

MEMSIC Inc
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

or

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

For the transition period from _____ to _____

Commission File No. 001-33813

MEMSIC, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

04-3457049
(I.R.S. Employer Identification No.)

One Tech Drive, Suite 325
Andover, Massachusetts
(Address of principal executive offices)

01810
(Zip Code)

(978) 738-0900
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such

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files). Yes No

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

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

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of common stock, par value \$0.00001 per share, of the registrant outstanding as of November 11, 2011 was 23,983,813.

MEMSIC, Inc.

FORM 10-Q, September 30, 2011

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

MEMSIC, Inc.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$52,526,619	\$55,694,205
Restricted cash	3,783,441	2,928,933
Short-term investments	1,414,008	-
Accounts receivable, net of allowance for doubtful accounts of \$6,441 as of September 30, 2011 and December 31, 2010	7,387,858	3,664,444
Inventories	9,528,049	8,923,127
Other assets	2,564,794	2,537,445
Total current assets	77,204,769	73,748,154
Property and equipment, net	30,743,881	22,015,502
Long-term investments	4,620,000	5,020,000
Goodwill	5,047,953	4,919,513
Intangible assets, net	11,276,779	11,894,328
Other assets	9,844	67,599
Total assets	\$128,903,226	\$117,665,096
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$7,931,325	\$4,563,420
Accrued expenses	2,717,747	2,969,839
Advance research funding	3,783,441	2,928,933
Current portion of long-term debt	500,000	-
Total current liabilities	14,932,513	10,462,192
Note payable to bank, net of current portion	17,430,000	17,930,000
Building liability	7,996,237	-
Deferred rent	132,457	90,036
Total other liabilities	25,558,694	18,020,036
Stockholders' equity:		
Common stock, \$0.00001 par value; authorized, 45,000,000 shares; 23,983,813 and 23,810,613 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	240	238
Additional paid-in capital	100,930,240	99,615,378
Accumulated other comprehensive income	3,775,636	3,029,372

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Accumulated deficit	(16,628,813)	(13,823,565)
MEMSIC, Inc. stockholders' equity	88,077,303	88,821,423
Non-controlling interest related to joint venture in Japan	334,716	361,445
Total stockholders' equity	88,412,019	89,182,868
Total liabilities and stockholders' equity	\$ 128,903,226	\$ 117,665,096

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales	\$18,357,300	\$10,844,719	\$46,684,854	\$27,212,338
Cost of goods sold	12,155,533	6,751,194	30,543,197	16,584,892
Gross profit	6,201,767	4,093,525	16,141,657	10,627,446
Operating expenses:				
Research and development	2,200,240	2,377,649	6,610,213	6,386,394
Sales and marketing	1,881,240	1,376,893	4,875,893	3,557,223
General and administrative	2,799,433	2,212,399	7,573,663	6,525,484
Amortization expense	403,835	406,561	1,212,001	1,146,844
Total operating expenses	7,284,748	6,373,502	20,271,770	17,615,945
Operating loss	(1,082,981)	(2,279,977)	(4,130,113)	(6,988,499)
Other income:				
Interest and dividend income	153,227	99,026	335,082	319,803
Foreign exchange gain	328,639	305,732	848,114	359,809
Other, net	323,587	19,342	406,007	70,552
Total other income	805,453	424,100	1,589,203	750,164
Loss before income taxes	(277,528)	(1,855,877)	(2,540,910)	(6,238,335)
Provision for (benefit from) income taxes	58,343	36,392	172,653	(79,102)
Net loss	(335,871)	(1,892,269)	(2,713,563)	(6,159,233)
Less: net income attributable to non-controlling interest	32,895	39,004	91,685	66,093
Net loss attributable to MEMSIC, Inc.	\$(368,766)	\$(1,931,273)	\$(2,805,248)	\$(6,225,326)
Net loss per common share to MEMSIC, Inc.:				
Basic	\$(0.02)	\$(0.08)	\$(0.12)	\$(0.26)
Diluted	\$(0.02)	\$(0.08)	\$(0.12)	\$(0.26)
Weighted average shares outstanding used in calculating net loss per common share:				
Basic	23,825,134	23,805,072	23,822,587	23,802,357
Diluted	23,825,134	23,805,072	23,822,587	23,802,357

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.
 CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
 (unaudited)

	Common Shares	Stock Par Value	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	MEMSIC, Inc. Stockholders' Equity	Non- controlling Interest	Total Equity
Balance at December 31, 2010	23,810,613	\$238	\$99,615,378	\$3,029,372	\$(13,823,565)	\$88,821,423	\$361,445	\$89,182,868
Net loss				-	(2,805,248)	(2,805,248)	91,685	(2,713,563)
Foreign currency translation adjustment				946,834	-	946,834	(3,025)	943,809
Unrealized loss onauction-rate securities				(200,000)		(200,000)		(200,000)
Comprehensive loss				746,264	(2,805,248)	(2,058,984)	88,660	(1,970,324)
Exercise of options to purchase common stock	33,200	1	55,661			55,662		55,662
Issuance of restricted stock award	140,000	1	(1)			-		-
Stock compensation expense			1,259,202			1,259,202		1,259,202
Dividend paid to non-controlling interest						-	(115,389)	(115,389)
Balance at September 30, 2011	23,983,813	\$240	\$100,930,240	\$3,775,636	\$(16,628,813)	\$88,077,303	\$334,716	\$88,412,019

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities:		
Net loss	\$(2,713,563)	\$(6,159,233)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	2,293,162	1,675,823
Amortization	1,240,241	1,146,844
Stock compensation expense	1,259,202	1,106,815
Deferred rent	42,421	(9,394)
Deferred income taxes	46,483	(53,050)
Changes in operating assets and liabilities, net of the effects of business acquisition:		
Restricted cash	(773,318)	(1,702,007)
Accounts receivable	(3,711,949)	(1,159,455)
Inventories	(338,568)	(1,234,045)
Other assets	(104,043)	(1,478,022)
Advance research funding	773,318	1,702,007
Accounts payable and accrued expenses	3,212,975	4,317,624
Net cash (used in) provided by operating activities	1,226,361	(1,846,093)
Cash flows from investing activities:		
Purchase of short-term investments	(1,414,578)	(500,000)
Proceeds from sale of long-term investments	200,000	180,000
Purchase of property and equipment	(2,502,862)	(8,022,260)
Acquisition payment, net of acquired cash of \$352,247	-	(17,647,753)
Net cash used in investing activities	(3,717,440)	(25,990,013)
Cash flows from financing activities:		
Cash dividend paid to non-controlling interest	(115,389)	(52,144)
Proceeds from exercise of options to purchase common stock	55,662	13,905
Proceeds from note payable to bank	-	17,930,000
Net cash (used in) provided by financing activities	(59,727)	17,891,761
Effect of exchange rate changes on cash and cash equivalents	(616,780)	(270,320)
Net decrease in cash and cash equivalents	(3,167,586)	(10,214,665)
Cash and cash equivalents —beginning of period	55,694,205	66,970,736
Cash and cash equivalents —end of period	\$52,526,619	\$56,756,071
Supplemental disclosures of cash flows information:		
Building liability	\$7,996,237	\$-

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.

Notes to Unaudited Consolidated Financial Statements

1. NATURE OF THE BUSINESS AND OPERATIONS

MEMSIC, Inc. (the Company) was incorporated on March 3, 1999 as a Delaware corporation. The Company is a leading provider of semiconductor sensor systems solutions based on micro electromechanical systems (MEMS) technology and advanced integrated circuit design. The Company has integrated a MEMS technology-based inertial sensor, commonly known as an accelerometer, with mixed signal processing circuitry onto a single chip using a standard complementary metal-oxide-semiconductor (CMOS) process. This proprietary technology has allowed for sensor solutions at lower cost, higher performance and improved functionality. Utilizing a standard CMOS process allows easy integration of additional functions and the creation of new sensors to expand into magnetic, touch and flow sensors, as well as other MEMS application areas beyond accelerometers. Any application that requires the control or measurement of motion is a potential application for accelerometers. The Company's sensor and solution products have a wide range of applications for consumer electronics, mobile phones, automotive (airbags, rollover detection, electronic stability control and navigation systems), as well as business, industrial and medical applications.

MEMSIC, Inc. maintains its corporate headquarters in Massachusetts. All manufacturing operations are provided by its wholly-owned subsidiary, MEMSIC Semiconductor (Wuxi) Company Limited (MEMSIC Semiconductor) and its indirect wholly owned subsidiary, MEMSIC Transducer Systems Company Limited, (MTS), which are located in the People's Republic of China (PRC).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICES

Principles of Consolidation

The accompanying unaudited consolidated financial statements include the accounts of the Company, MEMSIC Semiconductor, MTS and its majority owned and controlled joint venture, Crossbow Japan Limited (Crossbow Japan). The Company presents all of Crossbow Japan's assets, liabilities, revenue and expenses, as well as the non-controlling interest in Crossbow Japan (representing the 49% equity interest in the entity not owned by the Company) in its consolidated financial statements. All significant intercompany balances and transactions have been eliminated in consolidation.

Unaudited Interim Financial Information

The accompanying interim consolidated financial statements are unaudited. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and related notes, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, which is on file with the Securities and Exchange Commission (SEC).

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of management, the unaudited interim consolidated financial statements and notes have been prepared on the same basis as the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, and include all adjustments (consisting of normal, recurring adjustments) necessary for the fair presentation of the

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Company's financial position at September 30, 2011, results of operations for the three and nine months ended September 30, 2011 and 2010 and cash flows for the nine months ended September 30, 2011 and 2010. The interim periods are not necessarily indicative of results to be expected for any other interim periods or for the full year.

Reclassification

Certain amounts in the accompanying 2010 financial statements related to amortization expense and foreign exchange gain have been reclassified to permit comparison with the accompanying interim 2011 financial statements.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires the Company to make estimates and assumptions that affect at the date of the financial statements the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates.

Cash Equivalents

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents.

Advance Research Funding

Advance research funding represents research funding granted by the Chinese government for specific research and development projects the Company is taking on. The amount received is initially recorded as a liability and subsequently recognized as a credit to research and development expenses in the statements of operations or property and equipment in the balance sheets as the Company performs the projects and has complied with the conditions or performance obligations attached to the related government grants. There are no conditions under which amounts utilized are required to be refunded under the terms of the grants.

Advance research funding activities for the nine months ended September 30, 2011 are as follows:

Balance at January 1, 2011	\$2,928,933
Funds received	1,677,642
Research and development activities	(259,956)
Property and equipment expenditures	(563,178)
Balance at September 30, 2011	\$3,783,441

Foreign Currency

The Company's manufacturing operations and certain other operations are conducted by MEMSIC Semiconductor and MTS. The functional currency of MEMSIC Semiconductor and MTS is the Renminbi. Financial transactions between the Company, MEMSIC Semiconductor and MTS are conducted in United States (U.S.) dollars. At September 30, 2011 and December 31, 2010, the underlying currency for approximately 55.2% and 51.1% of consolidated assets, respectively, was the Renminbi. The functional currency of Crossbow Japan is the Japanese Yen. Financial transactions between the Company and Crossbow Japan are conducted in U.S. dollars. At September 30, 2011 and December 31, 2010, the underlying currency for approximately 1.1% of consolidated assets was the Japanese Yen. The Company has not utilized hedging strategies with respect to its foreign exchange exposure.

The financial statements of MEMSIC Semiconductor, MTS and Crossbow Japan are translated into U.S. dollars in accordance with U.S. GAAP. The functional currencies of MEMSIC Semiconductor, MTS and Crossbow Japan are translated into U.S. dollars utilizing the following method: assets and liabilities are translated at the exchange rate in effect at the end of the period, and revenues and expenses are translated at the weighted average exchange rate during

the period. Cumulative translation gains and losses are included as a separate component of stockholders' equity and reported as a part of comprehensive income. Transaction gains and losses are included in the consolidated statements of operations as incurred.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash equivalents, accounts receivable, accounts payable, notes payable and accrued expenses, approximate their fair values due to the short-term nature of the instruments.

Net Loss per Common Share

Basic net loss per share is calculated by dividing net loss by the weighted-average common shares outstanding during the period. Diluted net loss per share is calculated by dividing net loss by the weighted-average common shares and potentially dilutive securities outstanding during the period using the treasury stock method.

Income Taxes

Deferred tax assets and liabilities relate to temporary differences between the financial reporting basis and the tax basis of assets and liabilities, the carryforward tax losses and available tax credits. Such assets and liabilities are measured using tax rates and laws expected to be in effect at the time of their reversal or utilization. Valuation allowances are established, when necessary, to reduce the net deferred tax asset to an amount more likely than not to be realized. For interim reporting periods, the Company uses the estimated annual effective tax rate except with respect to discrete items, whose impact is recognized in the interim period in which the discrete item occurred.

Inventories

Inventories are stated at the lower of cost (weighted average FIFO) or market. The Company evaluates its inventory for potential excess and obsolete inventories based on forecasted demands and records a provision for such amounts as necessary. At September 30, 2011 and December 31, 2010, the Company's total inventory reserve balances were \$457,000 and \$482,000, respectively.

Revenue Recognition

The Company recognizes revenue from the sale of its products to its customers when all of the following conditions have been met: (i) evidence exists of an arrangement with the customer, typically consisting of a purchase order or contract; (ii) the Company's products have been shipped and risk of loss has passed to the customer; (iii) the Company has completed all of the necessary terms of the purchase order or contract; (iv) the amount of revenue to which the Company is entitled is fixed or determinable; and (v) the Company believes it is probable that it will be able to collect the amount due from the customer based upon an evaluation of the customer's creditworthiness. To the extent that one or more of these conditions has not been satisfied, the Company defers recognition of revenue. An allowance for estimated future product returns and sales price allowances is established at the date of revenue recognition. An allowance for uncollectible receivables is established by a charge to operations when, in the opinion of the Company, it is probable that the amount due to the Company will not be collected.

The Company sells its products to distributors as well as to end customers. Sales to distributors are made pursuant to distributor agreements, which allow for the return of goods under certain circumstances. Accordingly, the Company follows the following criteria for recognition of sales to distributors: (i) the selling price to the distributor is fixed or determinable at the date of shipment; (ii) the distributor's obligation to pay the selling price is not contingent on resale of the product; (iii) the Company's product has been shipped and risk of loss has passed to the distributor; (iv) it is probable that the amount due from the distributor will be collected; (v) the Company does not have significant future obligations to directly assist in the distributor's resale of the product; and (vi) the amount of future returns can be reasonably estimated. Once these criteria are met, the Company recognizes revenue upon shipment to the distributor

and estimates returns based on historical sales returns.

Stock-Based Compensation

The Company accounts for share-based payments to employees based on requirements that all share-based payments to employees, including grants of employee stock options, shall be recognized in the financial statements based on their fair values. The cost of equity-based service awards is based on the grant-date fair value of the award and is recognized over the period during which the employee is required to provide service in exchange for the award (vesting period). Stock-based compensation arrangements with non-employees are accounted for utilizing the fair value method or, if a more reliable measurement, the value of the services or consideration received. The resulting compensation expense is recognized for financial reporting purposes over the term of performance or vesting.

Recent Accounting Pronouncements

In September 2011, the FASB amended ASC 350, Intangibles — Goodwill and Other. This amendment is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The amended provisions are effective for reporting periods beginning on or after December 15, 2011. However, early adoption is permitted if an entity's financial statements for the most recent annual or interim period have not yet been issued. This amendment impacts testing steps only and, therefore, adoption will not have an impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2011, the FASB amended ASC 220, Comprehensive Income. This amendment was issued to enhance comparability between entities that report under GAAP and International Financial Reporting Standards (IFRS) and to provide a more consistent method of presenting non-owner transactions that affect an entity's equity. The amendment requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two separate but consecutive statements. It eliminates the option to report other comprehensive income and its components as part of the statement of changes in shareholders' equity. The amended provisions are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted, and full retrospective application is required. This amendment impacts presentation and disclosure only, and therefore adoption will not have an impact on the Company's consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS (ASU No. 2011-04). The amendments in this update apply to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in a reporting entity's shareholders' equity in the financial statements. ASU No. 2011-04 does not extend the use of fair value accounting, but provides guidance on how it should be applied where its use is already required or permitted by other standards within U.S. GAAP or IFRS. ASU No. 2011-04 changes the wording used to describe many requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Additionally, ASU No. 2011-04 clarifies the FASB's intent about the application of existing fair value measurements. The amendments in this update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company does not expect the provisions of ASU No. 2011-04 to have a material effect on its financial position, results of operations or cash flows.

In October 2009, the FASB issued ASU No. 2009-13, Revenue Recognition (Topic 605) — Multiple-Deliverable Revenue Arrangements. ASU No. 2009-13 addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. In addition, this guidance significantly expands required disclosures related to a vendor's multiple-deliverable revenue arrangements. ASU No. 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and early adoption is permitted. A company may elect, but will not be required, to adopt the amendments in ASU No. 2009-13 retrospectively for all prior periods. The adoption of ASU 2009-13 did not have a material impact on the Company's financial position or statement of operations.

3. LONG-TERM INVESTMENTS

Long-term investments held by the Company at September 30, 2011 and December 31, 2010 consisted primarily of auction rate securities, or ARS, and are considered available for sale. These securities reset the interest or dividend rates by auctions held at intervals of 7, 28, 35 or 49 days, and at such dates the Company has the option to sell such securities. The auction rate securities held by the Company have contractual maturities of greater than 10 years.

These investments are carried at fair value, with the unrealized gains and losses, if any, net of tax, reported in other comprehensive income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities are included in interest and dividend income. Quarterly, management reviews the valuation of investments and considers whether any decline in value is deemed to be other than a temporary decline.

At September 30, 2011, the Company held two ARS investments: Illinois Educational Facilities Authority Select Auction Variable Rate Securities having a value at par of \$3.0 million with a maturity date in 2028 and Montana Health Facility Authority Select Auction Variable Rate Securities having a value at par of \$2.2 million with a maturity date in 2017. The Company has classified these investments as long-term assets due to liquidity issues that have been experienced in global credit and capital markets as well as failed auctions since the first quarter of 2008. A failed auction means that the amount of securities submitted for sale at auction exceeded the amount of purchase orders. If an auction fails, the issuer becomes obligated to pay interest at penalty rates, and all of the auction rate securities the Company holds continue to pay interest in accordance with their stated terms. However, the failed auctions create uncertainty as to the liquidity of these securities.

Based on the Company's expected operating cash flows, and other sources of cash, the Company does not expect the potential lack of liquidity in these investments to affect its ability to execute its current business plan in the near term.

Fair Value Measurement

The Company accounts for assets and liabilities recognized or disclosed in the financial statements at fair value on a recurring basis in accordance with the provisions of ASC Topic 820.

ASC Topic 820 provides that fair value is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants based on the highest and best use of the asset or liability. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 requires the Company to use valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized as follows:

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs

Level 3: Unobservable inputs for which there is little or no market data and which require the Company to develop its own assumptions about how market participants would price the assets or liabilities

The valuation techniques that may be used to measure fair value are as follows:

A. Market approach - Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities

B. Income approach - Uses valuation techniques to convert future amounts to a single present amount based on current market expectations about those future amounts, including present value techniques, option-pricing models and excess earnings method

C. Cost approach - Based on the amount that currently would be required to replace the service capacity of an asset (replacement cost)

The Company's assets measured at fair value on a recurring basis during the period include (in thousands):

	Carrying amount as of September 30, 2011	Level 1	Level 2	Level 3	Valuation Technique
Auction rate securities	\$4,620	\$-	\$-	\$4,620	(B)

The reconciliation of the Company's assets measured at fair value on a recurring basis using unobservable inputs (Level 3) is as follows (in thousands):

	Auction Rate Securities
Balance at January 1, 2011	\$5,020
Redemptions	(200)
Transfers to Level 3	-
Gains and losses:	
Reported in earnings	-
Reported in other comprehensive loss	(200)
Balance at September 30, 2011	\$4,620

The Company historically accounted for the ARS held in its portfolio as available-for-sale investments. The carrying value of these ARS approximated fair value due to the frequent resetting of the interest rate. While the Company continues to earn interest at the specified contractual rate on those investments involved in failed auctions, due to the illiquidity of these securities under current market conditions, the Company has considered whether par value continues to be a reasonable basis for estimating the fair value of these ARS at September 30, 2011 and December 31, 2010. The Company estimated the fair value of these securities at September 30, 2011 and December 31, 2010 using broker valuations and internally-developed models of the expected future cash flows related to the securities as well as referencing a third party specialist's valuation. One of the more significant assumptions made in the Company's internally-developed models was the term of expected cash flows of the underlying auction rate securities and the discount related to the illiquidity of the investments. The Company developed several scenarios for the liquidation of the auction rate securities over periods that ranged from 3 to 7 years. In estimating the fair value of these investments, the Company considered the financial condition and near-term prospects of the issuers, the magnitude of the losses compared to the investments' cost, the length of time the investments have been in an unrealized loss position, the low probability that the Company will be unable to collect all amounts due according to the contractual terms of the security, whether the security has been downgraded by a rating agency, and the Company's ability and intent to hold these investments until the anticipated recovery in market value occurs. Based on its estimated operating cash flows and other sources of cash, the Company intends to hold these auction rate securities for the foreseeable future, if necessary.

The Company's valuation analysis in the third quarter of 2011 resulted in an additional charge of \$200,000 to the unrealized impairment loss on record at December 31, 2010. As of September 30, 2011, the unrealized impairment loss is \$600,000. The Company continues to monitor the market for auction rate securities and to assess its impact on the fair value of the Company's investments. If current market conditions deteriorate further, the Company may be required to record additional temporary unrealized losses in other comprehensive loss or, if the decline in fair value is judged to be other-than-temporary, the cost basis of the individual security may be written down to fair value as a new cost basis and the amount of the write-down would be reflected as a charge to earnings.

4. INVENTORIES

Inventories consist of the following:

	September 30, 2011	December 31, 2010
Raw materials	\$4,608,906	\$3,583,679
Work in process	3,189,021	3,276,095
Finished units	1,730,122	2,063,353
Total	\$9,528,049	\$8,923,127

5. GOODWILL AND INTANGIBLE ASSETS

Goodwill

Goodwill represents the excess cost of the Crossbow asset acquisition over the net fair value allocated to the tangible assets acquired and liabilities assumed and to the acquired intangible asset that does not qualify for separate recognition according to ASC 805. The Company reported goodwill of \$5,047,953 at September 30, 2011 which includes foreign exchange impact of \$128,440 for the nine months ended September 30, 2011.

The Company performed an annual impairment test for goodwill during the fourth quarter of 2010 and concluded that no impairment existed as of December 31, 2010. It is the Company's opinion that there has been no change in circumstances that would indicate a potential impairment as of September 30, 2011. The Company will continue to perform an annual impairment test for goodwill during the fourth quarter of each fiscal year, and more frequently if an event or circumstances indicate that an impairment loss has been incurred. Conditions that would trigger an impairment assessment include, but are not limited to, a significant adverse change in legal factors or business climate that could affect the value of an asset.

Intangible Assets

Intangible assets relate to issued and applied-for patents on the Company's core technology and gas meter processing know-how purchased in May 2008, as well as trademarks, customer relationships and developed technology acquired from Crossbow Technology, Inc. on January 15, 2010.

As of September 30, 2011, intangible assets consisted of the following:

	Gross carrying amount	Accumulated amortization	Net carrying amount	Expected life (Years)
Patents	\$1,216,039	\$(328,854)	\$887,185	15
Know-how	584,552	(374,263)	210,289	5
Trademarks	396,730	(279,387)	117,343	2
Customer relationships	4,777,164	(878,991)	3,898,173	8-10
Developed technology	7,445,442	(1,281,653)	6,163,789	8-10
	\$14,419,927	\$(3,143,148)	\$11,276,779	

Amortization expense expected over the next five years is approximately \$1.4 million per year. Amortization expense amounted to \$1.2 million and \$1.1 million respectively for the nine months ended September 30, 2011 and 2010.

The Company has considered the cash flows associated with the valuation of the definite-lived intangible assets and concluded that the straight line method best approximates the economic pattern of usefulness of those assets.

6. NOTE PAYABLE TO BANK

On June 30, 2010, MTS, a wholly owned subsidiary of MEMSIC Semiconductor, entered into a five-year project loan agreement with Agricultural Bank of China. The total loan available is \$20 million, of which \$15 million was used by the Company for the purchase of substantially all the assets acquired from Crossbow Technology, Inc., \$3 million for working capital purposes and \$2 million for the purchase of equipment to be used in the manufacture of the Company's system solution products.

The loan is collateralized by the buildings and land owned by MEMSIC Semiconductor as well as the land and intellectual property owned by MTS. The interest rate of the loan is a variable rate, adjusted semi-annually based on the LIBOR rate plus 4.00%. MTS has obtained agreement from the local government in Wuxi, China to fully subsidize the interest expense on a quarterly basis. There are no financial covenants required for this loan. As of September 30, 2011, MTS has withdrawn an amount of \$17.9 million and has \$2.1 million available for borrowing. Interest expense paid and subsidized by the Wuxi government for the three and nine months ended September 30, 2011 was \$0.2 million and \$0.6 million respectively. Based on the terms of the agreement, there are no circumstances in which amounts previously subsidized by the Wuxi government are repayable by the Company. In the remote event the Wuxi government is unable to fulfill its obligation, the Company would recognize the interest expense in its income statement. The repayment schedule of the principal amount is as follows:

Date	Payment Amount
June 29, 2012	\$500,000
June 29, 2013	\$1,000,000
June 29, 2014	\$2,500,000

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June 29, 2015	\$13,930,000
	\$17,930,000

7. BUILDING LIABILITY

At September 30, 2011, the Company recorded a building liability in the amount of \$8.0 million related to the construction of the new MTS facility in Wuxi, China, which is based upon an estimate of total construction costs incurred to date. The construction site is located on the same property as the Company's June 2010 land purchase. Construction of the facility started in August of 2010 and is completed as of September 2011. The construction is financed by the local Chinese government. Per agreement with the local Chinese government, at the completion of the building, the Company can either lease the building for five years or purchase the building at cost from the government within five years. The Company is in the process of determining which alternative provides the best result for the Company. The Company anticipates reaching a final agreement with the local Chinese government during the fourth quarter of 2011.

8. STOCK BASED COMPENSATION

Description of Plan

On March 29, 2000, the Company's stockholders and board of directors approved the 2000 Omnibus Stock Plan (the "2000 Plan"), as amended, under which 2,969,000 shares of the Company's common stock were reserved for issuance to directors, officers, employees, and consultants. With the adoption of the 2007 Plan discussed below, the Company no longer grants awards under the 2000 Plan.

On August 22, 2007, the Company's board of directors approved the 2007 Stock Incentive Plan (the "2007 Plan"), under which up to 3,000,000 shares of the Company's common stock may become available for issuance. At the adoption date, 1,526,425 shares were reserved for issuance. The reserved amount will increase by 300,000 shares at each of the five anniversaries of the adoption date, for a maximum of 3,000,000 shares issuable under the 2007 Plan.

Options granted under the 2000 Plan and the 2007 Plan may be incentive stock options or nonqualified stock options. Both the 2000 Plan and the 2007 Plan provide that the exercise price of incentive stock options must be at least equal to the market value of the Company's common stock at the date such option is granted. For incentive stock option grants to an employee who owns more than 10% of the outstanding shares of common stock of the Company, the exercise price on the incentive stock option must be 110% of market value at the time of grant. Granted options expire in ten years or less from the date of grant and vest based on the terms of the awards, generally ratably over four years.

Prior to December 19, 2007, there was no public market for the Company's common stock. Accordingly, the board of directors determined the market value of the common stock at the date of grant by considering a number of relevant factors, including the Company's operating and financial performance and corporate milestones achieved, the prices at which shares of convertible preferred stock in arm's-length transactions were sold, the composition of and changes to the management team, the superior rights and preferences of securities senior to the common stock at the time of each grant and the likelihood of achieving a liquidity event for the shares of common stock underlying stock options.

On December 9, 2009, the Company's board of directors approved the 2009 Nonqualified Inducement Stock Option Plan (the "2009 Plan") with an effective date on January 15, 2010, the closing date of the acquisition of Crossbow assets. Under the 2009 Plan, up to 1,250,000 shares of the Company's common stock may become available for issuance. On December 23, 2010, the Company's board of directors approved an Amended and Restated 2009 Nonqualified Inducement Stock Option Plan (the "Amended and Restated Plan") and an increase in shares of the Company's common stock available for issuance under the Amended and Restated Plan from 1,250,000 to 2,500,000. Except as otherwise determined by the Compensation Committee of the Company's board of directors, the form of option to be employed under the Amended and Restated Plan shall be substantially identical to the form of nonqualified option customarily used under the Company's 2007 Stock Incentive Plan.

On June 29, 2011 at its Annual Meeting of Stockholders, the Company's stockholders and board of directors approved the amendment and restatement of the Company's 2007 Plan. The Amended and Restated 2007 Plan

- permits the granting of restricted stock units (“RSU”), performance-based stock awards and stock appreciation rights;
 - eliminates the ability to reprice options;
 - extends the expiration date of the plan to June 29, 2021;
- provides that awards may qualify as “performance-based compensation” under Section 162(m) of the Internal Revenue Code of 1986, as amended; and
 - incorporates certain other administrative provisions.

The approval of the amendment and restatement of the 2007 Plan does not change the number of shares available for awards under the 2007 Plan.

Valuation of Stock Options

The Company uses the Black-Scholes option pricing model to calculate the grant-date fair value of an option award. The weighted-average fair value per share of the options granted during the nine months ended September 30, 2011 was \$1.97, while the weighted-average fair values per share of the options granted during the three and nine months ended September 30, 2010 were \$2.35 and \$3.23, respectively, utilizing the following assumptions:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Volatility *	NA	65%	64%	65% - 70%
Expected dividend yield	0%	0%	0%	0%
Expected life *	NA	6.0 years	5.6 - 5.8 years	5.0 - 6.0 years
Risk free interest rate *	NA	1.76%	2.20% - 2.34%	1.76%-2.65%
Forfeitures	36%	36%	36% - 37%	36%- 37%

* The company only granted restricted stock units in the third quarter of 2011 and did not have option grants.

The Company is responsible for estimating volatility and has considered a number of factors, including analysis of volatility data for a peer group of companies. The Company determined the volatility for options granted in the nine months ended September 30, 2011 based on the historical volatility of the Company’s common stock, which the Company believes results in the best estimate of the grant-date fair value of employee stock options because it reflects the market’s current expectations of future volatility. Prior to January 1, 2010, due to limited historical information on the volatility of the Company’s common stock, the Company determined the volatility for options based on an analysis of reported data for a peer group of companies that issued options with substantially similar terms. The expected volatility for options granted was determined using an average of the historical volatility measures of this peer group of companies for a period equal to the expected life of the option.

The Company has not paid and does not anticipate paying cash dividends on its shares of common stock; therefore, the expected dividend yield is assumed to be zero.

The Company uses historical employee exercise and option expiration data to estimate the expected life assumption for the Black-Scholes grant-date valuation. The Company believes that this historical data is currently the best estimate of the expected term of a new option, and generally its employees exhibit similar exercise behavior.

The risk-free interest rate is based on a zero coupon United States treasury instrument whose term is consistent with the expected life of the stock options. The Company applies an estimated forfeiture rate, based on its historical forfeiture experience, in determining the expense recorded in the Company's consolidated statement of operations.

For the three months ended September 30, 2011 and 2010, the Company recorded stock-based compensation expense of \$464,972 and \$433,109, respectively. For the nine months ended September 30, 2011 and 2010, the Company recorded stock-based compensation expense of \$1,259,202 and \$1,106,815, respectively. Stock-based compensation expense related to stock options and RSUs for the three and nine months ended September 30, 2011 and 2010 was allocated as follows:

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	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Research and development	\$41,464	\$102,544	\$226,043	\$167,631
Sales and marketing	47,917	44,082	135,845	129,139
General and administrative	375,591	286,483	897,314	810,045
Total	\$464,972	\$433,109	\$1,259,202	\$1,106,815

The Company has historically accounted for stock options granted to consultants using the fair value method for the calculation of compensation cost. The Company has no compensation expense for stock option grants to consultants in the first nine months of 2011 and 2010.

The Company accounted for restricted stock awards (“RSA”) and RSUs using the fair value at the date of the grant for the calculation of compensation cost. For the three and nine months ended September 30, 2011, the Company recorded compensation expense for RSAs and RSUs in the amount of \$122,000 and \$186,000.

At September 30, 2011, total unrecognized stock-based compensation expense for stock options, RSAs and RSUs granted to the Company’s employees and directors was estimated to approximate \$4.2 million.

The stock option, RSA and RSU activity under the 2000, 2007 and 2009 Plans for the nine months ended September 30, 2011 is as follows:

	Options Outstanding	Weighted Average Exercise Price	Remaining Contractual Term in Years	Aggregate Intrinsic Value
Options outstanding at December 31, 2010	2,588,080	\$4.76	7.4	\$1,863,883
Granted	951,000	1.09		
Exercised	(33,200)	1.68		
Cancelled	(444,588)	3.12		
Options outstanding at September 30, 2011	3,061,292	\$3.89	7.4	\$2,419,609
Options exercisable at September 30, 2011	1,272,568	\$4.45	5.8	\$741,558
Options available for grant at September 30, 2011	2,638,363			

The intrinsic values (aggregate market value of the underlying common stock minus aggregate exercise price) of stock options exercised during the three and nine months ended September 30, 2011 were \$22,000 and \$27,000, respectively. The total fair value of options which became exercisable during the three and nine months ended September 30, 2011 were approximately \$498,000 and \$687,000, respectively. The total fair value of options which became exercisable during the three and nine months ended September 30, 2010 were approximately \$386,000 and

\$705,000, respectively.

9. COMPREHENSIVE LOSS

Comprehensive loss is defined to include all changes in stockholders' equity during the period other than those changes that result from investments by and distributions to stockholders. For the three and nine months ended September 30, 2011 and 2010, the Company's comprehensive loss is the sum of net loss, unrealized loss on investment and the foreign currency translation adjustment, as follows:

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	Three months ended		Nine months ended	
	September 30, 2011	2010	September 30, 2011	2010
Net loss attributable to MEMSIC, Inc.	\$(368,766)	\$(1,931,273)	\$(2,805,248)	\$(6,225,326)
Other comprehensive income (loss):				
Unrealized gain (loss) on investments	241	-	(570)	-
Foreign currency translation adjustment	398,169	364,368	946,834	549,613
Unrealized impairment loss on auction rate securities	(200,000)	(153,000)	(200,000)	(153,000)
Comprehensive loss attributable to MEMSIC, Inc.	(170,356)	(1,719,905)	(2,058,984)	(5,828,713)
Net income (loss) attributable to noncontrolling interest	32,895	39,004	91,685	66,093
Foreign currency translation adjustment	-	-	(3,025)	-
Comprehensive loss attributable to noncontrolling interest	32,895	39,004	88,660	66,093
Total comprehensive loss	\$(137,461)	\$(1,680,901)	\$(1,970,324)	\$(5,762,620)

10. COMMON STOCK

The Company reserved 5,699,655 and 4,206,577 shares at September 30, 2011 and 2010, respectively for issuance upon exercise of options to purchase common stock and RSUs.

11. NET LOSS PER COMMON SHARE

The calculation of the numerator and denominator for basic and diluted net loss per common share is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2011	2010	September 30, 2011	2010
Numerator:				
Net loss attributable to MEMSIC, Inc.	\$(368,766)	\$(1,931,273)	\$(2,805,248)	\$(6,225,326)
Denominator:				
Basic weighted average shares	23,825,134	23,805,072	23,822,587	23,802,357
Dilutive effect of common stock equivalents	-	-	-	-
Diluted weighted average shares	23,825,134	23,805,072	23,822,587	23,802,357
Net loss per common share	\$(0.02)	\$(0.08)	\$(0.12)	\$(0.26)

During the nine months ended September 30, 2011 and 2010, the Company had 1.8 million and 2.1 million, respectively, dilutive potential common shares in the form of stock options which were not included in the computation of net loss per diluted share because these stock options would be anti-dilutive.

12. SEGMENT INFORMATION

The Company conducts its operations and manages its business in two reporting segments. The Company develops, designs, manufactures and markets (i) semiconductor sensor products ("sensor products") based on MEMS technology and advanced integrated circuit design, and (ii) sensor system solution products ("system solution products") which incorporates sensors with on-board computing, wireless communications and systems and application software

solutions. In making operating decisions, the Company's chief executive officer, who is the chief operating decision maker, considers the gross profit results of the sensor product unit and the system solution product unit separately, but utilizes enterprise wide operating expense and earning results.

Revenues and gross profit by reportable segment

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Revenue				
Sensor products	\$15,935,106	\$8,192,684	\$38,913,453	\$19,446,787
System solution products	2,422,193	2,652,035	7,771,400	7,765,551
Total	\$18,357,300	\$10,844,719	\$46,684,854	\$27,212,338

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Gross Profit				
Sensor products	\$4,919,964	\$2,805,563	\$11,957,813	\$6,958,068
System solution products	1,281,803	1,287,962	4,183,844	3,669,378
Total	\$6,201,767	\$4,093,525	\$16,141,657	\$10,627,446

Revenues by product application

The categorization of revenue by product application is determined using a variety of data points including the technical characteristics of the product, the end customer product and application into which the Company's product will be incorporated.

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Mobile phone	\$9,737,128	\$2,647,989	\$21,889,987	\$4,746,569
Consumer	1,991,405	2,086,800	4,623,725	4,756,194
Automotive	3,766,068	2,922,593	11,066,547	8,560,266
Industrial/other	2,862,699	3,187,337	9,104,595	9,149,309
Total	\$18,357,300	\$10,844,719	\$46,684,854	\$27,212,338

Revenues by geographical region

Revenue by geographic region, based upon customer location, for the three and nine months ended September 30, 2011 and 2010 was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Asia (excluding Japan)	\$10,513,338	\$3,657,276	\$25,430,554	\$8,697,456
Europe	897,630	875,130	2,581,518	2,615,094
Japan	2,441,347	1,729,084	5,668,284	4,263,666
North America	4,459,558	3,873,645	12,795,129	10,683,770
Other	45,427	709,584	209,369	952,352
Total	\$18,357,300	\$10,844,719	\$46,684,854	\$27,212,338

Total Assets by geographical region

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Total assets by geographical region are as follows:

	September 30, 2011	December 31, 2010
United States	\$56,322,340	\$56,250,073
China	71,182,696	60,172,360
Japan	1,398,190	1,242,663
Total	\$128,903,226	\$117,665,096

Total long-lived assets by geographical region are as follows:

	September 30, 2011	December 31, 2010
United States	\$ 898,511	\$ 1,034,156
China	29,844,321	20,980,268
Japan	1,049	1,078
Total	\$ 30,743,881	\$ 22,015,502

13. CONTINGENCIES

The Company may be subject to claims that arise out of the ordinary course of business in legal disputes. In management's opinion, these matters will not have a material adverse effect on the financial position of the Company.

14. SUBSEQUENT EVENTS

The Company evaluated subsequent events occurring after September 30, 2011 through the date of filing these financial statements, and concluded that there was no event of which management was aware that occurred after the balance sheet date that would require any adjustment to the accompanying consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

This information should be read in conjunction with the unaudited condensed consolidation financial statements and related notes included in Item 1 of the Quarterly Report on Form 10-Q and the audited consolidated financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

This quarterly report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include any expectation of earnings, revenues, or other financial items; any statements of the plans, strategies and objectives of management for future operations; factors that may affect our operating results; statements concerning new products or services; statements related to future capital expenditures; statements related to future economic conditions or performance; statements as to industry trends and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "plan," "target," "continue," and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included elsewhere in this Form 10-Q and in our other filings with the SEC. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We provide advanced semiconductor sensor and system solutions based on integrated MEMS technology and mixed signal circuit design. We operate and manage our business in two reporting segments. We develop, design, manufacture and market:

- semiconductor sensor products, which we refer to as sensor products, based on MEMS technology and advanced integrated circuit design; and
- sensor system solution products, which we refer to as system solution products, which incorporate sensors with on-board computing, wireless communications and systems and application software solutions.

In making operating decisions, our chief executive officer, who is the chief operating decision maker, considers the gross profit results of the sensor product segment and the system solution product segment separately, but utilizes enterprise wide operating expense and earning results.

Our sensor products combine proprietary thermal-based MEMS technology and advanced analog mixed signal processing circuitry design into a single chip using a standard CMOS process. This approach allows us to provide sensor solutions at a lower cost, with higher performance and greater functionality than our competitors. In addition, our technology platform allows us to easily integrate additional functions or create new sensors to expand into magnetic, touch and flow sensors and related applications. Our sensor products have a wide range of applications such

as mobile phones, automotive safety systems and video projectors.

Our system solution products, initially acquired from Crossbow Technology, Inc. in January 2010, consist of wireless sensors that connect the physical environment with enterprise management and information systems to provide advanced monitoring, automation and control solutions for a range of industries, as well as inertial systems that provide end-users and systems integrators with MEMS-based solutions for measurement of static and dynamic motion in a wide variety of challenging environments, including avionics, remotely operated vehicles, agricultural and construction vehicles, automotive test and wind power turbines.

We manufacture our sensor products utilizing a “semi-fabless” model by outsourcing the production of CMOS wafers and completing the post-CMOS MEMS process in-house. By outsourcing the standard CMOS manufacturing process, we are able to more efficiently manage our capital expenditures and cost of goods sold. The system solution products were initially manufactured for us by Crossbow under a manufacturing agreement that we entered into in connection with the acquisition. We are in the process of migrating the manufacture of these products to China, with the objective of outsourcing most of the assembly process to third-party contract assembly vendors and performing final testing and programming functions in-house at our facility in Wuxi.

We sell our products either to distributors, which then resell to original equipment manufacturers, (“OEMs”) and original design manufacturers, (“ODMs”), or to OEM and ODM customers directly. Historically, a small number of our customers have accounted for a substantial portion of our revenue, and sales to our largest distributor customers and OEM and ODM customers have varied significantly. This significant variation is in part due to the fact that our sales are made on the basis of purchase orders rather than long-term contracts. Although our distributors generally provide us with non-binding rolling forecasts, our distributors generally have up to 30 days prior to delivery to cancel or reschedule shipments pursuant to our distribution agreements. This arrangement has added to the fluctuation and unpredictability of our sales. Because our products are a component of our customers’ products, our sales performance is significantly affected by the sales performance of our customers’ products. It is difficult for us to accurately forecast our product demand because in the case where we sell our products to distributors, we may not know the identity of the distributor’s OEM and ODM customers and information regarding their demand.

OEM and ODM customers’ products are complex and require significant time to define, design and ramp to volume production. Our sales cycle begins with our marketing and sales staff and application engineers engaging with our OEM and ODM customers’ system designers and management, which is typically a multi-month, or even multi-year, process. If this process is successful, an OEM and ODM customer will decide to incorporate our solution in its product, which we refer to as a design-win. Because the sales cycles for our products are long, we incur expenses to develop and sell our products, regardless of whether we achieve the design-win and well in advance of generating revenue, if any, from those expenditures. Although we do not have long-term purchase commitments from any of our distributor customers or OEM and ODM customers, once one of our products is incorporated into an OEM’s or ODM’s design, it is likely to remain a part of the design for the life cycle of its product. We believe this to be the case because a redesign would generally be time consuming and expensive.

Description of Certain Line Items

Net Sales

Net sales represent gross revenue net of an allowance for the estimated amount of product returns and sales rebates from our customers. Sales to distributors are made pursuant to distributor agreements, which allow for the return of goods under certain circumstances upon authorization of the Company. We recognize revenue in accordance with ASC Topic 605-15, Revenue Recognition. We sell our products to distributors as well as end customers.

Historically, our revenue has been derived primarily from shipments of our accelerometer products. As a result of our Crossbow acquisition in January 2010, our revenue has expanded to include net sales from system solution products, which accounted for 16.6% of our net sales in the first nine months of 2011. The primary factors that affect our revenue are the sales volumes and average selling prices of our products. Growth in our net sales has generally been attributable to the increase in the unit volumes of our products, as the average selling prices of our products generally decline due to the following factors, among others:

• The semiconductor market is highly competitive, and as a result, the average selling prices of particular products generally experience rapid declines over the course of their respective product and technology life cycles. This trend

has been particularly evident in the market for mobile phone applications. We seek to mitigate the impact of this trend on our business by continuing to rapidly design, develop and sell new generations of products with additional functionalities to replace older generation products;

• We may also reduce our product prices as we are able to increase our production yields by continuously improving the manufacturing efficiency or to reduce our manufacturing costs by re-engineering our product and reducing the overall material cost;

• Changes in our product mix may affect the average selling prices of our products. For example, our products for consumer and mobile phone markets generally have lower average selling prices than products for the automotive and industrial markets. The average selling prices of products may also be affected by our strategy to increase market adoption of our products in certain markets; and

• We occasionally grant discounts or modified payment terms to our large customers or OEM and ODM customers for high volume purchases.

Net Sales by Reportable Segment

Our sales consist of two reportable segments: sensor products that are used as components in our customers' products and system solution products that incorporate sensors with on-board computing, wireless communications and systems and application software solutions and offer a complete system solution to our customers. The following table sets forth our net sales by reportable segment for the periods indicated by amount and as a percentage of our net sales (dollar amounts in thousands).

	Three months ended September 30,				Nine months ended September 30,			
	2011		2010		2011		2010	
	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales
Sensor products	\$15,935	86.8 %	\$8,193	75.5 %	\$38,914	83.4 %	\$19,447	71.5 %
System solution products	2,422	13.2	2,652	24.5	7,771	16.6	7,765	28.5
Total	\$18,357	100.0 %	\$10,845	100.0 %	\$46,685	100.0 %	\$27,212	100.0 %

Sales from sensor products increased in 2011 as compared to 2010 primarily due to a significant increase in our magnetic sensor sales in the mobile phone applications and steady year over year increases in sales in the automotive applications.

Net Sales by Application

In the first nine months of 2011, net sales from mobile phone applications were the largest component of our total sales, representing 46.9% of total net sales, compared with 17.4% of total net sales for the corresponding period in 2010. The increase was primarily due to increased magnetic sensor sales to a major mobile phone manufacturer. We expect that net sales from mobile phone applications will continue to be a major component of our total sales for the remainder of 2011 as we are increasing design-in activities with our magnetic sensor product into smart phone applications.

Net sales from automotive applications were the second largest component of our total sales, representing 23.7% of total net sales. We expect our sales from automotive applications will remain strong with our new application and the recovery of the automotive market. To increase net sales from the automotive market, we will continue to seek to increase sales from new automotive applications and to expand our customer base. However, revenue increases, if any, from the automotive market will require significant time, as the development lead time in this market is generally longer than other markets in which we participate.

Net sales from industrial and other applications were relatively flat in the first nine months of 2011 compared to the corresponding period of 2010.

Net sales from consumer applications decreased slightly in absolute terms in the first nine months of 2011 compared to the corresponding period of 2010. Net sales from consumer applications have fluctuated historically as a result of the generally short life cycle of consumer electronics and changes in our customer base. As our product offering and customer base for consumer applications continue to diversify, we expect net sales from consumer applications to fluctuate less.

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The following table sets forth our net sales by application for the periods indicated by amount and as a percentage of our net sales (dollar amounts in thousands).

	Three months ended September 30,				Nine months ended September 30,			
	2011		2010		2011		2010	
	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales
Mobile phone	\$9,737	53.0 %	\$2,648	24.4 %	\$21,890	46.9 %	\$4,747	17.4 %
Consumer	1,991	10.9	2,087	19.2	4,623	9.9	4,756	17.5
Automotive	3,766	20.5	2,923	27.0	11,067	23.7	8,560	31.5
Industrial/other	2,863	15.6	3,187	29.4	9,105	19.5	9,149	33.6
Total	\$18,357	100.0 %	\$10,845	100.0 %	\$46,685	100.0 %	\$27,212	100.0 %

Net Sales by Customer Base

Our customers primarily consist of distributors, OEMs and ODMs. Historically, a small number of our customers have accounted for a substantial portion of our net sales. We have two customers representing 10% or more of our net sales, which combined accounted for approximately 56.7% of our net sales in the third quarter of 2011 compared with 35.0% in the corresponding period of 2010. The increase in 2011 over the prior year period is primarily due to the increase in sales of magnetic sensor product to a major cell phone manufacturer.

We have experienced and will continue to experience fluctuations in demand from a significant number of customers. It is difficult for us to accurately forecast our product demand, particularly in the case of sales to our distributors, as we may not know the identity of the distributor's OEM and ODM customers and lack information regarding their demand, and recent adverse macro-economic changes have increased the difficulty of accurately forecasting product demand and revenue. Occasionally, design changes in the products of our OEM and ODM customers have resulted in the loss of sales.

Net Sales by Geography

Our products are shipped to OEM and ODM customers worldwide. However, we focus on different application markets among geographical regions. In Asia (excluding Japan), our revenue is primarily derived from products for mobile phone applications. We are also seeking to expand the consumer and industrial applications markets in that region. In Japan, our revenue has primarily been derived from products for consumer applications, particularly projectors and digital cameras. We are also seeking to penetrate the automotive market in Japan. In North America, our revenue has primarily been derived from products for automotive applications. In Europe, our revenue has fluctuated. The Crossbow acquisition has broadened our sales in the industrial and other markets in North America, Japan and Europe.

The following table sets forth our net sales by geographical region for the periods indicated by amount and as a percentage of our net sales (dollar amounts in thousands).

	Three months ended September 30,				Nine months ended September 30,			
	2011		2010		2011		2010	
	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales
Asia (excluding Japan)	\$10,513	57.3 %	\$3,657	33.7 %	\$25,431	54.5 %	\$8,697	32.0 %
Europe	898	4.9	875	8.1	2,582	5.5	2,615	9.6

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Japan	2,441	13.3	1,729	15.9	5,668	12.1	4,264	15.7
North America	4,460	24.3	3,874	35.7	12,795	27.4	10,684	39.2
Other	45	0.2	710	6.5	209	0.5	952	3.5
Total	\$18,357	100.0 %	\$10,845	100.0 %	\$46,685	100.0 %	\$27,212	100.0 %

The increase in net sales to Asia in both the third quarter and year to date is mainly attributable to increased magnetic sensor sales to a major mobile phone manufacturer.

Cost of Goods Sold

We are a semi-fabless company. For our sensor products, we outsource wafer production to third-party foundries and complete the post-CMOS MEMS and most of the packaging, assembly and testing functions in-house. We also purchase our ceramic packaging materials from third-party suppliers. Cost of goods sold consists of: (i) cost of wafer, ceramic and other materials purchased from third parties; (ii) manufacturing overhead, primarily consisting of salaries and wages of our quality control employees and manufacturing-related management employees, depreciation, and equipment and parts; (iii) direct labor, primarily consisting of salaries and wages of our manufacturing operators; and (iv) outsourced processing fees paid to our third-party packaging service providers.

Our relationships with third-party foundry and packaging service providers do not provide for guaranteed levels of production capacity at pre-determined prices. As a result, our outsourcing costs relating to wafer production, and to a lesser extent, packaging services, are susceptible to sudden changes based on conditions in the global semiconductor market and our service providers' available capacity.

During the first nine months of 2011, our wireless system solution products and part of the inertial system solution products were manufactured by our indirect subsidiary MTS in Wuxi. We are still in the process of transitioning the manufacturing of the rest of the non-FAA inertial system products from Crossbow Technology to MTS and expect to complete the transition by the end of this year. Meanwhile, we've extended the manufacturing agreement with Crossbow Technology for another 12-month support of manufacturing the non-FAA certified products and 24-month support of manufacturing the FAA certified products.

Gross Profit and Gross Margin

Recently our gross profit and gross margin from our sensor product have tended to decrease due to a variety of factors, including average selling prices of our products, our product application mix, prices of wafers, excess and obsolete inventory, pricing by competitors, changes in production yields, and percentage of sales conducted through distributors. Our products for mobile phone and consumer applications have historically had lower margins than our products for automotive and industrial applications. Notwithstanding the relatively lower margin in the mobile phone applications market, we are increasing our market share in that market by introducing improved low cost sensor products because of the significant potential for further revenue growth in the mobile phone applications market. We have focused on continuous cost reduction through reengineering our sensor products, improving manufacturing efficiency and vendor management. We expect average gross margin will gradually stop declining as a result of our cost reduction efforts.

The gross margin from systems solution products in the first nine months of 2011 are beginning to reflect the reduced cost associated with our transfer of manufacturing to our Wuxi, China operations. We expect the gross margins for our system solution products will improve as we complete the transition to in-house manufacturing in China.

Research and Development Expenses

Research and development expenses are recognized as they are incurred and primarily consist of salaries and wages of research and development employees; research costs, primarily consisting of mask costs and prototype wafers, consulting fees paid for outside design services; travel and other expenses; and stock-based compensation attributable to our research and development employees.

Historically, research and development expenses have increased both in absolute terms and as a percentage of total net sales. We expect our research and development expenses in absolute terms to continue to increase for the remainder of 2011 as we seek to diversify into non-accelerometer products. However, research and development expenses as a percentage of total net sales are expected to decline as our total net sales continue to increase.

Sales and Marketing Expenses

Sales and marketing expenses primarily consist of wages, salaries and commissions for our sales and marketing personnel; consulting expenses, primarily consisting of sales consulting services and software application consulting services; travel expenses; independent sales representatives' commissions; office rental; market promotion and other expenses and stock-based compensation. We expect sales and marketing expense to continue to increase for the remainder of 2011 as we continue to invest in sales and marketing resources to develop new market applications, expand our sales marketing network and engage in additional marketing and promotional activities.

General and Administrative Expenses

General and administrative expenses primarily consist of salaries and wages for administrative personnel; costs for professional services, including legal, tax and accounting services; depreciation and amortization expenses for non-manufacturing equipment; travel and entertainment expenses; office supply and other office-related expenses; office rental expenses; other expenses, such as utilities, insurance and provision for accounts receivable; and stock-based compensation.

Other Income (Expense)

Other income (expense) primarily consists of interest income earned on our investments of cash and cash equivalents, and interest expense incurred on our borrowings and net foreign currency exchange gains and losses.

Provision for Income Taxes

We conduct sensor sales through our headquarters in Andover, Massachusetts. Our Wuxi subsidiary is primarily engaged in manufacturing and engineering activities and does not conduct direct sales of our sensor products to customers. For internal accounting and PRC tax purposes, we account for the transfers of goods from our Wuxi subsidiary to our U.S. headquarters as sales, and calculate the transfer price of such sales based on a markup of manufacturing and operating costs. We believe the prices of these sales were consistent with the prevailing market prices.

U.S. Tax

In the United States, we are subject to the federal income tax and the Massachusetts state income tax, which are approximately at the rates of 34.0% and 8.75%, respectively. At December 31, 2010, the Company had gross U.S. net operating loss carryforwards of \$6.3 million, which expire in various amounts beginning in 2028. Included within this amount is approximately \$260,000 of excess tax deductions associated with non-qualified stock options that have been exercised. When these excess tax benefits actually result in a reduction to currently payable income taxes, the tax benefit will be recorded as an increase to additional paid-in capital. The Company's operating losses may be subject to limitations under provisions of the Internal Revenue Code.

PRC Enterprise Income Tax

PRC enterprise income tax is calculated based on taxable income determined under PRC accounting principles. In accordance with the "Enterprise Income Tax Law", which approved by the National People's Congress on March 16, 2007 and took effect on January 1, 2008, Foreign Investment Enterprises, or FIEs and domestic companies are subject to a uniform tax rate of 25%.

Prior to January 1, 2008, the Foreign Enterprise Income Tax Law and the related implementing rules provide certain favorable tax treatments to FIEs which qualify as high-technology companies and are registered and operate in designated high-technology zones in the PRC. Our Wuxi subsidiary is a high-technology FIE registered and operating in a designated high-technology zone. Accordingly, under the Foreign Enterprise Income Tax Law, its implementing rules and several local regulations, our Wuxi subsidiary is entitled to a preferential enterprise income tax rate of 15%. In addition, our Wuxi subsidiary is entitled to a five-year tax holiday, pursuant to which it is exempted from paying the enterprise income tax for 2007, the year in which it first had positive accumulated earnings, and 2008. After the two-year exemption period, our Wuxi subsidiary is entitled to a 50% reduction from the then applicable income tax rate for each year from 2009 through 2011. After the expiration of this five-year tax holiday period, a preferential enterprise income tax rate of 15% may apply for so long as our Wuxi subsidiary continues to be recognized as a

“high-technology company especially supported by the PRC government.”

To qualify as a “high-technology company especially supported by the PRC government” for PRC enterprise income tax purposes, a business entity generally must meet certain financial and non-financial criteria, including, but not limited to:

• products or services of the business falling under the scope of “high-technology especially supported by the PRC government”;

• a minimum level of revenue generated from high-technology related sales or services as a percentage of total revenue;

• a minimum number of employees engaged in research and development as a percentage of total number of employees; and

- a minimum level of research and development expenses as a percentage of total revenue.

If the PRC central government or applicable local governments determine that our Wuxi subsidiary is not or no longer qualifies as a “high-technology company especially supported by the PRC government,” our effective enterprise income tax rate would increase as a result.

In addition, as an FIE, our Wuxi subsidiary MEMSIC Semiconductor enjoys certain tax deductions for purchasing equipment made in China. Under the relevant regulation, if an FIE purchases Chinese-made equipment, and the price does not exceed the total investment amount of the FIE, for projects that fall within certain specified categories, 40% of the purchase price amount may be credited against the surplus between the amount of enterprise income tax payable in the current year and the amount paid in the previous year. If the credited amount is greater than the surplus, the excess amount can be carried forward for up to five years, subject to certain exceptions.

If MEMSIC Semiconductor ceases to qualify for its current preferential enterprise income tax rates, we will consider options that may be available at the time that would enable it to qualify for other preferential tax treatment. To the extent we are unable to offset the expiration of, or the inability to obtain, preferential tax treatment with new tax exemptions, tax incentives or other tax benefits, our effective tax rate will increase. The amount of income tax payable by our Wuxi subsidiary in the future will depend on various factors, including, among other things, the results of operations and taxable income of our Wuxi subsidiary (which is in turn partially dependent on our internal transfer pricing policies) and the applicable statutory tax rate.

The new “Enterprise Income Tax Law” provides a five-year transition period starting from its effective date for those enterprises which were established before the promulgation date of the new tax law and which were entitled to a preferential lower tax rate under the then effective tax laws or regulations. In accordance with regulations issued by the State Council, the tax rate of such enterprises may gradually transition to the uniform tax rate within the transition period. For those enterprises which are enjoying tax holidays, such tax holidays may continue until their expiration in accordance with the regulations issued by the State Council. While the new tax law equalizes the tax rates for FIEs and domestic companies, preferential tax treatment would continue to be given to companies in certain encouraged sectors and to entities classified as “high-technology companies especially supported by the PRC government,” whether FIEs or domestic companies.

MEMSIC Semiconductor has been qualified as a “high-technology company especially supported by the PRC government.” Therefore, a preferential enterprise income tax rate of 15% under the new tax law may apply to our Wuxi subsidiary. However, according to the relevant transition preferential tax policies issued by the State Council, the preferential enterprise income tax rate under the new tax law and the transition-period preferential tax policy can not apply simultaneously. Our Wuxi subsidiary may either choose to enjoy the exemption from enterprise income tax for 2007 and 2008 and a 50% reduction on the uniform enterprise income tax rate of 25% from 2009 to 2011, or, choose the preferential enterprise income tax rate of 15% for qualified high-technology companies under the new tax law. We believe the adoption of the transition-period preferential tax policy will be more beneficial to our Wuxi subsidiary. Therefore, from 2009 to 2011, the effective income tax rate for our Wuxi subsidiary is 12.5%.

As a result of the new tax law, following the year 2011, upon expiration of our 50% reduction from the then applicable income tax rate, our effective tax rate may increase, unless we are otherwise eligible for preferential treatment.

Our indirect Wuxi subsidiary MTS is registered as a China domestic company and has not been qualified as a high-technology company, therefore is currently subject to the uniform tax rate of 25%.

At December 31, 2010, the net operating loss carryforward from our Wuxi subsidiaries was \$2.0 million, which will expire in 2015.

See “Risk Factors—Risks Related to Doing Business in China—The discontinuation of any of the preferential tax treatments currently available to us in China could materially and adversely affect our business, financial condition and results of operations” included in our Annual Report on Form 10-K for the period ended December 31, 2010.

Crossbow Japan Taxes

Our majority owned joint venture in Japan is subject to Japan taxes including enterprise income tax, value-added tax, and certain other miscellaneous taxes. The effective income tax rate for Crossbow Japan is 40%.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements and related notes requires us to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, net sales and expenses, and related disclosure of contingent assets and liabilities. We have based our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We consider all accounting policy to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the consolidated financial statements. For a discussion of the critical accounting policies that we consider to be the most sensitive and that require the most significant estimates and assumptions used in the preparation of our consolidated financial statements, see our Annual Report on Form 10-K for the year ended December 31, 2010, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations--Critical Accounting Policies." There has been no change in our critical accounting policies and estimates from those described in our Annual Report on Form 10-K for the year ended December 31, 2010.

Results of Operations

The following tables set forth a summary of our unaudited statements of operations data by reportable segments for the periods described by amount and as a percentage of our total net sales. This information should be read together with our unaudited consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. The operating results in any period are not necessarily indicative of the results that may be expected for any future period:

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2011		2010		2011		2010	
	Amount	% of net sales	Amount	% of net sales	Amount	% of net sales	Amount	% of net sales
	(dollar amounts in thousands)				(dollar amounts in thousands)			
Net sales	\$18,357	100.0 %	\$10,845	100.0 %	\$46,685	100.0 %	\$27,212	100.0 %
Cost of goods sold	12,156	66.2	6,751	62.2	30,543	65.4	16,585	60.9
Gross profit	6,201	33.8	4,094	37.8	16,142	34.6	10,627	39.1
Operating expenses:								
Research and development	2,200	12.0	2,378	21.9	6,610	14.2	6,386	23.5
Sales and marketing	1,881	10.3	1,377	12.7	4,876	10.4	3,557	13.1
General and administrative	2,799	15.2	2,212	20.4	7,573	16.2	6,525	24.0
Amortization	404	2.2	407	3.8	1,212	2.6	1,147	4.2

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Total operating expenses	7,284	39.7	6,374	58.8	20,271	43.4	17,615	64.8
Operating loss	(1,083)	(5.9)	(2,280)	(21.0)	(4,129)	(8.8)	(6,988)	(25.7)
Other income:								
Interest and dividend income	153	0.8	99	0.9	335	0.7	320	1.2
Foreign exchange gain	329	1.8	306	2.8	848	1.8	360	1.3
Other, net	323	1.8	19	0.2	406	0.9	70	0.3
Total other income	805	4.4	424	3.9	1,589	3.4	750	2.8
Loss before income taxes	(278)	(1.5)						