MONOLITHIC POWER SYSTEMS INC
Form 10-Q
May 09, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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 March 31, 2006

OR

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

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

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE AND TELEPHONE NUMBER)

Securities registered pursuant to Section 12(b) of the Act: NONE

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

Common Stock, $0.001 Par Value

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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer (as defined), or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

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

There were 29,592,307 shares of the registrant s common stock issued and outstanding as of April 24, 2006.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(in thousands)

(Unaudited)

	March 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 25,938	$ 25,091
Short-term investments	38,724	38,814
Accounts receivable, net of allowances of $227 and $227 at 2006 and 2005, respectively	7,364	9,537
Inventories	8,543	6,165
Deferred income tax asset current	3,774	3,671
Prepaid expenses and other current assets	1,751	1,501
Restricted assets current	3,502	2,938
Total current assets	89,596	87,717
Property and equipment, net	9,480	6,238
Other assets	403	387
Restricted assets	6,514	6,433
Total assets	$ 105,993	$ 100,775
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,655	$ 6,583
Accrued compensation and related benefits	2,273	2,974
Accrued income tax payable	645	2,913
Accrued liabilities	10,046	9,797
Total current liabilities	23,619	22,267
Deferred rent	212	209
Deferred income tax liability	212	131
Total liabilities	24,043	22,607
Stockholders equity:		
Common stock, $0.001 par value, $29 and $29 in 2006 and 2005, respectively; shares authorized: 150,000; shares issued and outstanding: 29,372 and 29,156 in 2006 and 2005, respectively	99,231	98,342
Deferred stock compensation	(1,762)	(4,544)
Notes receivable from stockholders		(398)
Accumulated other comprehensive income (loss)	(17)	(138)
Accumulated deficit	(15,502)	(15,094)

Total stockholders equity	81,950	78,168
Total liabilities and stockholders equity	$ 105,993	$ 100,775

See accompanying notes to condensed consolidated financial statements.

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MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended March 31, 2006	For the Three Months Ended March 31, 2005
Revenue	$ 24,763	$ 14,637
Cost of revenue (including stock-based compensation of $141 in 2006 and $129 in 2005)	9,373	5,546
Gross profit	15,390	9,091
Operating expenses:		
Research and development (including stock-based compensation of $1,363 in 2006 and $778 in 2005)	5,067	3,182
Selling, general and administrative (including stock-based compensation of $1,179 in 2006 and $752 in 2005)	7,427	3,555
Patent litigation	4,064	4,498
Total operating expenses	16,558	11,235
Loss from operations	(1,168)	(2,144)
Other income (expense):		
Interest and other income	599	372
Interest and other expense	(70)	(41)
Total other income (expense), net	529	331
Loss before income taxes	(639)	(1,813)
Income tax benefit	(231)	(430)
Net loss	(408)	(1,383)
Basic and diluted net loss per common share	$ (0.01)	$ (0.05)
Shares used in basic and diluted loss per common share	28,816	27,537

See accompanying notes to condensed consolidated financial statements.

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MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Cash flows from operating activities:		
Net loss	$ (408)	$ (1,383)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	548	375
Deferred income taxes	(23)	(587)
Tax benefit related to stock-based compensation plans	181	
Excess tax benefit from stock option transactions	(174)	
Stock-based compensation	2,683	1,662
Changes in operating assets and liabilities:		
Accounts receivable	2,181	(130)
Inventories	(2,379)	(1,086)
Prepaid expenses and other assets	(265)	158
Accounts payable	2,938	1,363
Accrued liabilities	240	628
Accrued tax payable	(2,270)	(147)
Accrued compensation and related benefits	(718)	408
Deferred rent	14	47
Net cash provided by operating activities	2,548	1,308
Cash flows from investing activities:		
Property and equipment purchases	(2,634)	(758)
Purchases of investments	(13,883)	(1,800)
Proceeds from sale of investments	13,973	2,200
Change in restricted assets	(564)	(27)
Net cash used in investing activities	(3,108)	(385)
Cash flows from financing activities:		
Proceeds from stockholder note receivable	398	
Proceeds from issuance of common stock	806	139
Additional IPO offering expenses		(32)
Excess tax benefits from exercise of stock options	174	
Net cash provided by financing activities	1,378	107
Effect of change in exchange rates	29	(34)
Net increase in cash and cash equivalents	847	996
Cash and cash equivalents, beginning of period	25,091	32,019
Cash and cash equivalents, end of period	$ 25,938	$ 33,015

Supplemental disclosures of cash flow information:		
Income tax paid	$ 1,886	$ 248
Supplemental disclosures of non-cash investing and financing activities:		
Liability accrued for equipment purchase	$ 1,132	$
Unrealized loss on investments	$	$ (17)
Restricted stock and stock options granted at less than fair market value	$ 781	$ 2,629

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. ***Basis of Presentation*** The accompanying unaudited condensed consolidated financial statements have been prepared by Monolithic Power Systems, Inc. (the Company or MPS) in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States 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 Form 10-K filed with the SEC on March 28, 2006.

In the opinion of management, the accompanying unaudited 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 three-month period ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006 or for any other future period.

2. ***Stock-Based Compensation*** Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (SFAS 123(R)). SFAS 123(R) establishes accounting for stock-based awards based on the fair value of the award measured at grant date. Accordingly, stock-based compensation cost is recognized as an expense over the requisite service period. The Company previously recognized expense in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations and provided the required pro forma disclosures of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123). The Company elected to adopt the modified prospective application method as provided by SFAS 123(R). Under the modified prospective method, prior period results are not restated. The fair value of (i) stock options granted after December 31, 2005 and (ii) the unvested portion of stock options granted after the Company s initial filing of its registration statement on Form S-1 on July 13, 2004 for its initial public offering and before the adoption of SFAS 123(R) are recognized as compensation expense using the Black-Scholes method. Stock options granted prior to July 13, 2004, the date the Company became a public company, will continue to be accounted for and recognized as compensation expense using the intrinsic value method under APB Opinion No. 25 and related interpretations as required under SFAS 123(R).

At March 31, 2006, the Company had two stock option plans and an employee stock participation plan the 1998 Stock Option Plan, the 2004 Equity Incentive Plan and the 2004 Employee Stock Purchase Plan (ESPP Plan). In the first quarter of fiscal 2006, the Company s net loss was $408,000, which included, as a result of adopting SFAS 123(R), share-based compensation in the amount of $2.7 million and an income tax benefit of $231,000. If the Company had continued to account for share-based compensation under APB Opinion No. 25 as the Company did in the first quarter of fiscal 2005, share-based compensation in the first quarter of fiscal 2006 would have been $868,000 and the income tax benefit would have been approximately $178,000.

1998 Stock Option Plan

Under the Company s 1998 Stock Option Plan (the 1998 Plan), the Company reserved for issuance, 11,807,024 shares of common stock to be granted to the Company s employees, directors and consultants. These grants had a maximum contractual term of ten years and had graded vesting generally over a four year requisite service period. The Plan provided for the granting of incentive stock options at a per share price of not less than 100% of the fair market value of the underlying stock at the grant date. Nonstatutory stock options were granted at a per share price of not less than 85% of the fair market value of the underlying stock at the date of grant. However, when incentive stock options or nonstatutory stock options were granted to an employee, director or consultant who, at the time of grant, owned stock representing more than 10% of the voting power of all classes of stock, the exercise price per share was no less than 110% of the fair market value of the underlying stock on the date of grant. On November 19, 2004, the effective date of the Company s initial public offering, the 1998 Plan was closed for future grants and the remaining 1,392,750 shares available for grant were moved to the Company s 2004 Equity Incentive Plan.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

2004 Equity Incentive Plan

The Company s Board of Directors approved the 2004 Equity Incentive Plan in March 2004 and it was subsequently approved by the Company s stockholders in November 2004. These grants have a maximum contractual term of ten years and have graded vesting generally over a four year requisite service period, subject to the employee s continuous employment status. Generally, the options granted may be exercised upon vesting. There were 800,000 shares initially reserved for issuance under the 2004 Equity Incentive Plan. The 2004 Equity Incentive Plan provides for annual increases in the number of shares available for issuance beginning on January 1, 2005 equal to the lesser of 5% of the outstanding shares of common stock on the first day of the year; 2,400,000 shares; or a number of shares determined by the Board of Directors. Effective January 1, 2006, 1,457,786 shares were added to the 2004 Equity Incentive Plan pursuant to the automatic refresh provision of the plan.

The following table summarizes stock option activity, vesting and price information as follows:

	Stock Options	Weighted Average Exercise Price
Outstanding at December 31, 2005	8,379,216	$ 5.87
Options Granted	947,400	$ 16.81
Options Exercised	(86,918)	$ 2.85
Options Forfeited or Expired	(119,625)	$ 6.83
Outstanding at March 31, 2006	9,120,073	$ 7.02
Vested and exercisable	3,887,153	$ 3.96

As of March 31, 2006, 2,368,946 shares were available for future stock option grants. At March 31, 2006 the intrinsic value and average remaining contractual life was $106 million and 8.03 years for all outstanding options and $57.1 million and 7.01 years for vested options. Options granted in the three months ended March 31, 2006 and 2005 had a weighted-average grant date fair value of $7.10 and $4.60, respectively. The total intrinsic value of options exercised for the three months ended March 31, 2006 and 2005 was approximately $1,127,115 and $589,339, respectively.

The value of the Company s stock options granted under its stock option plans during the first three months of 2006 and 2005 was estimated at the date of grant using the following assumptions:

	March 31, 2006	March 31, 2005
Expected term	5.3 years	4 years
Expected volatility	67.39%	57.84%
Risk-free interest rate	4.55%	4.30%
Dividend yield		

The Company estimated the expected term of its options based on historical exercises and cancellations of vested shares. The estimated expected volatility was based on the historical stock prices of companies similar to MPS, as it does not have sufficient historical data as a public company to determine reasonable estimates. MPS considered companies of similar size, industry and financial structure to devise its estimate. The Company uses the U.S. Treasury yield for its risk-free interest rate and a dividend yield of zero as it does not issue dividends.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

At March 31, 2006, unamortized compensation expense related to unvested options was approximately $21.4 million. The weighted average period over which compensation expense related to these options will be recognized is approximately 1.39 years.

2004 Employee Stock Purchase Plan

The Employee Stock Purchase Plan (the Purchase Plan) became effective on the closing of the Company s initial public offering. These grants have no maximum contractual term and are vested at the purchase date. Under the Purchase Plan, eligible employees may purchase common stock through payroll deductions. Participants may not purchase (i) more than 2,000 shares in a six-month offering period or (ii) stock having a value greater than $25,000 in any calendar year as measured at the beginning of the offering period in accordance with the Internal Revenue Code and applicable Treasury Regulations. A total of 200,000 shares of common stock were reserved for issuance under the Purchase Plan. The Purchase Plan provides for annual automatic increases beginning on January 1, 2005 by an amount equal to the lesser of 1,000,000 shares; 2% of the outstanding shares of common stock on the first day of the year; or a number of shares as determined by the Board of Directors. In January 2006, the number of shares available for future issuance under the Employee Stock Purchase Plan was increased by 583,114 shares. As of March 31, 2006, there were 1,157,097 shares available for issuance under the Purchase Plan.

The Purchase Plan contains a look-back option of up to six months prior to the purchase date and thus provides for a purchase price that is 85% of the lesser of the price on the grant date or the purchase date. Therefore, the plan is considered compensatory under FAS123R and is accounted for in accordance with Financial Accounting Standards Board (FASB) Technical Bulletin 97-1 (FTB97-1) *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option*. The fair value of stock purchase rights granted under the Company s Purchase Plan is estimated on the date of grant using the Black-Scholes option valuation model. Expected volatilities are based, as above, on the historical volatility of a peer-group. The Company uses the U.S. Treasury yield for the risk-free interest rate.

The value of the Company s stock purchase rights granted under the Purchase Plan during the three months ended March 31, 2006 and 2005 was estimated at the date of grant using the following weighted average assumptions:

	March 31, 2006	March 31, 2005
Expected term	0.58 years	0.73 years
Expected volatility	36.70%	40.00%
Risk-free interest rate	3.82%	4.00%
Dividend yield		

Prior to the Company s adoption of SFAS 123(R), the Company accounted for stock-based awards to employees under the recognition and measurement principles of APB Opinion No. 25 and related interpretations. The Company amortized 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*

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 SFAS 123, *Accounting for Stock-Based Compensation*. As required under SFAS 123, the reported net income and earnings per share for the three months ended March 31, 2005 have been presented to reflect the impact had the Company been required to include the fair value amortization (as determined using the Black-Scholes option pricing model) as an expense. The pro-forma amounts are as follows (in thousands):

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

	March 31, 2005
Net loss, as reported	$ (1,383)
Add stock-based employee compensation included in net loss	1,051
Less stock-based employee compensation expense determined under the fair value method, net of tax	(1,659)
Pro forma net loss	(1,991)
Basic and diluted loss per share:	
As reported	$ (0.05)
Pro forma	$ (0.07)

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

	March 31, 2006	December 31, 2005
Work in progress	$ 3,410	$ 2,516
Finished goods	5,133	3,649
Total inventories	$ 8,543	$ 6,165

4. Accrued Liabilities - Accrued liabilities consist of the following (in thousands):

	March 31, 2006	December 31, 2005
Legal expense and settlement costs	$ 7,610	$ 7,297
Professional fees	757	731
Warranty	699	490
Deferred Revenue	318	266
Accrued outside sales commissions	269	355
Other	393	658
Total accrued liabilities	$ 10,046	$ 9,797

5. Comprehensive Loss and Net Loss per Share Basic Net Income (Loss) per Share is computed based only on the weighted average number of common shares outstanding during the period and does not include the dilutive effect of common equivalent shares, such as stock options. Diluted Net Income (Loss) per Share is computed based on both the weighted average number of common shares outstanding during the period and the dilutive effect of common equivalent shares, such as stock options.

For the three months ended March 31, 2006 and 2005, the Company had securities outstanding, that could potentially dilute basic earnings per share in the future, but were excluded in 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:

	Three months ended	
	March 31,	
(Shares in thousands)	**2006**	**2005**
Stock options	8,974	8,315
Warrants	34	94
Restricted stock	335	
Total	9,343	8,409

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

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 March 31, 2006	2005
Net loss	$ (408)	$ (1,383)
Other comprehensive income (loss):		
Unrealized holding gains (losses) on available-for-sale securities		(17)
Foreign currency translation adjustments	121	(18)
Comprehensive loss	$ (287)	$ (1,418)

6. *Income Taxes*

The Company computes income taxes for interim reporting purposes using estimates of the effective annual income tax rate for the entire fiscal year. This process involves estimating the actual current tax liability together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These temporary differences result in deferred tax assets and liabilities, which are recorded on the Company s Consolidated Balance Sheet in accordance with SFAS No. 109. The Company must assess the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent the Company believes that recovery is not likely, it must establish a valuation allowance. Changes in the Company s valuation allowance in a period are recorded through the Income Tax Provision on the Consolidated Statements of Operations.

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 March 31, 2006, the Company s estimate of the effective tax rate for the year ending December 31, 2006 is 37.7%. The Company s effective tax rate for the year ended December 31, 2005 was 36.6%.

We also adopted SFAS 123(R) as of January 1, 2006 and, as a result, incurred significant stock-based compensation expense, most of which related to incentive stock options for which no corresponding tax benefit is recognized unless a disqualifying disposition occurs. Disqualifying dispositions result in a reduction of income tax expense in the quarter when the disqualifying disposition occurs in an amount equal to the tax benefit relating to previously expensed stock compensation. Tax benefits related to tax deductions in excess of previously expensed stock compensation are recorded as an addition to paid-in-capital. During the quarter ended March 31, 2006, tax expense was reduced by $231,000 as a result of disqualifying dispositions.

7. *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. Geographic revenue is based on the location to which customer shipments are delivered. The Company derived substantially all of its revenue from sales delivered to customers located outside North America during the three months ended March 31, 2006 and 2005. For the three months ended March 31, 2006, the Company had one customer to which sales exceeded 10% of revenue, accounting for 17% of revenue. For the three months ended March 31, 2005, the Company had three customers to which sales exceeded 10% of revenue, which accounted for 24%, 20%, and 11% of the Company s revenue, respectively. The year over year decrease in the number of customers to which sales exceeded 10% of our revenue is due to our revenue growth and the diversification of our customer base. The following is a summary of revenue by geographic region based on customer ship-to location (in thousands):

Three Months Ended

Country	March 31, 2006	March 31, 2005
China	$ 9,519	$ 7,489
Taiwan	7,844	4,186
Korea	2,731	1,590
Europe	1,786	102
Japan	1,659	980
USA	774	176
Other	450	114
Total	$ 24,763	$ 14,637

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

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

	Three Months Ended	
	March 31,	March 31,
Product	**2006**	**2005**
DC to DC Converters	$ 16,415	$ 7,310
LCD Backlight Inverters	7,403	6,754
Audio Amplifiers	945	573
Total	$ 24,763	$ 14,637

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

	March 31,	December 31,
Country	**2006**	**2005**
China	5,421	2,059
United States	4,031	4,148
Taiwan	111	105
Japan	39	43
Korea	32	19
Total	$ 9,634	$ 6,374

8. ***Litigation***

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

Since November 2000, the Company has been engaged in multiple legal proceedings against O2 Micro, Inc. and its parent corporation, O2 Micro International Limited (referred to here as O2). These proceedings involve various claims and counterclaims in the United States and Taiwan alleging patent infringement, trade secret misappropriation, and unfair competition. All of these claims relate to the Company s CCFL backlight inverter products, which are part of the Company s LCD backlight inverter family, and all of the Company s CCFL products could be affected by O2 s claims. For fiscal 2005, revenue from the Company s CCFL backlight inverter product family was $38.1 million or 38.4% of total revenue. For the first quarter of 2006, CCFL revenue was $7.4 million, or 30% of total revenue. Products used in Asia represented a substantial portion of the Company s 2005 CCFL revenue. 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.

Regardless of the extent to which these legal actions have been successful or not successful, the legal expenses associated with the various actions in the U.S. and Taiwan have been high and have had a significant impact on the Company s financial position and results of operations.

Patents at Issue

The various litigations arise from patents issued to O2 and the Company covering products that compete with each other.

The Company s Patents. The Company s patents at issue are (i) U.S. Patent No. 6,114,814, issued on November 5, 2000 and relating to inverter ICs for LCD display products (which include, for example, the Company s CCFL backlight inverter product family) (the 814 patent) and (ii) U.S. Patent No. 6,316,881 (the 881 patent), a continuation of the 814 patent that was issued on November 13, 2001.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

O2 s Patents. The O2 patents at issue are (i) U.S. Patent No. 6,259,615 issued to O2 on July 10, 2001 and also relating to inverter ICs for LCD display products (the 615 patent), (ii) U.S. Patent No. 6,396,722 (the 722 patent), a continuation of the 615 patent that was issued to O2 on May 28, 2002, (iii) U.S. Patent No. 6,804,129 (the 129 patent), a continuation of the 615 and 722 patents that was issued to O2 on October 12, 2004, and (iv) Taiwan Patent No. 152318 that was issued to O2 on March 1, 2002, which is a counterpart to the 615 patent (the 318 patent). 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 and accordingly the U.S. patent was narrowed significantly before issuance. The Taiwan patent, however, was not similarly narrowed and was issued in the broader form originally requested.

U.S. Litigation

In consolidated cases pending in the United States District Court for the Northern District of California, O2 claimed that the Company misappropriated certain trade secrets, interfered with its economic advantage, and infringed its 615 patent, and the Company claimed that O2 infringed its 814 and 881 patents. In February and May, 2004, the judge ruled that the Company did not infringe O2 s 615 patent and dismissed O2 s claims for interference with economic advantage. In the trial of that case, the jury returned a verdict on July 18, 2005, finding that the Company had willfully misappropriated certain O2 trade secrets and awarding O2 damages in the amount of $12 million. The jury also found that O2 did not infringe the Company s 814 and 881 patents and that the patent claims the Company had asserted against O2 are invalid. On October 3, 2005, the judge in the case issued a partial judgment that the Company s products do not infringe O2 s 615 patent, confirming the previous summary judgment entered in the Company s favor in February 2004. O2 has appealed this judgment. On November 10, 2005, the judge granted the Company s motion to set aside the jury s $12 million damages award, and instead awarded O2 a royalty of $900,000. Based on the jury s finding of willful misappropriation of trade secrets, the judge also awarded exemplary damages of $1.8 million, bringing the total damages award to $2.7 million plus interest and costs of suit. The judge denied O2 s requests for an injunction and for attorneys fees, and also found that the Company had not engaged in inequitable conduct in the prosecution of the Company s patents. On November 30, the judge issued an amended judgment clarifying the previous judgment. On December 30, the court awarded O2 its costs in the amount $0.1 million. On March 9, 2006, the judge ruled on the remaining post-trial motions and entered a second amended judgment. The judge denied all of the motions made by the Company and O2, except that the judge awarded O2 pre-judgment interest in the amount $0.3 million on the royalty previously awarded, and granted a procedural motion the Company had made to preserve certain rights pending resolution of issues on appeal. The Company has obtained and filed a bond to stay execution of the judgment previously entered, and is seeking a bond on the costs and pre-judgment interest awards pending any appeals. The Company and O2 have appealed from various aspects of the second amended judgment. The Company will continue to incur substantial legal expense in connection with any appeals in this case. If O2 were to be successful on any appeals from the judgments in the Company s favor, the jury s $12 million verdict could be reinstated and/or O2 s claims could be remanded for further proceedings, potentially including trial of issues that were decided in the Company s favor on summary judgment. Rulings against the Company on any of these issues on retrial could result in an award of damages to O2 or an injunction against selling the Company s products in the U.S. Any such injunction or damages award would have a material adverse effect on the Company s business and results of operations, at least for several quarters and possibly for a much longer period of time, depending on the extent of any such damage award and the scope and applicability of any such injunction.

In January 2003, O2 filed a lawsuit against Sumida Corp. and the Company s customer Taiwan Sumida Electronics Inc. (TSE) in the U.S. District Court for the Eastern District of Texas alleging that TSE s use of some of the Company s CCFL products in its inverter board products infringes the 615 and 722 patents.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued) (Unaudited)

Sumida Corp. was subsequently dismissed from the case. On November 3, 2005, the judge ruled that TSE s accused products do not infringe the 615 patent, based on the judgment entered in favor of the Company in Oakland. On November 17, 2005, the jury in the case rendered a verdict that TSE willfully contributed to and induced infringement of certain claims of O2 s 722 patent and that those claims of the patent are valid. A partial judgment has been entered in favor of TSE that it does not directly infringe those claims and that it does not infringe O2 s 615 patent. On April 12, 2006, the judge in the case rendered an opinion reversing the jury s verdict that TSE contributed to infringement of the patent claims, but agreeing with the jury s verdict that TSE induced infringement. A final judgment has been entered against Sumida for $4 million in damages plus O2 s costs in an amount to be determined. The judge also found that the case was a special case, entitling O2 to recover its attorneys fees in an amount to be determined. TSE and O2 have agreed that any award of attorneys fees will not exceed $3 million. While the Company was not a party to the litigation, the Company expects that O2 will argue that any judgment of patent infringement against TSE should be binding on the Company. The Company will oppose any such argument. The Company had previously entered into an agreement with TSE under which the Company had agreed to indemnify TSE against claims by O2; however, in August, 2005, the Company terminated the agreement and sued TSE for material breach of the agreement. In January 2006, TSE filed a counterclaim against the Company for breach of contract.

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. That case has been assigned to the same judge presiding over the litigation over the 615, 814, and 881 patents described above. In October 2004, O2 filed a counterclaim for alleged infringement of the 722 patent, and added the Company s foundry, Advanced Semiconductor Manufacturing Corporation of Shanghai (ASMC), as a counterclaim defendant. The Company is defending and indemnifying ASMC. No trial date is set.

On October 12, 2004, O2 filed a lawsuit against the Company 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 the 129 patent. O2 has sued several of the Company s direct and indirect customers and ASMC in the case, and has asserted claims against them for infringement of the 129 patent, the 722 patent, and the 615 patent. The Company is defending and indemnifying some of these defendants. One of the other defendants, Compal Electronics has filed cross-claims for indemnity against the Company and a third party, Delta Electronics. On November 18, 2005, O2 filed a second amended complaint adding a claim for unfair competition against the Company and Michael Hsing, the Company s CEO. On December 19, 2005, the Company filed a counterclaim against Delta Electronics and a third party complaint against O2 for wrongful trade secret misappropriation and unfair competition. Pursuant to the Company s request, this case has been transferred to the Northern District of California, and is now pending before the same judge who is hearing the case pertaining to the 722 patent.

If the Company does not prevail in any of the pending U.S. litigations with O2 or does not prevail on its post-trial motions and/or appeal from the judgments entered in the Northern District of California, or if the Company is held to be bound by any adverse judgment entered against TSE, the Company and/or some of the Company s customers could be enjoined from selling some or all of the Company s CCFL products in the United States and/or the Company could be required to pay damages to O2 on its own behalf and/or on behalf of some of its customers and/or ASMC. Any such injunction or additional damages award would have a material adverse effect on the Company s business and results of operations.

Taiwan Litigation

Summary. 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 April 2004, O2 filed a lawsuit against the Company in Taipei District Court that the Company s products infringe O2 s 318 patent. Unlike the U.S., where a party seeking a preliminary injunction must first file a lawsuit on the merits of the underlying claim, in Taiwan it is possible for a party to be granted a preliminary injunction without first filing a lawsuit on the

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merits. In January 2003, the Shihlin District Court in Taiwan issued a preliminary injunction prohibiting the Company from manufacturing, designing, displaying, importing or selling the Company s MP1011A and MP1015 products in Taiwan, either directly or through a third party acting at the Company s request.

The Company believes that the Company has at all times conducted the Company s business in compliance with the injunction. Nevertheless, O2 has repeatedly attempted various actions to persuade the court that the Company has violated it. The court has not yet issued a ruling on O2 s motion. The Company intends to continue pursuing any and all available legal avenues to remove the preliminary injunction and/or have O2 s 318 patent declared invalid.

The Company s Counter-Injunctions against O2. The Company has obtained two counter-injunctions from the Taipei District Court against O2, the first of which prohibits O2 from interfering with the Company s or other parties use of the Company s MP 1011A and MP 1015 products. The second injunction 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, although the MP 1010B is not specifically addressed in this counter-injunction. The Company posted cash bonds of approximately $6.1 million (including the $90,000 bond discussed below) with the Taipei District Court in connection with the two defensive preliminary injunctions. These bonds are currently recorded as restricted assets on the Company s balance sheet. If the Company does not prevail at trial, 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.

O2 s Other Actions against The Company. In August 2003, November 2003, and March 2004, the court granted three provisional seizures against the Company in the Shihlin District Court and Taipei District Court, which would entitle O2 to seize up to approximately $1.9 million of the Company s assets in Taiwan, including but not limited to MP 1011A and MP 1015 parts. The execution of the first provisional seizure was exempted because the Company posted a bond in the amount of approximately $90,000. The second and third provisional seizure orders have not yet been executed to the satisfaction of O2 s demand, and accordingly O2 may continue to request that the court seize the Company s property under these orders. If O2 were to receive final judgment in its favor on the merits, O2 would be able to file an application to sell the seized assets by auction to cover any damages that the court determines O2 to have suffered.

Trial on the Merits in Taiwan. The Company could lose at trial on the question of whether some of the Company s products 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. 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 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 of the Company s MP 1011A or MP 1015 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.

O2 s Lawsuits against The Company s Customers and Other Third Parties.

In addition to lawsuits between O2 and the Company, O2 has also initiated numerous legal proceedings in Taiwan against other companies which have been purchasers and/or users of the Company s products. Under certain circumstances, the Company has agreed to indemnify certain customers against patent

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infringement. Continued expenditure of the Company s funds in defending customers and manufacturer against O2 s lawsuits could materially and adversely affect the Company s financial condition and operating results.

Microsemi Corporation

On October 7, 2004, Microsemi Corporation (Microsemi) filed a patent infringement lawsuit in the United States District Court for the Central District of California. The lawsuit asserted four patents allegedly infringed by the Company and sought an injunction to prevent the Company from allegedly infringing the patents, as well as unspecified damages, attorneys fees, costs, and expenses. The Company 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.

Effective March 24, 2006, the Company entered into a settlement agreement with Microsemi, pursuant to which all claims in the action were dismissed with prejudice, and Microsemi agreed not to sue the Company in the future on the four asserted patents. The Company made a one-time payment to Microsemi of $1.5 million, which was recorded in the fourth quarter of 2005 as a provision for litigation awards and settlements. The settlement agreement is attached to the Company s 2005 Form 10K as Exhibit 10.18. On March 29, 2006, pursuant to the terms of the settlement agreement, the action was dismissed with prejudice.

Micrel Corporation

On November 10, 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. Michael Hsing, the Company s Chief Executive Officer, and another of the Company s employees are named inventors on both of Micrel s patents and Jim Moyer, the Company s Chief Design Engineer, is a named inventor on one of them. Because Micrel s patents relate to semiconductor manufacturing processes and semiconductor design elements rather than a specific device, all of the Company s products could potentially be implicated. The complaint requests among other remedies preliminary and permanent injunctions to prevent the Company from allegedly infringing the patents, as well as unspecified damages, attorneys fees, costs, and expenses.

On November 29, 2004, Micrel filed an amended complaint adding causes of action for alleged statutory and common law misappropriation of trade secrets, alleged breach of confidentiality agreements by Messrs. Hsing and Moyer (both former employees of Micrel), and alleged violation of California s Unfair Competition Law. The amended complaint also adds Messrs. Hsing and Moyer as defendants. Micrel s amended complaint adds requests for 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. The Company filed motions to dismiss these claims on statute of limitations and preemption grounds. On December 9, 2005, the Court dismissed the two claims for misappropriation of trade secrets on statute of limitation grounds.

The court has not set a trial date, and discovery is in the early stages. A Markman hearing is scheduled for May 10, 2006. Because the litigation has not fully developed, 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 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

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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 business and results of operations.

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

This quarterly report on Form 10-Q contains forward-looking statements 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,

our plan to continually introduce new products, and our expectation that we will derive an increasing percentage of our revenue from new products,

seasonality in the markets in which we sell our products,

our expectation that we will experience higher revenue in the second half of each calendar year,

increasing diversity in our product mix,

expectations of, and provisions for, future income taxes, and

estimates of our future liquidity requirements.

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. These statements are only predictions based upon assumptions made that we believe 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 in the section entitled Factors that May Affect Future Operating Results. These factors may cause our actual results to differ materially from any forward-looking statements. 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.

Overview

We are a fabless semiconductor company that designs, develops, and markets proprietary, advanced analog and mixed-signal integrated circuits. We currently offer products that serve multiple markets including notebook computers, flat panel displays, cellular handsets, digital cameras, wireless local area network (LAN) access points, home entertainment systems, and personal digital assistants among others. We believe we differentiate ourselves by offering integrated circuit solutions that are more highly integrated, smaller in size, more energy efficient, more accurate with respect to performance specifications, and, accordingly, more cost-effective than many competing solutions. As we continue to grow our business, we plan to introduce additional new products within our existing product families and other products including voltage references.

We derive a majority of our revenue from sales of our DC to DC converter product family which services the computing, consumer electronics and wireless markets. In the future, we expect increased revenue from sales of our other products, such as audio ICs and the new product offerings mentioned above. 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.

We operate in the cyclical semiconductor industry. 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 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.

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The markets in which we sell our products are subject to seasonality. Our revenue is generally higher in the third and fourth quarters of each calendar year relative to the first and second quarters, as customers place orders to meet year-end holiday demand. Due to this seasonality, our revenue tends to decrease in the first quarter of each calendar year relative to the prior quarter. However, our overall revenue growth makes it difficult for us to assess accurately 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.

Following the introduction of a product, our sales cycle generally takes 6 to 12 months to complete. Volume production is usually achieved an additional 3 to 6 months after we receive initial customer orders for a new product. Typical lead times for orders are fewer than 90 days. These factors, combined with the fact that orders in the semiconductor industry can typically be cancelled or rescheduled without significant penalty to the customer, make the forecasting of our orders and revenue 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.

For the three months ended March 31, 2006, we had one customer to which sales exceeded 10% of our revenue, accounting for 17% of revenue. For the three months ended March 31, 2005, we had three customers to which sales exceeded 10% of revenue, accounting for 24%, 20%, and 11% of revenue, respectively. The year over year decrease in the number of customers to which sales exceeded 10% of our revenue is due to our revenue growth and the diversification of our customer base.

We derived 97% of our revenue from sales to foreign customers during the three months ended March 31, 2006. The vast majority of this revenue was from direct sales or sales through distribution arrangements to parties located in Asia, as many of our ICs are components in electronic products manufactured in Asia. Revenues for the three months ended March 31, 2006 were up 69% from the three months ended March 31, 2005 but down 24% from the three months ended December 31, 2005. In addition to the factors described in Results of Operations below, this sequential decline was due to first-quarter seasonality and a buildup in inventory by certain of our distributors in the three months ended December 31, 2005 that resulted in lower sales to such distributors in the three months ended March 31, 2006. Gross Margins for the three months ended March 31, 2006 remained in our target range of 58%- 63%. The startup of the Chengdu Test Operations in the three months ended March 31, 2006 as well as reduced efficiencies due to lower shipment volumes, contributed to lower gross margins as compared to the three months ended December 31, 2005. Lower revenues, the addition of sales and design personnel and employee stock-based compensation expense attributable to our recent adoption of FAS123R resulted in a net loss from operations in the quarter ended March 31, 2006. For more details see Results of Operations.

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, revenue 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, contingencies, litigation and valuation of stock-based compensation. 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.

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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 revenue 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 shipments (when title passes) to customers. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely impacted.

The majority of our sales are made through distribution arrangements with third parties. We recognize revenue upon our shipment to those third party distributors under these distribution arrangements. Although some of these arrangements include limited stock rotation rights that permit the return of a small percent of the previous six months purchases, we have not experienced any significant returns pursuant to these provisions. Our normal payment terms with our distributors are 30 days from invoice date, and our arrangements with our largest distributors generally do not include price protection provisions. In addition, the terms in a majority of our distribution agreements include the non-exclusive right to sell, and the agreement to use best efforts to promote and develop a market for, our products in certain regions of the world and the ability to terminate the agreement by either party with up to three months notice. Estimated sales returns are based on historical experience and are recorded at the time product revenue is recognized.

In the first quarter for 2006, we signed a distribution agreement with a major US Distributor. The majority of the revenue from this distributor will be recognized on a resale basis. Through the first quarter of 2006, no shipments were made under this agreement.

Warranty Reserves. Prior to August 1, 2005, we provided a standard 90-day warranty against defects in materials and workmanship. Effective August 1, 2005, we extended the warranty period to one year for all our products. For products sold under our warranty, we will repair the goods, provide replacements at no charge to the customer, or refund amounts to the customer for defective products. Warranty reserves were established beginning August 1, 2005 due to this change in the standard warranty period. We record estimated warranty costs at the time we recognize product revenue. These costs are based on historical experience by product over the preceding 12 months. As the complexity of our products increases, we could experience higher warranty claims relative to sales than we have previously experienced, and we may need to increase these estimated warranty reserves.

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

Accounting for Income Taxes. Statement of Financial Accounting Standards No. 109, (SFAS No. 109), *Accounting for Income Taxes*, establishes financial accounting and reporting standards for the effect of income taxes. In accordance with SFAS No. 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. We record a valuation allowance to reduce any deferred tax assets by the amount of any tax benefits that, based on available evidence and judgment, are not expected to be realized.

Our calculation of current and deferred tax assets and liabilities is based on certain estimates and judgments and involves dealing with uncertainties in the application of complex tax laws. Our estimates of current and deferred tax assets and liabilities may change based, in part, on added certainty or finality to an anticipated outcome, changes in accounting or tax laws in the United States (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.

We also adopted SFAS 123(R) as of January 1, 2006 and, as a result, incurred significant stock-based compensation expense, most of which related to incentive stock options for which no corresponding tax benefit is recognized unless a disqualifying disposition occurs. Disqualifying dispositions result in a reduction of income tax expense in the quarter when the disqualifying disposition occurs in an amount equal to the tax benefit relating to previously expensed stock compensation. Tax benefits related to tax deductions in excess of previously expensed stock compensation are recorded as an addition to paid-in-capital. During the quarter ended March 31, 2006, tax expense was reduced by $231,000 as a result of disqualifying dispositions.

As of March 31, 2006 and December 31, 2005, we had a valuation allowance of $2.2 million and $2.1 million, respectively, attributable to management s determination that a portion of the deferred tax assets associated with certain stock based compensation transactions will not be realized. Should it be determined that all or part of the net deferred tax asset would not be realized in the future, an adjustment to increase the deferred tax asset valuation allowance would be charged to income in the period such determination would be made.

Contingencies. We are currently engaged in litigations that are described in Note 8 to our Condensed Consolidated Financial Statements. In addition, from time to time, we become aware that we are subject to other contingent liabilities. When this occurs, we will evaluate the appropriate accounting for the potential contingent liabilities using 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 the facts and circumstances in each matter, we use our judgment to determine whether it is probable that a contingent loss has occurred and whether the amount of such loss can be estimated. If we determine a loss is probable and estimable, we record a contingent loss in accordance with SFAS 5. In determining the amount of a contingent loss, we take into account advice received from experts for each specific matter regarding the status of legal proceedings, settlement negotiations (which may be ongoing) prior case history and other factors. Should the judgments and estimates made by management need to be adjusted as additional information becomes available, we may need to record additional contingent losses that could materially and adversely impact our results of operations. Alternatively, if the judgments and estimates made by management are adjusted, for example, if a particular contingent loss does not occur, the contingent loss recorded would be reversed which could result in a favorable impact on results of operations.

Accounting for Stock-Based Compensation. Beginning in fiscal year 2006, we began accounting for stock-based compensation arrangements in accordance with the provisions of SFAS 123(R). Under SFAS 123(R), compensation cost is established by determining the fair value of the option on the date of grant. The compensation cost is then amortized straight-line over the vesting period. We use the Black Scholes option pricing model to determine the fair value of the stock options at the date of grant. Black Scholes requires us to estimate key assumptions such as expected term, volatility and forfeiture rates that determine the stock options fair value. The estimate of these key assumptions is based on historical information and judgment regarding market factors and trends. If actual results are not consistent with our assumptions and judgments used in estimating the key assumptions, we may be required to increase or decrease compensation expense or income tax expense, which could be material to our results of operations.

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Results of Operations

The table below sets forth the data from our statement of operations as a percentage of revenue for the periods indicated:

	Three months ended March 31,	
	2006	2005
Revenue	100.0%	100.0%
Cost of revenue (including stock-based compensation)	37.9	37.9
Gross profit	62.1	62.1
Operating expenses:		
Research and development (including stock-based compensation)	20.4	21.7
Selling, general and administrative (including stock-based compensation)	30.0	24.3
Patent litigation	16.4	30.7
Total operating expenses	66.8	76.7
Operating loss	(4.7)	(14.6)
Other income (expense):		
Interest and other income	2.4	2.5
Interest and other expense	(0.3)	(0.2)
Total other income (expense), net	2.1	2.3
Loss before income taxes	(2.6)	(12.3)
Income tax benefit	(1.0)	(2.8)
Net loss	(1.6)%	(9.5)%

Revenue. Revenue for the three months ended March 31, 2006 was $24.8 million, an increase of $10.1 million, or 69.2%, over $14.6 million for the three months ended March 31, 2005. Revenue from our DC to DC converter product family increased $9.1 million, or 124.6%, due to higher volume shipments resulting from increased order rates for existing and new products for shipments into the computer and consumer electronic communications markets. Revenue from our LCD backlight inverter product family increased $0.6 million, or 9.6%, due to higher volume shipments resulting from increased order rates for existing and new products. Revenue for our audio amplifier product family increased $0.4 million, or 64.9%, due to an increased demand for our existing products.

Non-domestic revenue for the three months ended March 31, 2006 was $24.0 million or 97%, an increase of $9.5 million as compared to non-domestic revenue of $14.5 million, or 98.8% of revenue, for the three months ended March 31, 2005. This increase was due mainly to higher volume shipments resulting from increased order rates for existing and new products.

In previous years, we have experienced rapid revenue growth and have gained significant market share in a relatively short period of time due to increased sales of our LCD backlight inverter and DC to DC converter product families. Specifically, our annual revenue increased 310% during the two years ending December 31, 2005. In the first quarter of 2006, we began experiencing shipment volumes lower than seasonal expectations. The ongoing litigation with O2 Micro and the recent adverse jury verdicts in two cases have resulted in some lost revenue and orders. In addition, certain of our distributors overestimated their own end customer demand and/or underestimated their own inventory at the end of the year. As a result, they ordered more of our products in the fourth quarter of 2005 than they needed to fulfill the requirements of their end customers. Accordingly, orders from these distributors in the first quarter of 2006 were lower than would otherwise have been expected. The following table illustrates changes in our revenue by product family (amounts in thousands):

	For the three months ended March 31, 2006 (in thousands)		2005 (in thousands)		
	Amount	% of Revenue	Amount	% of Revenue	Change
DC to DC Converters	$ 16,415	66.3%	$ 7,310	50.0%	124.6%
LCD Backlight Inverters	7,403	29.9%	6,754	46.1%	9.6%
Audio Amplifiers	945	3.8%	573	3.9%	64.9%
	$ 24,763	100.0%	$ 14,637	100.0%	69.2%

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Gross Profit. Gross profit as a percentage of revenue, was 62.1% for both the three months ended March 31, 2006 and March 31, 2005. Gross profit for the three months ended March 31, 2006 included $0.5 million of start-up expenses for our Chengdu testing facility.

Research and Development.

	Three months ended March 31,		
	2006	2005	Change
		(in thousands)	
Revenue	$ 24,763	$ 14,637	69.2%
Research and development (R&D) (including stock-based compensation of $1,363 in 2006 and $778 in 2005)	5,067	3,182	59.2%
R&D as a percentage of revenue	20.5%	21.7%	(1.2)%

Research and development expense was $5.1 million, or 20.5% of revenue, for the three months ended March 31, 2006 and $3.2 million, or 21.7% of revenue, for the three months ended March 31, 2005. This increase was due to costs associated with an increase in design engineering personnel as well as new product development activities both in the US and Asia. In the first quarter of 2006, we completed the start up phase of our design center in China and initiated start-up activities for several design centers outside of California. The increase in stock-based compensation is primarily due to the adoption of SFAS 123(R) effective January 1, 2006. See Note 2 Stock Based Compensation of Notes to the Condensed Consolidated Financial Statements for information regarding the adoption of SFAS 123(R).

Selling, General and Administrative.

	Three months ended March 31,		
	2006	2005	Change
		(in thousands)	
Revenue	$ 24,763	$ 14,637	69.2%
Selling, general and administrative (SG&A) (including stock-based compensation of $1,179 in 2006 and $752 in 2005)	7,427	3,555	108.9%
SG&A as a percentage of net revenue	30.0%	24.3%	5.7%

Selling, general and administrative expense was $7.4 million, or 30.0% of revenue, for the three months ended March 31, 2006, and $3.6 million, or 24.3% of revenue, for the three months ended March 31, 2005. $1.2 million was primarily due to increases in sales personnel and advertising expenses. We also incurred $1.8 million of additional professional fees primarily for auditing, tax and accounting services and activities related to finalizing year one of Sarbanes-Oxley compliance, the implementation of SFAS 123(R), and the restatement of prior SEC. Stock-based compensation allocated to selling, general and administrative expense was $1.2 million, or 4.8% of revenue for the three months ended March 31, 2006, compared to $0.8 million, or 5.1% of revenue for the three months ended March 31, 2005. The increase in stock-based compensation is primarily due to the adoption of SFAS 123(R) effective January 1, 2006.

Patent Litigation.

	Three months ended March 31,		
(in thousands)	2006	2005	Change
Revenue	$ 24,763	$ 14,637	69.2%
Litigation expenses	4,064	4,498	(9.6)%
Litigation expenses as a percentage of net revenue	16.4%	30.7%	(14.3)%

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Patent litigation expense was $4.1 million, or 16.4% of revenue, for the three months ended March 31, 2006, and $4.5 million or 30.7% of revenue, for the three months ended March 31, 2005. For a more complete description of our litigation matters, please see Note 8 Litigation of Notes to the Condensed Consolidated Financial Statements.

Income Tax Benefit. In the first quarter of 2006, we had an income tax benefit of $0.2 million. This was the result of our $0.6 million pre-tax loss for the three months ended March 31, 2006. Income tax expense in 2006 is based on our estimated annual effective tax rate of 37.7%. Our effective tax rate is based on the mix of income between domestic and non-domestic operations.

Liquidity and Capital Resources.

As of March 31, 2006, we had working capital of $66.0 million, including cash and cash equivalents of $25.9 million, investments of $38.7 million and restricted assets-current of $3.5 million. This compared to working capital of $65.5 million, including cash and cash equivalents of $25.1 million, investments of $38.8 million and restricted assets-current of $2.9 million as of December 31, 2005. Net cash provided by operating activities was $2.5 million for the three months ended March 31, 2006, compared to $1.3 million for the three months ended March 31, 2005. The increase in cash provided by operating activities for the three months ended March 31, 2006, was primarily driven by increased collection of accounts receivable, the timing of certain inventory related accounts payable and taxes payable. Net cash used in investing activities was $3.1 million in the three months ended March 31, 2006 and $0.4 million in the three months ended March 31, 2005. In the three months ended March 31, 2006, we purchased $2.6 million of capital equipment primarily for our Chengdu, China facility.

We use professional investment management firms to manage the majority of our invested cash. External investment firms managed 65.4% of our cash and investment balances for the year ended March 31, 2006. All investments are made according to guidelines and policies approved by the Board of Directors. Net cash provided by financing activities for the three months ended March 31, 2006 and 2005 was $1.4 million and $0.1 million, respectively. The increase in net cash provided by financing activities for the three months ended March 31, 2006 was due to $0.2 million in proceeds from the exercise of stock options, $0.6 million from the issuance of common stock under the Employee Stock Purchase Plan and repayment of a note by a stockholder.

We believe that cash generated from operations, together with the liquidity provided by existing cash balances and short term investments, will be sufficient to satisfy our liquidity requirements for the next 12 months. For further details regarding our operating, investing and financing activities, see our Consolidated Statement of Cash Flows.

Contractual Obligation and Off Balance Sheet Arrangements.

We lease our headquarters and sales offices under noncancelable operating leases which expire at various dates through 2010. Certain of our facility leases provide for periodic rent increases. In addition, we entered into lease arrangements in 2004 for facilities located in Chengdu, Shanghai and Shenzhen, China. Total obligations under these leases are included in the table below.

We outsource the production of wafers to a third party foundry. The agreement with the foundry provides for a non-binding rolling six-month production forecasts. Additionally, we purchased assembly services from 2 Asian contractors. As of March 31, 2006 total outstanding purchase commitments were $14.1 million.

As of March 31, 2006, we had no off-balance sheet financing arrangements or activities outside of operating leases and purchase orders other than those discussed above. The following table summarizes our contractual obligations at March 31, 2006, and the effect such obligations are expected to have on liquidity and cash flow over the next five years (in thousands):

	Payments by Period				
	Total	**Less than 1 year**	**1-3 years**	**3-5 years**	**Thereafter**
Operating leases	$ 2,783	$ 958	$ 1,652	$ 173	$
Outstanding purchase commitments	14,067	14,067			
	$ 16,850	$ 15,025	$ 1,652	$ 173	$

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

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

In connection with the filing of this quarterly report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer, with the participation of management, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q, and concluded that due to the material weaknesses described below, we 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 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. The following material weaknesses have been identified:

- A material weakness in the design and operating effectiveness of controls over the accuracy and disclosure of stock-based employee compensation expense in conformity with generally accepted accounting principles. Specifically, we did not maintain effective controls over the following:

  - the completeness and accuracy of the accounting for option cancellations and

  - the accuracy of the recording of stock-based compensation.

These control deficiencies led to a misstatement of stock-based compensation expense that resulted in a material misstatement to the financial statements in prior periods which was not prevented or detected.

- A material weakness in the design and operating effectiveness of controls over the accounting for income taxes, including the calculation of the income tax provision and related deferred tax assets and liabilities. This control deficiency led to a misstatement of the deferred tax asset and related tax provision that resulted in a material misstatement to the financial statements in prior periods which was not prevented or detected.

- A material weakness in the operating effectiveness of controls over the financial close, budgeting and reporting process. Specifically, we did not maintain effective controls over the following:

  - completing a reconciliation for all key accounts each month, and

  - completing a detailed review of the actual results versus the budgeted results for each period.

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A material weakness in the operating effectiveness of controls over allocation of expenses to the appropriate accounting period.

A material weakness in the control environment due to an insufficient number of qualified resources with required proficiency to apply our accounting policies.

These material weaknesses were previously reported in our 2005 Form 10-K filed with the SEC on March 28, 2006. We have not yet completed the remediation efforts required to address these material weaknesses. However, we have outlined a remediation plan that addresses all control deficiencies and material weaknesses.

Changes in internal control over financial reporting. In response to the material weaknesses described above, during the period covered by this quarterly report on Form 10-Q, we made the following changes to our internal controls over financial reporting that will materially affect, or are reasonably likely to materially affect, our internal control over financial reporting:

We hired a new Corporate Controller with over 20 years of financial and operations management experience in the semiconductor and electronic design automation industries to oversee all areas of finance and accounting.

We upgraded the software used to record awards of stock-based compensation and calculate related expense required by SFAS 123(R).

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a complete description of our legal proceedings, please see our Form 10K filed with the SEC on March 28, 2006, and Note 8 to our Condensed Consolidated Financial Statement, which are incorporated herein by reference. Only significant developments since March 28, 2006 are included in this Item.

O2 Micro, Inc. (O2)

In the consolidated cases pending in the United States District Court for the Northern District of California in which O2 alleges that certain of our CCFL products infringe O2 s 615 patent and that we misappropriated some of O2 s alleged trade secrets, and in which we allege that O2 infringes two of our patents, we have filed a Notice of Appeal from the second amended judgment that was entered on March 9, 2006, and O2 has filed a Notice of Cross-Appeal.

The case that O2 filed on October 12, 2004 in the United States District Court for the Eastern District of Texas, in which O2 alleges that we, ASMC, and certain of its customers infringe various of the O2 patents, has been transferred to the United States District Court for the Northern District of California. The case will be heard by the same judge who is hearing the case pertaining to O2 s 722 patent and who presided over the case involving O2 s 615 patent and alleged trade secrets. The case has not yet been scheduled for trial.

Taiwan Sumida Electronics Corporation (TSE)

In the action that O2 filed against TSE in January, 2003, in the United States District Court for the Eastern District of Texas, on April 12, 2006, the judge in the case rendered an opinion reversing the jury s verdict that TSE contributed to infringement of the asserted claims of O2 s 722 patent but agreeing with the jury s verdict that TSE induced infringement. A final judgment has been entered against Sumida for $4 million in damages plus costs in an amount to be determined. The judge also found that the case was a special case, entitling O2 to recover its attorneys fees in an amount to be determined. TSE and O2 have agreed that any award of attorneys fees will not exceed $3 million.

Microsemi Corporation

On March 29, 2006, pursuant to the terms of the settlement agreement entered into between Microsemi and us, the case that had been filed against us by Microsemi Corporation on October 7, 2004, in the United States District Court for the Central District of California was dismissed with prejudice.

ITEM 1.a. RISK FACTORS

Our business involves risks and uncertainties. You should carefully consider the risks described below, together with all of the other information in this Form 10-Q and other filings with the Securities and Exchange Commission in evaluating our business. If any of the following risks actually occur, our business, financial condition, operating results, and growth prospects would likely be 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.

If we are unsuccessful in any of the legal proceedings between us and O2 Micro, Micrel or Taiwan Sumida Electronics, we could be prevented from selling many of our products and/or be required to pay substantial damages or fines. An unfavorable outcome or an additional award of damages, attorney s fees or an injunction could cause our revenue to decline significantly and could severely harm our business and operating results.

We are engaged in various legal proceedings with O2 Micro and Micrel. These proceedings involve various claims and counterclaims in the United States and Taiwan alleging, among other things, patent and trade secret infringement, misappropriation of trade secrets, and unfair competition. O2 Micro has also taken legal action against our wafer manufacturer and various customers and users of our products in Taiwan and the United States, some of which we are indemnifying. See Part 1, Item 3, Legal Proceedings, for a description of each of these proceedings.

If we or our customers are not ultimately successful in any of these litigations or other litigations that could be brought against us, we could be ordered to pay monetary fines and/or damages. If we are found liable for willful patent infringement or trade secret misappropriation, damages could be doubled or tripled. We and/or our customers could also be prevented from selling some or all of our products, either into Taiwan or in the U.S. Moreover, our customers and end-users could decide not to use our products, our wafer manufacturer could decide to reduce or eliminate its manufacturing of some of our products, or our products or our customers accounts payable to us could be seized in Taiwan. Finally, interim developments in these proceedings could increase the volatility in our stock price as the market assesses the impact of such developments on the likelihood that we will or will not ultimately prevail in these proceedings.

In addition, we are also engaged in a legal proceeding with Taiwan Sumida Electronics Inc. (TSE), one of our customers. In November 2005, a jury found that TSE infringed one of O2 Micro s patents. The products that were the subject of the litigation contained some of our products. We had previously entered into an agreement with TSE under which we had agreed to indemnify TSE against claims by O2 Micro. However, in August 2005, we terminated the agreement and sued TSE for material breach of the agreement. In January 2006, TSE filed a counterclaim against us for breach of contract. If we do not ultimately prevail on our contention that TSE materially breached our agreement, we could be required to pay any damages awarded against TSE in favor of O2 Micro. In addition, we have lost some customer orders as a result of the verdict against TSE, and it is possible that additional business may be lost in the future.

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

Until our legal proceedings with O2 Micro, TSE, and Micrel are resolved, we will continue to incur significant legal expenses that vary with the level of activity in each of these proceedings. This level of activity is not entirely within our control as we may need to respond to legal actions by the opposing parties or scheduling decisions by the judges. Consequently, it is difficult for us to forecast our legal expenses for any given quarter, which adversely affects our ability to forecast our expected results of operations in general. If we fail to meet the expectations of securities or industry analysts as a result of unexpected increases in our legal expenses, our stock price could decline.

Our ongoing legal proceedings and the potential for additional legal proceedings have diverted 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 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 additional infringement claims. Such litigation is very costly. In the event any third party was to make a new infringement claim against us or our customers, we could incur additional ongoing legal expenses. 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 have a history of losses, and we may not sustain profitability on a quarterly or annual basis.

The fiscal year ended December 31, 2005 was our first profitable full year of operations. Prior to this year we had incurred losses on an annual basis since our inception, and we incurred a loss of $408,000 for the first quarter ended March 31, 2006. As of March 31, 2006, we had an accumulated deficit of $15.5 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 revenue 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.

We do not expect to sustain our recent growth rate.

Due primarily to increased sales of our DC to DC converter and LCD backlight inverter product families, we have experienced significant revenue growth in a relatively short period of time. Specifically, our annual revenue increased from $12.2 million in 2002 to $24.2 million in 2003 to $47.6 million in 2004 to $99.1 million in 2005. We do not expect similar degrees of revenue growth gains in future periods for several reasons, including the ongoing litigation with O2 and the recent adverse jury verdicts in two cases which have resulted in some lost revenue and orders.

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

We were incorporated in 1997 and did not begin generating meaningful revenue until 2000. As a result, we have only a short history from which to predict future revenue and budget our expenses. Our limited operating experience combined with the rapidly evolving nature of the markets into which we sell our products, as well as other factors beyond our control, reduce our ability to accurately forecast quarterly or annual revenue or our expected expenses. We provide components for end products and systems, and therefore demand for our products is influenced by demand for the ultimate end product built by our customers and their end customers. Our revenue depends on the timing, size, and speed of commercial introductions of end products and systems that use our products, all of which are inherently difficult to forecast, as well as the ongoing demand for previously introduced end products and systems. In addition, demand for our products is influenced by our customers management of their own inventory. Our sales to distributors are subject to higher risk and may be more volatile because they service demand from other companies which is difficult to forecast accurately. If our distributors do not manage their inventory correctly, or misjudge their own customers demand, our shipments to and orders from our distributors may vary unpredictably on a quarter to quarter basis. For example, in the fourth quarter of 2005, certain of our distributors overestimated their own end customer demand and/or underestimated their existing inventory and, as a result, ordered more of our products than they needed to fulfill their customer requirements. Accordingly, our shipments to these distributors in the first quarter of 2006 were lower than our normal seasonality would predict.

Finally, a significant percentage of our revenue in each quarter is dependent on sales that are booked and shipped during that quarter, which we refer to as our turns business. Due to our reliance on the turns business, combined with the fact that we typically do not enter into long-term agreements with our customers [nor do our customers provide us with forecasts of their future product requirements], accurately forecasting our revenue for any given quarter is difficult.

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 revenue, 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, seasonality in our business results in our revenue for the first quarter of each being less than the revenue for the last quarter of the previous year. We expect fluctuations to continue for a number of reasons, including:

- the timing of developments and the related expenses in our litigation matters with O2, Micrel, TSE and any future litigation;

- the possibility of additional lost business as a result of customer and prospective customer concerns about adverse outcomes in our litigations or about being litigation targets;

- our reliance on our turns business;
- 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 levels and product obsolescence;
- seasonality and variability in the computer, consumer electronics, and wireless markets;
- the availability of adequate manufacturing capacity from our outside suppliers;
- changes in manufacturing yields;
- general economic conditions in the countries where our products are sold or 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 and production capacity, as well as rapid erosion of average selling prices. Although the semiconductor industry experienced increased demand in 2005, 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 revenue will decrease.

We believe that applications of our products in the computer, consumer electronics, networking and wireless markets will continue to account for a majority of our revenue. If demand for our products declines in the major end markets that we serve, our revenue will decrease.

For example, as technology develops over time, there is increased ability to integrate the functionalities of various components, including our discrete semiconductor products, onto a single chip and/or onto other components of systems containing our products. Should our customers begin seeking integrated solutions that we do not offer, demand for our products could decrease, and our business and results of operations could be adversely affected.

As another example, approximately one third of our business is based on products that are used in systems that contain cold cathode fluorescent lighting. CCFL tubes contain mercury, which is the subject of environmental concerns, particularly in Europe, for example. Should environmental issues impair the widespread use of CCFL-based products, and should we be unable to ramp up replacement products based on LED lighting fast enough to compensate for loss of CCFL-related business, our business and results of operations could be adversely affected.

We receive a significant portion of our revenue 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 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 revenue and adversely affect our operations and financial condition.

Moreover, we believe a high percentage of our products are eventually sold to a number of 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 purchase commitments from these end users. 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 third party manufacturers in advance of selling our product. We place orders with our manufacturers 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 manufacturers. In the event that our predictions are inaccurate due to unexpected increases in orders or unavailability of product within the time frame that we need it, 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 are a small public company that has recently experienced a rapid rate of growth. If we fail to make continued improvements to our internal systems and staffing, particularly in the accounting and finance functions, and to manage the related expenses, our business may suffer.

As a small public company that has undergone a rapid rate of growth, we have experienced a significant strain on our management, operational and financial resources and systems that has, among other things, adversely affected our internal control over financial reporting. We recently restated our financial statements for certain prior periods and also reported that our internal control over financial reporting was not effective as a result of certain material weaknesses described in Item 4 of Part I of this quarterly report. The accounting errors that resulted in our recent restatements were due, in part, to insufficient resources in our finance department. We engaged outside consultants to assist us with these restatements because we did not have adequate internal resources to complete this task on our own. If

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we fail to adequately staff our accounting and finance function with permanent personnel and maintain internal controls that meet the demands of our business, our ability to operate effectively will suffer. Because of the limited number of personnel in our finance department, the operation of our business depends upon our ability to retain these employees while we continue to improve controls and add additional personnel. These employees hold a significant amount of institutional knowledge about the company, and, if they were to terminate their employment, our internal control over financial reporting could be adversely affected.

We have a complex international tax structure which could lead to unfavorable adjustments by the Internal Revenue Service or other tax authorities.

We have a complex international tax structure. 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 United States 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. Such an adjustment could have a material impact on our financial condition and results of operations.

We face risks in connection with the material weaknesses in our internal control over financial reporting and any related remedial measures that we undertake.

In accordance with Section 404 of the Sarbanes-Oxley Act, we included in our 2005 annual report on Form 10-K a management report regarding the effectiveness of our internal control over financial reporting as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934. In preparation for issuing this management report, we documented, evaluated and tested our internal control over financial reporting.

As a result of various accounting errors, we recently restated our annual report on Form 10-K for the year ended December 31, 2004 and quarterly reports on Form 10-Q for the first and second quarters of 2005. In conjunction with these restatements and our assessment of the effectiveness of our internal control over financial reporting, we identified a number of material weaknesses that are described in Item 4 of Part I of this quarterly report.

As of the date of this report, we have not remediated any of these material weaknesses. We cannot be certain that the measures we have already taken and are planning to take to remediate the material weaknesses will sufficiently and satisfactorily address these identified material weaknesses in full. Furthermore, we cannot be certain that we will not discover additional material weaknesses in the future. If we are unable to assert that our internal control over financial reporting is effective in any future period, or we continue to experience material weaknesses in our internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which may have an adverse effect on our stock price and potentially subject us to litigation.

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 our key executives, including 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 revenue and gross margin 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 and our management relationships. 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. 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 revenue.

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 revenue and gross margin may decline.

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

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

All of our products are assembled by third-party subcontractors and a significant percentage of our testing is currently performed by third-party subcontractors. We do not have any long-term agreements with these subcontractors. As a result, we may not have direct control over product delivery schedules or product quality. Also, due to the amount of time typically required to qualify assembly and test subcontractors, we could experience delays in the shipment of our products if we were forced to find alternate third parties to assemble or test our products. 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 revenue 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 revenue from customers located in Asia through direct or indirect sales through distribution arrangements with parties located in Asia. As a result, we are subject to increased risks due to this geographic concentration of business and operations. In 2005, 98% of our revenue was from foreign customers, and approximately 90% of our revenue in the first quarter of 2006 was from customers located in Asia. 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, including restrictions imposed by the United States government on trading with parties in foreign countries;
- transportation delays;
- international political relationships and threats of war;
- terrorism and threats of terrorism;
- epidemics and illnesses;
- 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;
- enforcing contracts generally;

- currency exchange rate fluctuations impacting intra-company transactions; and

- less effective protection of intellectual property and contractual arrangements.

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. The recent decision of the Chinese Government to let its 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. In

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addition, because we collect payments from all customers in U.S. dollars, fluctuations in the value of foreign currencies could have an adverse impact on our customers business, which could negatively impact our business and results of operations.

We and our manufacturing partners are or will be subject to extensive Chinese government regulation, and may receive the benefit of various incentives from Chinese governments that include conditions or may be reduced or eliminated, any of 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.

We may incur additional delays and expenses in connection with the establishment of our testing facility in China, which could increase product costs and restrict our capacity to meet demand for our products.

We have constructed a new testing facility in China and have begun limited operations. The establishment of a testing facility in China involves its own risks and uncertainties. In addition to the risks discussed elsewhere in this quarterly report, we face the following risks, among others:

- inability to establish appropriate and acceptable manufacturing controls;
- failure to achieve ISO certification for the facility, timely or at all;
- inability to establish sufficient controls and processes for compliance with Section 404 of the Sarbanes-Oxley Act of 2002; and
- higher than anticipated overhead and other costs of operation.

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

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

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

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

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

- timely and efficient completion of process design and device structure improvements;
- timely and efficient implementation of manufacturing, assembly, and test processes;
- 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 revenue 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 revenue and may not ultimately achieve our forecasted sales for our products.

The introduction of new products presents significant business challenges because product development plans and expenditures must be made up to two years or more in advance of any sales. It takes us up to 12 months or more to design and manufacture a new product prototype. Only after we have a prototype do we introduce the product to the market and begin selling efforts in an attempt to achieve design wins. This sales process, which averages 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 revenue because a significant portion of our operating expenses is relatively fixed and based on expected revenue. The lengthy sales cycles of our products also make forecasting the volume and timing of orders difficult. In addition, the delays inherent in lengthy sales cycles raise additional risks that customers may cancel or change their orders. Our sales are made by purchase orders. Because industry practice allows customers to reschedule or cancel orders on relatively short notice, backlog is not always a good indicator of our future sales. If customer cancellations or product changes occur, we could lose anticipated sales and not have sufficient time to reduce our inventory and operating expenses.

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. We have recently extended our standard warranty period from 90 days to one year. As a result, we now have an increased risk of claims for defects and failures. If defects and failures occur in our products, we could experience lost revenue, increased costs, including warranty expense and costs associated with customer support, delays in 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 domestic and foreign operations through internal growth, strategic relationships, or acquisitions. We expect that any such expansion will strain our systems and operational and financial controls, some of which are already in need of improvement as evidenced by the material weaknesses that are described in Item 4 of Part I of this quarterly report on Form 10-Q. In addition, we are likely to incur significantly higher operating costs. To manage our growth effectively, we must continue to improve and expand our systems and controls, as well as hire experienced administrative and financial personnel. If we fail to do so, our growth will be limited. If we fail to effectively manage our planned expansion of operations, our business and operating results may be harmed.

We 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 non-domestic semiconductor companies, many of which have substantially greater financial and other resources with which to pursue engineering, manufacturing, marketing, and distribution of their products. We are in direct and active competition, with respect to one or more of our product lines with at least 10 manufacturers of such products, of varying size and financial strength. The number of our competitors has grown due to expansion of the market segments in which we participate. We consider our competitors to include, but not be limited to; Intersil Corporation, Linear, Maxim Integrated Products, Micrel, Microsemi, National Semiconductor Corporation, O2, Semtech Corporation, STMicroelectronic, Fairchild Semiconductor, Analog Devices 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.

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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, and 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;

- 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 33% of our outstanding common stock. Additionally, Jim Jones, one of our directors, is associated with BAVP, LP, which owns approximately 7% 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.

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 revenue, 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 may 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.

ITEM 6. EXHIBITS

(a) See Exhibit Index.

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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: May 9, 2006

/s/ C. RICHARD NEELY, JR.
C. Richard Neely, Jr.
Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

10.1	Purchase Order to ASM America, Inc. to purchase Epitaxial Reactor.
31.01	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* 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.