 that also found no violation. The ITC's final determination concludes that none of our accused products infringes O2Micro's U.S. Patent No. 7,417,382 (the '382 patent).

In addition to the matter before the ITC, a related case is pending before the Northern District of California Court in Oakland, California. Subsequent to the ITC's final determination finding of no violation, O2Micro filed a motion to dismiss its claims for infringement of the '382 patent, with prejudice, and covenanted not to sue us or any of our distributors or customers for infringement of the '382 patent. On June 23, 2010, the court granted this motion and vacated the jury trial that was scheduled on July 12, 2010. We filed a motion seeking recovery of costs and attorney fees from O2Micro. On March 3, 2011, the court issued an order granting our motion in part. It ordered O2Micro to pay \$339,315 in costs forthwith and ordered the parties to meet and confer to try to reach an agreement as to the reasonable attorneys fees to be paid. If the parties are unable to reach an agreement, we are to submit detailed documentation to the court in support of our fees request.



## Linear Technology Corporation

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

## PART II

## ITEM 5. Market for the Registrant’s Common Equity, Related Stockholders Matters, and Issuer Purchases of Equity Securities.

## Market Price of Our Common Stock

Our common stock is traded on the Nasdaq Global Select Market under the symbol “MPWR”. The following table sets forth, for the periods indicated, the high and low sales price per share of our common stock on the Nasdaq Global Select Market. These prices represent quotations among dealers without adjustments for retail mark-ups, markdowns or commissions, and may not represent prices of actual transactions.

|  | High     | Low      |
|--|----------|----------|
| 2010                                   |          |          |
| Fourth Quarter ended December 31, 2010 | \$ 18.52 | \$ 14.75 |
| Third Quarter ended September 30, 2010 | \$ 19.90 | \$ 15.46 |
| Second Quarter ended June 30, 2010     | \$ 25.34 | \$ 17.34 |
| First Quarter ended March 31, 2010     | \$ 24.50 | \$ 18.40 |
| 2009                                   |          |          |
| Fourth Quarter ended December 31, 2009 | \$ 24.75 | \$ 18.93 |
| Third Quarter ended September 30, 2009 | \$ 25.26 | \$ 20.80 |
| Second Quarter ended June 30, 2009     | \$ 23.40 | \$ 14.92 |
| First Quarter ended March 31, 2009     | \$ 16.90 | \$ 10.67 |

## Holders of Our Common Stock

As of February 22, 2011, we had approximately 22 stockholders of record and the closing price of common stock was \$21.66 per share as reported by The Nasdaq Global Select Market. Many of our shares of common stock are held by brokers and other institutions on behalf of stockholders. Based on several factors, including our proxy mailing from 2010, we estimate the total number of stockholders represented by these record holders to be at least 1,452.

## Dividend Policy

We have not paid cash dividends on our common stock since our inception. We currently expect to retain earnings for use in the operation and expansion of our business, and therefore do not anticipate paying any cash dividends for the next several years.

## Performance of Our Common Stock

The following graph compares the cumulative 60-month total return provided shareholders on our common stock relative to the cumulative total returns of the Nasdaq Composite Index, the S & P 500 Index and the Philadelphia Semiconductor Index. An investment of \$100 (with reinvestment of all dividends) is assumed to have been made in

our common stock on 1/1/2010 and its relative performance is tracked through 12/31/2010.

The information contained in the Stock Performance Graph section shall not be deemed to be “soliciting material” or “filed” or incorporated by reference in future filings with the SEC, or subject to the liabilities of Section 18 of the Exchange Act, except to the extent that the Company specifically incorporates it by reference into a document filed under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

#### Recent Sales of Unregistered Securities

There were no sales of unregistered securities during the year ended December 31, 2010.

#### Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On July 27, 2010, the Company announced that its Board of Directors approved a stock repurchase program that authorizes the Company to repurchase up to \$50.0 million of its common stock between August 2, 2010 and December 31, 2011. In February 2011, the Board of Directors approved an increase from \$50.0 million to \$70.0 million. As of December 31, 2010, the following shares have been repurchased through the open market and subsequently retired:

| 2010 Calendar Year              | Shares Repurchased | Average Price per Share | Value (in thousands) |
|---------------------------------|--------------------|-------------------------|----------------------|
| August                          | 983,189            | \$ 17.29                | \$ 16,998            |
| November                        | 916,600            | \$ 15.85                | \$ 14,529            |
| <b>Total Shares Repurchased</b> | <b>1,899,789</b>   |                         | <b>\$ 31,527</b>     |

On February 5, 2008, the Company announced that its Board of Directors approved a stock repurchase program that authorizes the Company to repurchase up to \$25.0 million of its common stock through the end of 2008. As of December 31, 2008, the following shares have been repurchased through the open market and subsequently retired:

| 2008 Calendar Year       | Shares Repurchased | Average Price per Share | Value (in thousands) |
|--------------------------|--------------------|-------------------------|----------------------|
| February                 | 27,500             | \$ 16.88                | \$ 464               |
| March                    | 527,332            | \$ 17.12                | \$ 9,028             |
| April                    | 201,863            | \$ 20.03                | \$ 4,043             |
| May                      | 100                | \$ 21.98                | \$ 2                 |
| June                     | 18,000             | \$ 21.66                | \$ 390               |
| July                     | 14,155             | \$ 21.86                | \$ 309               |
| August                   | 100                | \$ 22.03                | \$ 2                 |
| September                | 307,355            | \$ 18.82                | \$ 5,784             |
| October                  | 333,700            | \$ 15.05                | \$ 5,021             |
| Total Shares Repurchased | 1,430,105          |                         | \$ 25,043            |

There were no shares repurchased in 2009.

#### ITEM 6. SELECTED FINANCIAL DATA

The following financial data is derived from our audited annual consolidated financial statements as of and for the years ended December 31, 2010, 2009, 2008, 2007 and 2006. You should read the following table in conjunction with the consolidated financial statements and the related notes contained elsewhere in this report on Form 10-K. Operating results for any year are not necessarily indicative of results to be expected for any future periods.

Consolidated Statement of Operations Data:

|  | 2010       | Year ended December 31,                  |            |            | 2006       |
|--|------------|--|------------|------------|------------|
|  |            | 2009                                     | 2008       | 2007       |            |
|  |            | (in thousands, except per share amounts) |            |            |            |
| Revenue  | \$ 218,840 | \$ 165,008                               | \$ 160,511 | \$ 134,004 | \$ 105,015 |
| Cost of revenue, including stock-based compensation*                     | 97,383     | 67,330                                   | 61,184     | 48,781     | 38,107     |
| Gross profit   | 121,457    | 97,678                                   | 99,327     | 85,223     | 66,908     |
| Operating expenses:  |            |  |            |            |            |
| Research and development, including stock-based compensation*            | 44,372     | 38,295                                   | 34,850     | 27,342     | 22,301     |
| Selling, general and administrative, including stock-based compensation* | 41,169     | 36,752                                   | 35,256     | 29,537     | 27,594     |
| Lease abandonment  | -          | -  | -          | (496 )     | 1,218      |
| Litigation expense   | 5,418      | 9,457                                    | 6,714      | 9,370      | 11,560     |
| Patent litigation settlement (provision reversal)                        | -          | (6,356 )                                 | -          | 9,800      | 3,000      |
| Total operating expenses   | 90,959     | 78,148                                   | 76,820     | 75,553     | 65,673     |
| Income from operations   | 30,498     | 19,530                                   | 22,507     | 9,670      | 1,235      |
| Other income (expense):  |            |  |            |            |            |

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|   |           |           |           |           |            |
|---|-----------|-----------|-----------|-----------|------------|
| Interest and other income   | 1,156     | 1,047     | 3,587     | 4,741     | 2,637      |
| Other expense   | (234 )    | (429 )    | (652 )    | (139 )    | (273 )     |
| Total other income, net   | 922       | 618       | 2,935     | 4,602     | 2,364      |
| Income before income taxes  | 31,420    | 20,148    | 25,442    | 14,272    | 3,599      |
| Income tax provision  | 1,857     | 474       | 1,216     | 2,692     | 6,024      |
| Net income (loss)   | 29,563    | 19,674    | 24,226    | 11,580    | (2,425 )   |
| Basic income (loss) per share   | \$ 0.83   | \$ 0.57   | \$ 0.72   | \$ 0.37   | \$ (0.08 ) |
| Diluted income (loss) per share   | \$ 0.78   | \$ 0.54   | \$ 0.67   | \$ 0.33   | \$ (0.08 ) |
| Weighted-average common shares outstanding                                | 35,830    | 34,310    | 33,509    | 31,703    | 29,502     |
| Stock options, restricted stock and warrants                              | 1,996     | 2,324     | 2,611     | 3,387     | -          |
| Diluted weighted-average common equivalent shares outstanding             | 37,826    | 36,634    | 36,120    | 35,090    | 29,502     |
| * Stock-based compensation has been included in the following line items: |           |           |           |           |            |
| Cost of revenue   | \$ 393    | \$ 246    | \$ 344    | \$ 539    | \$ 539     |
| Research and development  | 6,742     | 6,408     | 5,821     | 4,625     | 5,236      |
| Selling, general and administrative                                       | 9,675     | 7,957     | 6,993     | 6,064     | 5,749      |
| Total   | \$ 16,810 | \$ 14,611 | \$ 13,158 | \$ 11,228 | \$ 11,524  |

## Consolidated Balance Sheet Data:

|                            | 2010      | 2009      | As of December 31, |           | 2006      |
|----------------------------|-----------|-----------|--------------------|-----------|-----------|
|                            |           |           | 2008               | 2007      |           |
|                            |           |           | (in thousands)     |           |           |
| Cash and cash equivalents  | \$ 48,010 | \$ 46,717 | \$ 83,266          | \$ 83,114 | \$ 50,816 |
| Short-term investments     | 129,709   | 118,914   | 21,922             | 27,765    | 27,674    |
| Long-term investments      | 19,180    | 19,445    | 37,425             | -         | -         |
| Restricted cash            | -         | -         | 7,360              | 7,350     | -         |
| Working capital            | 195,403   | 179,577   | 117,365            | 119,348   | 77,111    |
| Restricted assets          | -         | -         | 7                  | 8,340     | 8,309     |
| Total assets               | 281,603   | 241,821   | 195,299            | 172,590   | 117,327   |
| Common stock               | 178,269   | 175,518   | 147,298            | 143,890   | 113,168   |
| Total stockholders' equity | 246,895   | 212,957   | 164,645            | 137,537   | 95,025    |

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and related notes which appear elsewhere in this annual report on Form 10-K.

## Overview

We are a fabless semiconductor company that designs, develops, and markets proprietary, advanced analog and mixed-signal semiconductors. We currently offer products that serve multiple markets, including flat panel televisions, wireless communications, telecommunications equipment, general consumer products, notebook computers, cellular handsets, and set top boxes, among others. We believe that we differentiate ourselves by offering solutions that are more highly integrated, smaller in size, more energy efficient, more accurate with respect to performance specifications and, consequently, more cost-effective than many competing solutions. We plan to continue to introduce additional new products within our existing product families, as well as in new product categories.

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

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

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

We derive most of our revenue from sales through distribution arrangements or direct sales to customers in Asia, where the components we produce are incorporated into an end-user product. 87% of our revenue for the year ended December 31, 2010 and 84% of our revenue for the year ended December 31, 2009 was attributable to direct or indirect sales to customers in Asia. We derive a majority of our revenue from the sales of our DC to DC converter

product family which services the consumer electronics, communications and computing markets. We believe our ability to achieve revenue growth will depend, in part, on our ability to develop new products, enter new market segments, gain market share, manage litigation risk, diversify our customer base and successfully secure manufacturing capacity.

#### Critical Accounting Policies and Estimates

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

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

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

Approximately 85% of our distributor sales, including sales to our value-added resellers, are made through distribution arrangements with third parties. These arrangements do not include any special payment terms (our normal payment terms are 30-45 days for our distributors, with value-added resellers having payment terms up to 90 days), price protection or exchange rights. Returns are limited to our standard product warranty. Certain of our large distributors have contracts that include limited stock rotation rights that permit the return of a small percentage of the previous six months’ purchases in return for a compensating new order of equal or greater dollar value.

We maintain a sales reserve for stock rotation rights, which is based on historical experience of actual stock rotation returns on a per distributor basis, where available, and information related to products in the distribution channel. This reserve is recorded at the time of sale. In the future, if we are unable to estimate our stock rotation returns accurately, we may not be able to recognize revenue from sales to our distributors based on when we sell inventory to our distributors. Instead, we may have to recognize revenue when the distributor sells through such inventory to an end-customer.

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

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

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

Approximately 15% of our distributor sales are made through small distributors based on purchase orders rather than formal distribution arrangements. These distributors do not receive any stock rotation rights and, as such, hold very little inventory, if any. We do not have a history of accepting returns from these distributors.



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

In 2006, we signed a distribution agreement with a U.S. distributor. Revenue from this distributor is recognized upon sale by the distributor to the end customer because the distributor has certain rights of return which management believes are not estimable. The deferred revenue balance from this distributor as of December 31, 2010 and 2009 was \$1.0 million and \$0.9 million, respectively.

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

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

Our calculation of current and deferred tax assets and liabilities is based on certain estimates and judgments and involves dealing with uncertainties in the application of complex tax laws. Our estimates of current and deferred tax assets and liabilities may change based, in part, on added certainty or finality or uncertainty to an anticipated outcome, changes in accounting or tax laws in the U.S., or foreign jurisdictions where we operate, or changes in other facts or circumstances. In addition, we recognize liabilities for potential U.S. and foreign income tax for uncertain income tax positions taken on our tax returns if it has less than a 50% likelihood of being sustained. If we determine that payment of these amounts is unnecessary or if the recorded tax liability is less than our current assessment, we may be required to recognize an income tax benefit or additional income tax expense in our financial statements in the period such determination is made. We have calculated our uncertain tax positions which were attributable to certain estimates and judgments primarily related to transfer pricing, cost sharing and our international tax structure exposure.

As of December 31, 2010, 2009 and 2008, we had a valuation allowance of \$16.8 million, \$14.6 million and \$14.4 million, respectively, attributable to management's determination that none of the deferred tax assets will be realized, except for certain deferred tax assets related to uncertain income tax positions. As a result of the cost sharing arrangements with the Company's international subsidiaries (cost share arrangements), relatively small changes in costs that are not subject to sharing under the cost share arrangements can significantly impact the overall profitability of the US entity. Historically, the US operations have shown an inconsistent earnings pattern due to litigation costs not subject to cost sharing. The Company evaluated its US valuation allowance at December 31, 2010 by reviewing both its earnings history and its expected earnings for the next 12 months in its US entity. Because of the US entity's inconsistent earnings history and uncertainty of future earnings, the Company has determined that it is more likely than not that the US deferred tax benefits would not be realized. We have settled most of our legacy litigation matters that resulted in litigation cost that were not subject to cost share in the past. As a result, during our next fiscal year, a relatively small number of design wins in the US, and the absence of new litigation that may be not subject to cost share may position the US entity for a stable earnings pattern. As such, we will continue to evaluate if our facts and circumstances warrant a reversal of the valuation allowance against the US deferred tax benefits during fiscal year 2011.

**Contingencies.** We are engaged in legal proceedings regarding our intellectual property, challenges to the enforceability or validity of our intellectual property and claims that our products infringe on the intellectual property rights of others. In addition, from time to time, we become aware that we are subject to other contingent liabilities. When this occurs, we will evaluate the appropriate accounting for the potential contingent liabilities using ASC 450-20-25-2 Contingencies – Loss Contingencies - Recognition to determine whether a contingent liability should be recorded. In making this determination, management may, depending on the nature of the matter, consult with internal

and external legal counsel and technical experts. Based on the facts and circumstances in each matter, we use our judgment to determine whether it is probable that a contingent loss has occurred and whether the amount of such loss can be estimated. If we determine a loss is probable and estimable, we record a contingent loss in accordance with ASC 450-20-25-2. In determining the amount of a contingent loss, we take into account advice received from experts for each specific matter regarding the status of legal proceedings, settlement negotiations (which may be ongoing), prior case history and other factors. Should the judgments and estimates made by management need to be adjusted as additional information becomes available, we may need to record additional contingent losses that could materially and adversely impact our results of operations. Alternatively, if the judgments and estimates made by management are adjusted, for example, if a particular contingent loss does not occur, the contingent loss recorded would be reversed which could result in a favorable impact on our results of operations.

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

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

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

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

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

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

At December 31, 2010, the face value of our holdings in auction rate securities was \$20.2 million, all of which was classified as long-term available-for-sale investments. Investments in available-for-sale securities are recorded at fair value, and unrealized gains or losses (that are deemed to be temporary) are recognized through shareholders' equity, as a component of accumulated other comprehensive income in our consolidated balance sheet. We record an impairment charge to earnings when an available-for-sale investment has experienced a decline in value that is deemed to be other-than-temporary. Investments in trading securities are recorded at fair value and unrealized gains and losses are recognized in other income (expense) in our consolidated statement of operations.

We adopted the provisions of ASC 320-10-35 Investments – Debt and Equity Securities – Overall – Subsequent Measurement and ASC 320-10-50 Investments – Debt and Equity Securities – Overall - Disclosure, effective April 1, 2009 and used the guidelines therein to determine whether the impairment is temporary or other-than temporary. Other-than-temporary impairment charges exist when the entity has the intent to sell the security or it will more likely than not be required to sell the security before anticipated recovery. During the year ended December 31, 2009, we recognized a credit loss of \$70,000, which was deemed to be other-than-temporary in other income (expense) in our Consolidated Statement of Operations.

Based on certain assumptions described in Note 2 to our consolidated financial statements and the Liquidity and Capital Resources section of Part II, Item 7 of this annual report on Form 10-K, we recorded impairment charges on our holdings in auction-rate securities. The valuation of these securities is subject to fluctuations in the future, which will depend on many factors, including the collateral quality, potential to be called or restructured, underlying final maturity, insurance guaranty, liquidity and market conditions, among others.

#### Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2009-13, "Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13"). The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. ASU 2009-13 is effective for fiscal years beginning on or after June 15, 2010. We are currently evaluating ASU 2009-13 and the impact, if any, that it may have on our results of operations or financial position.

## Results of Operations

The table below shows the Consolidated Statements of Operations amounts (in thousands) and shows each as a percentage of revenue.

|   | Year ended December 31,            |         |            |         |            |         |
|---|------------------------------------|---------|------------|---------|------------|---------|
|   | 2010                               |         | 2009       |         | 2008       |         |
|   | (in thousands, except percentages) |         |            |         |            |         |
| Revenue   | \$ 218,840                         | 100.0 % | \$ 165,008 | 100.0 % | \$ 160,511 | 100.0 % |
| Cost of revenue                                   | 97,383                             | 44.5    | 67,330     | 40.8    | 61,184     | 38.1    |
| Gross profit                                      | 121,457                            | 55.5    | 97,678     | 59.2    | 99,327     | 61.9    |
| Operating expenses:                               |                                    |         |            |         |            |         |
| Research and development                          | 44,372                             | 20.3    | 38,295     | 23.3    | 34,850     | 21.7    |
| Selling, general and administrative               | 41,169                             | 18.8    | 36,752     | 22.3    | 35,256     | 22.0    |
| Litigation expense                                | 5,418                              | 2.5     | 9,457      | 5.7     | 6,714      | 4.2     |
| Patent litigation settlement (provision reversal) | -                                  | -       | (6,356 )   | (3.9 )  | -          | -       |
| Total operating expenses                          | 90,959                             | 41.6    | 78,148     | 47.4    | 76,820     | 47.9    |
| Income from operations                            | 30,498                             | 13.9    | 19,530     | 11.8    | 22,507     | 14.0    |
| Interest and other income                         | 1,156                              | 0.6     | 1,047      | 0.6     | 3,587      | 2.2     |
| Other expense                                     | (234 )                             | (0.1 )  | (429 )     | (0.2 )  | (652 )     | (0.4 )  |
| Total other income, net                           | 922                                | 0.5     | 618        | 0.4     | 2,935      | 1.8     |
| Income before income taxes                        | 31,420                             | 14.4    | 20,148     | 12.2    | 25,442     | 15.9    |
| Income tax provision                              | 1,857                              | 0.9     | 474        | 0.3     | 1,216      | 0.8     |
| Net income  | \$ 29,563                          | 13.5 %  | \$ 19,674  | 11.9 %  | \$ 24,226  | 15.1 %  |

The following table shows our revenue by product family (amounts in thousands, except percentages):

| Product Family            | Year ended December 31, |              |            |              |            |              | Percent Change      |                     |
|---------------------------|-------------------------|--------------|------------|--------------|------------|--------------|---------------------|---------------------|
|                           | 2010                    | % of Revenue | 2009       | % of Revenue | 2008       | % of Revenue | 2010 to 2009 Change | 2009 to 2008 Change |
| DC to DC Converters       | \$ 183,051              | 83.7 %       | \$ 123,581 | 74.9 %       | \$ 115,373 | 71.9 %       | 48.1%               | 7.1%                |
| Lighting Control Products | 28,554                  | 13.0 %       | 27,836     | 16.9 %       | 32,308     | 20.1 %       | 2.6%                | (13.8%)             |
| Audio Amplifiers          | 7,235                   | 3.3 %        | 13,591     | 8.2 %        | 12,830     | 8.0 %        | (46.8%)             | 5.9%                |
| Total                     | \$ 218,840              | 100.0 %      | \$ 165,008 | 100.0 %      | \$ 160,511 | 100.00 %     |                     |                     |

Revenue. Revenue for the year ended December 31, 2010 was \$218.8 million, an increase of \$53.8 million, or 32.6%, from \$165.0 million for the year ended December 31, 2009. Sales during the first three quarters of 2010 were strong for MPS and the semiconductor industry in general. However, due to product shortages early in 2010, several major customers in Korea sought alternative suppliers, which impacted our revenue in the fourth quarter and may continue to impact our revenue in future periods. In addition, in the fourth quarter of 2010, sales were lower because distributors used up inventory that was shipped in the third quarter and the general demand for consumer products declined more than seasonally. Sales during 2009 were generally weak, primarily from the deterioration in the general demand for electronic products as a result of a worldwide financial crises and associated macro-economic slowdowns.

In 2010, we saw an increase in demand for our DC to DC products, with sales having increased by \$59.5 million or 48.1% over sales in 2009. The increase was primarily because of higher demand for electronic products in the consumer and communications markets. Sales of our lighting control products increased slightly as a result of greater demand for our WLED solution for consumer electronics products. This was partially offset by a reduction in the demand for our CCFL products. Audio sales were down year over year due to lower demand and a decline in the average selling price for certain of our audio products.

Revenue for the year ended December 31, 2009 was \$165.0 million, an increase of \$4.5 million, or 2.8%, from \$160.5 million for the year ended December 31, 2008. The increase in revenue between these two periods resulted primarily from increased sales of our DC to DC products of \$8.2 million as a result of an increase in demand for electronic products in the consumer and communications markets. This was partially offset by a decrease in the sales of our lighting control products in the amount of \$4.5 million as a result of the continuing shift of notebook backlighting from CCFL solutions to WLED solutions. Sales for our audio products for the year ended December 31, 2009 remained relatively flat year over year.

Gross Profit. Gross profit as a percentage of revenue, or gross margin, was 55.5% for the year ended December 31, 2010 and 59.2% for the year ended December 31, 2009. Gross margin declined year-over-year as a result of a change in the product mix, higher product costs from increased wafer and gold costs, underutilized capacity towards the end of 2010 and an increase in inventory reserves.

Gross profit as a percentage of revenue was 59.2% for the year ended December 31, 2009 and 61.9% for the year ended December 31, 2008. Gross margin declined year-over-year as a result of increasing price pressure and therefore declining average selling prices, and an increase in inventory reserves resulting from a decrease in the general demand for certain of our lighting control products.

Research and Development. Research and development (R&D) expenses consist of salary and benefit expenses for design and product engineers, expenses related to new product development, and related facility costs.

|  | Year ended December 31,            |            |            | Percentage Change |                 |
|--|------------------------------------|------------|------------|-------------------|-----------------|
|  | 2010                               | 2009       | 2008       | 2010 to<br>2009   | 2009 to<br>2008 |
|  | (in thousands, except percentages) |            |            |                   |                 |
| Revenue  | \$ 218,840                         | \$ 165,008 | \$ 160,511 | 32.6 %            | 2.8 %           |
| Research and development ("R&D"), excluding stock-based compensation | 37,630                             | 31,887     | 29,029     | 18.0 %            | 9.8 %           |
| R&D stock-based compensation   | 6,742                              | 6,408      | 5,821      | 5.2 %             | 10.1 %          |
| Total R&D  | \$ 44,372                          | \$ 38,295  | \$ 34,850  | 15.9 %            | 9.9 %           |
| R&D as a percentage of net revenue                                   | 20.3 %                             | 23.2 %     | 21.7 %     |                   |                 |

R&D expenses were \$44.4 million, or 20.3% of revenue, for the year ended December 31, 2010 and \$38.3 million, or 23.2% of revenue, for the year ended December 31, 2009. The year-over-year increase was primarily due to an increase in variable compensation, facilities costs and costs associated with new product development.

R&D expenses were \$38.3 million, or 23.2% of revenue, for year ended December 31, 2009 and \$34.9 million, or 21.7% of revenue, for the year ended December 31, 2008. The year-over-year increase was primarily due to an increase in personnel and new product development expenses to support new product development. Stock-based compensation expenses increased by \$0.6 million, primarily due to the acceleration of certain awards.

Selling, General and Administrative. Selling, general and administrative (SG&A) expenses include salary and benefit expenses for sales, marketing and administrative personnel, sales commissions, travel expenses, related facilities costs, outside legal and accounting fees, and fees associated with Sarbanes-Oxley compliance requirements.

|  | Year ended December 31,            |            |            | Percentage Change |                 |
|--|------------------------------------|------------|------------|-------------------|-----------------|
|  | 2010                               | 2009       | 2008       | 2010 to<br>2009   | 2009 to<br>2008 |
|  | (in thousands, except percentages) |            |            |                   |                 |
| Revenue  | \$ 218,840                         | \$ 165,008 | \$ 160,511 | 32.6 %            | 2.8 %           |
| Selling, general and administrative ("SG&A"), excluding stock-based compensation | 31,494                             | 28,795     | 28,263     | 9.4 %             | 1.9 %           |
| SG&A stock-based compensation  | 9,675                              | 7,957      | 6,993      | 21.6 %            | 13.8 %          |
| Total SG&A   | \$ 41,169                          | \$ 36,752  | \$ 35,256  | 12.0 %            | 4.2 %           |
| SG&A as a percentage of net revenue  | 18.8 %                             | 22.3 %     | 22.0 %     |                   |                 |



SG&A expenses were \$41.2 million, or 18.8% of revenue, for the year ended December 31, 2010 and \$36.8 million, or 22.3% of revenue, for the year ended December 31, 2009. SG&A as a percentage of revenue declined compared to the corresponding period in the prior year due to the efficiencies of greater scale from increased revenues. Total SG&A expenses increased year over year due to higher stock-based compensation expenses and an increase in sales commissions and other variable compensation as a result of increased revenue in 2010.

SG&A expenses were \$36.8 million, or 22.3% of revenue, for the year ended December 31, 2009 and \$35.3 million, or 22.0% of revenue, for the year ended December 31, 2008. For the year ended December 31, 2009, SG&A expenses increased compared to the corresponding period in the prior year due to an increase in sales and sales-related expenses. Stock-based compensation increased by \$1.0 million, primarily related to certain severance arrangements and the acceleration of certain awards.

Litigation Expense, excluding Patent Litigation Settlement and Provision Reversal, net.

|  | Year ended December 31,            |            |            | Percentage Change |                 |
|--|------------------------------------|------------|------------|-------------------|-----------------|
|  | 2010                               | 2009       | 2008       | 2010 to<br>2009   | 2009 to<br>2008 |
|  | (in thousands, except percentages) |            |            |                   |                 |
| Revenue  | \$ 218,840                         | \$ 165,008 | \$ 160,511 | 32.6 %            | 2.8 %           |
| Litigation expense                                   | 5,418                              | 9,457      | 6,714      | (42.7 %)          | 40.9 %          |
| Litigation expense as a<br>percentage of net revenue | 2.5 %                              | 5.7 %      | 4.2 %      |                   |                 |

Litigation expenses, excluding patent litigation settlements and provision reversals were \$5.4 million, or 2.5% of revenue, for the year ended December 31, 2010 as compared to \$9.5 million, or 5.7% of revenue, for the year ended December 31, 2009. As a result of settling our lawsuits involving O2Micro in the second quarter of 2010, our legal expenses were significantly lower in 2010 compared to 2009.

Litigation expenses, excluding patent litigation settlements and provision reversals were \$9.5 million, or 5.7% of revenue, for the year ended December 31, 2009 as compared to \$6.7 million, or 4.2% of revenue, for the year ended December 31, 2008. During the year ended December 31, 2009, we incurred significant legal expenses to defend our lawsuit against O2Micro. During the year ended December 31, 2008, we incurred significant legal expenses to defend our lawsuit against Linear Technology.

For a more complete description of our litigation matters, please see Part I, Item 3 “Legal Proceedings” and Note 10 “Litigation” of Notes to Consolidated Financial Statements.

Patent Litigation Settlement (Provision Reversal, net).

|  | Year ended December 31,            |            |            | Percentage Change |                 |
|--|------------------------------------|------------|------------|-------------------|-----------------|
|  | 2010                               | 2009       | 2008       | 2010 to<br>2009   | 2009 to<br>2008 |
|  | (in thousands, except percentages) |            |            |                   |                 |
| Revenue  | \$ 218,840                         | \$ 165,008 | \$ 160,511 | 32.6 %            | 2.8 %           |
| Patent litigation settlement<br>(provision reversal)                                   | -                                  | (6,356 )   | -          |                   |                 |
| Patent litigation settlement<br>(provision reversal)<br>as a percentage of net revenue | 0.0 %                              | (3.9 %)    | 0.0 %      |                   |                 |

There were no patent litigation settlements or provision reversals in 2010. Patent litigation provision reversal, net was \$6.4 million for the year ended December 31, 2009. In 2009, we completed the litigation process with respect to the lawsuit related to TSE, a customer. The conclusion of this lawsuit resulted in recording a reversal of a patent litigation provision of approximately \$7.4 million. This provision was recorded as a patent litigation provision in the second quarter of 2007 and the reversal of this provision in 2009 is reflected in the Patent Litigation Settlement and Provision Reversal, net item in the Consolidated Statement of Operations. In connection with the completion of this lawsuit, the Company also jointly terminated an escrow agreement with TSE and retrieved the deposit of \$7.4 million. This recovery was reduced by certain litigation stipulations for other parties involved in the case in the amount of \$1.0 million.

Interest and Other Income. For the years ended December 31, 2010, 2009 and 2008, interest and other income was \$1.2 million, \$1.0 million and \$3.6 million, respectively. Interest rates remained low in 2010, resulting in a small increase in interest income as our cash and investment balances grew year over year. For the years ended December 31, 2009 and 2008, despite year over year increases in cash, cash equivalents and investment balances, interest income decreased due to significant declines in interest rates as a result of the economic downturn.

Other Expense. Other expense, comprised mainly of foreign exchange losses, was \$0.2 million, \$0.4 million and \$0.7 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Income Tax Provision. The income tax provision for the year ended December 31, 2010 was \$1.9 million or 5.9% of our income before income taxes. This was lower than the federal statutory rate of 34% primarily because our foreign income was taxed at lower rates and because of the benefit that we realized as a result of stock options exercised and restricted units released.

The income tax provision for the year ended December 31, 2009 was \$0.5 million or 2.4% of the pre-tax income, respectively. This differs from the U.S. federal statutory rate of 34% primarily because our foreign income is taxed at lower rates and because of the benefit that we realized as a result of stock options exercised and restricted units released.

The income tax provision for the year ended December 31, 2008 was \$1.2 million or 4.8% of our income before income taxes. This was lower than the U.S. federal statutory rate of 34% due primarily to a benefit from earnings in low foreign tax jurisdictions and a decrease in prior-year uncertain tax position reserves under ASC 740-10, which was partially offset by an increase in current-year ASC 740-10 reserves, additional ASC 740-10 interest accruals, an increase in the valuation allowance in the U.S. and non-deductible stock option compensation expenses.

For additional information, see Note 8 “Income Taxes” of the Notes to Consolidated Financial Statements.

### Liquidity and Capital Resources

As of December 31, 2010, we had working capital of \$195.4 million, including cash and cash equivalents of \$48.0 million and short-term investments of \$129.7 million compared to working capital of \$179.6 million, including cash and cash equivalents of \$46.7 million and short-term investments of \$118.9 million as of December 31, 2009. Our working capital increased year-over-year primarily due to cash generated from operating activities and the proceeds received from the exercise of options and from the employee stock purchase program.

For the year ended December 31, 2010, net cash provided by operating activities was \$48.5 million, primarily due to strong operating results, partially offset by an increase in inventory to support the deliveries in the first quarter of 2011.

For the year ended December 31, 2009, net cash provided by operating activities was \$31.8 million, primarily due to strong operating results during the year. This was offset by an increase in accounts receivable as a result of increased shipments at the end of the quarter ended December 31, 2009 for which collections had not yet been made and a decrease in accrued and long-term liabilities. For the year ended December 31, 2008, net cash provided by operating activities was \$39.6 million, primarily due to strong operating results.

For the year ended December 31, 2010, net cash used in investing activities was \$33.8 million, primarily related to the Chengdu building construction and equipment purchases for our Chengdu facility and the net purchase of short-term investments. For the year ended December 31, 2009, net cash used in investing activities was \$82.1 million, primarily related to the net purchase of short-term investments. For the year ended December 31, 2008, net cash used in investing activities was \$29.6 million, primarily related to the purchase of \$28.1 million in auction-rate securities, which became illiquid in February 2008, and the purchase of \$5.2 million in capital equipment. This was offset by the release of \$8.6 million in restricted assets as a result of an agreement between O2Micro and us relating to certain legal proceedings in Taiwan.

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

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

At December 31, 2010, the Company’s investment portfolio included \$19.2 million, net of impairment charges of \$1.0 million, in government-backed student loan auction-rate securities. The underlying maturity of these auction-rate securities is up to 37 years. Although it is unclear as to when these investments will regain their liquidity, management has concluded that as of December 31, 2010 and 2009, the cumulative impairment of \$1.0 million and \$1.1 million, respectively, was temporary based on the following analysis:

1. The decline in the fair value of these securities is not attributable to adverse conditions specifically related to these securities or to specific conditions in an industry or in a geographic area;
  2. Management possesses both the intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value;
3. Management believes that it is more likely than not that the Company will not have to sell these securities before recovery of its cost basis;
4. Except for the credit loss of \$70,000 recognized in year ended December 31, 2009 for the Company's holdings in auction rate securities described below, the Company does not believe that there is any additional credit loss associated with other auction-rate securities because the Company expects to recover the entire amortized cost basis;
5. The majority of the securities remain AAA rated, with \$8.6 million of the auction rate securities having been downgraded by Moody's to A3-Baa3 during the year ended December 31, 2009, and there have been no downgrades during the year ended December 31, 2010; and
  6. All scheduled interest payments have been made pursuant to the reset terms and conditions.

Based on the guidance of ASC 320-10-35 and ASC 320-10-50, the Company evaluated the potential credit loss of each of the auction-rate securities that are currently held by the Company. Based on such analysis, the Company determined that those securities that are not 100% FFELPS guaranteed are potentially subject to credit risks based on the extent to which the underlying debt is collateralized and the security-specific student-loan default rates. The Company's portfolio includes three such securities, one of which has a senior parity ratio of approximately 126%, which is substantially above the expected student-loan default rate for that security. Conversely, the senior parity ratio for the other two securities is approximately 105%. If, therefore, the student-loan default rate and borrowing rate increases for these issuers, the remaining balance in these trusts may not be sufficient to cover the senior debt. The Company therefore concluded that there is potential credit risk for these two securities and as such, used the discounted cash flow model to determine the amount of credit loss to be recorded. In valuing the potential credit loss, the following parameters were used: 20 year expected term, cash flows based on the 90-day t-bill rates for 20 year forwards and a risk premium of 5.9%, the amount of interest that the Company was receiving on these securities when the market was last active. As of December 31, 2010 and 2009, the potential credit loss associated with these securities was \$70,000, which the Company deemed other-than-temporary and recorded in other expense in its Consolidated Statement of Operations during 2009.

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

The valuation of the auction-rate securities is subject to fluctuations in the future, which will depend on many factors, including the collateral quality, potential to be called or restructured, underlying final maturity, insurance guaranty, liquidity and market conditions, among others. To determine the fair value of the auction-rate securities at December 31, 2009, March 31, 2010, June 30, 2010, September 30, 2010 and December 31, 2010, we used a discounted cash flow model, for which there are three valuation parameters, including time-to-liquidity, discount rate and expected return. The following are the values used in the discounted cash flow model:

|   | December 31,<br>2009   | March 31,<br>2010   | June 30, 2010   | September<br>30, 2010   | December 31,<br>2010  |
|---|--|---|---|---|---|
| Time-to-Liquidity   | 24 months  | 24 months   | 24 months   | 24 months   | 24 months   |
| Expected Return (Based on the requisite treasury rate, plus a contractual penalty rate)     | 2.4%   | 2.4%  | 2.7%  | 2.2%  | 2.9%  |
| Discount Rate (Based on the requisite LIBOR, the cost of debt and a liquidity risk premium) | 5.2% - 10.0%,<br>depending on<br>the<br>credit-rating<br>of the security | 4.6% - 9.4%,<br>depending on<br>the<br>credit-rating<br>of the security | 3.8% - 8.6%,<br>depending on<br>the<br>credit-rating<br>of the security | 3.2% - 8.0%,<br>depending on<br>the<br>credit-rating<br>of the security | 4.1% - 8.9%,<br>depending on<br>the<br>credit-rating<br>of the security |

In October 2008, the Company accepted an offer to participate in an auction-rate security rights offering from UBS to sell up to \$18.2 million in face value of eligible auction-rate securities commencing in June 2010. Between October 2008 and June 2010, \$9.6 million of these auction-rate securities were called at par. On June 30, 2010, the Company exercised the UBS put right and sold the remaining \$8.6 million in auction rate securities at par, for which the sale was completed and proceeds were received on July 1, 2010. At December 31, 2009, we had \$16.9 million in eligible auction-rate securities remaining at UBS. The impairment related to these auction-rate securities and the corresponding put right were valued at \$0.7 million. The change in the impairment and the fair value of the put right was recorded in accordance with the provisions of ASC 320-10-35 and ASC 320-10-50 in other income (expense) in

the Consolidated Statement of Operations.

From the end of the third quarter of 2010 to the end of the fourth quarter of 2010, we sold \$0.2 million in auction-rate securities at par. However, the FFELPS-guaranteed student-loan credit default spread and the spread between the 90-day libor and t-bill forward rates increased. The net effect of the adjustments was an increase in the overall impairment from \$0.9 million at September 30, 2010 to \$1.0 million at December 31, 2010.

From the end of the second quarter of 2010 to the end of the third quarter of 2010, we kept the time-to-liquidity constant at 2.0 years. There was a slight decrease in the spread between the 90-day libor and t-bill forward rates as well as a small decrease in the FFELPS-guaranteed student-loan credit default spread. We also sold \$8.8 million in auction-rate securities at par, all of which was related to the exercise of the UBS put right. The net effect of the adjustments was a reduction in the overall impairment from \$1.3 million at June 30, 2010 to \$0.9 million at September 30, 2010.

From the end of the first quarter of 2010 to the end of the second quarter of 2010, we kept the time-to-liquidity constant at 2.0 years. The spread between the 90-day libor and t-bill forward rates remained relatively constant. We sold \$8.1 million in auction rate securities at par, all of which were held at UBS. However, the FFELPs-guaranteed student-loan credit default spread increased slightly. The net effect of the adjustments was a reduction in the overall impairment from \$1.5 million at March 31, 2010 to \$1.3 million at June 30, 2010. The overall impairment decreased primarily because we sold a large amount of auction-rate securities back to UBS at par. This was partially offset by a slight increase in the FFELPS-guaranteed student-loan credit default spread.

From the end of the fourth quarter of 2009 to the end of the first quarter of 2010, we kept the time-to-liquidity constant at 2.0 years. We sold \$0.2 million in auction-rate securities at par. The spread between the 90-day libor and t-bill forward rate decreased and the FFELPs-guaranteed student-loan credit default spread decreased. The net effect of the adjustments was a reduction in the overall impairment from \$1.8 million at December 31, 2009 to \$1.5 million at March 31, 2010.

Net cash used in financing activities for the year ended December 31, 2010 was \$14.0 million, primarily related to the repurchase of our common stock in the amount of \$31.5 million, which was partially offset by the exercise of options and proceeds from our Employee Stock Purchase Plan in the amount of \$16.2 million. Net cash provided by financing activities for the year ended December 31, 2009 was \$13.6 million, primarily from the exercise of stock options and proceeds from our Employee Stock Purchase Plan in the amount of \$13.0 million.

Net cash used by financing activities for the year ended December 31, 2008 was \$9.8 million, primarily from the repurchase of \$25.0 million of our common stock. This was partially offset by the proceeds related to the exercise of options and proceeds from our Employee Stock Purchase Plan of common stock in the amount of \$14.5 million and excess tax benefits related to the exercise of options of \$0.8 million.

On July 27, 2010, we announced that our Board of Directors approved a stock repurchase program that authorizes the Company to repurchase up to \$50.0 million of its common stock between August 2, 2010 and December 31, 2011. In February 2011, the Board of Directors approved an increase from \$50.0 million to \$70.0 million. As of December 31, 2010, the following shares have been repurchased through the open market and subsequently retired:

| 2010 Calendar Year       | Shares Repurchased | Average Price per Share | Value (in thousands) |
|--------------------------|--------------------|-------------------------|----------------------|
| August                   | 983,189            | \$ 17.29                | \$ 16,998            |
| November                 | 916,600            | \$ 15.85                | \$ 14,529            |
| Total Shares Repurchased | 1,899,789          |                         | \$ 31,527            |

There were no repurchases in 2009.

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. For further details regarding our operating, investing and financing activities, see the Consolidated Statement of Cash Flows.

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

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

#### Contractual Obligations



We lease our headquarters and sales offices in San Jose, California. The San Jose facility was sold and the new landlord has exercised their right to terminate the lease, effective April 18, 2012.

In September 2004, we signed an agreement with the Chinese local authority to construct a facility in Chengdu, China. Pursuant to this agreement, we agreed to contribute capital in the form of cash, in-kind assets, and/or intellectual property, of at least \$5.0 million to our wholly-owned Chinese subsidiary as the registered capital for the subsidiary and exercised the option to purchase land use rights for the facility of approximately \$0.2 million. We also have the option to acquire the facility after a five-year lease term for the original construction cost less rents paid, which is currently estimated at \$1.9 million and which becomes exercisable in March 2011. We will likely enter into a purchase agreement for this facility at a date to be determined and as the opportunity necessitates.

As of December 31, 2010, our total outstanding purchase commitments were \$14.4 million, which includes wafer purchases from our two foundries, the purchase of assembly services primarily from multiple contractors in Asia and purchase commitments related to the construction of our Chengdu facility. This compares to purchase commitments of \$13.2 million as of December 31, 2009.

The following table summarizes our contractual obligations at December 31, 2010, and the effect such obligations are expected to have on our liquidity and cash flow over the next five years (in thousands).

|                                  | Total     | Payments by Period |        |        |      |      | Thereafter |
|----------------------------------|-----------|--------------------|--------|--------|------|------|------------|
|                                  |           | 2011               | 2012   | 2013   | 2014 | 2015 |            |
| Operating leases                 | \$ 2,413  | \$ 1,665           | \$ 574 | \$ 174 | \$ - | \$ - | \$ -       |
| Outstanding purchase commitments | \$ 14,379 | \$ 14,379          | \$ -   | \$ -   | \$ - | \$ - | \$ -       |
|                                  | \$ 16,792 | \$ 16,044          | \$ 574 | \$ 174 | \$ - | \$ - | \$ -       |

Because of the uncertainty as to the timing of payments related to our liabilities for unrecognized tax benefits, we have excluded estimated obligations of \$5.0 million, after considering the valuation allowance, from the table above.

#### Off Balance Sheet Arrangements

As of December 31, 2010, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of the Securities and Exchange Commission's Regulation S-K.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

##### Interest Rate Risk

Our cash equivalents and investments are subject to market risk, primarily interest rate and credit risk. Our investments are managed by outside professional managers within investment guidelines set by us. Such guidelines include security type, credit quality and maturity and are intended to limit market risk by restricting our investments to high quality debt instruments with relatively short-term maturities.

We do not use derivative financial instruments in our investment portfolio. Investments in debt securities are classified as available-for-sale or trading. For available-for-sale investments, no gains or losses are recognized by us in our results of operations due to changes in interest rates unless such securities are sold prior to maturity or are determined to be other-than-temporarily impaired. Available-for-sale investments are reported at fair value with the related unrealized gains or losses being included in accumulated other comprehensive income, a component of stockholders' equity. Trading securities are reported at fair value with unrealized gains and losses included in earnings.

Fluctuations in interest rates of +/- 10% could impact our annual results of operations by approximately \$0.1 million.

##### Foreign Currency Exchange Risk

Our sales outside the United States are transacted in U.S. dollars. Accordingly, our sales are not generally impacted by foreign currency rate changes. In 2010, the primary functional currency of the Company's offshore operations was the local currency, primarily the New Taiwan Dollar and the Chinese Yuan. To date, fluctuations in foreign currency exchange rates have not had a material impact on our results of operations. However, fluctuations of +/- 10% in such local currencies could impact our annual results of operations by approximately \$4.2 million.

##### Value Change to Long-Term Investments

As of December 31, 2010, all of our holdings in auction rate securities, which have a face value of \$20.2 million, have failed to reset as a result of current market conditions. Should these auctions continue to fail and if the credit rating for these securities decline, a 10% decline in the fair value could impact our results of operations by approximately \$2.0 million.

In valuing the auction-rate securities using the discounted cash flow model, a change in either the liquidity risk premium or time-to-liquidity by 10% would result in a \$0.1 million change in the value of our auction-rate securities portfolio.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MONOLITHIC POWER SYSTEMS, INC.

CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Monolithic Power Systems, Inc.

We have audited the accompanying consolidated balance sheets of Monolithic Power Systems, Inc. and subsidiaries (collectively, the “Company”) as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Monolithic Power Systems, Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 4, 2011 expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ Deloitte & Touche LLP

San Jose, California  
March 4, 2011

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Monolithic Power Systems, Inc.

We have audited the internal control over financial reporting of Monolithic Power Systems, Inc. and subsidiaries (collectively, the "Company") as of December 31, 2010, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2010, of the Company and our report dated March 4, 2011 expressed an unqualified opinion on those consolidated financial statements.

/s/ Deloitte & Touche LLP

San Jose, California  
March 4, 2011

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## MONOLITHIC POWER SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS  
(in thousands, except share amounts)

|  | December 31, |           |
|--|--------------|-----------|
|  | 2010         | 2009      |
| <b>ASSETS</b>  |              |           |
| Current assets:  |              |           |
| Cash and cash equivalents  | \$48,010     | \$46,717  |
| Short-term investments   | 129,709      | 118,914   |
| Accounts receivable, net of allowances of \$0 in both 2010 and 2009  | 18,347       | 15,521    |
| Inventories  | 25,789       | 19,616    |
| Deferred income tax assets, net - current  | 204          | 5         |
| Prepaid expenses and other current assets  | 2,314        | 2,726     |
| Total current assets   | 224,373      | 203,499   |
| Property and equipment, net  | 37,262       | 17,968    |
| Long-term investments  | 19,180       | 19,445    |
| Deferred income tax assets, net - long-term  | 39           | 175       |
| Other assets   | 749          | 734       |
| Total assets   | \$281,603    | \$241,821 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |              |           |
| Current liabilities:   |              |           |
| Accounts payable   | \$8,979      | \$7,787   |
| Accrued compensation and related benefits  | 8,792        | 8,454     |
| Accrued liabilities  | 11,199       | 7,681     |
| Total current liabilities  | 28,970       | 23,922    |
| Non-current income tax liability   | 5,015        | 4,915     |
| Other long-term liabilities  | 723          | 27        |
| Total liabilities  | 34,708       | 28,864    |
| Stockholders' equity:  |              |           |
| Common stock, \$0.001 par value, \$35 and \$35 in 2010 and 2009, respectively;<br>shares authorized: 150,000,000; shares issued and outstanding: 35,063,033<br>and 35,165,316 in 2010 and 2009, respectively | 178,269      | 175,518   |
| Retained earnings  | 66,647       | 37,085    |
| Accumulated other comprehensive income   | 1,979        | 354       |
| Total stockholders' equity   | 246,895      | 212,957   |
| Total liabilities and stockholders' equity   | \$281,603    | \$241,821 |

See accompanying notes to consolidated financial statements.



## MONOLITHIC POWER SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share amounts)

|   | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2010                    | 2009      | 2008      |
| Revenue   | \$218,840               | \$165,008 | \$160,511 |
| Cost of revenue   | 97,383                  | 67,330    | 61,184    |
| Gross profit  | 121,457                 | 97,678    | 99,327    |
| Operating expenses:   |                         |           |           |
| Research and development                                      | 44,372                  | 38,295    | 34,850    |
| Selling, general and administrative                           | 41,169                  | 36,752    | 35,256    |
| Litigation expense  | 5,418                   | 9,457     | 6,714     |
| Litigation provision reversal, net                            | -                       | (6,356)   | -         |
| Total operating expenses                                      | 90,959                  | 78,148    | 76,820    |
| Income from operations  | 30,498                  | 19,530    | 22,507    |
| Other income (expense):                                       |                         |           |           |
| Interest and other income                                     | 1,156                   | 1,047     | 3,587     |
| Other expense   | (234)                   | (429)     | (652)     |
| Total other income, net                                       | 922                     | 618       | 2,935     |
| Income before income taxes                                    | 31,420                  | 20,148    | 25,442    |
| Income tax provision  | 1,857                   | 474       | 1,216     |
| Net income  | \$29,563                | \$19,674  | \$24,226  |
| Basic income per share  | \$0.83                  | \$0.57    | \$0.72    |
| Diluted income per share                                      | \$0.78                  | \$0.54    | \$0.67    |
| Weighted-average common shares outstanding                    | 35,830                  | 34,310    | 33,509    |
| Stock options and restricted stock                            | 1,996                   | 2,324     | 2,611     |
| Diluted weighted-average common equivalent shares outstanding | 37,826                  | 36,634    | 36,120    |

See accompanying notes to consolidated financial statements.

## MONOLITHIC POWER SYSTEMS, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands, except share amounts)

|  | Common Stock |            | Deferred<br>Stock<br>Compensation | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders'<br>Equity |
|--|--------------|------------|-----------------------------------|--|---|----------------------------------|
|  | Shares       | Amount     |                                   |  |   |                                  |
| Balance as of December 31,<br>2007   | 33,454,595   | \$ 143,890 | \$ (3 )                           | \$ (6,815 )                                      | \$ 465  | \$ 137,537                       |
| Components of comprehensive loss:  |              |            |                                   |  |   |                                  |
| Net income   |              |            |                                   | 24,226   |   | 24,226                           |
| Impairment of Auction Rate Securities                                      |              |            |                                   |  | (1,400 )  | (1,400 )                         |
| Unrealized gains   |              |            |                                   |  | (1 )  | (1 )                             |
| Foreign exchange gain  |              |            |                                   |  | 872   | 872                              |
| Total comprehensive income   |              |            |                                   |  |   | 23,697                           |
| Exercise of stock options,<br>including net excess tax benefit<br>of \$765 | 1,417,585    | 13,480     |                                   |  |   | 13,480                           |
| Repurchase of common shares  | (1,430,105 ) | (25,043 )  |                                   |  |   | (25,043 )                        |
| Shares purchased through ESPP  | 125,207      | 1,778      |                                   |  |   | 1,778                            |
| Stock-based compensation<br>expense, net of forfeitures                    |              | 13,151     | 3                                 |  |   | 13,154                           |
| Compensation expense for<br>non-employee stock options                     |              | 42         |                                   |  |   | 42                               |
| Release of restricted stock upon<br>vesting                                | 79,539       | -          |                                   |  |   | -                                |
| Balance as of December 31,<br>2008   | 33,646,821   | \$ 147,298 | \$ -                              | \$ 17,411  | \$ (64 )  | \$ 164,645                       |
| Components of comprehensive income:  |              |            |                                   |  |   |                                  |
| Net income   |              |            |                                   | 19,674   |   | 19,674                           |
| Impairment of Auction Rate Securities                                      |              |            |                                   |  | 340   | 340                              |
| Unrealized losses  |              |            |                                   |  | (109 )  | (109 )                           |
| Foreign exchange gain  |              |            |                                   |  | 187   | 187                              |
| Total comprehensive income   |              |            |                                   |  |   | 20,092                           |
| Exercise of stock options,<br>including net excess tax benefit<br>of \$643 | 1,217,272    | 11,824     |                                   |  |   | 11,824                           |
| Shares purchased through ESPP  | 161,026      | 1,794      |                                   |  |   | 1,794                            |
| Stock-based compensation<br>expense, net of forfeitures                    |              | 14,484     | 118                               |  |   | 14,484                           |
|  |              |            |                                   |  |   | 118                              |

|  |              |            |      |           |          |            |
|--|--------------|------------|------|-----------|----------|------------|
| Compensation expense for non-employee stock options                    |              |            |      |           |          |            |
| Release of restricted stock upon vesting                               | 140,197      | -          |      |           |          | -          |
| Balance as of December 31, 2009  | 35,165,316   | \$ 175,518 | \$ - | \$ 37,085 | \$ 354   | \$ 212,957 |
| Components of comprehensive income:                                    |              |            |      |           |          |            |
| Net income   |              |            |      | 29,563    |          | 29,563     |
| Impairment of Auction Rate Securities                                  |              |            |      |           | 160      | 160        |
| Unrealized losses  |              |            |      |           | 104      | 104        |
| Foreign exchange gain  |              |            |      |           | 1,361    | 1,361      |
| Total comprehensive income   |              |            |      |           |          | 31,188     |
| Exercise of stock options, including net excess tax benefit of \$1,256 | 1,452,245    | 15,597     |      |           |          | 15,597     |
| Repurchase of common shares  | (1,899,789 ) | (31,527 )  |      |           |          | (31,527 )  |
| Shares purchased through ESPP  | 114,387      | 1,885      |      |           |          | 1,885      |
| Stock-based compensation expense, net of forfeitures                   |              | 16,803     |      |           |          | 16,803     |
| Compensation expense for non-employee stock options                    |              | (7 )       |      |           |          | (7 )       |
| Release of restricted stock upon vesting                               | 230,874      | -          |      |           |          | -          |
| Balance as of December 31, 2010  | 35,063,033   | \$ 178,269 | \$ - | \$ 66,647 | \$ 1,979 | \$ 246,895 |

See accompanying notes to consolidated financial statements

## MONOLITHIC POWER SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)

|   | Year Ended December 31, |           |          |
|---|-------------------------|-----------|----------|
|   | 2010                    | 2009      | 2008     |
| <b>Cash flows from operating activities:</b>                                      |                         |           |          |
| Net income  | \$29,563                | \$19,674  | \$24,226 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |           |          |
| Depreciation and amortization   | 8,016                   | 6,573     | 5,725    |
| Loss on disposal of property and equipment  | 1                       | 17        | 5        |
| Amortization and realized gain (loss) on debt instruments                         | 688                     | 380       | (36)     |
| Deferred income tax assets  | (56)                    | (84)      | 710      |
| Credit loss on auction-rate securities  | -                       | 70        | -        |
| Tax benefit from stock option transactions  | 3,349                   | 2,288     | 2,110    |
| Excess tax benefit from stock option transactions                                 | (1,256)                 | (643)     | (765)    |
| Stock-based compensation  | 16,810                  | 14,611    | 13,158   |
| Changes in operating assets and liabilities:                                      |                         |           |          |
| Accounts receivable   | (2,826)                 | (6,406)   | (876)    |
| Inventories   | (6,184)                 | (737)     | (1,356)  |
| Prepaid expenses and other assets   | 378                     | (101)     | 2,242    |
| Accounts payable  | 1,155                   | 2,699     | (1,382)  |
| Accrued and long-term liabilities   | 556                     | (5,633)   | (1,816)  |
| Accrued income taxes payable and noncurrent tax liabilities                       | (1,995)                 | (1,492)   | (1,897)  |
| Accrued compensation and related benefits   | 295                     | 548       | (458)    |
| Net cash provided by operating activities   | 48,494                  | 31,764    | 39,590   |
| <b>Cash flows from investing activities:</b>                                      |                         |           |          |
| Property and equipment purchases  | (22,779)                | (9,954)   | (5,233)  |
| Purchase of intangible assets   | -                       | (310)     | -        |
| Purchase of short-term investments  | (208,621)               | (159,917) | (36,608) |
| Proceeds from sale of short-term investments                                      | 197,243                 | 80,586    | 30,985   |
| Proceeds from sale of long-term investments                                       | 425                     | 100       | 725      |
| Changes in restricted assets  | (19)                    | 7,367     | 8,566    |
| Net cash used in investing activities   | (33,751)                | (82,128)  | (29,615) |
| <b>Cash flows from financing activities:</b>                                      |                         |           |          |
| Proceeds from issuance of common stock  | 14,339                  | 11,181    | 12,715   |
| Proceeds from employee stock purchase plan  | 1,885                   | 1,794     | 1,778    |
| Repurchase of common stock  | (31,527)                | -         | (25,043) |
| Excess tax benefits from stock option transactions                                | 1,256                   | 643       | 765      |
| Net cash provided by (used in) financing activities                               | (14,047)                | 13,618    | (9,785)  |
| Effect of change in exchange rates  | 597                     | 197       | (38)     |
| Net increase (decrease) in cash and cash equivalents                              | 1,293                   | (36,549)  | 152      |
| Cash and cash equivalents, beginning of period                                    | 46,717                  | 83,266    | 83,114   |

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|  |          |          |            |
|--|----------|----------|------------|
| Cash and cash equivalents, end of period                                 | \$48,010 | \$46,717 | \$83,266   |
| Supplemental disclosures for cash flow information:                      |          |          |            |
| Cash paid (received) for taxes   | \$35     | \$321    | \$(2,482 ) |
| Supplemental disclosures of non-cash investing and financing activities: |          |          |            |
| Liability accrued for equipment purchases                                | \$4,264  | \$663    | \$228      |
| Unrealized loss on auction-rate securities                               | \$(104 ) | \$(340 ) | \$1,400    |
| Temporary impairment of auction-rate securities                          | \$(160 ) | \$70     | \$(1,250 ) |
| Other-than-temporary impairment of short-term investments                | \$-      | \$525    | \$-        |
| Value of auction-rate security put right                                 | \$-      | \$(525 ) | \$1,250    |

See accompanying notes to consolidated financial statements

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

**Business** — Monolithic Power Systems, Inc. (MPS or the Company) was incorporated in the State of California on August 22, 1997. On November 17, 2004, the Company was reincorporated in the State of Delaware. MPS designs, develops and markets proprietary, advanced analog and mixed-signal semiconductors. The Company combines advanced process technology with its highly experienced analog designers to produce high-performance power management integrated circuits (ICs) for DC to DC converters, LED drivers, Cold Cathode Fluorescent Lamp (CCFL) backlight controllers, Class-D audio amplifiers, and other Linear ICs. MPS products are used extensively in computing and network communications products, LCD monitors and TVs, and a wide variety of consumer and portable electronics products. MPS partners with world-class manufacturing organizations to deliver top quality, ultra-compact, high-performance solutions through productive, cost-efficient channels.

**Basis of Presentation** — The consolidated financial statements include the accounts of Monolithic Power Systems, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Foreign Currency Transactions** — The Company's foreign subsidiaries operate primarily using their respective local currencies, and therefore, the local currency has been determined to be the functional currency for each foreign subsidiary. Accordingly, all assets and liabilities of the Company's foreign subsidiaries are translated using exchange rates in effect at the end of the period. Revenue and costs are translated using average exchange rates for the period. The resulting translation adjustments are presented as a separate component of accumulated other comprehensive income (loss) in stockholders' equity.

**Use of Estimates** — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Certain Significant Risks and Uncertainties** — Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term and long-term investments and accounts receivable. The Company's cash consists of checking and savings accounts. The Company's cash equivalents include short-term, highly liquid investments purchased with remaining maturities at the date of purchase of three months or less. The Company's short-term investments consist primarily of government agencies and treasuries and the Company's long-term investments consist of government-backed student loan auction-rate securities. The Company generally does not require its customers to provide collateral or other security to support accounts receivable. To manage credit risk, management performs ongoing credit evaluations of its customers' financial condition.

The Company participates in the dynamic high technology industry and believes that changes in any of the following areas could have a material adverse effect on the Company's future financial position, results of operations or cash flows: advances and trends in new technologies and industry standards; competitive pressures in the form of new products or price reductions on current products; changes in product mix; changes in the overall demand for products offered by the Company; changes in third-party manufacturers; changes in key suppliers; changes in certain strategic

relationships or customer relationships; litigation or claims against the Company based on intellectual property, patent, product, regulatory or other factors; fluctuations in foreign currency exchange rates; risk associated with changes in domestic and international economic and/or political regulations; availability of necessary components or subassemblies; availability of foundry capacity; and the Company's ability to attract and retain employees necessary to support its growth.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

- Level 1: Quoted prices in active markets for identical assets;
- Level 2: Valuations based on observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities or quoted prices in markets that are not active; and
- Level 3: Significant unobservable inputs.

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

The Company's financial instruments include cash and cash equivalents and short-term and long-term investments. Cash equivalents are stated at cost, which approximates fair market value based on quoted market prices. Short-term and long-term investments are stated at their fair market value.

At December 31, 2010, the face value of the Company's holdings in auction rate securities was \$20.2 million, all of which was classified as long-term available-for-sale investments. Investments in available-for-sale securities are recorded at fair value, and unrealized gains or losses (that are deemed to be temporary) are recognized through shareholders' equity, as a component of accumulated other comprehensive income in our consolidated balance sheet. The Company records an impairment charge to earnings when an available-for-sale investment has experienced a decline in value that is deemed to be other-than-temporary. Investments in trading securities are recorded at fair value and unrealized gains and losses are recognized in other income (expense) in the Company's consolidated statement of operations.

The Company adopted the provisions of ASC 320-10-35 Investments – Debt and Equity Securities – Overall – Subsequent Measurement and ASC 320-10-50 Investments – Debt and Equity Securities – Overall - Disclosure, effective April 1, 2009 and used the guidelines therein to determine whether the impairment is temporary or other-than-temporary. Other-than-temporary impairment charges exist when the entity has the intent to sell the security or it will more likely than not be required to sell the security before anticipated recovery. During the year ended December 31, 2009, the Company recognized a credit loss of \$70,000, which was deemed to be other-than-temporary in other income (expense) in our Consolidated Statement of Operations. There were no such losses recognized in 2010 and 2008.

Based on certain assumptions described in Note 2, the Company recorded impairment charges on its holdings in auction-rate securities. The valuation of these securities is subject to fluctuations in the future, which will depend on many factors, including the collateral quality, potential to be called or restructured, underlying final maturity, insurance guaranty, liquidity and market conditions, among others.



**Inventories** — Inventories are stated at the lower of the standard cost (which approximates actual cost on a first-in, first-out basis) or current estimated market value. The Company monitors manufacturing variances and revises standard costs if necessary. Due to continued demand changes, potential obsolescence, and product life cycle, the Company writes down inventory to net realizable values, as needed.

**Property and Equipment** — Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally three to five years. Leasehold improvements are amortized over the shorter of the estimated useful life or the lease period. The Chengdu building, which was placed in service in October 2010, has a depreciation life of 30 years.

**Long-Lived Assets** — The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value based on the present value of estimated future cash flows.

**Other Assets** — Other assets consist primarily of intangible assets for the land use rights in Chengdu, purchased patents and long-term lease deposits.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Approximately 85% of the Company’s distributor sales, including sales to the Company’s value-added resellers, are made through distribution arrangements with third parties. These arrangements do not include any special payment terms (our normal payment terms are 30-45 days for our distributors, with value-added resellers having payment terms up to 90 days), price protection or exchange rights. Returns are limited to the Company’s standard product warranty. Certain of the Company’s large distributors have contracts that include limited stock rotation rights that permit the return of a small percentage of the previous six months’ purchases in return for a compensating new order of equal or greater dollar value.

The Company maintains a sales reserve for stock rotation rights, which is based on historical experience of actual stock rotation returns on a per distributor basis, where available, and information related to products in the distribution channel. This reserve is recorded at the time of sale. In the future, if the Company is unable to estimate its stock rotation returns accurately, the Company may not be able to recognize revenue from sales to its distributors based on when it sells inventory to its distributors. Instead, the Company may have to recognize revenue when the distributor sells through such inventory to an end-customer.

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

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

If the Company enters into arrangements that have rights of return that are not estimable, the Company recognizes revenue under such arrangements only after the distributor has sold the Company’s products to an end customer.

Approximately 15% of the Company's distributor sales are made through small distributors based on purchase orders rather than formal distribution arrangements. These distributors do not receive any stock rotation rights.

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

In 2006, the Company signed a distribution agreement with a U.S. distributor. Revenue from this distributor is recognized upon sale by the distributor to the end customer because the distributor has certain rights of return which management believes are not estimable. For the years ended December 31, 2010 and 2009, the deferred revenue balance from this distributor was \$1.0 million and \$0.9 million, respectively.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Stock-Based Compensation** — The Company accounts for stock-based compensation in accordance with the provisions of ASC 718-10-30 Compensation – Stock Compensation – Overall – Initial Measurement, under the modified prospective method. ASC 718-10-30 eliminated the alternative of applying the intrinsic value measurement to stock compensation awards issued to employees. Rather, the standard requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). The Company currently use the Black-Scholes option-pricing model to estimate the fair value of its share-based payments. The Black-Scholes option-pricing model is based on a number of assumptions, including historical volatility, expected life, risk-free interest rate and expected dividends.

**Research and Development** — Costs incurred in research and development are charged to operations as incurred.

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

The Company's calculation of current and deferred tax assets and liabilities is based on certain estimates and judgments and involves dealing with uncertainties in the application of complex tax laws. The Company's estimates of current and deferred tax assets and liabilities may change based, in part, on added certainty or finality or uncertainty to an anticipated outcome, changes in accounting or tax laws in the U.S., or foreign jurisdictions where we operate, or changes in other facts or circumstances. In addition, the Company recognizes liabilities for potential U.S. and foreign income tax for uncertain income tax positions taken on its tax returns if it has less than a 50% likelihood of being sustained. If the Company determines that payment of these amounts is unnecessary or if the recorded tax liability is less than the Company's current assessment, the Company may be required to recognize an income tax benefit or additional income tax expense in its financial statements in the period such determination is made. The Company has calculated its uncertain tax positions which were attributable to certain estimates and judgments primarily related to transfer pricing, cost sharing and the Company's international tax structure exposure.

As of December 31, 2010, 2009 and 2008, the Company had a valuation allowance of \$16.8 million, \$14.6 million and \$14.4 million, respectively, attributable to management's determination that none of the US deferred tax assets will be realized, except for certain deferred tax assets related to uncertain income tax positions. As a result of the cost sharing arrangements with the Company's international subsidiaries (cost share arrangements), relatively small changes in costs that are not subject to sharing under the cost share arrangements can significantly impact the overall profitability of the US entity. Historically, the US operations have shown an inconsistent earnings pattern due to litigation costs not subject to cost sharing. The Company evaluated its US valuation allowance at December 31, 2010 by reviewing both its earnings history and its expected earnings for the next 12 months in its US entity. Because of the US entity's inconsistent earnings history and uncertainty of future earnings, the Company has determined that it is

more likely than not that the US deferred tax benefits would not be realized. The Company has settled most of its legacy litigation matters that resulted in litigation cost that were not subject to cost share in the past. As a result, during the Company's next fiscal year, a relatively small number of design wins in the US, and the absence of new litigation that may be not subject to cost share may position the US entity for a stable earnings pattern. As such, the Company will continue to evaluate if its facts and circumstances warrant a reversal of the valuation allowance against the US deferred tax benefits during fiscal year 2011.

The Company incurred significant stock-based compensation expense, some of which related to incentive stock options for which no corresponding tax benefit is recognized unless a disqualifying disposition occurs. Disqualifying dispositions result in a reduction of income tax expense in the period when the disqualifying disposition occurs in an amount equal to the tax benefit relating to previously recognized stock compensation expense. Tax benefits related to realized tax deductions in excess of previously expensed stock compensation are recorded as an addition to paid-in-capital.

Patent Litigation — Costs incurred in registering and defending the Company's patents and other proprietary rights are charged to operations as incurred (See Note 10).

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Comprehensive Income (Loss) — Comprehensive income represents the change in the Company's net assets during the period from non-owner sources. Comprehensive income (loss) includes unrealized gains/(losses) on investments and foreign exchange gains/(losses) for the years ended December 31, 2010, 2009 and 2008.

|  | Years Ended December 31, |          |          |
|--|--------------------------|----------|----------|
|  | 2010                     | 2009     | 2008     |
| Net income   | \$29,563                 | \$19,674 | \$24,226 |
| Other comprehensive income (loss):                                 |                          |          |          |
| Change in value of temporary impairment of auction-rate securities | 160                      | 340      | (1,400)  |
| Unrealized gain (loss) on available-for-sale securities            | 104                      | (109)    | (1)      |
| Foreign currency translation adjustments                           | 1,361                    | 187      | 872      |
| Comprehensive income   | \$31,188                 | \$20,092 | \$23,697 |

Accumulated other comprehensive income presented in the Consolidated Balance Sheet at December 31, 2010 consisted primarily of approximately \$2.8 million related to translation gains, offset by \$0.9 million related to the impairment of the Company's holdings in auction-rate securities. Accumulated other comprehensive income presented in the Consolidated Balance Sheet at December 31, 2009 consisted primarily of \$1.5 million related to translation gains, offset by \$1.1 million related to the impairment of the Company's holdings in auction-rate securities.

New Accounting Standards — In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2009-13, "Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13"). The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. ASU 2009-13 is effective for fiscal years beginning on or after June 15, 2010. The Company is currently evaluating ASU 2009-13 and the impact, if any, that it may have on its results of operations or financial position.

## 2. Fair Value Measurements

The following is a schedule of the Company's cash and cash equivalents and short-term and long-term investments as of December 31, 2010 and 2009 (in thousands):

|  | Adjusted Cost and Estimated<br>Fair Market Value as of December 31, |            |
|--|---|------------|
|  | 2010  | 2009       |
| Cash, Cash Equivalents and Investments               |   |            |
| Cash in Banks  | \$ 48,010   | \$ 44,717  |
| Government Agencies / Treasuries                     | 117,302   | 104,064    |
| Commercial Paper / Corporate Notes                   | 12,407  | -          |
| Auction-Rate Securities backed by Student-Loan Notes | 19,180  | 35,570     |
| Put Right  | -   | 725        |
| Total Cash, Cash Equivalents and Investments         | \$ 196,899  | \$ 185,076 |

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|  |    |         |    |         |
|--|----|---------|----|---------|
| Cash and Cash Equivalents                    | \$ | 48,010  | \$ | 46,717  |
| Short-term Available-for-Sale Investments    |    | 129,709 |    | 102,064 |
| Short-term Trading Investments               |    | -       |    | 16,850  |
| Long-term Available-for-Sale Investments     |    | 19,180  |    | 19,445  |
| Total Cash, Cash Equivalents and Investments | \$ | 196,899 | \$ | 185,076 |

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## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The contractual maturities of the Company's investments classified as available-for-sale or trading securities as of December 31, 2010 and 2009 is as follows (in thousands):

|                      | 2010       | 2009       |
|----------------------|------------|------------|
| Less than 1 year     | \$ 100,637 | \$ 73,566  |
| 1 - 5 years          | 29,072     | 20,053     |
| Greater than 5 years | 19,180     | 44,740     |
|                      | \$ 148,889 | \$ 138,359 |

The Company follows the provisions of ASC 820-10 Fair Value Measurements and Disclosures – Overall, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles in the United States of America, and requires that assets and liabilities carried at fair value be classified and disclosed in one of the three categories noted in the table below. The Company also adopted the provisions of ASC 820-10-35-51 Fair Value Measurement and Disclosure – Overall – Subsequent Measurement – Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, effective April 1, 2009, which provides additional guidance for estimating fair value in accordance with ASC 820-10 Fair Value Measurements and Disclosures – Overall, when the volume and level of activity for the asset or liability have significantly decreased. Effective January 1, 2010, the Company adopted the provisions of ASU 2010-06, “Disclosures About Fair Value Measurements”, which adds new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements.

The following tables detail the fair value measurements as of December 31, 2010 and 2009 within the fair value hierarchy of the financial assets that are required to be recorded at fair value (in thousands):

|   | Fair Value Measurements at December 31, 2010 Using |   |   |  |
|---|--|---|---|--|
|   | Total  | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>Level 1 | Significant<br>Other<br>Observable<br>Inputs<br>Level 2 | Significant<br>Unobservable<br>Inputs<br>Level 3 |
| US Treasury and US Government Agency<br>Bonds           | \$ 117,302   | \$ 117,302  | \$-   | \$-  |
| Commercial Paper / Corporates                           | 12,407   | -   | 12,407  | -  |
| Long-term available-for-sale auction-rate<br>securities | 19,180   | -   | -   | 19,180   |
|   | \$ 148,889   | \$ 117,302  | \$ 12,407   | \$ 19,180  |

|  | Fair Value Measurements at December 31, 2009 Using     |  |                                       |
|--|--|--|---------------------------------------|
|  | Quoted Prices<br>in Active<br>Markets for<br>Identical | Significant<br>Other<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs |



|   | Total      | Assets<br>Level 1 | Level 2 | Level 3   |
|---|------------|-------------------|---------|-----------|
| US Treasury and US Government Agency<br>Bonds           | \$ 104,064 | \$ 104,064        | \$-     | \$-       |
| Long-term available-for-sale auction-rate<br>securities | 19,445     | -                 | -       | 19,445    |
| Short-term trading auction-rate securities              | 16,125     | -                 | -       | 16,125    |
| Put right   | 725        | -                 | -       | 725       |
|   | \$ 140,359 | \$ 104,064        | \$-     | \$ 36,295 |

At December 31, 2010, fixed income available-for-sales securities included \$117.3 million in US government agencies and treasuries and \$12.4 million in corporate notes and commercial paper, all of which are classified as short-term investments. From these investments, there was \$18,000 in unrealized losses. The impact of gross unrealized gains and losses was not material. At December 31, 2010, the Company also had \$20.2 million in face value of auction-rate securities, all of which are classified as long-term available-for-sale investments and \$15.6 million in money market funds.

At December 31, 2009, fixed income available-for-sale securities include securities issued by government agencies and treasuries, \$102.1 million of which are classified as short-term investments and \$2.0 million which are classified as cash equivalents on the Consolidated Balance Sheet. At December 31, 2009, the Company had \$18.0 million invested in money market funds. At December 31, 2009, there was \$0.1 million in unrealized losses from these investments. The impact of gross unrealized gains and losses was not material.

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

The following table provides a reconciliation of the beginning and ending balances for the assets measured at fair value using significant unobservable inputs (Level 3) (in thousands):

|  | Auction-Rate<br>Securities | Put Right | Total     |
|--|----------------------------|-----------|-----------|
| Beginning balances as of January 1, 2009                   | \$ 36,175                  | \$ 1,250  | \$ 37,425 |
| Sales and Settlement                                       | (1,400 )                   | -         | (1,400 )  |
| Unrealized Gain  | 270                        | -         | 270       |
| Gain (loss) from UBS auction rate securities and put right | 525                        | (525 )    | -         |
| Ending balances at December 31, 2009                       | \$ 35,570                  | \$ 725    | \$ 36,295 |
| Sales and Settlement                                       | (17,275 )                  | -         | (17,275 ) |
| Unrealized Gain  | 160                        | -         | 160       |
| Gain (loss) from UBS auction rate securities and put right | 725                        | (725 )    | -         |
| Ending balances at December 31, 2010                       | \$ 19,180                  | \$ -      | \$ 19,180 |

During the year ended December 31, 2010, the Company sold \$17.3 million in auction rate securities at par. Of this amount, \$16.9 million was classified as short-term investments and the remaining \$0.4 million was classified as long-term investments.

In October 2008, the Company accepted an offer to participate in an auction-rate security rights offering from UBS to sell up to \$18.2 million in face value of eligible auction-rate securities commencing in June 2010. Between October 2008 and June 2010, \$9.6 million of these auction-rate securities were called at par. On June 30, 2010, the Company exercised the UBS put right and sold the remaining \$8.6 million in auction rate securities at par, for which the sale was completed and proceeds were received on July 1, 2010. At December 31, 2009, the Company had \$16.9 million in eligible auction-rate securities remaining at UBS. The impairment related to these auction-rate securities and the corresponding put right were valued at \$0.7 million. The change in the impairment and the fair value of the put right was recorded in accordance with the provisions of ASC 320-10-35 and ASC 320-10-50 in other income (expense) in the Consolidated Statement of Operations.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company's Level 3 assets consist of government-backed student loan auction-rate securities, with interest rates that reset through a Dutch auction every 7 to 35 days and which became illiquid in 2008. At December 31, 2010, the Company's investment portfolio included \$19.2 million, net of impairment charges of \$1.0 million, in government-backed student loan auction-rate securities. The underlying maturity of these auction-rate securities is up to 37 years. Although it is unclear as to when these investments will regain their liquidity, management has concluded that as of December 31, 2010 and 2009, the cumulative impairment of \$1.0 million and \$1.1 million, respectively, was temporary based on the following analysis:

- The decline in the fair value of these securities is not largely attributable to adverse conditions specifically related to these securities or to specific conditions in an industry or in a geographic area;
- Management possesses both the intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value;
  - Management believes that it is more likely than not that the Company will not have to sell these securities before recovery of its cost basis;
- Except for the credit loss of \$70,000 recognized during the year ended December 31, 2009 for the Company's holdings in auction rate securities described below, the Company does not believe that there is any additional credit loss associated with other auction-rate securities because the Company expects to recover the entire amortized cost basis;
- The majority of the securities remain AAA rated, with \$8.6 million of the auction rate securities having been downgraded by Moody's to A3-Baa3, during the year ended December 31, 2009 and there have been no downgrades during the year ended December 31, 2010; and
  - All scheduled interest payments have been made pursuant to the reset terms and conditions.

Based on the guidance of ASC 320-10-35 and ASC 320-10-50, the Company evaluated the potential credit loss of each of the auction-rate securities that are currently held by the Company. Based on such analysis, the Company determined that those securities that are not 100% FFELPS guaranteed are potentially subject to credit risks based on the extent to which the underlying debt is collateralized and the security-specific student-loan default rates. The Company's portfolio includes three such securities, one of which has a senior parity ratio of approximately 126%, which is substantially above the expected student-loan default rate for that security. Conversely, the senior parity ratio for the other two securities is approximately 105%. If, therefore, the student-loan default rate and borrowing rate for these issuers increases, the remaining balance in these trusts may not be sufficient to cover the senior debt. The Company therefore concluded that there is potential credit risk for these two securities and as such, used the discounted cash flow model to determine the amount of credit loss to be recorded. In valuing the potential credit loss, the following parameters were used: 20 year expected term, cash flows based on the 90-day t-bill rates for 20 year forwards and a risk premium of 5.9%, the amount of interest that the Company was receiving on these securities when the market was last active. As of December 31, 2010 and 2009, the potential credit loss associated with these securities was \$70,000, which the Company deemed other-than-temporary and recorded in other expense in its Consolidated Statement of Operations during 2009.

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

The valuation of the auction-rate securities is subject to fluctuations in the future, which will depend on many factors, including the collateral quality, potential to be called or restructured, underlying final maturity, insurance guaranty, liquidity and market conditions, among others. To determine the fair value of the auction-rate securities at December 31, 2009, March 31, 2010, June 30, 2010, September 30, 2010 and December 31, 2010, the Company used a discounted cash flow model, for which there are three valuation parameters, including time-to-liquidity, discount rate and expected return. The following are the values used in the discounted cash flow model:

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

|  | December 31,<br>2009  | March 31,<br>2010  | June 30, 2010  | September<br>30, 2010  | December 31,<br>2010   |
|--|---|--|--|--|--|
| Time-to-Liquidity  | 24 months   | 24 months  | 24 months  | 24 months  | 24 months  |
| Expected Return (Based on the 2-year treasury rate, plus a contractual penalty rate)     | 2.4%  | 2.4%   | 2.7%   | 2.2%   | 2.9%   |
| Discount Rate (Based on the 2-year LIBOR, the cost of debt and a liquidity risk premium) | 5.2% - 10.0%,<br>depending on<br>the credit-rating<br>of the security | 4.6% - 9.4%,<br>depending on<br>the credit-rating<br>of the security | 3.8% - 8.6%,<br>depending on<br>the credit-rating<br>of the security | 3.2% - 8.0%,<br>depending on<br>the credit-rating<br>of the security | 4.1% - 8.9%,<br>depending on<br>the credit-rating<br>of the security |

The gross accumulated impairment charge was \$1.0 million as of December 31, 2010, of which \$0.9 million was recorded as temporary and \$0.1 million was previously recorded as other-than-temporary. The gross accumulated impairment charge was \$1.8 million as of December 31, 2009, of which \$1.1 million was recorded as temporary and the remaining \$0.7 million was recorded as other-than-temporary.

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

### 3. Inventories

Inventories consist of the following (in thousands):

|                   | December 31,<br>2010 | December 31,<br>2009 |
|-------------------|----------------------|----------------------|
| Work in progress  | \$ 11,559            | \$ 11,082            |
| Finished goods    | 14,230               | 8,534                |
| Total inventories | \$ 25,789            | \$ 19,616            |

### 4. Property and Equipment, net

Property and equipment consist of the following (in thousands):

|                                   | December 31,<br>2010 | 2009     |
|-----------------------------------|----------------------|----------|
| Computers, software and equipment | \$48,123             | \$33,716 |
| Leasehold improvements            | 2,302                | 4,894    |
| Vehicles                          | 944                  | 657      |
| Building                          | 15,074               | 459      |
| Furniture and fixtures            | 735                  | 355      |
| Total                             | 67,178               | 40,081   |

|  |           |           |
|--|-----------|-----------|
| Less accumulated depreciation and amortization | (29,916 ) | (22,113 ) |
| Property and equipment, net                    | \$37,262  | \$17,968  |

Depreciation expense for the years ended December 31, 2010, 2009 and 2008 was \$7.9 million, \$6.6 million and \$5.7 million, respectively.

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## 5. Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

|   | December 31,<br>2010 | December 31,<br>2009 |
|---|----------------------|----------------------|
| Deferred revenue and customer prepayments | \$3,200              | \$2,109              |
| Legal expenses and settlement costs       | 844                  | 2,940                |
| Stock rotation reserve                    | 811                  | 864                  |
| Warranty                                  | 764                  | 294                  |
| Chengdu building construction cost        | 3,633                | -                    |
| Other                                     | 1,947                | 1,474                |
| <b>Total accrued liabilities</b>          | <b>\$11,199</b>      | <b>\$7,681</b>       |

## 6. Stockholders' Equity

The Company has two stock option plans and an employee stock purchase plan—the 1998 Stock Option Plan, the 2004 Equity Incentive Plan and the 2004 Employee Stock Purchase Plan. The Company recognized stock-based compensation expenses for the years ended December 31, 2010, 2009 and 2008, as follows (in thousands):

|                  | Year ended December 31, |                 |                 |
|------------------|-------------------------|-----------------|-----------------|
|                  | 2010                    | 2009            | 2008            |
| Non-Employee     | \$(7                    | ) \$118         | \$42            |
| ESPP             | 609                     | 671             | 676             |
| Restricted Stock | 8,271                   | 3,353           | 3,054           |
| Stock Options    | 7,937                   | 10,469          | 9,386           |
| <b>TOTAL</b>     | <b>\$16,810</b>         | <b>\$14,611</b> | <b>\$13,158</b> |

## 1998 Stock Option Plan

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

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## 2004 Equity Incentive Plan

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

|  |              |
|--|--------------|
| Available for Grant as of December 31, 2009  | 2,023,943    |
| 2010 Additions to Plan                       | 1,758,265    |
| 2010 Grants                                  | (1,304,740 ) |
| 2010 Cancellations                           | 477,139      |
| Available for Grants as of December 31, 2010 | 2,954,607    |

A summary of the status of the Company's stock option plans at December 31, 2010, 2009 and 2008 and changes therein are presented in the table below:

|  | Stock Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (Years) | Aggregate<br>Intrinsic<br>Value |
|--|---------------|--|---|---------------------------------|
| Outstanding at December 31, 2007<br>(3,722,936 options exercisable at a<br>weighted-average exercise price of<br>\$6.94 per share) | 7,442,806     | \$ 10.50                                 | 6.64  | \$ 81,762,963                   |
| Options granted (weighted-average<br>fair value of \$6.08 per share)   | 2,566,290     | \$ 17.10                                 |   |                                 |
| Options exercised  | (1,417,585 )  | \$ 8.97                                  |   |                                 |
| Options forfeited and expired  | (394,874 )    | \$ 14.72                                 |   |                                 |
| Outstanding at December 31, 2008<br>(3,766,630 options exercisable at a<br>weighted-average exercise price of<br>\$8.26 per share) | 8,196,637     | \$ 12.62                                 | 5.91  | \$ 20,193,958                   |
| Options granted (weighted-average<br>fair value of \$8.42 per share)   | 706,000       | \$ 17.52                                 |   |                                 |
| Options exercised  | (1,217,272 )  | \$ 9.19                                  |   |                                 |
| Options forfeited and expired  | (274,451 )    | \$ 17.27                                 |   |                                 |
| Outstanding at December 31, 2009<br>(4,112,763 options exercisable at a  | 7,410,914     | \$ 13.48                                 | 5.04  | \$ 77,918,848                   |



|   |              |    |       |      |    |            |
|---|--------------|----|-------|------|----|------------|
| weighted-average exercise price of<br>\$10.93 per share)                          |              |    |       |      |    |            |
| Options granted (weighted-average<br>fair value of \$8.95 per share)              | 370,500      | \$ | 19.92 |      |    |            |
| Options exercised   | (1,452,245 ) | \$ | 9.87  |      |    |            |
| Options forfeited and expired   | (494,051 )   | \$ | 15.67 |      |    |            |
| Outstanding at December 31, 2010  | 5,835,118    | \$ | 14.61 | 4.30 | \$ | 19,035,591 |
| Options exercisable at December 31,<br>2010 and expected to become<br>exercisable | 5,584,241    | \$ | 14.46 | 4.27 | \$ | 18,802,775 |
| Options vested and exercisable at<br>December 31, 2010                            | 4,264,268    | \$ | 13.33 | 4.02 | \$ | 17,725,853 |

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following summarizes information as of December 31, 2010 concerning outstanding and exercisable options:

| Range of Exercises Prices | Options Outstanding                            |   |                                 | Options Exercisable                            |                                 |
|---------------------------|--|---|---------------------------------|--|---------------------------------|
|                           | Number of Options Outstanding as if 12/31/2010 | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number of Options Exercisable as of 12/31/2010 | Weighted Average Exercise Price |
| \$0.08 - \$5.00           | 689,212  | 2.90  | \$ 3.63                         | 689,212  | \$ 3.63                         |
| \$7.50 - \$10.37          | 591,598  | 4.08  | \$ 8.73                         | 576,098  | \$ 8.69                         |
| \$10.58 - \$12.99         | 609,745  | 3.79  | \$ 12.20                        | 590,780  | \$ 12.22                        |
| \$13.01 - \$15.08         | 668,229  | 4.78  | \$ 13.62                        | 426,485  | \$ 13.79                        |
| \$15.18 - \$15.64         | 364,288  | 4.15  | \$ 15.60                        | 250,300  | \$ 15.62                        |
| \$15.74 - \$15.74         | 610,000  | 4.82  | \$ 15.74                        | 330,415  | \$ 15.74                        |
| \$16.00 - \$17.93         | 597,906  | 4.34  | \$ 16.53                        | 457,334  | \$ 16.47                        |
| \$17.98 - \$19.91         | 602,265  | 4.40  | \$ 18.76                        | 435,576  | \$ 18.61                        |
| \$20.06 - \$22.26         | 617,375  | 5.08  | \$ 21.12                        | 242,253  | \$ 21.39                        |
| \$22.47 - \$25.84         | 484,500  | 4.83  | \$ 23.76                        | 265,815  | \$ 23.79                        |
|                           | 5,835,118                                      |   |                                 | 4,264,268                                      |                                 |

The total fair value of options that vested was \$7.9 million, \$10.5 million and \$9.4 million, respectively, for the years ended December 31, 2010, 2009 and 2008. Total intrinsic value of options exercised was \$17.4 million, \$15.0 million and \$20.5 million, respectively, for the years ended December 31, 2010, 2009 and 2008. Net cash proceeds from the exercise of stock options were \$14.3 million for the year ended December 31, 2010 and \$11.2 million for the year ended December 31, 2009. At December 31, 2010, unamortized compensation expense related to unvested options was approximately \$9.6 million. The weighted average period over which compensation expense related to these unvested options will be recognized is approximately 1.8 years.

The employee stock-based compensation expense recognized under ASC 718-10-30 Compensation – Stock Compensation – Overall – Initial Measurement, was determined using the Black-Scholes option pricing model. Option pricing models require the input of subjective assumptions and these assumptions can vary over time. The Company used the following weighted-average assumptions to determine the fair value of the awards granted during the respective periods:

Year ended December 31,

|                         | 2010 |   | 2009 |   | 2008 |   |
|-------------------------|------|---|------|---|------|---|
| Expected term (years)   | 4.1  |   | 4.1  |   | 4.1  |   |
| Expected volatility     | 55.9 | % | 60.7 | % | 40.1 | % |
| Risk-free interest rate | 1.8  | % | 1.8  | % | 2.6  | % |
| Dividend yield          | -    |   | -    |   | -    |   |

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

#### Restricted Stock

A portion of the Company's shares of common stock were issued under restricted stock purchase agreements. Under these agreements, in the event of a termination of an employee, the Company has the right to repurchase the common stock at the original issuance price of \$0.001. The repurchase right expires over a 4-year period. A summary of our restricted stock awards is presented in the table below:

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

|                                  | Restricted<br>Stock Awards | Weighted<br>Average<br>Grant Date<br>Fair Value<br>Per Share | Weighted<br>Average<br>Remaining<br>Recognition<br>Period (Years) |
|----------------------------------|----------------------------|--|---|
| Outstanding at December 31, 2007 | 175,539                    | \$10.86  | 1.31  |
| Awards released                  | (88,576 )                  | 10.53  |   |
| Awards forfeited                 | (16,586 )                  | 9.62   |   |
| Outstanding at December 31, 2008 | 70,377                     | \$11.55  | 0.48  |
| Awards released                  | (57,577 )                  | 11.29  |   |
| Awards forfeited                 | (6,250 )                   | 8.64   |   |
| Outstanding at December 31, 2009 | 6,550                      | \$16.62  | 0.14  |
| Awards released                  | (6,550 )                   | 16.62  |   |
| Outstanding at December 31, 2010 | -                          | \$-  | -   |

The Company also grants restricted stock units, which vest generally over two to four years as determined by the Company's Compensation Committee, and are issued upon vesting. A summary of the restricted stock units is presented in the table below:

|                                  | Restricted<br>Stock<br>Units | Weighted<br>Average<br>Grant Date<br>Fair Value<br>Per Share | Weighted<br>Average<br>Remaining<br>Recognition<br>Period (Years) |
|----------------------------------|------------------------------|--|---|
| Outstanding at December 31, 2007 | 182,500                      | \$ 15.37   | 1.91  |
| Awards granted                   | 311,627                      | 18.48  |   |
| Awards released                  | (96,125 )                    | 15.39  |   |
| Awards forfeited                 | (8,359 )                     | 15.98  |   |
| Outstanding at December 31, 2008 | 389,643                      | \$ 18.11   | 2.72  |
| Awards granted                   | 54,200                       | 20.93  |   |
| Awards released                  | (146,447 )                   | 18.11  |   |
| Awards forfeited                 | (7,500 )                     | 16.66  |   |
| Outstanding at December 31, 2009 | 289,896                      | \$ 18.67   | 2.22  |
| Awards granted                   | 934,240                      | 20.05  |   |
| Awards released                  | (230,874 )                   | 19.24  |   |
| Awards forfeited                 | (33,088 )                    | 18.38  |   |
| Outstanding at December 31, 2010 | 960,174                      | \$ 19.88   | 2.91  |

The total fair value of restricted stock awards and units that vested was \$5.5 million, \$2.7 million and \$3.0 million for the years ended December 31, 2010, 2009 and 2008, respectively. The intrinsic value related to restricted stock awards and units released for the years ended 2010, 2009 and 2008 was \$4.5 million, \$3.8 million and \$3.4 million, respectively. The total intrinsic value of restricted units outstanding at December 31, 2010, 2009 and 2008 were \$15.9 million, \$7.1 million and \$5.8 million, respectively. At December 31, 2010, unamortized compensation expense related to unvested restricted stock units was approximately \$11.5 million with a weighted average remaining

recognition period of 2.9 years.

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

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 2004 Employee Stock Purchase Plan

Under the 2004 Employee Stock Purchase Plan (the Purchase Plan), eligible employees may purchase common stock through payroll deductions. Participants may not purchase more than 2,000 shares in a six-month offering period or stock having a value greater than \$25,000 in any calendar year as measured at the beginning of the offering period in accordance with the Internal Revenue Code and applicable Treasury Regulations. A total of 200,000 shares of common stock were reserved for issuance under the Purchase Plan. The Purchase Plan provides for an automatic annual increase beginning on January 1, 2005 by an amount equal to the least of 1,000,000 shares; 2% of the outstanding shares of common stock on the first day of the year; or a number of shares as determined by the Board of Directors. For the years ended December 31, 2010, 2009 and 2008, 114,387 shares, 161,026 shares and 125,207 shares, respectively, were issued under the Purchase Plan. The following is a summary of the Purchase Plan and changes during the year ended December 31, 2010:

|  |            |
|--|------------|
| Available Shares as of December 31, 2009 | 2,553,012  |
| 2010 Additions to Plan                   | 703,306    |
| 2010 Purchases                           | (114,387 ) |
| Available Shares as of December 31, 2010 | 3,141,931  |

The Purchase Plan is considered compensatory under ASC 718-50-25-2 Compensation – Stock Compensation – Employee Share Purchase Plans – Recognition, and is accounted for in accordance with ASC 718-50-30-2 Compensation – Stock Compensation – Employee Share Purchase Plans – Initial Measurements – Look-Back Plans. The intrinsic value for stock purchased was \$0.3 million, \$1.0 million and \$0.8 million for the years ended December 31, 2010, 2009 and 2008, respectively. The unamortized expense as of December 31, 2010 was \$0.1 million, which will be recognized over 0.1 years. The Black-Scholes option pricing model was used to value the employee stock purchase rights. For the years ended December 31, 2010, 2009 and 2008, the following assumptions were used in the valuation of the stock purchase rights:

|                         | Year ended December 31, |        |        |
|-------------------------|-------------------------|--------|--------|
|                         | 2010                    | 2009   | 2008   |
| Expected term (years)   | 0.5                     | 0.5    | 0.5    |
| Expected volatility     | 39.5                    | % 79.8 | % 48.3 |
| Risk-free interest rate | 0.2                     | % 0.4  | % 2.0  |
| Dividend yield          | -                       | -      | -      |

Cash proceeds from employee stock purchases for the year ended December 31, 2010, 2009 and 2008 was \$1.9 million, \$1.8 million and \$1.8 million, respectively.

## 7. Net Income Per Share

Basic net income per share excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock, and calculated using the treasury stock method. For the years ended December 31, 2010, 2009 and 2008, the Company had securities outstanding, which could potentially dilute basic net income per share in the future, but were

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excluded from the computation of diluted net loss per share in the periods presented, as their effect would have been anti-dilutive. The following table shows the number of shares of common stock issuable upon conversion or exercise of such outstanding securities:

|               | Year ended December 31, |           |           |
|---------------|-------------------------|-----------|-----------|
|               | 2010                    | 2009      | 2008      |
| Stock Options | 1,952,379               | 2,897,202 | 3,241,066 |

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 8. Income Taxes

The components of income before income taxes for the years ended December 31, 2010, 2009 and 2008 are (in thousands):

|               | 2010     | 2009     | 2008     |
|---------------|----------|----------|----------|
| United States | \$2,770  | \$6,303  | \$5,540  |
| International | 28,650   | 13,845   | 19,902   |
| Consolidated  | \$31,420 | \$20,148 | \$25,442 |

Federal income taxes have not been provided for the unremitted earnings of foreign subsidiaries totaling \$76.0 million because such earnings are intended to be permanently reinvested.

The income tax provision consists of the following (in thousands):

|                      | Year ended December 31, |       |         |
|----------------------|-------------------------|-------|---------|
|                      | 2010                    | 2009  | 2008    |
| <b>Current:</b>      |                         |       |         |
| Federal              | \$1,369                 | \$344 | \$(643) |
| State                | 15                      | 70    | 67      |
| Foreign              | 534                     | 147   | 1,082   |
| <b>Deferred:</b>     |                         |       |         |
| Federal              | (1,415)                 | 315   | (1,245) |
| State                | (848)                   | (688) | (490)   |
| Foreign              | (61)                    | (85)  | (47)    |
| Valuation allowance  | 2,263                   | 371   | 2,492   |
| Income tax provision | \$1,857                 | \$474 | \$1,216 |

The effective tax rate differs from the applicable U.S. statutory federal income tax rate as follows:

|   | December 31, |   |        |   |        |   |
|---|--------------|---|--------|---|--------|---|
|   | 2010         |   | 2009   |   | 2008   |   |
| U.S. statutory federal tax rate                             | 34.0         | % | 34.0   | % | 34.0   | % |
| State taxes, net of federal benefit                         | 0.0          |   | 0.1    |   | 0.6    |   |
| Research and development credits                            | (2.9)        | ) | (0.9)  | ) | (2.7)  | ) |
| Stock compensation  | 5.6          |   | 8.6    |   | 6.3    |   |
| Foreign income taxed at lower rates                         | (35.6)       | ) | (33.3) | ) | (35.7) | ) |
| Subpart F / Inventory transfer                              | -            |   | -      |   | 0.3    |   |
| Decrease of prior year FIN 48 liabilities                   | -            |   | -      |   | (4.4)  | ) |
| Change in valuation allowance on federal timing differences | 4.3          |   | (6.0)  | ) | 5.2    |   |
| Litigation reserves & Other                                 | 0.5          |   | (0.1)  | ) | 1.2    |   |
| Effective tax rate  | 5.9          | % | 2.4    | % | 4.8    | % |





## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The components of deferred tax assets and liabilities consist of the following (in thousands):

|                                      | December 31, |          |
|--------------------------------------|--------------|----------|
|                                      | 2010         | 2009     |
| Deferred tax assets:                 |              |          |
| Research tax credits                 | \$6,772      | \$5,982  |
| Stock compensation                   | 7,223        | 6,249    |
| Other costs not currently deductible | 2,290        | 1,592    |
| Depreciation and amortization        | 769          | 969      |
| Total deferred tax assets            | 17,054       | 14,792   |
| Valuation allowance                  | (16,815)     | (14,614) |
| Net deferred tax assets              | \$239        | \$178    |

As a result of the cost sharing arrangements with the company's international subsidiaries (cost share arrangements), relatively small changes in costs that are not subject to sharing under the cost share arrangements can significantly impact the overall profitability of the US entity. Historically, the US operations have shown an inconsistent earnings pattern due to litigation costs not subject to cost sharing. The Company evaluated its US valuation allowance at December 31, 2010 by reviewing both its earnings history and its expected earnings for the next 12 months in its US entity. Because of the US entity's inconsistent earnings history and uncertainty of future earnings, the Company has determined that it is more likely than not that the US deferred tax benefits would not be realized.

As of December 31, 2010, the federal and state net operating loss carryforwards for income tax purposes were approximately \$6.9 million and \$28.4 million, respectively. The federal net operating loss carryforwards will begin to expire in 2027 and the State net operating loss carry forwards will expire beginning in 2021. \$6.9 million of the federal net operating loss carry forwards and \$24.7 million of the state operating loss carry forwards are related to excess tax benefits as a result of stock option exercises and therefore will be recorded in additional paid-in-capital in the period that they become realized.

As of December 31, 2010, the Company had research tax credit carryforwards of \$9.5 million for federal income tax purposes, which will begin to expire in 2022 and \$7.8 million for state income tax purposes, which can be carried forward indefinitely. \$2.9 million of the federal research tax credit and \$0.8 million of the state research tax credit carryovers are related to excess tax benefits as a result of stock option exercises and therefore will be recorded in additional-paid-in-capital in the period that they become realized.

ASC 740-10 Income Taxes - Overall sets forth the accounting for uncertainty in income taxes recognized in an entity's financial statements and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under ASC 740-10, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, ASC 740-10 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.



## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

At December 31, 2010, the Company had \$9.1 million of unrecognized tax benefits, \$5.0 million of which would affect its effective tax rate if recognized after considering the valuation allowance. At December 31, 2009, the Company had \$9.0 million of unrecognized tax benefits, \$4.9 million of which would affect its effective tax rate if recognized after considering the valuation allowance.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits is as follows (in thousands):

|  |         |
|--|---------|
| Balance at January 1, 2008                       | \$7,910 |
| Gross increases for tax positions of prior year  | 96      |
| Gross increases for tax position of current year | 1,794   |
| Reductions for prior year tax positions          | (1,245) |
| Reduction due to statutes expiring               | (2)     |
| Balance at December 31, 2008                     | 8,553   |
| Gross increases for tax positions of prior year  | -       |
| Gross increases for tax position of current year | 1,080   |
| Reductions for prior year tax positions          | -       |
| Settlement                                       | (615)   |
| Reduction due to statutes expiring               | (12)    |
| Balance at December 31, 2009                     | 9,006   |
| Gross increases for tax positions of prior year  | -       |
| Gross increases for tax position of current year | 983     |
| Reductions for prior year tax positions          | -       |
| Settlement                                       | (883)   |
| Reduction due to statutes expiring               | -       |
| Balance at December 31, 2010                     | \$9,106 |

The Company recognizes interest and penalties, if any, related to uncertain tax positions in its income tax provision. At December 31, 2008, 2009 and 2010, the Company has approximately \$0.4 million, \$0.5 million and \$0.6 million respectively, of accrued interest related to uncertain tax positions.

Uncertain tax positions relate to the allocation of income and deductions among the Company's global entities and to the determination of the research and experimental tax credit. The Company estimates that there will be no material changes in its uncertain tax positions in the next 12 months.

The Company files income tax returns in the U.S. federal jurisdiction, and various U.S. states and foreign jurisdictions. Generally, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years prior to 2005 because of the statute of limitations. However, because the Company is currently under an IRS audit for tax years ended December 31, 2006 and December 31, 2007, the statute of limitations for tax year ended December 31, 2005 was extended to September 12, 2011.

Our U.S. Federal income tax returns for the years ended December 31, 2006 and December 31, 2007 are under examination by the Internal Revenue Service ("IRS"). The IRS is also auditing the research and development credits generated in the years 2000 through 2007, which will be carried forward to future tax years. We received a Notice of Proposed Adjustments ("NOPA") from the IRS in February 2011 to decrease the amount of research and development

credits generated in years 2000 through 2007, which we are currently reviewing.

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 9. Commitments and Contingencies

The following table summarizes the Company's commitments as of December 31, 2010 (in thousands):

|                                  | Total     | Payments by Period |        |        |      |      |            |
|----------------------------------|-----------|--------------------|--------|--------|------|------|------------|
|                                  |           | 2011               | 2012   | 2013   | 2014 | 2015 | Thereafter |
| Operating leases                 | \$ 2,413  | \$ 1,665           | \$ 574 | \$ 174 | \$ - | \$ - | \$ -       |
| Outstanding purchase commitments | \$ 14,379 | \$ 14,379          | \$ -   | \$ -   | \$ - | \$ - | \$ -       |
|                                  | \$ 16,792 | \$ 16,044          | \$ 574 | \$ 174 | \$ - | \$ - | \$ -       |

## Lease Obligations

The Company leases its headquarters and sales offices in San Jose, California. The San Jose facility was sold and the new landlord has exercised their right to terminate the lease, effective April 18, 2012. In addition, the Company entered into a five-year lease arrangement in September 2004 for its manufacturing facility located in Chengdu, China. Pursuant to this agreement, the Company contributed capital in the form of cash, in-kind assets, and/or intellectual property, of at least \$5.0 million to its wholly-owned Chinese subsidiary as the registered capital for the subsidiary and exercised the option to purchase land use rights for the facility of approximately \$0.2 million. The Company also has the option to acquire the facility after a five-year lease term for the original construction cost less rents paid, which is currently estimated at \$1.9 million and which becomes exercisable in March 2011. The Company will likely enter into a purchase agreement for this facility at a date to be determined and as the opportunity necessitates. The Company also leases its sales offices in Japan, China, Taiwan and Korea. Certain of the Company's facility leases provide for periodic rent increases. Rent expense for the years ended December 31, 2010, 2009 and 2008 was \$1.8 million, \$1.3 million and \$1.1 million, respectively.

## Warranty and Indemnification Provisions

The Company provides a standard one-year warranty against defects in materials and workmanship and will either repair the goods, provide replacements at no charge to the customer, or refund amounts for defective units. On occasion the Company permits the return of defective products outside the normal warranty period. In such cases, the Company accrues for the related costs at the time the decision to permit the return is made. Reserve requirements are recorded in the period of sale and are based on an assessment of the products sold with warranty and historical warranty costs incurred.

The changes in warranty reserves during 2010, 2009 and 2008 are as follows (in thousands):

|   | 2010   | 2009   | 2008     |
|---|--------|--------|----------|
| Balance at beginning of year                      | \$ 294 | \$ 764 | \$ 1,025 |
| Warranty costs                                    | (107 ) | (137 ) | (109 )   |
| Reserve adjustments and unused warranty provision | (224 ) | (728 ) | (724 )   |
| Warranty provision for product sales              | 801    | 395    | 572      |
| Balance at end of year                            | \$ 764 | \$ 294 | \$ 764   |

The Company provides indemnification agreements to a supplier and certain direct or indirect customers. The Company agrees to reimburse these parties for any damages, costs and expenses incurred by them as a result of legal actions taken against them by third parties for infringing upon their intellectual property rights as a result of using the Company's products and technologies. These indemnification provisions are varied in their scope and are subject to certain terms, conditions, limitations and exclusions. Such costs were \$1.0 million for the year ended December 31, 2009. There were no indemnification costs in 2008 and 2010. These costs are charged to operations as incurred. The Company also provides for indemnification of its directors and officers.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

10. Litigation -

O2Micro

The Company has been engaged in a number of legal proceedings involving patent infringement claims with O2Micro, Inc. and its parent corporation, O2Micro International Limited (referred to hereinafter as “O2Micro”). There are two proceedings, both involving O2Micro’s U.S. Patent No. 7,417,382 (‘382 patent). On June 18, 2010, the U.S. International Trade Commission (“ITC”) issued a final determination finding of no violation of Section 337 by the Company or its customers in an action brought by O2Micro International, Ltd. in 2008. An ITC administrative law judge had previously issued an initial determination on April 20, 2010 that also found no violation. The ITC's final determination concludes that none of the Company’s accused products infringes O2Micro's U.S. Patent No. 7,417,382 (the '382 patent).

In addition to the matter before the ITC, a related case is pending before the Northern District of California Court in Oakland, California. Subsequent to the ITC’s final determination finding of no violation, O2Micro filed a motion to dismiss its claims for infringement of the '382 patent, with prejudice, and covenanted not to sue the Company or any of its distributors or customers for infringement of the '382 patent. On June 23, 2010, the court granted this motion and vacated the jury trial that was scheduled on July 12, 2010. The Company filed a motion seeking recovery of costs and attorney fees from O2Micro. On March 3, 2011, the court issued an order granting the Company’s motion in part. It ordered O2Micro to pay \$339,315 in costs forthwith and ordered the parties to meet and confer to try to reach an agreement as to the reasonable attorneys fees to be paid. If the parties are unable to reach an agreement, the Company is to submit detailed documentation to the court in support of its fees request.

Linear Technology Corporation

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

11. Employee Benefits Plan

The Company sponsors a 401(k) savings and profit-sharing plan (“the Plan”) for all employees in the United States who meet certain eligibility requirements. Participants may contribute up to the amount allowable as a deduction for federal income tax purposes. The Company is not required to contribute and did not contribute to the Plan for the years ended December 31, 2010, 2009 and 2008.

12. Major Customers

The following table summarizes the percentages of accounts receivable, net and corresponding revenue for those customers, with accounts receivable balances at year end that accounted for 10% or more of total accounts receivable, net at the end of 2010 and 2009 or with sales that accounted for 10% or more of the Company’s revenue for each respective year:



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| Customers | Revenue                 |      |                         |      |                         |      | Accounts Receivable, Net |      |                    |  |
|-----------|-------------------------|------|-------------------------|------|-------------------------|------|--------------------------|------|--------------------|--|
|           | Year ended December 31, |      | Year ended December 31, |      | Year ended December 31, |      | as of December 31,       |      | as of December 31, |  |
|           | 2010                    | 2009 | 2010                    | 2009 | 2008                    | 2010 | 2009                     | 2010 | 2009               |  |
| A         | 14                      | % 13 | % 20                    | % 12 | % *                     | % *  | % *                      | % *  | % *                |  |
| B         | *                       | 10   | % 10                    | % *  | % *                     | % *  | % *                      | % *  | % *                |  |
| C         | *                       | 10   | % *                     | % *  | % *                     | % *  | % *                      | % *  | % *                |  |
| D         | *                       | *    | *                       | *    | *                       | 20   | % 15                     | %    | %                  |  |

\* Represents less than 10% of accounts receivable, net or revenue

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 13. Segment Information

As defined by the requirements of ASC 280-10-55, Segment Reporting – Overall – Implementation Guidance and Illustrations, the Company operates in one reportable segment, the design, development, marketing and sale of high-performance, mixed-signal analog semiconductors for the computing, consumer electronics and communications markets. The Company's chief operating decision maker is its chief executive officer. The Company does not specifically allocate any of its resources to or measure the performance of, individual product families.

The Company derived a substantial majority of its revenue from sales to customers located outside North America during 2010, 2009 and 2008, with geographic revenue based on the customers' ship-to location.

The following is a summary of revenue by geographic region based on customer ship-to location for the years ended December 31, 2010, 2009 and 2008 (in thousands):

| Country | Year ended December 31, |            |            |
|---------|-------------------------|------------|------------|
|         | 2010                    | 2009       | 2008       |
| China   | \$ 105,233              | \$ 66,694  | \$ 72,402  |
| Korea   | 33,761                  | 32,028     | 25,747     |
| Taiwan  | 25,840                  | 21,719     | 21,978     |
| Europe  | 20,416                  | 19,251     | 12,918     |
| Japan   | 14,255                  | 11,972     | 15,583     |
| USA     | 8,415                   | 6,106      | 4,330      |
| Other   | 10,920                  | 7,238      | 7,553      |
| Total   | \$ 218,840              | \$ 165,008 | \$ 160,511 |

The following is a summary of net revenue by product type for the years ended December 31, 2010, 2009 and 2008 (in thousands):

| Product Family            | 2010       | Year ended December 31, |              | 2009    | Year ended December 31, |              | 2008 | Year ended December 31, |  |
|---------------------------|------------|-------------------------|--------------|---------|-------------------------|--------------|------|-------------------------|--|
|                           |            | % of Revenue            | % of Revenue |         | % of Revenue            | % of Revenue |      |                         |  |
| DC to DC Converters       | \$ 183,051 | 83.7 %                  | \$ 123,581   | 74.9 %  | \$ 115,373              | 71.9 %       |      |                         |  |
| Lighting Control Products | 28,554     | 13.0 %                  | 27,836       | 16.9 %  | 32,308                  | 20.1 %       |      |                         |  |
| Audio Amplifiers          | 7,235      | 3.3 %                   | 13,591       | 8.2 %   | 12,830                  | 8.0 %        |      |                         |  |
| Total                     | \$ 218,840 | 100.0 %                 | \$ 165,008   | 100.0 % | \$ 160,511              | 100.0 %      |      |                         |  |

The following is a summary of long-lived assets by geographic region, excluding restricted assets, as of December 31, 2010 and 2009 (in thousands):

|               | December 31, |           |
|---------------|--------------|-----------|
|               | 2010         | 2009      |
| China         | \$ 34,468    | \$ 15,440 |
| United States | 2,719        | 2,484     |

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|        |          |          |
|--------|----------|----------|
| Taiwan | 134      | 75       |
| Japan  | 85       | 75       |
| Other  | 58       | 34       |
| TOTAL  | \$37,464 | \$18,108 |

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## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 14. Valuation and Qualifying Accounts

The Company had insignificant activity and balance in its accounts receivable allowances in 2010, 2009 and 2008.

## 15. Stock Repurchase Program

On July 27, 2010, the Board of Directors approved a stock repurchase program that authorizes MPS to repurchase up to \$50.0 million in the aggregate of its common stock between August 2, 2010 and December 31, 2011. In February 2011, the Board of Directors approved an increase from \$50.0 million to \$70.0 million. As of December 31, 2010, the following shares have been repurchased through the open market and subsequently retired:

| 2010 Calendar Year       | Shares Repurchased | Average Price per Share | Value (in thousands) |
|--------------------------|--------------------|-------------------------|----------------------|
| August                   | 983,189            | \$ 17.29                | \$ 16,998            |
| November                 | 916,600            | \$ 15.85                | \$ 14,529            |
| Total Shares Repurchased | 1,899,789          |                         | \$ 31,527            |

On February 5, 2008, the Company announced that its Board of Directors approved a stock repurchase program that authorizes the Company to repurchase up to \$25.0 million of its common stock through the end of 2008. As of December 31, 2008, the following shares have been repurchased through the open market and subsequently retired:

| 2008 Calendar Year       | Shares Repurchased | Average Price per Share | Value (in thousands) |
|--------------------------|--------------------|-------------------------|----------------------|
| February                 | 27,500             | \$ 16.88                | \$ 464               |
| March                    | 527,332            | \$ 17.12                | \$ 9,028             |
| April                    | 201,863            | \$ 20.03                | \$ 4,043             |
| May                      | 100                | \$ 21.98                | \$ 2                 |
| June                     | 18,000             | \$ 21.66                | \$ 390               |
| July                     | 14,155             | \$ 21.86                | \$ 309               |
| August                   | 100                | \$ 22.03                | \$ 2                 |
| September                | 307,355            | \$ 18.82                | \$ 5,784             |
| October                  | 333,700            | \$ 15.05                | \$ 5,021             |
| Total Shares Repurchased | 1,430,105          |                         | \$ 25,043            |

There were no shares repurchased in 2009.

## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 16. Quarterly Financial Data (Unaudited)

|   | Three months ended |                  |                          |                         |
|---|--------------------|------------------|--------------------------|-------------------------|
|   | March 31,<br>2010  | June 30,<br>2010 | September<br>30,<br>2010 | December<br>31,<br>2010 |
| Revenue   | \$ 50,250          | \$ 55,690        | \$ 65,843                | \$ 47,057               |
| Cost of revenue*  | 20,954             | 23,256           | 29,857                   | 23,316                  |
| Gross profit  | 29,296             | 32,434           | 35,986                   | 23,741                  |
| Operating expenses:   |                    |                  |                          |                         |
| Research and development*   | 11,040             | 11,785           | 11,291                   | 10,256                  |
| Selling, general and<br>administrative*                                   | 10,393             | 11,615           | 10,296                   | 8,865                   |
| Litigation expense  | 1,567              | 2,228            | 964                      | 659                     |
| Total operating expenses  | 23,000             | 25,628           | 22,551                   | 19,780                  |
| Income from operations  | 6,296              | 6,806            | 13,435                   | 3,961                   |
| Other income (expense):   |                    |                  |                          |                         |
| Interest and other income   | 347                | 338              | 240                      | 231                     |
| Interest and other expense  | -                  | (4 )             | (159 )                   | (71 )                   |
| Total other income, net   | 347                | 334              | 81                       | 160                     |
| Income before income taxes  | 6,643              | 7,140            | 13,516                   | 4,121                   |
| Income tax provision  | 287                | 733              | 297                      | 540                     |
| Net income  | \$ 6,356           | \$ 6,407         | \$ 13,219                | \$ 3,581                |
| Basic net income per share  | \$ 0.18            | \$ 0.18          | \$ 0.37                  | \$ 0.10                 |
| Diluted net income per share  | \$ 0.17            | \$ 0.17          | \$ 0.35                  | \$ 0.10                 |
| Weighted average common shares<br>outstanding                             | 35,421             | 36,291           | 36,185                   | 35,420                  |
| Stock options and restricted stock  | 2,362              | 2,064            | 1,542                    | 1,309                   |
| Diluted weighted-average common<br>equivalent shares outstanding          | 37,783             | 38,355           | 37,727                   | 36,729                  |
| * Stock-based compensation has been included in the following line items: |                    |                  |                          |                         |
| Cost of revenue   | \$ 79              | \$ 116           | \$ 70                    | \$ 128                  |
| Research and development  | 1,735              | 1,995            | 1,647                    | 1,365                   |
| Selling, general and administrative                                       | 2,210              | 3,428            | 2,445                    | 1,592                   |
| Total   | \$ 4,024           | \$ 5,539         | \$ 4,162                 | \$ 3,085                |



## MONOLITHIC POWER SYSTEMS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

|   | Three months ended |                  |                          |                         |
|---|--------------------|------------------|--------------------------|-------------------------|
|   | March 31,<br>2009  | June 30,<br>2009 | September<br>30,<br>2009 | December<br>31,<br>2009 |
| Revenue   | \$ 29,322          | \$ 41,173        | \$ 47,966                | \$ 46,547               |
| Cost of revenue*  | 12,431             | 16,823           | 18,868                   | 19,208                  |
| Gross profit  | 16,891             | 24,350           | 29,098                   | 27,339                  |
| Operating expenses:   |                    |                  |                          |                         |
| Research and development*   | 8,117              | 9,732            | 10,080                   | 10,366                  |
| Selling, general and administrative*                                      | 7,808              | 9,321            | 9,438                    | 10,185                  |
| Litigation expense  | 2,046              | 2,233            | 2,811                    | 2,367                   |
| Litigation provision reversal, net  | -                  | -                | (6,356 )                 | -                       |
| Total operating expenses  | 17,971             | 21,286           | 15,973                   | 22,918                  |
| Income (loss) from operations   | (1,080 )           | 3,064            | 13,125                   | 4,421                   |
| Other income (expense):   |                    |                  |                          |                         |
| Interest and other income   | 385                | 281              | 161                      | 220                     |
| Interest and other expense  | (94 )              | (185 )           | (76 )                    | (74 )                   |
| Total other income, net   | 291                | 96               | 85                       | 146                     |
| Income (loss) before income taxes   | (789 )             | 3,160            | 13,210                   | 4,567                   |
| Income tax provision (benefit)  | (61 )              | (26 )            | 648                      | (87 )                   |
| Net income (loss)   | \$ (728 )          | \$ 3,186         | \$ 12,562                | \$ 4,654                |
| Basic net income (loss) per share   | \$ (0.02 )         | \$ 0.09          | \$ 0.36                  | \$ 0.13                 |
| Diluted net income (loss) per share                                       | \$ (0.02 )         | \$ 0.09          | \$ 0.34                  | \$ 0.12                 |
| Weighted average common shares<br>outstanding                             | 33,696             | 34,070           | 34,552                   | 34,987                  |
| Stock options and restricted stock  | -                  | 2,319            | 2,695                    | 2,418                   |
| Diluted weighted-average common<br>equivalent shares outstanding          | 33,696             | 36,389           | 37,247                   | 37,405                  |
| * Stock-based compensation has been included in the following line items: |                    |                  |                          |                         |
| Cost of revenue   | \$ 81              | \$ 67            | \$ 69                    | \$ 29                   |
| Research and development  | 1,560              | 1,687            | 1,409                    | 1,752                   |
| Selling, general and administrative                                       | 1,772              | 2,098            | 1,688                    | 2,399                   |
| Total   | \$ 3,413           | \$ 3,852         | \$ 3,166                 | \$ 4,180                |





ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this Annual Report on Form 10-K. Our disclosure controls and procedures have been designed to ensure that material information relating to us, including our consolidated subsidiaries, required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective at December 31, 2010 and provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Our management, including our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f) and Rule 15d-(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external purposes in accordance with generally accepted accounting principles ("GAAP").

Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are made only in accordance with authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not

operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Our management, including our Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2010. In performing this assessment, management used the criteria established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control— Integrated Framework. Based upon this assessment, our management has concluded that, as of December 31, 2010, our internal control over financial reporting was effective.

Our independent registered public accounting firm, Deloitte & Touche LLP, which audited the consolidated financial statements included in this annual report on Form 10-K, has issued an attestation report, included elsewhere herein, on the effectiveness of our internal control over financial reporting.

#### Inherent Limitations on Effectiveness of Controls

While our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance that their respective objectives will be met, we do not expect that our disclosure controls and procedures or our internal control over financial reporting are or will be capable of preventing or detecting all errors and all fraud. Any control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks.

#### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2010 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

#### ITEM 9B. OTHER INFORMATION

None

### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Reference is made to the information regarding directors and nominees, code of ethics, corporate governance matters and disclosure relating to compliance with Section 16(a) of the Securities Exchange Act of 1934 appearing under the captions "Election of Directors" and "Compliance with Section 16(a) Beneficial Ownership Reporting Compliance" in our Proxy Statement for our Annual Meeting of Stockholders to be held on June 16, 2011, which information is incorporated in this Form 10-K by reference. Information regarding executive officers is set forth under the caption "Executive Officers of the Registrant" in Part I of this Form 10-K.

#### ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is set forth under "Executive Officer Compensation" in our Proxy Statement for the 2011 Annual Meeting of Stockholders, and is incorporated herein by reference.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is set forth under the captions “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in our Proxy Statement for the 2011 Annual Meeting of Stockholders, and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is set forth under the captions “Certain Relationships and Related Transactions” and “Election of Directors” in our Proxy Statement for the 2011 Annual Meeting of Stockholders, and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item is set forth under the caption “Accounting Fees” in our Proxy Statement for the 2011 Annual Meeting of Stockholders, and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

(a) Documents filed as part of this report

(1) All financial statements

Index to Financial Statements

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

(2) Schedules

All schedules have been omitted because the required information is not present or not present in amounts sufficient to require submission of the schedules, or because the information required is included in the consolidated financial statements or notes thereto.

(3) Exhibits

The exhibits listed on the accompanying index to exhibits in Item 15(b) below are filed as part of, or hereby incorporated by reference into, this Form 10-K.

(b) Exhibits

Exhibit

| Number      | Description  |
|-------------|--|
| 3.1 (1)     | Amended and Restated Certificate of Incorporation.   |
| 3.2 (2)     | Amended and Restated Bylaws.   |
| 10.1+ (3)   | Registrant's 1998 Stock Plan and form of option agreement.   |
| 10.2+ (4)   | Registrant's Amended 2004 Equity Incentive Plan and form of option agreement.  |
| 10.3+ (5)   | Registrant's 2004 Employee Stock Purchase Plan and form of subscription agreement.   |
| 10.4+ (6)   | Form of Directors' and Officers' Indemnification Agreement.  |
| 10.5† (7)   | Foundry Agreement between the Registrant and Advanced Semiconductor Manufacturing Corp. of Shanghai, dated August 14, 2001.  |
| 10.6 (8)    | Office Lease, First Amendment to Office Lease, and Second Amendment to Office Lease between the Registrant and Boccardo Corporation, dated May 6, 2002, October 30, 2003, and May 6, 2004, respectively. |
| 10.7+ (9)   | Employment Agreement with Michael Hsing and Amendment thereof.   |
| 10.8+ (10)  | Employment Agreement with Maurice Sciammas and Amendment thereof.  |
| 10.9+ (11)  | Employment Agreement with Jim Moyer.   |
| 10.10+ (12) | Employment Agreement with Deming Xiao and Amendment thereof.   |
| 10.11+ (13) | Employment Agreement with Paul Ueunten and Amendment thereof.  |
| 10.12 (14)  | Distribution Agreement with Asian Information Technology Inc. Ltd., dated March 1, 2004.   |

10.13 (15) Business Purchase Agreement with Uppertech Hong Kong Ltd., dated March 1, 2004.

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Exhibit

| Number      | Description  |
|-------------|--|
| 10.14† (16) | Investment and Cooperation Contract, dated August 19, 2004.  |
| 10.15† (17) | Patent License Agreement, dated May 1, 2004.   |
| 10.16† (18) | Settlement Agreement with Linear Technology Corporation.   |
| 10.17+ (19) | Employment Agreement with C. Richard Neely, Jr. and Amendment thereof  |
| 10.18 (20)  | Settlement Agreement with Microsemi Corporation.   |
| 10.19 (21)  | Settlement Agreement with Micrel Corporation.  |
| 10.20+ (22) | Employment Agreement with Adriana Chiocchi and Amendment thereof.  |
| 10.21+ (23) | Form of Performance Unit Agreement.  |
| 10.22 (24)  | Sublease Agreement between the Registrant and FedEx Freight West, Inc. and Brokaw Interests dated June 13, 2006.   |
| 10.23+ (25) | Letter Agreement with Victor Lee.  |
| 10.24 (26)  | Sublease Agreement between the Registrant and Anchor Bay Technologies for the property located at 983 University Avenue, Building A, Los Gatos, CA 95032 dated May 14, 2007. |
| 10.25+ (27) | Letter Agreement with Douglas McBurnie.  |
| 10.26+ (28) | Letter Agreement with Karen A. Smith Bogart.   |
| 10.27 (29)  | Settlement Agreement with Taiwan Sumida Electronics.   |
| 10.28+ (30) | Registrant's Employee Bonus Plan, as amended effective March 6, 2008.  |
| 10.29 (32)  | Lease Agreement between the Registrant and Brokaw Interests, dated October 23, 2008  |
| 10.30 (33)  | Form of Restricted Stock Award Agreement   |
| 10.31+ (36) | Termination Agreement between the Company and Adriana Chiocchi, dated December 15, 2009  |
| 10.32+ (35) | Letter Agreement with Jeff Zhou  |
| 10.33       | Employment Agreement with Meera P. Rao and Amendment thereof   |

| Exhibit Number | Description   |
|----------------|---|
| 14.1 (31)      | Code of Ethics.   |
| 21.1 (34)      | Subsidiaries of Monolithic Power Systems, Inc.  |
| 23.1           | Consent of Independent Registered Public Accounting Firm.   |
| 24.1           | Power of Attorney (included on Signature page to this Form 10-K).   |
| 31.01          | 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. |
| 31.02          | 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. |
| 32.01*         | 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.    |

+ Management contract or compensatory plan or arrangement.

† Confidential treatment requested for portions of this agreement, which portions have been omitted and filed separately with the Securities and Exchange Commission

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

- (1) Incorporated by reference to Exhibit 3.2 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (2) Incorporated by reference to Exhibit 3.4 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (3) Incorporated by reference to Exhibit 10.1 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (4) Incorporated by reference to Exhibit 10.2 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004 and to exhibits 9.01(c)(1) and (2) to the Registrant’s Current Report on Form 8-K, filed with the Securities and Exchange Commission on December 7, 2004.
- (5) Incorporated by reference to Exhibit 10.3 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (6) Incorporated by reference to Exhibit 10.4 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (7) Incorporated by reference to Exhibit 10.5 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (8) Incorporated by reference to Exhibit 10.6 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (9) Incorporated by reference to Exhibit 10.7 of the Registrant’s current report on Form 8-K filed with the Securities and Exchange Commission on March 11, 2008 and Exhibit 10.1 of the Registrant’s current report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2008.
- (10) Incorporated by reference to Exhibit 10.8 of the Registrant’s current report on Form 8-K filed with the Securities and Exchange Commission on March 11, 2008 and Exhibit 10.3 of the Registrant’s current report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2008.
- (11) Incorporated by reference to Exhibit 10.9 of the Registrant’s Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (12) Incorporated by reference to Exhibit 10.10 of the Registrant’s current report on Form 8-K filed with the Securities and Exchange Commission on March 11, 2008 and Exhibit 10.4 of the Registrant’s current report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2008.



- (13) Incorporated by reference to Exhibit 10.11 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on March 11, 2008 and Exhibit 10.6 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2008.
- (14) Incorporated by reference to Exhibit 10.11 of the Registrant's Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (15) Incorporated by reference to Exhibit 10.12 of the Registrant's Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (16) Incorporated by reference to Exhibit 10.13 of the Registrant's Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.

- (17) Incorporated by reference to Exhibit 10.14 of the Registrant's Form S-1 Registration Statement (Registration No. 333-117327), declared effective by the Securities and Exchange Commission on November 18, 2004.
- (18) Incorporated by reference to Exhibit 10.1 of the Registrant's quarterly report on Form 10-Q, filed with the Securities and Exchange Commission on March 13, 2006.
- (19) Incorporated by reference to Exhibit 10.17 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on March 11, 2008 and Exhibit 10.2 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2008.
- (20) Incorporated by reference to Exhibit 10.18 of the Registrant's annual report on Form 10-K, filed with the Securities and Exchange Commission on March 28, 2006.
- (21) Incorporated by reference to Exhibit 10.1 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on September 22, 2006.
- (22) Incorporated by reference to Exhibit 10.20 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on March 11, 2008 and Exhibit 10.5 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2008.
- (23) Incorporated by reference to Exhibit 10.1 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on November 1, 2006.
- (24) Incorporated by reference to Exhibit 99.1 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on June 16, 2006.
- (25) Incorporated by reference to Exhibit 10.1 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on September 14, 2006.
- (26) Incorporated by reference to Exhibit 10 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on May 17, 2007
- (27) Incorporated by reference to Exhibit 10.1 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on May 25, 2007
- (28) Incorporated by reference to Exhibit 10.2 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on May 25, 2007
- (29) Incorporated by reference to Exhibit 10.5 of the Registrant's quarterly report on Form 10-Q filed with the Securities and Exchange Commission on August 1, 2007.
- (30) Incorporated by reference to Exhibit 10.31 of the Registrant's annual report on Form 10-K filed with the Securities and Exchange Commission on March 11, 2008.
- (31) Incorporated by reference to Exhibit 14.1 of the Registrant's annual report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2007.
- (32) Incorporated by reference to Exhibit 10 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on October 24, 2008.
- (33) Incorporated by reference to Exhibit 10.1 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on February 15, 2008.
- (34) Incorporated by reference to Exhibit 21.1 of the Registrant's annual report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2009.
- (35) Incorporated by reference to Exhibit 10.1 of the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on February 2, 2010.
- (36) Incorporated by reference to Exhibit 10.31 of the Registrant's annual report on Form 10-K filed with the Securities and Exchange Commission on February 16, 2010.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

MONOLITHIC POWER SYSTEMS, INC.

Date: March 4, 2011

By: /s/ MICHAEL R. HSING  
Michael R. Hsing  
President and Chief Executive Officer

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Michael R. Hsing and Meera P. Rao, and each of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and re-substitution, for him and in his name, place, and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming that all said attorneys-in-fact and agents, or any of them or their or his substitute or substituted, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 4, 2011 by the following persons on behalf of the registrant and in the capacities indicated:

/s/ MICHAEL R. HSING  
Michael R. Hsing  
President, Chief Executive Officer, and Director (Principal Executive Officer)

/s/ MEERA P. RAO  
Meera P. Rao  
Chief Financial Officer (Principal Financial and Accounting Officer and Duly Authorized Officer)

/s/ KAREN A. SMITH BOGART  
Karen A. Smith Bogart  
Director

/s/ HERBERT CHANG  
Herbert Chang  
Director

/s/ VICTOR K. LEE  
Victor K. Lee  
Director

/s/ DOUGLAS MCBURNIE  
Douglas McBurnie  
Director

/s/ JAMES C. MOYER  
James C. Moyer  
Director

/s/ UMESH PADVAL            Director  
Umesh Padval

/s/ JEFF ZHOU             Director  
Jeff Zhou

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