MONOLITHIC POWER SYSTEMS INC
Form 10-Q/A
March 10, 2006
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1 to Form 10-Q)

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

Commission file number: 000-51026

Monolithic Power Systems, Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

983 University Avenue, Building A, Los Gatos, CA 95032 (408) 357-6600

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE AND 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 x

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

There were 28,233,187 shares of the Registrant s common stock issued and outstanding as of August 10, 2005.

Table of Contents

MONOLITHIC POWER SYSTEMS, INC.

Table of Contents

Explanatory Note:

We are filing this amendment on Form 10-Q/A to restate our condensed consolidated financial statements for the quarterly periods ended June 30, 2005 and 2004. See Note 11 to the condensed consolidated financial statements for detail regarding the restatement.

The following sections in this report have been amended as a result of the restatements:

Part 1 Item 1 Financial Statements

Part 1 Item 2 Management Discussion and Analysis of Financial Condition and Results of Operations

Part 1 Item 4 Controls and Procedures

Part II Item 6 Exhibits

We have not modified or updated disclosures presented in our original Form 10-Q for the quarterly period ended June 30, 2005, except as required to reflect the effects of the restatement in this Form 10-Q/A. Accordingly this Amendment No. 1 on Form 10-Q/A does not reflect events occurring after the filing of our original quarterly report on Form 10-Q for the quarterly period ended June 30, 2005 and does not modify or update those disclosures affected by subsequent events, except for the restatement referenced above. Information not affected by this restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-Q for the quarterly period ended June 30, 2005 filed on August 15, 2005. References to the quarterly report on Form 10-Q herein shall refer to our quarterly report on Form 10-Q originally filed on August 15, 2005.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(in thousands)

(Unaudited)

	June 30, 2005 (As restated see Note 11)	December 31, 2004 (As restated see Note 11)
ASSETS		
Current Assets:		
Cash and Cash equivalents	$ 34,673	$ 32,019
Investments	17,100	17,000
Accounts Receivable, Net of allowances $227 and $222 at June 30, 2005 and December 31, 2004 respectively	6,687	3,996
Inventories	6,343	5,398
Deferred Income Taxes Current	6,586	1,393
Prepaid Expenses and Other Current Assets	775	1,116
Total Current Assets	72,164	60,922
Property and Equipment, Net	4,853	4,180
Deferred Income Taxes Long term	601	508
Other Assets	126	134
Restricted Assets	6,668	6,641
TOTAL ASSETS	$ 84,412	$ 72,385
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts Payable	4,004	3,396
Accrued Compensation and Related Benefits	2,863	1,518
Accrued Income Taxes	2	374
Accrued Liabilities	17,717	2,996
Total Current Liabilities	24,586	8,284
Deferred Rent	211	161
Stockholders Equity:		
Common stock, $0.001 par value, $28 in 2005 and $28 in 2004; shares authorized: 150,000; shares issued and outstanding: 28,190 and 27,741 at June 30, 2005 and December 31, 2004; respectively	95,126	93,236
Deferred Stock Compensation	(7,050)	(8,941)
Notes Receivable from Stockholders	(398)	(398)
Accumulated Other Comprehensive Income	225	243
Accumulated Deficit	(28,288)	(20,200)

Total Stockholders Equity		59,615		63,940
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	84,412	$	72,385

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2005 (As restated see Note 11)	June 30, 2004 (As restated see Note 11)	June 30, 2005 (As restated see Note 11)	June 30, 2004 (As restated see Note 11)
Revenues	$ 22,257	$ 11,264	$ 36,894	$ 18,059
Cost of Revenues (including Stock-Based Compensation of $131 and $260 for the three and six month period ended June 30, 2005, respectively and $242 and $491 for the three and six month period ended June 30, 2004, respectively)	8,168	4,752	13,714	8,065
Gross Profit	14,089	6,512	23,180	9,994
Operating Expenses:				
Research and Development (including Stock-Based Compensation of $698 and $1,477 for the three and six month period ended June 30, 2005, respectively and $1,381 and $2,686 for the three and six month period ended June 30, 2004, respectively)	3,753	3,345	6,936	6,013
Selling, General and Administrative (including Stock-Based Compensation of $531 and $1,283 for the three and six month period ended June 30, 2005, respectively and $1,345 and $2,844 for the three and six month period ended June 30, 2004, respectively)	4,528	2,999	8,083	6,029
Patent Litigation	5,372	874	9,870	1,475
Provision for Litigation	12,000		12,000	
Total Operating Expenses	25,653	7,218	36,889	13,517
Loss from Operations	(11,564)	(706)	(13,709)	(3,523)
Other Income (Expense):				
Interest Income	320	43	693	69
Other Expense	(45)	(10)	(86)	(11)
Total Other Income, net	275	33	607	58
Loss Before Income Taxes	(11,289)	(673)	(13,102)	(3,465)
Income Tax Benefit	(4,585)		(5,014)	
Net Loss	(6,704)	(673)	(8,088)	(3,465)
Accretion of Redeemable Convertible Preferred Stock		335		670
Loss Attributable to Common Stockholders	$ (6,704)	$ (1,008)	$ (8,088)	$ (4,135)
Basic and Diluted Net Loss per Common Share	$ (0.24)	$ (0.15)	$ (0.29)	$ (0.63)
Shares Used in Basic and Diluted Loss per Common Share	27,721	6,706	27,638	6,603

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

	Six Months Ended	
	June 30, 2005 (As restated see Note 11)	**June 30, 2004 (As restated see Note 11)**
Cash Flows from Operating Activities:		
Net Loss	$ (8,088)	$ (3,465)
Adjustments to reconcile Net Loss to Net Cash provided by (used in) Operating Activities:		
Depreciation	808	513
Loss on Disposal of Property and Equipment		1
Deferred Income Taxes	(5,286)	
Tax Benefit from Stock Option Transactions	266	
Amortization of Deferred Stock Compensation and Other Stock-based expense	3,008	6,186
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(2,692)	925
Inventories	(945)	(101)
Prepaid Expenses and Other	350	(1,323)
Accounts Payable	608	380
Accrued Liabilities	14,721	810
Accrued Income Taxes Payable	(371)	
Accrued Compensation and Related Benefits	1,346	1,255
Deferred Rent	49	74
Net Cash provided by Operating Activities	3,774	5,255
Cash Flows from Investing Activities:		
Property and Equipment Purchases	(1,483)	(804)
Proceeds from Sale of Fixed Assets	1	
Purchases of Investments	(43,400)	
Proceeds from sale of investments	43,300	501
Changes in Restricted Assets	(27)	(5,216)
Net Cash used in Investing Activities	(1,609)	(5,519)
Cash Flows from Financing Activities:		
Proceeds from Issuance of Common Stock	522	270
Initial Public Offering Expenses	(15)	
Net Cash provided by Financing Activities	507	270
Effect of Change in Exchange Rates	(18)	(47)
Net Increase (Decrease) in Cash and Cash Equivalents	2,654	(41)
Cash and Cash Equivalents, Beginning of Period	32,019	12,135
Cash and Cash Equivalents, End of Period	34,673	12,094
Supplemental Disclosures of Cash Flow information:		
Income Taxes Paid	248	

Supplemental Disclosures of Non-Cash Flow Investing and Financing Activities:		
Deferred Stock Compensation, Net of Forfeitures	2,120	11,151
Unrealized Gain (Loss) on Investments	(11)	(6)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. ***Basis of Presentation*** The accompanying unaudited condensed consolidated financial statements of Monolithic Power Systems, Inc. (the Company) have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted in accordance with these rules and regulations. The information in this report should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in its Amendment No. 1 on Form 10-K/A for the fiscal year ended December 31, 2004 filed with the SEC on March 9, 2006.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly the Company s financial position, results of operations and cash flows for the interim periods presented. The operating results for the six-month period ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005 or for any other future period. The condensed consolidated balance sheet as of December 31, 2004 is derived from the audited consolidated financial statements as of and for the year then ended.

2. ***Stock-Based Compensation*** In December of 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 123, Share-Based Payment (SFAS 123R). SFAS 123R requires the Company to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. Until the Company adopts SFAS 123R in fiscal 2006, the Company will continue to account for stock-based awards to employees under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. The Company amortizes deferred stock-based compensation over the vesting periods of the related options, which are generally four years, in accordance with FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, an interpretation of APB Opinions No. 15 and 25*. The Company accounts for stock-based compensation related to equity instruments issued to non-employees in accordance with Emerging Issues Task Force No. 96-18, *Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring or in Conjunction with Selling Goods or Services* and Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation (SFAS 123)*. The Company amortizes deferred stock compensation using the multiple option award method. Accounting for employee stock-based compensation using the fair value method in accordance with SFAS 123 would have produced the following results (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 30, 2005	**June 30, 2004**	**June 30, 2005**	**June 30, 2004**
Net Loss, as reported	$ (6,704)	$ (673)	$ (8,088)	$ (3,465)
Add stock-based employee compensation included in Net Loss	855	2,695	1,906	5,530
Less stock-based employee compensation expense determined under the fair value method, net of tax	(1,584)	(2,764)	(3,243)	(5,219)
Pro forma Net Income (Loss)	$ (7,433)	$ (742)	$ (9,425)	$ (3,154)
Accretion of Redeemable Convertible Preferred Stock		(335)		(670)
Pro forma Net Income (Loss) Attributable to Common Stockholders	$ (7,433)	$ (1,077)	$ (9,425)	$ (3,824)
Basic and diluted loss per share:				
As reported	$ (0.24)	$ (0.15)	$ (0.29)	$ (0.63)
Pro forma	$ (0.27)	$ (0.16)	$ (0.34)	$ (0.58)

Table of Contents

3. *Inventories* Inventories are stated at the lower of cost or market (first in, first out) and include material, labor and manufacturing overhead costs. Inventories consist of the following (in thousands):

	June 30, 2005	December 31, 2004
Work in Progress	$ 2,474	$ 3,426
Finished Goods	3,869	1,971
Total Inventories	$ 6,343	$ 5,397

Inventories for the three and six months ended June 30, 2005 contained certain components and assemblies in excess of the Company s current estimated requirements and were written down by $0.5 million and $0.9 million resulting in an unfavorable impact on gross margins. Inventories for the three and six months ended June 30, 2004 were below the Company s estimated requirements at that time. As a result, inventory that was previously forecasted as excess was used to meet the Company s shipment requirements. This resulted in a favorable impact on gross margins of $0.09 million and $0.1 million for the three and six months ended June 30, 2004.

Certain of the Company s products contain critical components supplied by a single or limited number of third parties. The Company has an inventory of such components to ensure an available supply of products for its customers. Any significant shortage of such components or the failure of the third-party suppliers to maintain or enhance these components could materially adversely affect the Company s results of operations.

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

	June 30, 2005	December 31, 2004
Legal Expense	$ 4,553	$ 2,442
Provision for litigation	12,000	
Commissions	187	88
SOX Consulting Fees	236	
Deferred Revenue	475	
Other	266	466
Total Accrued Liabilities	$ 17,717	$ 2,996

Table of Contents

5. *Net Loss per Share* Basic net loss per share is computed based only on the weighted average number of common shares outstanding during the period and does not give effect to the dilutive effect of common equivalent shares, such as stock options.

	Three Months Ended		Six Months Ended	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
Net Loss Attributable to Common Stockholders	$ (6,704)	$ (1,008)	$ (8,088)	$ (4,135)
Loss per share - Basic and Diluted	$ (0.24)	$ (0.15)	$ (0.29)	$ (0.63)
Shares used in Basic and Diluted per share calculation (in thousands)	27,721	6,706	27,638	6,603

As of June 30, 2005 and June 30, 2004, the Company had securities outstanding, which could potentially dilute basic earnings per share in the future, but were excluded from the computation of diluted net loss per share in the periods presented, as their effect would have been antidilutive. The shares of common stock issuable upon conversion or exercise of such outstanding securities consist of the following (in thousands):

	June 30, 2005	June 30, 2004
Convertible Preferred Stock		10,368
Redeemable Convertible Preferred Stock		5,088
Stock options	8,415	7,049
Warrants	34	214
Restrictive Common Stock	464	
Total Dilutive Shares	8,913	22,719

6. *Comprehensive Income (Loss)* The Company s comprehensive loss includes unrealized holding gains (losses) on available-for-sale securities and foreign currency translation adjustments. The following table sets forth the components of other comprehensive income (loss) net of income tax (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
Net Loss	$ (6,704)	$ (673)	$ (8,088)	$ (3,465)
Other Comprehensive Income (Loss):				
Unrealized holding gains (losses) on available-for-sale securities	6	(1)	(11)	(6)
Foreign Currency Translation Adjustments	10	(47)	(7)	(47)
Comprehensive Loss	$ (6,688)	$ (721)	$ (8,106)	$ (3,518)

Table of Contents

7. ***Income Taxes*** The provision for income taxes has been calculated based on the Company s estimate of its effective tax rate for the full fiscal year. At June 30, 2005, the Company s estimate of the effective tax rate was 28.3%. At June 30, 2004, the Company s estimate of the effective tax rate was zero. The increase from 2004 to 2005 was principally attributable to a significant reduction of the valuation allowance on net deferred tax assets. In the three and six months ended June 30, 2005, the Company had an income tax benefit rate of 41% and 38%, respectively.

During the three months ended June 30, 2005, the Company recorded an $11.3 million pre-tax loss and recognized an income tax benefit of approximately $4.6 million. This benefit was recorded as a net increase to the net deferred tax asset.

The determination of the provision for income taxes requires the Company to take positions on certain issues where there is uncertainty in the application of the tax law. The provision for income taxes includes amounts intended to satisfy unfavorable adjustments by the Internal Revenue Service and other tax authorities in an examination of the Company s income tax returns. The ultimate resolution of these uncertainties may result in an assessment that is materially different from the current estimate of the liability and, if favorable, may result in income tax benefits being recognized in a future period. In addition, the Company recognized a $12 million provision for litigation and the associated tax benefit in the second quarter. If the final judgment is significantly different from this amount, it may have a material impact on our future tax provision.

8. ***Segment Information*** As defined by the requirements of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, 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 wireless markets. The Company s chief operating decision maker is its chief executive officer. Geographic revenue is based on the customer s ship-to location. The Company derived substantially all of its revenues from sales to customers located outside North America during the three and six months ended June 30, 2005 and 2004. During the six months ended June 30, 2004, the Company had significant sales to a third party in the United States, with whom it had a distribution arrangement, who resold primarily to customers in Asia. In March 2004, the Company discontinued such distribution arrangement with this third party and began using other distributors in Asia for sales to customers in that region.

The table below shows the percent of total sales to our three largest customers for each period.

	Three Months Ended		Six Months Ended	
Customer	**June 30, 2005**	**June 30, 2004**	**June 30, 2005**	**June 30, 2004**
Uppertech	21%	23%	23%	19%
AIT	20%	29%	20%	22%
Yosun	11%	12%	11%	11%

Table of Contents

The following is a summary of net revenues by geographic region based on customer location (in thousands):

Country	Three Months Ended June 30, 2005	Three Months Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
United States	$ 643	$ (64)	$ 819	$ 1,322
Taiwan	6,503	4,692	10,689	6,827
Japan	979	711	1,959	1,365
China	10,542	5,634	18,031	6,939
Korea	3,235		4,825	
Other	355	291	571	1,606
Total	$ 22,257	$ 11,264	$ 36,894	$ 18,059

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

Product	Three Months Ended June 30, 2005	Three Months Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
LCD Backlight Inverters	$ 8,427	$ 5,428	$ 15,181	$ 8,840
DC to DC Converters	10,237	4,363	16,352	7,086
LED Drivers	2,922	1,262	4,117	1,856
Audio Amplifiers	671	211	1,244	277
Total	$ 22,257	$ 11,264	$ 36,894	$ 18,059

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

Country	June 30, 2005	December 31, 2004
United States	$ 4,788	$ 4,153
Taiwan	87	71
China	84	69
Korea	20	21
Total	$ 4,979	$ 4,314

9. ***Litigation***

O2 Micro, Inc. ***Overview***

Since November 2000, the Company has been engaged in multiple legal proceedings against O2 Micro, Inc. (O2 Micro) and its parent corporation, O2 Micro International Limited (O2 International). The Company refers to O2 Micro and O2 International together as (O2). These proceedings involve various claims and counterclaims in the United States and Taiwan by the Company and O2 alleging patent infringements and trade secret misappropriation, all of which related to the Company s CCFL backlight inverter product family. In 2004, revenues from the Company s CCFL backlight inverter product family were $21.9 million, or 46% of total revenues. O2 has also sued a number of other companies in the U.S. and Taiwan for patent infringement, including purchasers and/or users of certain of the Company s products and the Company s wafer manufacturer. All of these legal proceedings pose various degrees of risk to the Company s business.

Table of Contents

O2 Micro, Inc. ***U.S. Litigation***

In the case pending in the U.S. District Court for the Eastern District of Texas in which O2 alleges that certain of the Company s CCFL products infringe O2 s U.S. Patent No. 6,804,129 (the 129 patent). O2 amended its complaint to add Advanced Semiconductor Manufacturing Corporation of Shanghai (ASMC), Compal, Asustek and some of their respective affiliates as additional defendants, and asserted claims against them for infringement of the 129 patent, U.S. Patent No. 6,396,722 (the 722 patent), and U.S. Patent No. 6,259,615 (the 615 patent). The Company is defending and indemnifying ASMC and Asustek.

ASMC has filed a motion to dismiss the action against it for lack of personal jurisdiction and the Company has moved to transfer the case to Oakland, California. While these motions are still pending, the judge in the case has scheduled jury selection for the trial in the case for August 7, 2006.

In the case pending in the Northern District of California in which the Company asserted that O2 infringes the Company s 6,114,814 (814) and 6,316,881 (881) patents, O2 claimed that the Company misappropriated its trade secrets and that the 814 and 881 patents are invalid, the jury returned a verdict on July 18, 2005. The jury found that the Company willfully misappropriated certain trade secrets belonging to O2Micro and awarded O2Micro damages in the amount of $12 million; that O2Micro does not infringe claim numbers 3 and 10 of the 814 patent number, and does not infringe claim numbers 1, 2, 8, 9, 14, 21 and 25 of the 881 patent; and that those claims of the 814 patent and the 881 patent were anticipated by certain prior art and are invalid. The judge will be determining certain other issues before entering judgment in the case. Among other things, O2 has asked the judge to enter an injunction against the Company, prohibiting the Company from selling many of its CCFL products for up to six months, and has asked for a reasonable royalty as well as a tripling of the $12 million jury verdict. The Company has asked the judge to overturn portions of the jury verdict, including the $12 million damages award. The Company expects the judge to rule on these matters, and order the entry of judgment, in mid-September. The Company also expects that both parties will file post-trial motions challenging various other aspects of the jury verdict and the judgment. The Company expects the judge to rule on those motions toward the end of 2005. Once all motions have been decided and a final judgment has been entered, the Company will evaluate all of its legal options, including appeal. As a result of the jury verdict, the Company has recorded a $12 million provision for patent litigation. An adverse outcome in this matter could result in additional damages and the Company could be enjoined from selling its products in the U.S. Any such injunction would have a material adverse effect on the Company s business and results of operations.

In January 2003, O2 filed a lawsuit against Sumida Corp. and Taiwan Sumida Electronics Inc. in the U.S. District Court for the Eastern District of Texas alleging that Sumida s use of our products in Sumida s products infringes the 615 and 722 patents. The Company is defending Sumida in that case which has been set for trial on September 19, 2005.

In response to O2 s action against Sumida, in May 2004, the Company filed a complaint against O2 in the U.S. District Court for the Northern District of California seeking a declaratory judgment that the Company does not infringe O2 s 722 patent. In October 2004, O2 filed a counterclaim for alleged infringement of the 722 patent, and added the Company s foundry, ASMC, as a counterclaim defendant. No trial date has yet been set in this matter.

O2 Micro, Inc. ***Taiwan Litigation***

In addition to the U.S. litigation described above, O2 has brought legal proceedings against the Company in Taiwan based upon its 318 patent. In January 2003, upon O2 s request, the Shihlin District Court in Taiwan issued a preliminary injunction prohibiting us from manufacturing, designing, displaying, importing or selling our MP1011A and MP1015 products in Taiwan, either directly or through a third party acting at our request. The Company has also taken several legal actions in an attempt to have the injunction lifted and/or to have O2 s 318 patent declared invalid.

In August 2004, the Taiwan Intellectual Property Office (TIPO) issued a letter ordering O2 to amend its 318 patent. In December 2004, O2 filed its amendment to the 318 patent, and, in February 2005, the Company submitted its comments on the amendment to TIPO. In May 2005, TIPO accepted O2 s 318 patent as amended. The Company has filed an appeal to the Taiwan Intellectual Property Office (TIPO) regarding its decision to accept O2 s amendment to its 318 patent and to dismiss the Company s invalidation action against this patent. The case is pending decision at Taiwan s Ministry of Economic Affairs.

In July, 2005, Taipei District Court dismissed the lawsuit where the Company claims that O2 abused its patent which caused damage to the Company s reputation and violated Fair Trade Law in Taiwan. The defensive preliminary-injunction that the court issued against O2 which prohibits O2 from interfering with manufacturing, selling, importing and using the Company s products such as MP1010 and other products specially enumerated in that injunction is still in place. The Company intends to appeal this case on its merits. In connection with this lawsuit, the Company has obtained a defensive counter-injunction from the Taipei District Court that prohibits O2 from interfering with the manufacture, sale, use or importation, by either the Company or a third party, of a number of the Company s other products which are specifically enumerated in the injunction. In connection with a second lawsuit where the Company claims that O2 abused its patent, the Company obtained another injunction of which prohibits O2 from interfering with the Company s or other parties use of the Company s MP1011A and MP1015 products. The second lawsuit is still pending with the Taipei District Court. In connection with the defensive counter-injunctions, the Company posted cash bonds of approximately $6.1 million (including the $90,000 bond discussed below) with the Taipei District Court. These bonds are currently recorded as restricted assets on the Company s balance sheet. If the final judgments of these suits awarded by the court are not in the Company s favor and if O2 also prevails in claiming damages against these bonds, the Company might have to forfeit some or all of these bonds. Any such forfeiture would be an expense in the quarter in which the outcome of the trial is probable and reasonably estimable. A forfeiture of any substantial part of the bonds would materially and adversely affect the Company s results of operations and financial position for that quarter.

In August 2003, November 2003, and March 2004, the Shihlin District Court and Taipei District Court granted O2 provisional seizures against the Company, which entitle O2 to seize up to approximately $1.9 million of the Company s assets in Taiwan, including but not limited to MP1011A and MP1015 parts. The execution of the first provisional seizure was exempted because the Company posted a bond in the amount of approximately $90,000. The Company elected not to post a bond to exempt the second and third provisional seizure orders, and the court seized property from the Company s Taiwan office. The Company has appealed the second and third provisional seizures in various proceedings.

The Company could lose at trial on the question of whether the Company s products infringe O2 s 318 patent. Although O2 has named only the Company s MP1011A and MP1015 products in its lawsuit, if the court were to conclude that those products infringe the 318 patent, the court could also conclude that many of the Company s newer products, including the 1010B and other CCFL products that are physically similar to the MP1011A and/or the MP1015, infringe O2 s 318 patent. The Company does not believe that the 318 patent is a valid patent or that any of the Company s products infringe the 318 patent, but a court may come to a different conclusion. O2 s original applications for its U.S. 615 patent and its Taiwan 318 patent were substantially similar, but some of O2 s claims contained in the 318 patent were rejected by the U.S. Patent and Trademark Office. Since the claims in the 318 patent are formulated more broadly than those of the 615 patent, the summary judgment in the U.S. that the Company s products do not infringe the 615 patent may not be as helpful to the Company in the 318 case as it might be if the patents were identical.

If the court were to conclude that any of the Company s products infringe the 318 patent, the Company could be liable to O2 for damages based on past sales, and could further be permanently enjoined from selling those products (directly or through distribution arrangements) for use in Taiwan. Although many system and module manufacturers who use the Company s products have shifted, and are continuing to shift, their manufacturing from Taiwan to China, a significant portion of the Company s expected future revenue over the next several years is expected to come from users of the Company s CCFL backlight inverter product family in Taiwan. A final judgment awarded by a court prohibiting direct or indirect sales

Table of Contents

of the Company s MP1011A or MP1015 products into Taiwan would have a material adverse effect on the Company s business and results of operations for at least several quarters while the Company works to transition customers to alternative, non-infringing products. The Company cannot be sure that the Company could successfully effect such a transition. If the Company is permanently enjoined from selling other, newer products into Taiwan, this would have an immediate, drastic, and adverse effect on the Company s ability to continue in the Company s business as presently conducted.

Linear Technology Corporation

On July 16, 2004, Linear filed a complaint with the U.S. International Trade Commission (ITC) under section 337 of the Tariff Act of 1930. In its complaint, Linear alleges that two of the Company s products, the MP1556 (a product within the Company s DC to DC converter product family) and the EV0063 (the evaluation board containing the MP1556), infringe its U.S. Patent Nos. 5,481,178 and 6,580,258. On August 11, 2004, the U.S. International Trade Commission (ITC) ordered that an investigation be instituted to determine whether there has been a violation of section 337, as alleged in the complaint. The matter had been scheduled for trial before the ITC commencing October 5, 2005. The target date for conclusion of the investigation is currently scheduled for February 17, 2006.

If Linear is successful in securing an exclusion order against the MP1556, EV0063 and potentially other products, such an exclusion order would prevent shipments of such products to the U.S. and would have a material adverse effect on the Company s cash flow, results of operations and financial condition.

Microsemi Corporation

On October 7, 2004, Microsemi filed a patent infringement lawsuit in the United States District Court for the Central District of California. The lawsuit identifies four patents U.S. Patent Nos. 5,615,093; 5,923,129; 5,930,121; and 6,198,234 that purportedly are now owned by Microsemi and alleges that the Company infringes those patents. The complaint requests an injunction to prevent the Company from allegedly infringing the patents, as well as unspecified damages, attorneys fees, costs, and expenses. The Company has filed an answer and counterclaim, denying infringement and seeking a declaration that the Company does not infringe the patents and/or that the patents are invalid. Trial has been scheduled for March 6, 2006.

Based upon the description of the technology contained in Microsemi s complaint and Microsemi s responses to discovery requests, the Company understands that Microsemi will contend that one or more of the Company s CCFL backlight inverter products infringes its patents. Because the litigation is in an early stage, it is difficult to predict how it will proceed or what the ultimate outcome will be. If the Company does not prevail in the litigation, the Company could be ordered to pay monetary damages, and the Company could be enjoined from selling one or more of the Company s CCFL backlight inverter products into the U.S., either directly or indirectly. In 2004, revenues from the Company s CCFL backlight inverter product family were $21.9 million, respectively, or 46.0% of total revenue. Because many of the Company s products are sold indirectly by the Company s customers back into the U.S., a U.S. injunction covering one or more of the Company s products would likely substantially reduce sales of those products. Any of the results described above would have a material adverse effect on the Company s cash flow, results of operations, and financial condition.

Micrel Corporation

In November 2004, Micrel filed a patent infringement lawsuit in the United States District Court for the Northern District of California. The lawsuit identifies two patents U.S. Patent Nos. 5,517,046, entitled High Voltage Lateral DMOS Device With Enhanced Drift Region, and 5,556,796, entitled Self-Alignment Technique For Forming Junction Isolation And Wells that purportedly are owned by Micrel and alleges that the Company s products infringe those patents. The complaint requests among other remedies preliminary and permanent injunctions to prevent the Company from allegedly infringing the patents, as well as damages attributable to the alleged misappropriation of Micrel s trade secrets and alleged violation of the confidentiality agreements; for preliminary and permanent injunctive relief to prevent the Company s future use of Micrel s alleged trade secrets; and for attorneys fees and costs.

Table of Contents

Our motion to dismiss certain claims on statute of limitations grounds was granted by the Court; however Micrel was given permission to file an amended complaint to try to state claims that fall within the statute of limitations. On May 2, 2005, Micrel filed a second amended complaint. The Company filed a second motion to dismiss the trade secret-related allegations on statute of limitations grounds, and the matter will be heard on September 30, 2005.

If the Company does not prevail in the litigation, the Company could be ordered to pay to Micrel substantial monetary damages, including restitution, disgorgement of profits and punitive damages, and the Company could be enjoined from selling one or more of the Company s products into the U.S., either directly or indirectly. Because many of the Company s products are sold indirectly by the Company s customers back into the U.S., a U.S. injunction covering one or more of the Company s products would likely substantially reduce sales of those products. Any of these results would have a material and adverse effect on the Company s results of operations and any injunction that prohibits the Company from selling significant products for any length of time would have an immediate and drastic negative effect on the Company s cash flow, results of operations, and financial condition.

Regardless of the extent to which these legal actions have been successful or unsuccessful, the legal expenses associated with the various actions in the U.S. and Taiwan have been high and have had a significant impact on our financial position and results of operations.

10. ***New Accounting Pronouncements*** On December 21, 2004, the FASB issued FASB Staff Position No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* (FSP FAS 109-2). The American Jobs Creation Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. The Company currently has no plans to repatriate foreign earnings.

In November of 2004, the FASB issued Statement of Financial Accounting Standard No. 151, *Inventory Costs An Amendment of ARB No. 43, Chapter 4* (SFAS 151). SFAS 151 clarifies treatment of abnormal amounts of idle facility expense, freight, handling costs and spoilage, specifying that such costs should be expensed as incurred and not included in overhead. The new statement also requires that allocation of fixed production overheads to conversion costs should be based on normal capacity of the production facilities. The provisions in SFAS 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Companies must apply the standard prospectively. The Company does not believe that the impact of this new standard will have any material effect on its financial statements or results of operations.

In December 2004, the FASB issued SFAS 153, *Exchanges of Nonmonetary Assets, an amendment of APB* No. 29, *Accounting for Nonmonetary Transactions.* SFAS 153 requires exchanges of productive assets to be accounted for at fair value, rather than at carryover basis, unless (1) neither the asset received nor the asset surrendered has a fair value that is determinable within reasonable limits or (2) the transactions lack commercial substance. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not expect the adoption of this standard will have a material effect on its financial position, results of operations or cash flows.

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R eliminates the alternative of applying the intrinsic value measurement provisions of Opinion 25 to stock compensation awards issued to employees. Rather, the new standard requires enterprises 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 has not yet quantified the effects of the adoption of SFAS 123R, but it is likely that the new standard will result in significant stock-based compensation expense. The effects of adopting SFAS 123R will be dependent on numerous factors including, but not limited to, the valuation model chosen by the Company to value stock-based awards; the assumed award forfeiture rate; the accounting policies

Table of Contents

adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method (as described below) chosen for adopting SFAS 123R.

On April 14, 2005, the SEC decided to allow companies to adopt the standard at the beginning of the first fiscal year that begins after June 15, 2005. The Company will be required to implement SFAS 123R beginning January 1, 2006. The adoption will be applied on a modified prospective basis and measured and recognized on January 1, 2006. Under this method SFAS 123R is applied to new awards and to awards modified, repurchased, or cancelled after the effective date. Additionally, compensation cost for the portion of awards granted or modified after July 13, 2004 for which the requisite service has not been rendered (such as unvested options) that are outstanding as of the date of adoption shall be recognized as the remaining requisite services are rendered. The compensation cost relating to unvested awards at the date of adoption shall be based on the fair value of those awards at the grant date as calculated for pro forma disclosures under the original SFAS 123.

In March 2005, the FASB issued FASB Interpretation No. 47 (FIN 47), *Accounting for Conditional Asset Retirement Obligations.* FIN 47 clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal year ending after December 15, 2005. The Company will adopt FIN 47 in its fiscal year 2006. The Company is currently analyzing FIN 47 and believes the adoption of FIN 47 will not have material impact on the Company s financial condition, results of operations or liquidity.

11. Restatement

Subsequent to the issuance of the condensed consolidated financial statements for the quarter ended June 30, 2005, the Company determined that certain non-statutory stock options were incorrectly classified as incentive stock options. Therefore, the Company had not previously recognized the appropriate tax benefit associated with these stock options. The Company also determined that its provision for income taxes was not calculated and recorded correctly. Therefore, the Company had not previously recognized the appropriate income tax benefit. In addition, the Company determined that errors were made in the computation of stock-based compensation expense and the recognition of decreases to these expenses arising from cancelled grants as a result of the departure of employees.

As a result, the Company has restated the accompanying condensed consolidated financial statements as of and for the three months ended June 30, 2005 and 2004 from amounts previously reported to correct the accounting for taxes and reduce the income tax benefit by $370,000 for the three months ended June 30, 2005 and to reduce stock-based compensation expense by $379,000 for the three months ended June 30, 2005 and $53,000 for the three months ended June 30, 2004. The Company has restated the accompanying condensed consolidated financial statements as of and for the six months ended June 30, 2005 from amounts previously reported to correct the accounting for taxes and reduce the income tax benefit by $401,000 for the six months ended June 30, 2005 and to reduce stock-based compensation expense by $449,000 for the six months ended June 30, 2005 and $159,000 for the six months ended June 30, 2004. There was no effect to taxes for the three and six months ended June 30, 2004.

A summary of the effects of the restatement is shown below:

Consolidated Balance Sheets

(In thousands)

	As of June 30, 2005		As of December 31, 2004	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Deferred income tax assets current	$ 6,230	$ 6,586	$ 807	$ 1,393
Total current assets	71,808	72,164	60,335	60,922
Deferred income tax assets long term	658	601	658	508
Total assets	84,113	84,412	71,948	72,385
Common stock	95,038	95,126	93,527	93,236

Deferred stock compensation	(6,726)	(7,050)	(9,180)	(8,941)
Accumulated deficit	(28,824)	(28,288)	(20,690)	(20,200)
Total stockholders equity	59,315	59,615	63,503	63,940
Total liabilities and stockholders equity	84,113	84,412	71,948	72,385

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Consolidated Statement of Operations

(in thousands, except per share amounts)

	For the Three Months Ended June 30, 2005		For the Three Months Ended June 30, 2004		For the Six Months Ended June 30, 2005		For the Six Months Ended June 30, 2004	
	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated
Cost of revenues (including stock-based compensation) (1a)	$ 8,155	$ 8,167	$ 4,730	$ 4,752	$ 13,690	$ 13,714	$ 8,002	$ 8,065
Gross profit	14,102	14,089	6,534	6,512	23,204	23,180	10,057	9,994
Research and development expense (including stock-based compensation) (1b)	3,919	3,753	3,343	3,345	7,206	6,936	5,719	6,014
Selling, general and administrative expense (including stock-based compensation) (1c)	4,754	4,528	3,075	2,999	8,286	8,083	6,545	6,028
Total operating expenses	26,046	25,654	7,292	7,218	37,362	36,889	13,739	13,517
Loss from operations	(11,944)	(11,565)	(758)	(706)	(14,158)	(13,709)	(3,682)	(3,523)
Loss before income taxes	(11,668)	(11,289)	(725)	(673)	(13,551)	(13,102)	(3,624)	(3,465)
Income tax benefit	(4,955)	(4,585)			(5,416)	(5,014)		
Net loss	(6,713)	(6,704)	(725)	(673)	(8,135)	(8,088)	(3,624)	(3,465)
Net loss attributable to common stockholders	(6,713)	(6,704)	(1,060)	(1,008)	(8,135)	(8,088)	(4,294)	(4,135)
Basic and diluted net loss per common share	$ (0.24)	$ (0.24)	$ (0.16)	$ (0.15)	$ (0.29)	$ (0.29)	$ (0.65)	$ (0.63)

(1) Stock-based compensation included in the following:

a Cost of revenues	$ 118	$ 131	$ 220	$ 242	$ 236	$ 260	$ 428	$ 491
b Research and development	864	698	1,379	1,381	1,747	1,477	2,391	2,686
c Selling, general and administrative	757	531	1,422	1,345	1,486	1,283	3,361	2,844

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

This quarterly report on Form 10-Q/A contains forward-looking statements that involve many risks and uncertainties. These statements relate to future events and our future performance and are based on current expectations, estimates, forecasts and projections about the industries in which we operate and the beliefs and assumptions of our management. These include statements concerning the above-average industry growth of product and market areas that we have targeted, the continued development and expansion of our business, the increasing percentage of our revenue that we expect to derive from DC to DC converter, LED driver ICs and new products, the degree to which we expect to see the impact of such changes in our product mix on our gross margins offset by increased sales of higher margin products, increased revenues in the third and fourth quarters of each calendar year, decreased revenues in the first quarter of each calendar year and it is possible that the Company may prevail on a post-trial motion to set aside a $12 million jury verdict recently rendered against us. In other cases, you can identify forward-looking statements by terms such as would, could, may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, potential, targets, seek, or continue, the negative of these terms or other variations of such terms. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our business and other characterizations of future events or circumstances are forward-looking statements. These statements are only predictions based upon assumptions made that are believed to be reasonable at the time, and are subject to risk and uncertainties. Therefore, actual events or results may differ materially and adversely from those expressed in any forward-looking statement. In evaluating these statements, you should specifically consider the risks described below and elsewhere in this Form 10-Q/A. These factors may cause our actual results to differ materially from any forward-looking statements. Additional factors that could cause actual results to differ include, but are not limited to the risks, uncertainties and cost of litigation in which the company is involved, outcome of any post-trial motions and appeals, risks associated with the continued development and expansion of our business, acceptance of, or demand for, our products being lower than expected, the potential impact on our financial performance if our litigation provisions are inadequate, difficulty in predicting or budgeting for future expenses and financial contingencies, and the other important risk factors identified in the section of this 10-Q/A entitled Factors that May Affect Future Operating Results . Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Restatement of Condensed Consolidated Financial Statements

The accompanying Management s Discussion and Analysis reflects the effects of the restatement discussed in Note 11 to the Condensed Consolidated Financial Statements.

Overview

We design, develop, and market proprietary, advanced analog and mixed-signal semiconductors. Our products include liquid crystal display (LCD) backlight inverter Integrated Circuits (ICs), direct current (DC) to DC converter ICs, light emitting diode (LED) driver ICs, and audio amplifier ICs. These products are used to perform functions such as lighting electronic displays, converting or controlling voltages or current within systems, and amplifying sound. Since our incorporation in 1997, we have focused on delivering products for large and high growth market opportunities, and are currently targeting the computing, consumer electronics, and wireless markets.

We operate in the cyclical semiconductor industry. Although the semiconductor industry has recently experienced increased demand, the industry may experience downturns in the future. While we will not be immune from future industry downturns, we have targeted product and market areas that we believe have the ability to offer above average industry growth over the long term. In addition, we currently operate as a fabless semiconductor company, working with third parties to manufacture and assemble our integrated circuits. This has enabled us to minimize our capital expenditures and fixed costs, while focusing our engineering and design resources on our core strengths.

Table of Contents

We derive a majority of our revenues from sales of our LCD backlight inverter product family to the computing and consumer electronics markets and from sales of our DC to DC converter IC product family to the computing, consumer electronics and wireless markets. The end markets for our LED driver ICs are beginning to overlap with the end markets for our LCD backlight inverter product family because LED drivers are increasingly used in larger panel applications. In the future, we expect increased revenues from sales of our other products; such as audio ICs and new products to be introduced that include operational amplifiers, 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, diversify our customer base, and successfully secure manufacturing capacity.

The markets in which we sell our products are subject to seasonality. Our revenues generally tend to increase in the third and fourth quarters of each calendar year, when customers place orders to meet year-end holiday demand, and our revenues tend to decrease in the first quarter of each calendar year. However, our rapid revenue growth makes it difficult for us to assess the impact of seasonal factors on our business. This difficulty is partly attributable to increasing diversity in our product mix and to the differential rates of market share growth in our product families.

Our sales cycle generally takes 6 to 12 months to complete following the introduction of a product, and volume production of products that use our ICs generally takes an additional 3 to 6 months to be achieved, after initial customer orders are received. As a result of our sales cycle and our relatively long product life cycles, characteristics of an analog and mixed-signal semiconductor company, our revenue for any given period tends to be weighted toward products that we introduced for sale in the prior one to two years. This combined with the fact that orders in the semiconductor industry can typically be cancelled or rescheduled without significant penalty to the customer, makes the forecasting of our orders and revenues challenging.

We sell our ICs primarily through distribution arrangements and through our direct sales and applications support organization to original design manufacturers and electronic manufacturing service providers. The table below shows the percent of total sales to our three largest customers for each period.

	Three Months Ended		Six Months Ended	
Customer	**June 30, 2005**	**June 30, 2004**	**June 30, 2005**	**June 30, 2004**
Uppertech	21%	23%	23%	19%
AIT	20%	29%	20%	22%
Yosun	11%	12%	11%	11%

Original design manufacturers, electronic manufacturing service providers and other third parties under distribution arrangements are not end customers, but rather serve as a channel to many end users of our products, while other end users of our products purchase from us directly.

We derive a substantial majority of our revenues from direct and indirect sales to foreign customers; 97% for the three months ended June 30, 2005 and 98% for the six months ended June 30, 2005. These are sales either directly or through distribution arrangements to parties located in Asia, a majority of which represents revenues from parties with whom we have distribution arrangements for resale to users of our product in Taiwan. This is because many of the products that use our ICs are manufactured in Asia. As a result, we believe that a substantial majority of our revenues will continue to come from customers located in Asia, although in the future we expect sales into Taiwan to decrease as a percentage of revenues as sales into other Asian regions increase.

Our gross margins have improved steadily over the past three years, reaching 63% for the three months ended June 30, 2005. On a quarterly basis, our gross margins may fluctuate, and our first quarters have historically been our lowest gross margin quarters due to seasonality. As a fabless semiconductor company, we rely on a third party foundry to manufacture our wafers. We also rely on third-party assemblers to assemble and package our ICs prior to final product testing and shipping. Our improvement in gross margins was primarily due to a growth in unit volumes, which resulted in a lower per unit cost, as well as a reduction in our manufacturing and testing costs and improvements in our production yields. As we diversify our revenue mix, we expect to see a reduction in overall average selling prices as our DC to DC converter ICs, which we expect will represent an increasing percentage of revenues, typically sell at lower prices. However, we expect the impact of these changes in product mix on our overall gross margins to be approximately offset by increased sales of new higher margin products and lower manufacturing costs. However, there can be no assurance that margin growth can be achieved, and margins can fluctuate due to changes in overall average selling prices, product mix, market acceptance of new products, and manufacturing efficiencies.

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 accounting principles generally accepted 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, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates on an on-going basis, including those related to uncollectible accounts receivable, inventories, income taxes, warranty obligations and contingencies, and litigation. 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 under different estimates, assumptions or conditions.

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

Revenue Recognition. We recognize revenues in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition* (SAB 104) issued by the Staff of the SEC. SAB 104 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 recognizing revenue upon shipment (when title passes) to most customers. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenues recognized for any reporting period could be adversely impacted.

The majority of our sales are made through distribution arrangements with third parties. Although some of these arrangements include stock rotation rights that permit the return of up to 5% of the previous six months purchases (no more than once every six months), we have not experienced any significant returns pursuant to these provisions. Our normal payment terms with our distributors are 30 days after the date of the invoice and the majority of our arrangements with our distributors do not include price protection provisions. Although some of our arrangements with smaller distributors include price protection provisions permitting them a credit for unsold inventory if we reduce our list prices, we have not experienced any significant claims pursuant to these provisions. In addition, terms of our significant 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 agreement by either party with up to 90 days notice. Beginning August 1, 2005 we provided 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 under certain circumstances, refund amounts to the customer for defective products. We estimate the effect of this change in our warranty policy will not have a material impact on our results of operations. Estimated sales returns and warranty costs, based on historical experience by product, are recorded at the time product revenue is recognized.

Inventory Valuation. We value our inventory at the lower of the actual costs of our inventory or its current estimated market value. We write down inventory for obsolescence or unmarketable inventories based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Accounting for Income Taxes. Statement of Financial Accounting Standards No. 109, (SFAS 109), *Accounting for Income Taxes*, establishes financial accounting and reporting standards for the effect of income taxes. In accordance with SFAS 109, 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; and 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 valuation allowance was $1.9 million at June 30, 2005 and $1.8 million at December 31, 2004. Management determined that valuation allowances were necessary because not all tax benefits associated with deferred tax assets were 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 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 contingencies based on our estimate of whether, and the extent to which, additional taxes may be due. 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, accordingly.

Contingencies. From time to time, we become aware that the Company may be obligated to record a contingent liability. When this occurs, we investigate the potential contingent liability using Statement of Financial Accounting Standards No. 5 (SFAS 5), *Accounting for Contingencies,* 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 management s judgment and given the facts and circumstances in each matter, we 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 SFAS 5. In determining the amount of a contingent loss, we take into account advice received from subject matter experts for each specific matter; 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 and, for example, a particular contingent loss does not occur, the contingent loss recorded would be reversed which could result in a favorable impact on operations.

Accounting for Stock-Based Compensation. Our stock-based employee compensation plans are described more fully in Note 8 to the audited consolidated financial statements included in our Amendment No. 1 to Form 10-K/A for the year ended December 31, 2004 filed with the SEC on March 9, 2006. We account for these plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. We amortize deferred stock-based compensation over the vesting periods of the related options, which are generally four years, in accordance with FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, an interpretation of APB Opinions No. 15 and 25.*

We have recorded deferred stock-based compensation representing the difference between the deemed fair market value of our common stock at the grant date and the option exercise price. Prior to our initial public offering we determined the fair market value of our common stock based upon several factors, including trends in the broad market for technology stocks and the expected valuation we would obtain in an initial public offering. Had different assumptions or criteria been used to determine the fair market value of our common stock, materially different amounts of stock-based compensation could have been reported.

Pro forma information regarding net loss attributable to common stockholders and net loss per share attributable to common stockholders is required in order to show our net loss as if we had accounted for employee stock options under the fair value method of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation, Transition and Disclosure*. This information is contained in Note 2 to our condensed consolidated financial statements. The fair value of options issued pursuant to our option plans at the grant date was estimated using the Black-Scholes option-pricing model.

Results of Operations. The table below sets forth data from our statements of operations as a percentage of revenues for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30, 2005	**June 30, 2004**	**June 30, 2005**	**June 30, 2004**
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of Revenue	36.7%	42.2%	37.2%	44.7%
Gross Profit	63.3%	57.8%	62.8%	55.3%
Operating Expenses:				
Research and Development (including Stock-Based Compensation)	16.9%	29.7%	18.8%	33.3%
Selling, General and Administrative (including Stock-Based Compensation)	20.3%	26.6%	21.9%	33.4%
Patent Litigation	24.1%	7.8%	26.8%	8.2%
Provision for litigation	53.9%	0%	32.5%	0%
Total Operating Expenses	115.2%	64.1%	100.0%	74.9%
Loss from Operations	(51.9%)	(6.3%)	(37.2%)	(19.6%)
Other Income (Expense):				
Interest Income	1.4%	0.4%	1.9%	0.4%
Other Expense	(0.2%)	(0.1%)	(0.2%)	(0.1%)
Total Other Income	1.2%	0.3%	1.7%	0.3%
Loss Before Income Taxes	(50.7%)	(6.0%)	(35.5%)	(19.3%)
Income Tax Benefit	(20.6%)	0%	(13.6%)	0%
Net Loss	(30.1%)	(6.0%)	(21.9%)	(19.3%)
Accretion of Redeemable Convertible Preferred Stock		3.0%		3.7%
Net Loss Attributable to Common Stockholders	(30.1%)	(9.0%)	(21.9%)	(23.0%)

Revenues. Revenues for the three months ended June 30, 2005 were $22.3 million, an increase of $11.0 million, or 98%, over $11.3 million for the three months ended June 30, 2004. Revenues from our DC to DC converter product family increased $5.9 million, or 135%, due to higher volume shipments resulting from increased order rates for existing and new products for shipments into the computing, consumer electronics and wireless markets. Average selling prices remained relatively constant.

Table of Contents

Revenues from our LCD backlight inverter product family increased $3.0 million or 55%, due to higher volume shipments resulting from increased order rates for existing and new products partially offset by higher volume shipments of products with lower average selling prices. Revenues from our LED driver product family increased $1.7 million, or 132%, due to higher volume shipments resulting from increased order rates for existing and new products partially offset by lower average selling prices. Revenues for our audio amplifier product family increased $0.5 million, or 218%, due to an increased demand for our existing products partially offset by decreases in the average selling price

Revenues for the six months ended June 30, 2005 were $36.9 million, an increase of $18.8 million, or 104%, over $18.1 million for the six months ended June 30, 2004. Revenues from our DC to DC converter product family increased $9.3 million, or 131%, due to higher volume shipments resulting from increased order rates for existing and new products for shipments into the computing, consumer electronics and wireless markets. Average selling prices remained relatively constant. Revenues from our LCD backlight inverter product family increased $6.3 million or 72%, due to higher volume shipments resulting from increased order rates for existing and new products partially offset by higher volume shipments of products with lower average selling prices. The increase in higher volumes was partially offset by decrease in average selling prices due to product mix. Revenues from our LED driver product family increased $2.3 million, or 122%, due to higher volume shipments resulting from increased order rates for existing and new products. Revenues for our audio amplifier product family increased $1.0 million, or 349%, due to an increased demand for our existing products.

Geographically, international revenues for the three months ended June 30, 2005 were $21.6 million or 97% of net revenues, an increase of $10.5 million as compared to international revenues of $11.2 million, or 99% of net revenues for the three months ended June 30, 2004. This increase was due to higher volume shipments resulting from increased order rates for existing and new products. International revenues consist of shipments to countries outside North America.

Geographically, international revenues for the six months ended June 30, 2005 were $36.1 million or 98% of net revenues, an increase of $19.4 million as compared to international revenues of $16.7 million or 93% of net revenues for the six months ended June 30, 2004. This increase was due to higher volume shipments resulting from increased order rates for existing and new products. In addition, in March 2004 we discontinued a distribution arrangement with a third party located in the United States who resold primarily to customers in Asia.

Due primarily to increased sales of our LCD backlight inverter product family and our DC to DC converter product family, we have experienced significant revenue growth and have gained significant market share in a relatively short period of time. Specifically, our annual revenues increased from $12.2 million in 2002 to $24.2 million in 2003 to $47.6 million in 2004. We have completed six months of 2005 with $36.9 million in revenues. However, we do not expect similar revenue growth or market share gains in future periods. Accordingly, you should not rely on results of any prior quarterly or annual periods as an indication of our future operating performance.

The following table illustrates changes in our revenues by product family (amounts in thousands):

	Three Months Ended		Six Months Ended	
Product	**June 30, 2005**	**June 30, 2004**	**June 30, 2005**	**June 30, 2004**
LCD Backlight Inverters	$ 8,427	$ 5,428	$ 15,181	$ 8,840
DC to DC Converters	10,237	4,363	16,352	7,086
LED Drivers	2,922	1,262	4,117	1,856
Audio Amplifiers	671	211	1,244	277
Total	$ 22,257	$ 11,264	$ 36,894	$ 18,059

Gross Profit. Gross profit, as a percentage of revenues, was 63% for the three months ended June 30, 2005, compared to 58% for the three months ended June 30, 2004. The increase in gross margin was primarily due to volume efficiencies attributable to a growth in unit shipments and manufacturing cost reductions. The gross margin was favorably impacted by a reduction in stock compensation expense to $0.1 million, or 0.6%, for the three months ended June 30, 2005, compared to $0.2 million, or 2% of net revenues, for the three months ended June 30, 2004.

Gross profit, as a percentage of revenues, was 63% for the six months ended June 30, 2005, compared to 55% for the six months ended June 30, 2004. The increase in gross margin was primarily due to volume efficiencies attributable to a growth in unit shipments from our DC to DC converter product family and from our LCD backlight inverter product family. The gross margin was favorably impacted by a reduction in stock compensation expense of $0.3 million, or 1%, for the six months ended June 30, 2005, compared to $0.5 million, or 4% of net revenues, for the six months ended June 30, 2004.

Research and Development. Research and development expenses consist of salary and benefit expenses for design and product engineers, expenses related to new product development, related facilities costs, and expenses associated with computer equipment used in integrated circuit development.

Research and development expenses (excluding stock-based compensation) were $3.1 million, or 14% of revenues, for the three months ended June 30, 2005 and $2.0 million, or 17% of revenues for the three months ended June 30, 2004. This increase of $1.1 million was due to an increase in personnel and other expenses associated with new product development activities.

Research and development expenses (excluding stock-based compensation) were $5.5 million, or 15% of revenues for the six months ended June 30, 2005 and $3.3 million, or 18% of revenues, for the six months ended June 30, 2004. This increase of $2.2 million was primarily the result of hiring additional engineers to support the Company s research and development efforts and expenses associated with new product development activities.

	Three Months Ended		%	Six Months Ended		%
(in thousands)	June 30, 2005	June 30, 2004	Change	June 30, 2005	June 30, 2004	Change
Net Revenues	$ 22,257	$ 11,264	98%	$ 36,894	$ 18,059	104%
Research and Development (R&D)- excluding stock-based compensation	3,055	1,964	56%	5,459	3,328	64%
R&D- stock-based compensation	698	1,381	(49%)	1,477	2,686	(45%)
Total R&D Expenses	3,753	3,345	12%	6,936	6,014	15%
R&D as a percentage of Revenue	17%	30%		19%	33%	

Stock-based compensation allocated to research and development expenses was $0.7 million, or 3% of revenues, for the three months ended June 30, 2005, compared to $1.4 million, or 12% of revenues for the three months ended June 30, 2004. Stock-based compensation allocated to research and development expenses was $1.5 million, or 4% of revenues, for the six months ended June 30, 2005, compared to $2.7 million, or 15% of revenues, for the six months ended June 30, 2004. The decrease of $0.7 million for the three months ended June 30, 2005 and $1.2 million for the six months ended June 30, 2005 was primarily due to our current year employee options being granted with exercise prices equal to the fair market value resulting in no stock-based compensation expense under current accounting rules. Our prior year options were granted with exercise prices less than fair market value resulting in deferred stock-based compensation which we amortize to expense following the multiple grant approach. This results in substantially higher amounts of amortization in earlier years as opposed to the single grant

Table of Contents

approach, which results in equal amortization over the vesting period of the options. The decrease was also due to the elimination of stock-based compensation as a result of the termination of employment of certain employees.

We believe that investments in research and development, including the recruiting and hiring of design engineers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced products. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of new products related to these end markets.

Selling, General and Administrative. Selling, general administrative expenses include salary and benefit expenses, sales commissions, travel expenses, related facilities costs, outside legal and accounting fees, and fees associated with Sarbanes-Oxley compliance requirements.

	Three Months Ended		**%**	**Six Months Ended**		**%**
(in thousands)	**June 30, 2005**	**June 30, 2004**	**Change**	**June 30, 2005**	**June 30, 2004**	**Change**
Net Revenues	$ 22,257	$ 11,264	98%	$ 36,894	$ 18,059	104%
Selling, General and Administrative (SG&A)- excluding stock-based compensation	3,997	1,653	142%	6,800	3,184	113%
SG&A- stock-based compensation	531	1,345	(61%)	1,283	2,844	(55%)
Total SG&A Expenses	4,528	2,998	51%	8,083	6,028	34%
SG&A as a percentage of Net Revenues	20%	27%		22%	33%	

Selling, general and administrative expenses (excluding stock-based compensation) were $4.0 million, or 18% of revenues, for the three months ended June 30, 2005 and $1.7 million, or 15% of revenues for the three months ended June 30, 2004. The increase of $2.3 million was due to an increase in sales and marketing personnel in the United States, Taiwan, Korea and China to support our increase in customers and revenue growth. In addition, general and administrative expenses increased due to an increase in professional fees, including fees for Sarbanes Oxley consultants, accountants, director and officer liability insurance and legal and tax advisors.

Selling, general and administrative expenses (excluding stock-based compensation) were $6.8 million, or 18% of revenues, for the six months ended June 30, 2005 and $3.2 million, or 18% of revenues for the six months ended June 30, 2004. The increase of $3.6 million was due to an increase in sales and marketing in the United States, Taiwan, Korea and China to support our increase in customers and revenue growth. In addition, general and administrative expenses increased due to personnel and other expenses associated with being a publicly traded company, including fees for legal advisors, accountants and other expenses related to Sarbanes Oxley compliance.

Stock-based compensation allocated to selling, general and administrative expenses were $0.5 million, or 2% of revenues for the three months ended June 30, 2005, compared to $1.3 million, or 12% of revenues for the three months ended June 30, 2004. Stock-based compensation allocated to selling, general and administrative expenses were $1.3 million, or 3% of revenues for the six months ended June 30, 2005, compared to $2.8 million, or 16% of revenues for the six months ended June 30, 2004. The decrease of $0.8 million for the three months ended June 30, 2005 and $1.5 million for the six months ended June 30, 2005 was primarily due to our current year employee options being granted with exercise prices equal to the fair market value resulting in no stock-based compensation expense under current accounting rules. Our prior year options were granted with exercise prices less than fair market value resulting in deferred stock-based compensation which we amortize to expense following the multiple grant approach, which results in substantially higher amounts of amortization in earlier years as opposed to the single grant approach, which results in equal amortization over the vesting period of the options The decrease was also due to the elimination of stock-based compensation as a result of the termination of employment of certain employees.

Patent Litigation. Patent litigation expenses were $5.4 million, or 24% of revenues for the three months ended June 30, 2005 and $9.9 million, or 27% of revenues, for the six months ended June 30, 2005. Patent litigation expenses were $0.9 million or 8% of revenues, for the three months ended June 30, 2004 and $1.5 million or 8% of revenues, for the six months ended June 30, 2004.

	Three Months Ended		(%)	Six Months Ended		(%)
(in thousands)	June 30, 2005	June 30, 2004	Change	June 30, 2005	June 30, 2004	Change
Net Revenues	$ 22,257	$ 11,264	98%	$ 36,894	$ 18,059	104%
Patent Litigation Expenses	5,373	874	515%	9,870	1,475	569%
Provision for Litigation	12,000		100%	12,000		100%
Litigation as a percentage of Net Revenues	24%	8%		27%	8%	

The increase in patent litigation expenses was due to the increase in activities associated with multiple lawsuits in the U.S. and Taiwan. In addition to the O2 lawsuit that existed in 2003, three more patent infringement suits were brought against us in the last half of 2004 by Linear, Microsemi and Micrel, and O2 brought an additional action against us, our supplier, and two of our customers in Texas. In the second quarter of 2005, we prepared three cases for trial, and one trial was commenced, while the other two were postponed.

Provision for Litigation. The $12 million provision for litigation in the quarter ended June 30, 2005 is based on the jury verdict rendered July 18, 2005, in the trial against O2 in Oakland, California. A final judgment has not been entered in that case. Based on certain pretrial rulings, it is possible that the Company may prevail on a post-trial motion to set aside the $12 million jury verdict.

Interest Income. Interest income was $0.3 million for the three months ended June 30, 2005, and $0.04 million for the three months ended June 30, 2004. Interest income was $0.7 million for the six months ended June 30, 2005, and $0.07 million for the six months ended June 30, 2004. Interest income is earned on our cash and investments. Cash and investments increased $39.2 million from June 30, 2004. $34.9 million of our cash and investments are from IPO proceeds, net of expenses, received in November 2004. Cash and investments are primarily held in interest bearing accounts.

Other Expense. Other expense was $0.05 million for the three months ended June 30, 2005 and $0.01 million for the three months ended June 30, 2004. The increase in other expense was due to Taiwan value added taxes withheld from payments and losses due to fluctuations in the Taiwan Dollar currency rates.

Other expense was $0.09 million for the six months ended June 30, 2005 and $0.01 million for the six months ended June 30, 2004. The increase in other expense was due to Taiwan value added taxes withheld from payments.

Income Tax Benefit. In the second quarter of 2005, we had an income tax benefit rate of 41%. For the six months ended June 30, 2005, we had an income tax benefit rate of 38%. The increase in rate for the second quarter was the result of projected tax implications associated with the Company s international business structure.

Liquidity and Capital Resources.

As of June 30, 2005, we had working capital of $47.6 million, including cash and cash equivalents of $34.7 million, investments of $17.1 million and an accrued legal liability for a provision for litigation of

$12.0 million. During the six months ended June 30, 2005, cash and cash equivalents increased by $2.7 million from $32.0 million as of December 31, 2004 to $34.7 million as of June 30, 2005. We have financed our growth primarily with proceeds from operating activities and from the issuance of common stock. In November 2004, we received total proceeds of $34.9 million, net of related issuance fees and estimated offering costs, from our initial public offering.

We generated $3.7 million of cash from operating activities during the six months ended June 30, 2005. The primary impact on operating cash flows for the six months ended June 30, 2005 was from an increase of $14.7 million in accrued liabilities, including a $12 million provision for litigation, an increase in non-cash stock-based compensation of $3.0 million and increases to accrued compensation and related benefits of $1.3 million, partially offset by our net loss of $8.1 million, deferred income taxes of $4.8 million and accounts receivable of $2.7 million.

We used $1.6 million of cash for investing activities during the six months ended June 30, 2005. Capital expenditures totaled $1.5 million, and purchases of short-term investments, net of proceeds from sales and maturities of short-term investments, totaled $0.1 million.

We generated $0.6 million of cash for financing activities during the six months ended June 30, 2005, through proceeds from the issuance of common stock under employee stock plans.

In addition, the following litigation-related contingencies might also affect our liquidity and capital resources: cash bonds of approximately $6.1 million posted with the courts in Taiwan, $12 million accrued provision for litigation stemming from our July 18, 2005 jury verdict outcome and potential penalties relating to injunctions, and/or possible future legal fees and indemnification obligations to be incurred in connection with litigation involving Linear, Microsemi, and Micrel. The information in this report should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in our annual report on Form 10-K/A for the fiscal year ended December 31, 2004 filed with the SEC on March 9, 2006.

We use professional investment management firms to manage most of our invested cash. External investment firms managed 90% of our invested balances during the second quarter of 2005. Within the U.S., the fixed income portfolio is primarily invested in municipal bonds. Outside of the U.S., our fixed income portfolio is primarily invested in U.S. Treasury notes and other sovereign obligations, 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. All investments are made according to guidelines and policies approved by the Board of Directors.

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 borrowing capability, 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 Condensed Consolidated Statement of Cash Flows.

Contractual Obligation and Off-Balance Sheet Arrangements.

The following table summarizes our non cancelable purchase commitments as of June 30, 2005 and the effect such obligations are expected to have on liquidity and cash flow over the next 12 months (in thousands):

	June 30, 2005	**Less than 1 year**
Non-cancellable purchase commitments	$ 9,613	$ 9,613
Total	$ 9,613	$ 9,613

As of June 30, 2005, the Company had no off-balance sheet financing arrangements or activities outside of operating leases and non-cancelable purchase orders. For a discussion of the Company s off-balance sheet financing arrangements at December 31, 2004, refer to Item 7, *Management s Discussion and*

Table of Contents

Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources - Contractual Obligation and Off-Balance Sheet Arrangements in the Company s annual report on Form 10-K/A for the fiscal year ended December 31, 2004. None of such off-balance sheet financing arrangements has changed materially from December 31, 2004.

Factors that May Affect Future Operating Results.

Our business involves risks and uncertainties. You should carefully consider the risks described below, together with all of the other information in this quarterly report on Form 10-Q/A 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.

We have a history of losses, and we may not achieve or sustain profitability on a quarterly or annual basis.

We have incurred losses on an annual basis since our inception. As of June 30, 2005, we had an accumulated deficit of $28.3 million. We expect to incur significant operating expenses over the next several years in connection with the continued development and expansion of our business. Our operating expenses include general and administrative expenses, selling and marketing expenses, litigation expenses, stock based compensation expenses, and research and development expenses relating to products that will not be introduced and will not generate revenues until later periods, if at all. In addition, we expect to continue to incur significant legal expenses associated with the litigations in which we are involved. We may not achieve or sustain profitability on a quarterly or annual basis in the future.

If we are unsuccessful in the patent infringement actions brought by O2 Micro International Limited in either the U.S. or in Taiwan, we could be prevented from selling many of our products and/or be required to pay substantial damages or fines. An unfavorable outcome in O2 s patent claims against us could cause our revenues in the LCD backlight product family to decline significantly and severely harm our business and operating results.

We are engaged in multiple legal proceedings with O2 Micro, Inc. and its parent corporation, O2 Micro International Limited. We refer to O2 Micro and O2 Micro International together as O2. These proceedings involve various claims and counterclaims in the United States and Taiwan by O2 and us alleging, among other things, patent infringements and misappropriation of trade secrets, all of which relate to our CCFL backlight inverter ICs, which are part of our LCD backlight inverter product family. The patent disputes relating to O2 s patents in both the United States and Taiwan involve issues that could affect all of our CCFL backlight inverter products used in the United States and Taiwan. In January 2003, O2 has obtained an injunction in Taiwan prohibiting us from manufacturing, designing, displaying, importing, or selling two of our most significant products in Taiwan, either directly or through a third party acting at our request. O2 has also taken legal action against our China wafer manufacturer and some of our customers and users of our products in Taiwan and the United States. If we are not successful in the litigation based on O2 s patents, we could be ordered to pay monetary fines and/or damages to O2 and/or our customers if we are found to be in violation of the Taiwan injunction or liable to O2 on its claims against us. We could also be prevented from selling many of our products, either into Taiwan, directly or through the distribution arrangements we currently employ, or in the U.S. Because we have agreed to indemnify certain of our customers and our manufacturer against certain claims of patent infringement and violations of trade secrets, and we are currently defending our manufacturer and certain of our customers against claims by O2, we could be liable to our manufacturer or customers whom we have indemnified against liability for damages arising from claims by O2 or others. Our customers and end-users of our products could decide not to use our products; our wafer manufacturer could decide to reduce or eliminate its manufacturing of some or all of our LCD backlight inverter product family; or our products or our customers accounts payable to us, could be seized from them.

Table of Contents

A significant portion of our expected future revenues over the next several years is expected to come from users of our LCD backlight product family in Taiwan. Any of the outcomes described above would have a material and adverse effect on our results of operations for one or more quarters, and any injunction that prohibits us from selling significant products for any length of time would have an immediate and drastic negative effect on our business and results of operations. Depending on the scope and severity of those claims, any injunctions that may be issued against us, or fines and/or damages that we may have to pay, could have a material and adverse effect on our business and results of operations.

Adverse customer reaction to the recent verdict against us in our trial with O2 or to the entry of an injunction against us could cause our revenues to decline significantly and severely harm our business and operating results.

Following the jury verdict in our trial in Oakland, California, certain issues remain to be decided by the judge, including whether to enter an injunction against us. Adverse customer reaction to the verdict and/or the entry of an injunction could cause customers to turn to other suppliers of CCFL products, could cause us to miss important design windows and/or design wins, could cause our revenues to decline and could severely harm our backlight inverter business and our operating results.

An award of an injunction against us could have a significant impact on our revenues and our business and operating results could be severely harmed.

Following the jury verdict in our trial in Oakland, California, certain issues remain to be decided by the judge in the case, including whether to award an injunction against us in connection with the jury s verdict that we misappropriated certain alleged O2 trade secrets. Should the judge award an injunction prohibiting us from selling some or all of our CCFL products for some period of time, customers could turn to other suppliers of CCFL products, we could miss important design windows and/or design wins, our revenues could be significantly impacted and our backlight inverter business and operating results could be severely harmed.

An award of additional damages and/or attorneys fees for willful misappropriation of trade secrets or inequitable conduct and/or a reasonable royalty to O2 could have a significant impact on our balance sheet and/or operating results.

On July 18, 2005, the jury in our trial against O2 in Oakland, California, returned a verdict finding that we had willfully misappropriated certain alleged trade secrets belonging to O2, that O2 does not infringe certain claims of two of MPS s patents, and that the patent claims we asserted that O2 infringed were invalid. Certain issues remain to be decided by the judge in the case, including whether to award additional damages and/or attorneys fees in connection with the jury s verdict that our misappropriation of alleged trade secrets was willful, whether to award attorneys fees for alleged inequitable conduct in connection with our patent prosecution, and whether to award O2 a reasonable royalty in addition to or in lieu of the monetary damages awarded by the jury. An award of additional damages and/or attorneys fees against us or the award of a royalty to O2 could have a significant impact on our balance sheet and/or operating results.

If we are unsuccessful in our current patent infringement lawsuits with Linear Technology Corporation, Microsemi Corporation, or Micrel, Incorporated, or in any additional third party lawsuits, we could be prevented from selling many of our products and/or be required to pay substantial damages or fines. Any unfavorable outcome could cause our revenues to decline significantly and could severely harm our business and operating results.

In July 2004, Linear Technology Corporation (Linear) filed a complaint with the U.S. International Trade Commission (ITC) alleging that two of our products, the MP1556 (a product within our DC to DC converter product family) and the EV0063 (the evaluation board containing the MP1556), infringe its U.S. Patent Nos. 5,481,178 and 6,580,258. Linear has subsequently supplemented its infringement allegations to include certain additional products and products under development, all of which are in the low-quiescent current segment of our DC to DC product line. This matter has been reset for a hearing beginning

October 5, 2005. Linear s complaint requests that the ITC issue an exclusion order and a cease and desist order that would prevent products utilizing the circuitry in question from being imported into the U.S. Sales of our products identified by Linear in its complaint accounted for less than 2% of our revenues for 2004 and less than 2% of our revenues in the first half of 2005. However, if Linear successfully adds other products to the investigation, then the potential financial impact on the Company could be much greater. Our DC to DC converter products are expected to account for a significant portion of our future revenues over the next several years.

In October 2004, Microsemi Corporation (Microsemi) sued us in the United States District Court for the Central District of California, alleging that our products infringe four of its patents. The complaint requests an injunction to prevent us from allegedly infringing the patents, as well as unspecified damages, attorneys fees, costs, and expenses. Microsemi has recently filed infringement contentions identifying 27 claims of four patents that it asserts are infringed by our CCFL backlight inverter products. We have filed an answer and counterclaim, denying infringement and seeking a declaration that we do not infringe the patents and/or that the patents are invalid.

In November 2004, Micrel, Incorporated (Micrel) sued us in the United States District Court for the Northern District of California alleging that our products infringe two of its patents. Michael Hsing, our Chief Executive Officer, and another of our employees are named inventors on both of Micrel s patents and Jim Moyer, our Chief Design Engineer, is a named inventor on one of them. All three of these individuals are former Micrel employees. Micrel s complaint does not identify which claims in the two patents are allegedly infringed nor does it identify which of our products supposedly infringe the patent claims. However, because Micrel s patents relate to semiconductor manufacturing processes and semiconductor design elements rather than a specific device, all of our products could potentially be implicated. Micrel s complaint requests an injunction to prevent us from allegedly infringing the patents, as well as unspecified damages, attorneys fees, costs, and expenses. Micrel subsequently filed an amended complaint adding Messrs. Hsing and Moyer as defendants, and adding causes of action for alleged statutory and common law misappropriation of trade secrets, breach of confidentiality agreements by Messrs. Moyer and Hsing, and alleged violation of California s Unfair Competition law. Our motion to dismiss these claims on statute of limitations grounds was granted with leave to amend; Micrel has filed a second amended complaint adding additional alleged facts; and we have filed a second motion to dismiss those claims on statute of limitations grounds.

If we do not prevail in the litigation with Linear Technology, Microsemi, or Micrel, we could be enjoined from selling one or more of our products into the U.S., either directly or indirectly. Because many of our products are sold indirectly by our customers back into the U.S., a U.S. injunction covering one or more of our products would likely substantially reduce sales of those products. In addition, if we do not prevail in the Microsemi or Micrel litigation, we could be ordered to pay monetary damages to Microsemi and/or Micrel. We could also be liable to customers who have purchased our products and whom we have indemnified against liability for damages arising from claims that our products infringe the intellectual property rights of others. Even if we are ultimately successful in the litigation with Linear, Microsemi, and Micrel, we could lose customers in the interim due to the surrounding uncertainty. Any of these results would have a material and adverse effect on our results of operations for one or more quarters, and any injunction that prohibits us from selling significant products for any length of time would have an immediate and drastic negative effect on our business and results of operations.

In addition, along with the claims asserted by O2, Linear, Microsemi, and Micrel, these or other third parties could assert that these or other of our products infringe their intellectual property rights, which could result in restrictions or prohibitions on the sale of our products and/or cause us to pay license fees and damages. Further, we have agreed to indemnify certain customers and supplier in some circumstances against liability from infringement by our products. In the event any third party were to make a new infringement claim against us or our customers, we could be enjoined from selling some or potentially all of our products, or could be required to indemnify our customers or pay royalties or other damages to third parties. If we were unable to obtain necessary licenses or other rights on acceptable terms, we would either have to change our products so that they did not infringe or stop selling the infringing products, which could have a material adverse effect on our operating results, financial condition, and cash flows.

Given our inability to control the timing and nature of significant events in our litigations, our legal expenses are difficult to forecast, and may vary substantially from our predictions with respect to any given quarter, and interim developments in the litigations may contribute to increased volatility in our stock price and business.

As described in Management s Discussion and Analysis of Financial Condition - Results of Operations Patent Litigation, until our litigations with O2, Linear, Microsemi, and Micrel are resolved we will continue to incur substantial legal expenses that vary with the level of activity in the legal proceedings. This level of activity is not within our control as we may need to respond to legal actions by the opposing parties or scheduling decisions by the judges. Consequently, we may find it difficult to predict the legal expenses for any given quarter, which will impair our ability to forecast our results of operations for that quarter. We are currently expecting an increase in our expenses in preparation for the trials scheduled in the third quarter. We are also expecting increased activity in the Micrel and Microsemi cases. Interim developments in these lawsuits may also contribute to increased volatility in our stock price as the market assesses the impact of those developments on the likelihood that we will or will not ultimately prevail. Interim developments may also affect customer perception of risk with respect to the purchasing of our products, and could unfavorably impact our business.

Our ongoing patent litigations and the potential for new litigations may divert financial and management resources.

The semiconductor industry is characterized by frequent claims of infringement and litigation regarding patent and other intellectual property rights, such as our litigation matters with O2, Linear, Microsemi, and Micrel. 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. Such litigation is very costly. For example, we spent $7.8 million, or 17% of revenue, in 2004, and $9.9 million, or 27% of revenue, in the first half of 2005 on patent litigation expenses. The $9.9 million excludes a $12 million provision for litigation in the second quarter of 2005. Our management team could also be required to devote so much time, effort and energy to the legal proceedings that the rest of our business may suffer.

We do not expect to sustain our recent growth rate.

Due primarily to increased sales of our LCD backlight inverter products and our DC to DC converter product family, we have experienced significant revenue growth and have gained significant market share in a relatively short period of time. Specifically, our annual revenues increased from $12.2 million in 2002 to $24.2 million in 2003 to $47.6 million in 2004 to $36.9 million in the first half of 2005. However, we do not expect similar revenue growth or market share gains in future periods. Accordingly, you should not rely on results of any prior quarterly or annual periods as an indication of our future operating performance.

Due to our limited operating history, we may have difficulty both in accurately predicting our future revenues and appropriately budgeting for our expenses.

We were incorporated in 1997 and did not begin generating meaningful revenues until 2000. As a result, we have only a short history from which to predict future revenues. Our limited operating experience combined with the rapidly evolving nature of the markets into which we sell our products, as well as other factors which are beyond our control, reduce our ability to accurately forecast quarterly or annual revenues. We are currently expanding our staff and increasing our expense levels in anticipation of future revenue growth. If our revenues do not increase as anticipated, significant losses could result due to our higher expense levels.

Table of Contents

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

Our revenues, expenses, and results of operations are difficult to predict, have varied significantly in the past and will continue to fluctuate significantly from quarter to quarter and year to year in the future due to a number of factors, many of which are beyond our control. For example, our revenues for the first quarter of each year tend to be significantly less than the revenues for the last quarter of the previous year. We expect fluctuations to continue for a number of reasons, including:

- the timing of developments in our litigation matters with O2, Linear, Microsemi, Micrel and any future litigation and the related expenses;
- the timing of new product introductions by us and our competitors;
- our ability to develop new process technologies and achieve volume production;
- the scheduling, rescheduling, or cancellation of orders by our customers;
- the cyclical nature of demand for our customers products;
- inventory level and product obsolescence;
- seasonality and variability in the computer, consumer electronics, and wireless markets;
- the availability of adequate supply commitments from our outside suppliers**;**
- changes in manufacturing yields;
- general economic conditions in the countries where our products are used; and
- movements in exchange rates, interest rates, or tax rates

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

The 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.

The semiconductor industry has historically 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, production capacity and rapid erosion of average selling prices. Although the semiconductor industry has recently experienced strong demand, the industry may experience severe or prolonged downturns in the future, which could result in pricing pressure on our products as well as lower demand for our products. Because a significant portion of our expenses is fixed in the short term or is incurred in advance of anticipated sales, we may not be able to decrease our expenses in a timely manner to offset any shortfall of sales. This could materially adversely affect our operating results, financial condition, and cash flows.

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

We believe that applications of our products in the computer, consumer electronics and wireless markets will continue to account for a majority of our revenues. In addition, within these markets we are dependent upon a small number of products. We are particularly dependent on the computing market, including notebook and flat panel monitor applications, and we expect that a significant level of our revenues and operating results will continue to be dependent upon notebook and flat panel monitor applications for at least the near term. If demand for our products declines in the major end markets that we serve, our revenues will decrease.

We receive a significant portion of our revenues from a small number of customers and the loss of any one of these customers or failure to collect a receivable from them could adversely affect our operations and financial position.

We market our products through distribution arrangements and through our direct sales and applications support organization to customers that include original equipment manufacturers, original design manufacturers, and electronic manufacturing service providers. Receivables from our customers are not secured by any type of collateral and are subject to the risk of being uncollectible. Significant

Table of Contents

deterioration in the liquidity or financial condition of any of our major customers or any group of our customers could have a material adverse impact on the collectibility of our accounts receivable and our future operating results.

We primarily conduct our sales on a purchase order basis, rather than pursuant to long-term supply contracts. 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 revenues and adversely affect our operations and financial condition.

Moreover, we believe a high percentage of our products are eventually sold to a number of end customer original equipment manufacturers, or OEMs. Although we communicate with OEMs in an attempt to achieve design wins, which are decisions by OEMs and/or original design manufacturers to use our products, we do not have agreements with any of these end customers, formal or informal. Therefore, there can be no assurance that they will continue to choose to incorporate our ICs into their products. 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 OEMs, or that the OEMs will be successful in selling products which incorporate our ICs.

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, we could have insufficient inventory to meet demand, which could have an adverse impact on our business and financial position. In the event that we order product that we are unable to sell due to a decrease in orders, unexpected order cancellations or product returns, we would have excess inventory which, if we were unable ultimately to sell it, we would be required to scrap.

We have recently become a public company and have had to improve our internal accounting systems and controls, and if we fail to make continued improvements and to manage the related expenses, our business may suffer.

We completed our initial public offering in November 2004. As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, our administrative staff will be required to perform additional tasks. For example, in 2004, we created or revised the roles and duties of our board committees, adopted additional internal controls and disclosure controls and procedures, retained a transfer agent and a financial printer and adopted an insider trading policy, and we will have all of the internal and external costs of preparing and distributing periodic public reports in compliance with our obligations under the securities laws.

Our reporting obligations as a public company place a significant strain on our management, operational and financial resources and systems for the foreseeable future. As we have been an early stage private company, we have had limited accounting personnel and other resources with which to address our internal controls and procedures. If, however, we fail to continue to adequately staff our accounting and finance function and maintain internal controls adequate to meet the demands that will be placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act of 2002, our business may suffer. Moreover, we are placing increased reliance on our internal information technology infrastructure; a catastrophic failure of that infrastructure could have a material adverse effect on our business.

Table of Contents

Standards for compliance with Section 404 of the Sarbanes-Oxley Act of 2002 are uncertain, and if we fail to comply in a timely manner, our business could be harmed and our stock price could decline.

We must comply with the rules promulgated under Section 404 of the Sarbanes-Oxley Act of 2002, by December 31, 2005. We expect to incur additional expense as we implement Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our independent registered public accounting firm to attest to, our internal controls. In addition, The NASDAQ National Market, on which our common stock is listed, has adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices. Our efforts to comply with such laws, rules and regulations require a significant amount of management time and are costly. If we fail to comply in a timely manner with the requirements of Section 404 or other requirements, public perception of our internal controls could be damaged, causing our financial results to suffer and our stock price to decline.

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

We currently depend on one third-party supplier to provide us with wafers for our products. If our wafer supplier fails to provide us sufficient wafers at acceptable yields and at anticipated costs, our revenues and gross margins may decline.

We have a supply arrangement with ASMC for the production of wafers. Although certain aspects of our relationship with ASMC are contractual, many important aspects of this relationship depend on their continued cooperation. We began this relationship with ASMC in 2001 and commenced volume production at ASMC s facilities in the first half of 2003. O2 has sued ASMC in two cases for patent infringement based on its manufacture of our products, and it is possible that our relationship with ASMC could be materially and adversely affected by the O2 litigation. We are negotiating in good faith with ASMC to renew our foundry agreement. While we believe we will be able to enter into an extension of that contract, an abrupt termination of our relationship with ASMC would have a material impact on our business and results of operations.

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, thereby reducing yields. The failure of ASMC to supply us wafers at acceptable yields could prevent us from fulfilling our customers orders for our products and would likely cause a decline in our revenues.

Although we provide ASMC with rolling forecasts of our production requirements, its ability to provide wafers to us is limited by the available capacity of the facilities in which it manufactures wafers for us. An increased need for capacity to meet internal demands or demands of other customers could cause ASMC to reduce capacity available to us. ASMC 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 customers requirements. If ASMC extends lead times, limits supplies, or increases prices due to capacity constraints or other factors, our revenues and gross margins may decline.

Further, as is common in the semiconductor industry, our customers may reschedule or cancel orders on relatively short notice. We are required under our agreement with ASMC to order wafers at least three months in advance. If we cancel these orders after ASMC s commencement of manufacturing which generally occurs six to fourteen weeks before scheduled delivery of the wafers, we must pay cancellation fees to ASMC. If our customers cancel orders after we have ordered the corresponding wafers from ASMC, we may be forced to incur cancellation fees or 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 small percentage of our testing is performed by third-party subcontractors. We do not have any ongoing 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. 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.

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. Moreover, in our recent trial in Oakland, California against O2, the jury returned a verdict holding that a number of the claims of two of our patents covering elements of our CCFL technology are invalid. We intend to continue protecting our proprietary technology, including through patents. 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.

We derive a substantial majority of our revenues from direct or indirect sales to foreign customers and have significant foreign operations, which may expose us to political, regulatory, economic, foreign exchange, and operational risks.

We derive a substantial majority of our revenues from direct or indirect sales to foreign customers, from sales either directly or through distribution arrangements to parties located in Asia, a majority of which represents revenues from parties with whom we have distribution arrangements for resale to users of our products in Taiwan. As a result, we are subject to increased risks due to this concentration of business and operations. There are risks inherent in doing business internationally, including:

changes in, or impositions of, legislative or regulatory requirements, including tax laws in the United States and in the countries in which we manufacture or sell our products;

trade restrictions;

transportation delays;

- international political relationships and threats of war;
- terrorism and threats of terrorism;
- epidemics and illnesses affecting international travel
- work stoppages;
- economic and political instability;
- changes in import/export regulations, tariffs, and freight rates;
- longer accounts receivable collection cycles and difficulties in collecting accounts receivables;
- difficulties in collecting receivables and enforcing contracts generally;
- currency exchange rate fluctuations adversely impacting intra-company transactions; and
- less effective protection of intellectual property.

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 be substantially located in China. In addition, we collect payments from all customers in U.S. dollars. The recent decision of the Chinese Government to let their currency float against a basket of international currencies may devalue the U.S. Dollar against the Chinese Yuan. 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.

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

Most of our manufacturing partners, including ASMC, our current foundry, are located in China. In addition, we are currently in the process of establishing 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 the facility we are establishing 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.

For example, pursuant to our agreement to establish the facility in Chengdu, China, the local authorities have agreed to pay for, design, and build our plant and related infrastructure based on our specifications. We have agreed to buy the plant five years after completion for the actual cost of construction. Prior to the plant purchase, we have agreed to make quarterly lease payments, which will ultimately be applied against the construction costs due at the end of the five years. The local authorities have agreed to ensure that we will obtain all necessary licenses for doing business, that we will obtain favorable tax treatment, similar to other foreign technology companies, and that we will obtain our land use rights. Additionally, we will not require an export license and, upon approval by the applicable authorities, will be exempt from certain import value-added taxes and custom duties. If, at the end of five years, we elect not to purchase the plant, then the agreement will be terminated and the local authorities can take back title to the plant, revoke our land use rights, and will refund our land purchase price. However, the local authority will retain all lease payments. If any of these terms or incentives is reduced, altered or

Table of Contents

eliminated, the profitability of our China facility could be harmed and overall our revenues and financial condition could be materially adversely affected.

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

We operate in a dynamic environment characterized by rapidly changing technologies and industry standards and technological obsolescence. 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 develop new technologies or to react to changes in existing technologies could materially delay our development of new products, which could result in product obsolescence, decreased revenues, and/or a loss of market share to competitors.

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;
- product performance;
- the quality and reliability of the product; and
- effective marketing, sales and service.

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

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 revenues 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 6 to 12 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 3 to 6 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 original equipment manufacturers, or OEMs, and original device manufacturers 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 revenues because a significant portion of our operating expenses is relatively fixed and based on expected revenues. 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.

Table of Contents

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. We have from time to time in the past experienced product quality, performance or reliability problems. If defects and failures occur in our products, we could experience lost revenues, increased costs, including warranty expense and costs associated with customer support, delays in or cancellations or rescheduling of orders or shipments, and product returns or discounts, any of which would harm our operating results.

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

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

We plan to expand our operations, domestically and internationally, and may do so through internal growth, strategic relationships, or acquisitions, including but not limited to the ongoing establishment of a testing facility in China. 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. 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 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 several 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 competitors to include Intersil Corporation, Linear, Maxim Integrated Products, Micrel, Microsemi, National Semiconductor Corporation, O2, Semtech Corporation, STMicroelectronic, and Texas Instruments. We expect continued competition from existing competitors as well as competition from new entrants in the semiconductor market.

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

Our current backlog may not be indicative of future sales.

Due to the nature of our business, in which order lead times may vary, and customers are generally allowed to reschedule or cancel orders on short notice, we believe that backlog is not necessarily a good indicator of future sales. Our quarterly revenues also depend on orders booked and shipped in that quarter. Because lead times for the manufacturing of our products generally take 6 to 8 weeks, we often

Table of Contents

must build in advance of orders. This exposes us to certain risks, most notably the possibility that expected sales will not materialize, leading to excess inventory, which we may be unable to sell to other customers. Therefore, our backlog may not be a reliable indicator of future sales.

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, 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 revenues, as well as our manufacturers and assemblers, are concentrated in Southeast 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.

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, we expect to review acquisition prospects that would complement our current product offerings, enhance our design capability or offer other growth opportunities. In the event of future acquisitions, we could use a significant portion of our available cash, issue equity securities which would dilute current stockholders percentage ownership, and/or incur substantial debt or contingent liabilities. Such actions by us could impact our operating results and/or the price of our common stock.

In addition, if we are unsuccessful in integrating any acquired company into our operations or if integration is more difficult than anticipated, we may experience disruptions that could harm our business.

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:

- the depth and liquidity of the market for our common stock;
- developments generally affecting the semiconductor industry;
- commencement of or developments relating to our involvement in litigation, including the ongoing O2, Linear, Microsemi, and/or Micrel litigation matters;
- investor perceptions of us and our business;
- changes in securities analysts expectations or our failure to meet those expectations;
- actions by institutional or other large stockholders;

terrorist acts;

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;

changes in the estimation of the future size and growth rate of our markets;

Table of Contents

- our results of operations and financial performance; and

- general economic, industry and market conditions.

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.

If securities or industry analysts 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 the Company 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 own in aggregate, approximately 35% of our outstanding common stock. Additionally, Jim Jones, one of our directors, is associated with BAVP, LP, which owns approximately 8% of our outstanding common stock and Herbert Chang, one of our directors, is associated with InveStar, which owns approximately 14% of our outstanding common stock. 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For a discussion of market risks at December 31, 2004, refer to Item 7A, Quantitative and Qualitative Disclosures about Market Risk in our annual report on Form 10-K/A for the fiscal year ended December 31, 2004 filed with the SEC on March 9, 2006. During the first six months of 2005, there were no material changes or developments that would materially alter the market risk assessment performed as of December 31, 2004.

ITEM 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company s reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and that such information is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Previously, the Company s Chief Executive Officer and Chief Financial Officer, with the participation of management, had evaluated the effectiveness of the Company s disclosure controls and procedures, and concluded that the disclosure controls and procedures were effective as of the end of the period June 30, 2005 covered by the Company s quarterly report on Form 10-Q. In connection with the filing of this Amendment No. 1 to its quarterly report on Form 10-Q/A, the Company s Chief Executive Officer and Chief Financial Officer, with the participation of management, reevaluated the effectiveness of the Company s disclosure controls and procedures, and concluded that due to the material weaknesses described below, the Company did not have effective disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q/A.

Table of Contents

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management identified the following material weaknesses in assessing the effectiveness of internal control over financial reporting:

1. As of June 30, 2005, the Company did not maintain effective controls over the accuracy, presentation and disclosure of stock-based compensation expense in conformity with generally accepted accounting principles. Specifically, the Company did not maintain effective controls over the following:

i. the completeness and accuracy of accounting for option cancellations and

ii. the accuracy of the recording of equity compensation.

These control deficiencies resulted in a misstatement of stock-based compensation expense that would result in a material misstatement to the quarterly financial statements that was not prevented or detected. Accordingly, management has determined that these control deficiencies constitute a material weakness.

2. As of June 30, 2005, the Company did not maintain effective controls over accounting for income taxes, including the calculation of the income tax provision and related deferred tax assets and liabilities. This control deficiency resulted in a misstatement of the tax provision and related deferred tax asset that would result in a material misstatement to the quarterly financial statements that was not prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

There was no change in the Company s internal control over financial reporting that occurred during the period covered by this quarterly report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a complete description of the Company s legal proceedings, please see the Company s annual report on Form 10-K/A for the fiscal year ended December 31, 2004 filed with the SEC on March 9, 2006 and updates in the Company s quarterly reports on Form 10-Q for the fiscal quarter ended March 31, 2005 filed with the SEC on May 13, 2005. The Company filed an amendment on Form 10-Q/A for the quarter ended March 31, 2005 on March 10, 2006 which did not amend any disclosures related to Legal Proceedings. Only material developments since May 13, 2005 through August 15, 2005 are included in this filing.

O2 Micro, Inc. ***U.S. Litigation***

In the case pending in the U.S. District Court for the Eastern District of Texas in which O2 alleges that certain of the Company s CCFL products infringe O2 s 129 patent, O2 amended its complaint to add ASMC, Compal, Asustek and some of their respective affiliates as additional defendants, and asserted claims against them for infringement of the 129, 722, and 615 patents. The Company is defending and indemnifying ASMC and Asustek. ASMC has filed a motion to dismiss the action against it for lack of personal jurisdiction and the Company has moved to transfer the case to Oakland, California. While these motions are still pending, the judge in the case has scheduled jury selection for the trial in the case for August 7, 2006.

In the case pending in the Northern District of California in which we asserted that O2 infringes our 6,114,814 (814) and 6,316,881 (881) patents, O2 claimed that the Company misappropriated its trade secrets and that the 814 and 881 patents are invalid, the jury returned a verdict on July 18, 2005. The jury found that the Company willfully misappropriated certain trade secrets belonging to O2Micro and awarded O2Micro damages in the amount of $12 million; that O2Micro does not infringe claim numbers 3 and 10 of the 814 patent number, and does not infringe claim numbers 1, 2, 8, 9, 14, 21 and 25 of the 881 patent; and that those claims of the 814 patent and the 881 patent were anticipated by certain prior art and are invalid. The judge will be determining certain other issues before entering judgment in the case. Among other things, O2 has asked the judge to enter an injunction against the Company, prohibiting us from selling many of our CCFL products for up to six months, and has asked for a reasonable royalty as well as a tripling of the $12 million jury verdict. The Company has asked the judge to overturn portions of the jury verdict, including the $12 million damages award. The Company expects the judge to rule on these matters, and order the entry of judgment, in mid-September. The Company also expects that both parties will file post-trial motions challenging various other aspects of the jury verdict and the judgment. The Company expects the judge to rule on those motions toward the end of 2005. Once all motions have been decided and a final judgment has been entered, the Company will evaluate all of its legal options, including appeal.

O2 Micro, Inc. ***Taiwan Litigation***

The Company has filed an appeal to the Taiwan Intellectual Property Office (TIPO) regarding its decision to accept O2 s amendment to its 318 patent and to dismiss the Company s invalidation action against this patent. The case is pending decision at the Ministry of Economic Affairs.

Taipei District Court dismissed the lawsuit where the Company claims that O2 abused its patent which caused damages to the Company s reputation and violated Fair Trade Law in Taiwan. The defensive preliminary-injunction that the court issued against O2 which prohibits O2 from interfering with manufacturing, selling, importing and using the Company s products such as MP1010 and other products specially enumerated in that injunction is still in place. The Company intends to appeal this case on its merits.

Linear Technology Corporation

In the investigation initiated by Linear Technology Corporation at the U.S. International Trade Commission (ITC), the hearing that was scheduled to commence on June 22, 2005, was postponed because the judge in the matter was injured in an accident. A new hearing date has been set for October 5, 2005. The target date for conclusion of the investigation, is currently scheduled for February 17, 2006.

Microsemi Corporation

In the patent infringement case filed by Microsemi Corporation in the United States District Court for the Central District of California, Microsemi has served its infringement contentions asserting that some or all of the Company s CCFL products infringe 27 claims of the four patents they have asserted against the Company. The Company is preparing its response to those contentions.

Micrel Corporation

In the patent infringement case filed by Micrel in the United States District Court for the Northern District of California, on May 2, 2005, Micrel filed a second amended complaint. The Company has filed a second motion to dismiss the trade secret-related allegations on statute of limitations grounds, and the matter will be heard by Judge White on September 30, 2005.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Company held the Annual Meeting of Stockholders of on June 2, 2005. The Company received proxies representing 18,459,065 shares of Common Stock or 66% of the total outstanding shares of Common Stock of the Company.

(b) The votes cast to elect Jim Jones and Umesh Padval as Directors of the Company to serve for a three year term are set forth below.

Director Candidate	Cast For	Withheld
Jim Jones	16,843,073	1,615,992
Umesh Padval	17,019,323	1,439,742

In addition, Michael R. Hsing, Jim C. Moyer, Herbert Chang, and Alan Earnhart each continued to serve as directors of the Company after the meeting.

(c) The votes cast to ratify the appointment of Deloitte and Touche LLP as the independent registered public accountants of the Company for the fiscal year ending December 31, 2005 are set forth below.

Cast For	Withheld
18,374,105	84,960

ITEM 6. EXHIBITS

(a) See Exhibit Index.

Table of Contents

MONOLITHIC POWER SYSTEMS, INC

SIGNATURE

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

		MONOLITHIC POWER SYSTEMS, INC.
Dated: March 9, 2006	By:	/s/ C. Richard Neely Jr. C. Richard Neely Jr.
		Chief Financial Officer
		(Principal Financial and Accounting Officer)

Table of Contents

EXHIBIT INDEX

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

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