MONOLITHIC POWER SYSTEMS INC
Form 10-Q
November 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0466789**

(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification Number)

79 Great Oaks Boulevard, San Jose, CA 95119

(Address of principal executive offices)(Zip code)

(408) 826-0600

(Registrant's telephone number, including area code)

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

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

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

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

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

There were 40,673,857 shares of the registrant's common stock issued and outstanding as of October 28, 2016.

MONOLITHIC POWER SYSTEMS, INC.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

(unaudited)

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 109,479	$ 90,860
Short-term investments	149,584	144,103
Accounts receivable, net	33,335	30,830
Inventories	70,692	63,209
Other current assets	3,720	2,926
Total current assets	366,810	331,928
Property and equipment, net	82,097	65,359
Long-term investments	5,382	5,361
Goodwill	6,571	6,571
Acquisition-related intangible assets, net	3,515	5,053
Deferred tax assets, net	644	672
Other long-term assets	29,837	16,341
Total assets	$ 494,856	$ 431,285
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ 17,332	$ 13,487
Accrued compensation and related benefits	16,311	9,812
Accrued liabilities	21,873	19,984
Total current liabilities	55,516	43,283
Income tax liabilities	3,594	2,941
Other long-term liabilities	19,448	16,545
Total liabilities	78,558	62,769
Commitments and contingencies		
Stockholders' equity:		

Common stock and additional paid-in capital, $0.001 par value; shares authorized: 150,000; shares issued and outstanding: 40,661 and 39,689 as of September 30, 2016 and December 31, 2015, respectively	304,700	265,763
Retained earnings	111,535	101,287
Accumulated other comprehensive income	63	1,466
Total stockholders’ equity	416,298	368,516
Total liabilities and stockholders’ equity	$ 494,856	$ 431,285

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per-share amounts)

(unaudited)

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2016	**2015**	**2016**	**2015**
Revenue	$106,456	$91,194	$285,047	$246,148
Cost of revenue	48,531	41,754	130,686	112,896
Gross profit	57,925	49,440	154,361	133,252
Operating expenses:				
Research and development	20,472	17,272	55,669	49,053
Selling, general and administrative	22,397	18,722	61,696	54,204
Litigation expense, net	55	136	92	717
Total operating expenses	42,924	36,130	117,457	103,974
Income from operations	15,001	13,310	36,904	29,278
Interest and other income (expense), net	780	(6)	1,920	871
Income before income taxes	15,781	13,304	38,824	30,149
Income tax provision	1,408	2,103	2,678	5,086
Net income	$14,373	$11,201	$36,146	$25,063
Net income per share:				
Basic	$0.35	$0.28	$0.90	$0.64
Diluted	$0.34	$0.28	$0.87	$0.62
Weighted-average shares outstanding:				
Basic	40,590	39,592	40,335	39,422
Diluted	41,895	40,689	41,752	40,676
Cash dividends declared per common share	$0.20	$0.20	$0.60	$0.60

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Net income	$14,373	$11,201	$36,146	$25,063
Other comprehensive loss, net of tax:				
Change in unrealized gains (losses) on auction-rate securities, net of $0 tax in 2016 and 2015	88	(11)	21	(25)
Change in unrealized gains (losses) on other available-for-sale securities, net of $0 tax in 2016 and 2015	(101)	41	169	76
Foreign currency translation adjustments	(52)	(3,132)	(1,593)	(2,778)
Total other comprehensive loss, net of tax	(65)	(3,102)	(1,403)	(2,727)
Comprehensive income	$14,308	$8,099	$34,743	$22,336

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2016	**2015**
Cash flows from operating activities:		
Net income	$36,146	$25,063
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of intangible assets	10,542	10,478
Losses on sales of property and equipment	58	-
(Gains) losses on investments, net	(478)	910
Deferred taxes, net	12	-
Excess tax benefits from equity awards	(1,078)	(4,221)
Stock-based compensation expense	34,241	29,191
Changes in operating assets and liabilities:		
Accounts receivable	(2,503)	(4,845)
Inventories	(7,522)	(26,378)
Other assets	(10,869)	141
Accounts payable	5,713	3,545
Accrued liabilities	4,308	4,154
Income tax liabilities	1,668	1,912
Accrued compensation and related benefits	6,549	5,449
Net cash provided by operating activities	76,787	45,399
Cash flows from investing activities:		
Property and equipment purchases	(29,036)	(8,410)
Purchases of short-term investments	(147,055)	(172,651)
Proceeds from sales of short-term investments	140,733	131,025
Contributions to employee deferred compensation plan, net	(2,314)	(3,455)
Net cash used in investing activities	(37,672)	(53,491)
Cash flows from financing activities:		
Property and equipment purchased on extended payment terms	(150)	(150)
Proceeds from exercise of stock options	1,191	6,876
Proceeds from shares issued under the employee stock purchase plan	2,463	2,227
Repurchases of common shares	-	(31,735)
Dividends and dividend equivalents paid	(24,634)	(21,853)
Excess tax benefits from equity awards	1,078	4,221
Net cash used in financing activities	(20,052)	(40,414)
Effect of change in exchange rates	(444)	(1,144)
Net increase (decrease) in cash and cash equivalents	18,619	(49,650)

Cash and cash equivalents, beginning of period	90,860	126,266
Cash and cash equivalents, end of period	$109,479	$76,616
Supplemental disclosures for cash flow information:		
Cash paid for taxes and interest	$843	$3,070
Supplemental disclosures of non-cash investing and financing activities:		
Liability accrued for property and equipment purchases	$197	$1,003
Liability accrued for dividends and dividend equivalents	$9,882	$9,648

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by Monolithic Power Systems, Inc. (the "Company" or "MPS") in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted in accordance with these accounting principles, rules and regulations. The information in this report should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on February 29, 2016.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows for the interim periods presented. The financial statements contained in this Form 10-Q are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 or for any other future periods.

Summary of Significant Accounting Policies

There have been no changes to the Company's significant accounting policies during the three and nine months ended September 30, 2016 as compared to the significant accounting policies described in the Company's audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-15, *Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments*, which amends the current guidance on the classification of certain cash receipts and payments in the statement of cash flows. The standard will be effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted. Entities will apply the standard retrospectively to all periods presented. The Company is evaluating the impact of the adoption on its cash flows and disclosures.

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

In March 2016, the FASB issued ASU No. 2016-09, *Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting,* which changes how entities account for certain aspects of share-based payment awards, including the accounting for excess tax benefits and tax deficiencies, forfeitures, statutory tax withholding requirements, as well as classification of excess tax benefits in the statements of cash flows. The standard will be effective for annual reporting periods beginning after December 15, 2016, with early adoption permitted. The manner of application varies by the different provisions of the guidance, with certain provisions applied on a retrospective or modified retrospective approach, while others are applied prospectively. The Company is evaluating the impact of the adoption on its consolidated financial position, results of operations, cash flows and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases,* which requires entities to recognize a right-of-use asset and a lease liability on the balance sheets for substantially all leases with a lease term greater than 12 months, including leases currently accounted for as operating leases. The standard requires modified retrospective adoption and will be effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted. The Company is evaluating the impact of the adoption on its consolidated financial position, results of operations, cash flows and disclosures.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers,* which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The standard's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB approved a one-year deferral of the effective date. The standard will be effective for annual reporting periods beginning after December 15, 2017. Early adoption is permitted for reporting periods beginning after December 15, 2016. The standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company is evaluating the impact of the adoption on its consolidated financial position, results of operations, cash flows and disclosures.

2. STOCK-BASED COMPENSATION

Stock Plan

The Board of Directors adopted the 2014 Equity Incentive Plan (the "2014 Plan") in April 2013, and the stockholders approved it in June 2013. In October 2014, the Board of Directors approved certain amendments to the 2014 Plan. The 2014 Plan became effective on November 13, 2014 and provides for the issuance of up to 5.5 million shares. The 2014 Plan will expire on November 13, 2024. As of September 30, 2016, 3.8 million shares remained available for future issuance.

Stock-Based Compensation Expense

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenue	$403	$303	$1,217	$829
Research and development	3,986	2,932	11,001	8,055
Selling, general and administrative	9,127	7,240	22,023	20,307
Total	$13,516	$10,475	$34,241	$29,191

In the first quarter of 2016, the Company's then Chief Financial Officer retired. As the service or performance conditions for certain of her unvested restricted stock units ("RSUs") had not been satisfied at the time of her departure, the Company reversed previously accrued stock-based compensation expenses of approximately $2.9 million associated with the unvested shares and recorded the one-time credit in selling, general and administrative expenses for the three months ended March 31, 2016.

RSUs

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

	Time-Based RSUs	Weighted-Average Grant Date Fair Value Per Share	PSUs and MPSUs	Weighted-Average Grant Date Fair Value Per Share	MSUs	Weighted-Average Grant Date Fair Value Per Share	Total	Weighted-Average Grant Date Fair Value Per Share
Outstanding at January 1, 2016	499	$ 40.75	1,933	$ 38.99	1,800	$ 23.57	4,232	$ 32.64
Granted	129	$ 62.54	1,288 (1)	$ 41.07	-	$ -	1,417	$ 43.03
Performance adjustment	-	$ -	(23)(2)	$ 40.05	-	$ -	(23)	$ 40.05
Released	(202)	$ 35.88	(649)	$ 29.86	-	$ -	(851)	$ 31.29
Forfeited	(23)	$ 43.83	(129)	$ 36.82	(180)	$ 23.57	(332)	$ 30.14
Outstanding at September 30, 2016	403	$ 50.05	2,420	$ 42.65	1,620	$ 23.57	4,443	$ 36.36

(1) Amount reflects the maximum number of awards that can be earned assuming the achievement of the highest level of performance conditions.

(2) Amount reflects the net adjustment to the number of awards that have not been earned or may not be earned based on management's probability assessment at each reporting period.

The intrinsic value related to awards released for the three months ended September 30, 2016 and 2015 was $10.6 million and $6.6 million, respectively. The intrinsic value related to awards released for the nine months ended September 30, 2016 and 2015 was $53.2 million and $40.6 million, respectively. As of September 30, 2016, the total intrinsic value of all outstanding awards was $341.2 million, based on the closing stock price of $80.50. As of September 30, 2016, unamortized compensation expense related to all outstanding awards was approximately $101.7 million with a weighted-average remaining recognition period of approximately four years.

<u>2016 Time-Based RSUs:</u>

For the nine months ended September 30, 2016, the Board of Directors granted 129,000 RSUs with service conditions to employees and non-employee directors. The RSUs generally vest over one year for non-employee directors and four years for employees, subject to continued employment with the Company.

<u>2016 PSUs:</u>

In February 2016, the Board of Directors granted 285,000 PSUs to the executive officers, which represent a target number of shares to be awarded based on the Company's average two-year (2016 and 2017) revenue growth rate compared against the analog industry's average two-year revenue growth rate as determined by the Semiconductor Industry Association ("2016 Executive PSUs"). The maximum number of shares that an executive officer can earn is 300% of the target number of the 2016 Executive PSUs. 50% of the 2016 Executive PSUs will vest in the first quarter of 2018 if the pre-determined performance goals are met during the performance period and approved by the Compensation Committee of the Board of Directors. The remaining 2016 Executive PSUs will vest over the following two years on a quarterly basis. Vesting is subject to the employees' continued employment with the Company. In March 2016, the Company cancelled 32,000 2016 Executive PSUs as a result of the departure of its then Chief Financial Officer. In July 2016, the Board of Directors granted 12,000 2016 Executive PSUs to the Company's new Chief Financial Officer. Assuming the achievement of the highest level of performance goals, the total stock-based compensation cost for the 2016 Executive PSUs is approximately $31.8 million.

In February 2016, the Board of Directors granted 64,000 PSUs to certain non-executive employees, which represent a target number of shares to be awarded based on the Company's 2017 revenue goals for certain regions or product line divisions, or the Company's average two-year (2016 and 2017) revenue growth rate compared against the analog industry's average two-year revenue growth rate as determined by the Semiconductor Industry Association ("2016 Non-Executive PSUs"). The maximum number of shares that an employee can earn is either 200% or 300% of the target number of the 2016 Non-Executive PSUs, depending on the job classification of the employee. 50% of the 2016 Non-Executive PSUs will vest in the first quarter of 2018 if the pre-determined performance goals are met during the performance period and approved by the Compensation Committee. The remaining 2016 Non-Executive PSUs will vest over the following two years on an annual or quarterly basis. Vesting is subject to the employees' continued employment with the Company. Assuming the achievement of the highest level of performance goals, the total stock-based compensation cost for the 2016 Non-Executive PSUs is approximately $6.2 million.

The 2016 Executive PSUs and the 2016 Non-Executive PSUs contain a purchase price feature, which requires the employees to pay the Company $20 per share upon vesting of the shares. Shares that do not vest will not be subject to the purchase price payment. The Company determined the grant date fair value of the 2016 Executive PSUs and the 2016 Non-Executive PSUs granted in February 2016 using the Black-Scholes model with the following assumptions: stock price of $58.98, expected term of 2.6 years, expected volatility of 31.1% and risk-free interest rate of 0.9%. For the 2016 Executive PSUs granted in July 2016, the Company used the following assumptions: stock price of $70.98, expected term of 2.3 years, expected volatility of 29.6% and risk-free interest rate of 0.7%.

2015 MPSUs:

On December 31, 2015, the Board of Directors granted 127,000 MPSUs to the executive officers and certain key employees, which represent a target number of shares to be awarded upon achievement of both market conditions and performance conditions ("2015 MPSUs"). The maximum number of shares that an employee can earn is 500% of the target number of the 2015 MPSUs. The 2015 MPSUs consist of four separate tranches with various performance periods ending on December 31, 2019. The first tranche contains market conditions only, which require the achievement of five MPS stock price targets ranging from $71.36 to $95.57 over a four-year period. The second, third and fourth tranches contain both market conditions and performance conditions. Each tranche requires the achievement of five MPS stock price targets to be measured against a base price equal to the greater of: (1) the average closing stock price during the 20 consecutive trading days immediately before the start of the measurement period for that tranche, or (2) the closing stock price immediately before the start of the measurement period for that tranche. In addition, each of the second, third and fourth tranches requires the achievement of one of following six operating metrics:

1. Successful implementation of full digital solutions vs. current analog topology for certain products.
2. Successful implementation and adoption by a key player of an integrated, software-based, field-oriented-control with 3D hall sensor to motor driver.
3. Successful implementation of certain advanced power analog processes.
4. Successful design wins and achievement of a specific level of revenue with a global networking customer.
5. Achievement of a specific level of revenue with a global electronics manufacturer.
6. Achievement of a specific level of market share with certain core power products.

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

The Company determined the grant date fair value of the 2015 MPSUs using a Monte Carlo simulation model with the following weighted-average assumptions: stock price of $61.35, expected volatility of 33.2%, risk-free interest rate of 1.3%, and an illiquidity discount of 7.8% to account for the post-vesting sales restrictions. In March 2016, the Company cancelled 13,000 2015 MPSUs as a result of the departure of its then Chief Financial Officer. Assuming the achievement of all of the required performance goals, the total stock-based compensation cost for the 2015 MPSUs is approximately $24.6 million to be recognized as follows: $8.3 million for the first tranche, $4.5 million for the second tranche, $5.2 million for the third tranche, and $6.6 million for the fourth tranche.

For the first tranche, stock-based compensation expense is recognized over the requisite service period even if the market conditions are not satisfied. For the second, third and fourth tranches, stock-based compensation expense for each tranche is recognized depending upon the number of the operating metrics management deems probable of achievement in each reporting period. As of March 31, 2016 and June 30, 2016, based on management's assessment, two of the six operating metrics were considered probable of being achieved during the performance period. As of September 30, 2016, three of the six operating metrics were considered probable of being achieved during the performance period. Accordingly, stock-based compensation expense is being recognized for the second, third and fourth tranches over the requisite service period.

Stock Options

As of September 30, 2016, outstanding and vested options totaled 22,000 shares, with a weighted-average exercise price of $17.08, a weighted-average remaining contractual term of one year, and an aggregate intrinsic value of $1.4 million.

Total intrinsic value of options exercised was $0.7 million and $0.4 million for the three months ended September 30, 2016 and 2015, respectively. Total intrinsic value of options exercised was $3.2 million and $15.8 million for the nine months ended September 30, 2016 and 2015, respectively. The net cash proceeds from the exercise of stock options were $1.2 million and $6.9 million for the nine months ended September 30, 2016 and 2015, respectively. As of September 30, 2016, there was no unamortized compensation expense.

Employee Stock Purchase Plan ("ESPP")

For the three months ended September 30, 2016 and 2015, 24,000 and 26,000 shares, respectively, were issued under the ESPP. For the nine months ended September 30, 2016 and 2015, 53,000 and 56,000 shares, respectively, were issued under the ESPP. As of September 30, 2016, 4.6 million shares were available for future issuance.

The intrinsic value of shares issued was $0.6 million and $0.2 million for the three months ended September 30, 2016 and 2015, respectively. The intrinsic value of shares issued was $1.0 million and $0.6 million for the nine months ended September 30, 2016 and 2015, respectively. As of September 30, 2016, the unamortized expense was $0.3 million, which will be recognized through the first quarter of 2017. The Black-Scholes model was used to value the employee stock purchase rights with the following weighted-average assumptions:

Three Months Ended September 30,	**Nine Months Ended September 30,**