

MONOLITHIC POWER SYSTEMS INC
Form 10-Q
May 01, 2014

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 March 31, 2014

OR

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

Commission file number: 000-51026

Monolithic Power Systems, Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

79 Great Oaks Boulevard, San Jose, CA 95119 (408) 826-0600

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

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

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

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

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

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

There were 38,605,790 shares of the registrant’s common stock issued and outstanding as of April 25, 2014.

MONOLITHIC POWER SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****MONOLITHIC POWER SYSTEMS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except par value)

(Unaudited)

	March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$88,885	\$ 101,213
Short-term investments	139,750	125,126
Accounts receivable, net of allowances of \$0 as of March 31, 2014 and December 31, 2013	22,057	23,730
Inventories	39,829	39,737
Deferred income tax assets, net	292	294
Prepaid expenses and other current assets	2,444	1,986
Total current assets	293,257	292,086
Property and equipment, net	65,897	64,837
Long-term investments	9,843	9,860
Deferred income tax assets, net	476	481
Other long-term assets	5,159	1,644
Total assets	\$374,632	\$ 368,908
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$11,748	\$ 10,694
Accrued compensation and related benefits	10,332	10,419
Accrued liabilities	8,559	17,376
Total current liabilities	30,639	38,489
Income tax liabilities	5,652	5,542
Other long-term liabilities	3,674	1,478
Total liabilities	39,965	45,509
Commitments and contingencies (Notes 6 and 8)		
Stockholders' equity:		

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Common stock, \$0.001 par value; shares authorized: 150,000; shares issued and outstanding: 38,672 and 38,291 as of March 31, 2014 and December 31, 2013, respectively	237,059	234,201
Retained earnings	91,956	82,938
Accumulated other comprehensive income	5,652	6,260
Total stockholders' equity	334,667	323,399
Total liabilities and stockholders' equity	\$ 374,632	\$ 368,908

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Revenue	\$60,061	\$51,470
Cost of revenue	27,964	24,085
Gross profit	32,097	27,385
Operating expenses:		
Research and development	15,603	12,123
Selling, general and administrative	16,109	13,258
Litigation benefit, net	(8,700)	(301)
Total operating expenses	23,012	25,080
Income from operations	9,085	2,305
Interest and other income (expense), net	190	(10)
Income before income taxes	9,275	2,295
Income tax provision (benefit)	257	(204)
Net income	\$9,018	\$2,499
Basic net income per share	\$0.23	\$0.07
Diluted net income per share	\$0.23	\$0.07
Weighted average common shares outstanding:		
Basic	38,470	36,259
Diluted	39,517	37,708

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Net income	\$9,018	\$2,499
Other comprehensive income (loss), net of tax:		
Change in unrealized losses on auction-rate securities, net of \$0 tax in 2014 and 2013	(17)	(15)
Change in unrealized gains on other available-for-sale securities, net of \$0 tax in 2014 and 2013	5	(7)
Foreign currency translation adjustments	(596)	303
Total other comprehensive income (loss), net of tax	(608)	281
Comprehensive income	\$8,410	\$2,780

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(Unaudited)

**Three Months Ended March 31,
2014****2013****Cash flows from operating activities:**

\$ 9,018 \$ 2,499

Net income
Adjustments to reconcile net income to net cash provided by
operating activities:

Depreciation and amortization 3,182 2,709

Amortization and realized loss (gain) on investments 71 98

Excess tax benefit from stock option transactions - (132)

Stock-based compensation 7,598 4,660

Changes in operating assets and liabilities:

Accounts receivable 1,673 (3,285)

Inventories (81) (2,836)

Prepaid expenses and other current assets (2,036) 315

Accounts payable 1,058 2,135

Accrued liabilities (8,473) 1,889

Accrued income taxes payable and noncurrent tax liabilities 38 (526)

Accrued compensation and related benefits (63) (822)

Net cash provided by operating activities 11,985 6,704

Cash flows from investing activities:

Property and equipment purchases (4,516) (3,435)

Purchases of short-term investments (41,977) (17,590)

Proceeds from sale of short-term investments 27,252 21,250

Proceeds from sale of long-term investments - 25

Net cash provided by (used in) investing activities (19,241) 250

Cash flows from financing activities:

Proceeds from issuance of common shares 5,554 9,839

Proceeds from employee stock purchase plan 1,053 1,167

Repurchases of common shares (11,358) -

Excess tax benefits from stock option transactions - 132

Net cash provided by (used in) financing activities (4,751) 11,138

Effect of change in exchange rates (321) 91

Net increase (decrease) in cash and cash equivalents (12,328) 18,183

Cash and cash equivalents, beginning of period 101,213 75,104

\$ 88,885 \$ 93,287

Supplemental disclosures for cash flow information:

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Cash paid for taxes	\$	217	\$	324
Supplemental disclosures of non-cash activities:				
Liability accrued for property and equipment purchases	\$	445	\$	4,230

See accompanying notes to unaudited condensed consolidated financial statements.

MONOLITHIC POWER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by Monolithic Power Systems, Inc. (the “Company” or “MPS”) in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been condensed or omitted in accordance with these rules and regulations. The information in this report should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 10, 2014.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company’s financial position, results of operations and cash flows for the interim periods presented. The financial statements contained in this Form 10-Q are not necessarily indicative of the results that may be expected for the year ending December 31, 2014 or for any other future period.

Summary of Significant Accounting Policies

There have been no changes to the Company’s significant accounting policies during the three months ended March 31, 2014 as compared to the significant accounting policies described in the Company’s audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2013.

Recently Adopted Accounting Pronouncement

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The standard gives guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists,

with the purpose of reducing diversity in practice. This new standard requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. The Company adopted this standard in the first quarter of 2014 prospectively and the adoption did not have an impact on its consolidated financial position, results of operations, or cash flows.

2. Stock-Based Compensation

Stock Plans

As of March 31, 2014, approximately 2.9 million shares were available for future issuance under the 2004 Equity Incentive Plan (the “2004 Plan”). The 2004 Plan will expire on November 12, 2014. Once the 2004 Plan expires, the Company will no longer be able to grant equity awards under the 2004 Plan, and any shares otherwise remaining available for future grants under the 2004 Plan will no longer be available for issuance.

The Company’s Board of Directors adopted the 2014 Equity Incentive Plan (the “2014 Plan”) in April 2013, and the Company’s stockholders approved it in June 2013. The 2014 Plan will become effective on November 13, 2014, the day after the 2004 Plan expires. The 2014 Plan provides for the issuance of up to 5,500,000 shares and will expire on November 13, 2024.

Stock-Based Compensation Expense

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

	Three Months Ended March 31,	
	2014	2013
Cost of revenue	\$205	\$156
Research and development	2,005	1,373
Selling, general and administrative	5,388	3,131
Tax benefit	-	(47)
Total	\$7,598	\$4,613

Restricted Stock

The Company's restricted stock units ("RSUs") include time-based RSUs, performance-based RSUs ("PSUs") and market-based RSUs ("MSUs"). A summary of the RSUs is presented in the table below:

		Weighted- Average Grant Date Fair	PSUs	Weighted- Average Grant Date Fair	MSUs	Weighted- Average Grant Date Fair	Total	Weighted- Average Grant Date Fair
	Time-Based RSUs	Value Per Share		Value Per Share		Value Per Share		Value Per Share
Outstanding at January 1, 2014	754,306	\$ 19.41	1,027,782	\$ 23.02	1,800,000	\$ 23.57	3,582,088	\$ 22.53
Awards granted (1)	120,135	\$ 32.06	756,684	\$ 31.58	-	\$ -	876,819	\$ 31.65
Performance adjustment (2)	-	\$ -	(155,255)	\$ 29.65	-	\$ -	(155,255)	\$ 29.65
Awards released	(145,524)	\$ 18.97	(165,136)	\$ 17.76	-	\$ -	(310,660)	\$ 18.33
Awards forfeited	(3,892)	\$ 18.39	-	\$ -	-	\$ -	(3,892)	\$ 18.39
	725,025	\$ 21.60	1,464,075	\$ 27.33	1,800,000	\$ 23.57	3,989,100	\$ 24.59

Outstanding at March
31, 2014

-
- (1) The number of PSUs granted reflects the maximum number of shares that can ultimately be earned assuming the achievement of the highest level of performance conditions under the programs.
- (2) The performance adjustment reflects the number of PSUs that have not been earned or will not ultimately be earned based on management's probability assessment.

The intrinsic value related to awards released for the three months ended March 31, 2014 and 2013 was \$10.2 million and \$8.7 million, respectively. As of March 31, 2014, the total intrinsic value of outstanding awards was \$154.7 million, based on the closing stock price of \$38.77. As of March 31, 2014, unamortized compensation expense related to outstanding awards was approximately \$61.2 million with a weighted-average remaining recognition period of approximately six years.

2014 Time-Based RSUs and PSUs:

In February 2014, the Board of Directors granted 336,000 shares to the Company's executive officers. These grants included 25% time-based RSUs which vest over two years on a quarterly basis, and 75% PSUs which represent a target number of RSUs to be awarded based on the Company achieving an average two-year (2014 and 2015) revenue growth rate compared against the analog industry's average two-year revenue growth rate as determined by the Semiconductor Industry Association ("2014 Executive PSUs"). The maximum number of 2014 Executive PSUs that an executive officer can ultimately earn is 300% of the target shares granted. Half of the 2014 Executive PSUs will vest in February 2016 if the pre-determined performance goals are met and approved by the Compensation Committee and the executive officer is employed by the Company. The remaining shares will vest over the following two years on a quarterly basis, subject to continued employment.

Stock Options

A summary of the stock options activities is presented in the table below:

	Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2014	1,356,446	\$ 15.86	1.9	\$25,505,753

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Options exercised	(350,920)	\$ 15.83		
Options forfeited and expired	(1,167)	\$ 11.48		
Outstanding at March 31, 2014	1,004,359	\$ 15.87	1.7	\$22,998,787
Options exercisable at March 31, 2014 and expected to vest	1,002,281	\$ 15.88	1.7	\$22,942,298
Options exercisable at March 31, 2014	942,757	\$ 16.01	1.5	\$21,459,665

Total intrinsic value of options exercised was \$6.9 million and \$5.6 million for the three months ended March 31, 2014 and 2013, respectively. The net cash proceeds from the exercise of stock options were \$5.6 million and \$9.8 million for the three months ended March 31, 2014 and 2013, respectively. At March 31, 2014, unamortized compensation expense related to unvested options was approximately \$0.4 million with a weighted-average remaining recognition period of approximately one year.

Employee Stock Purchase Plan

For the three months ended March 31, 2014 and 2013, 43,000 and 65,000 shares, respectively, were issued under the Employee Stock Purchase Plan. As of March 31, 2014, 4.8 million shares were available for future issuance.

The intrinsic value of stock purchased was \$0.5 million for both the three months ended March 31, 2014 and 2013. As of March 31, 2014, the unamortized expense was \$0.2 million, which will be recognized over five months. The Black-Scholes model was used to value the employee stock purchase rights with the following assumptions:

	Three Months Ended March 31, 2014 2013	
Expected term (years)	0.5	0.5
Expected volatility	33.9%	28.5%
Risk-free interest rate	0.1 %	0.1 %
Dividend yield	-	-

Cash proceeds from employee stock purchases for the three months ended March 31, 2014 and 2013 were \$1.1 million and \$1.2 million, respectively.

3. Balance Sheet Components

Inventories

Inventories consist of the following (in thousands):

	March 31,	December 31,
	2014	2013
Work in process	\$24,874	\$ 26,605
Finished goods	14,955	13,132
Total inventories	\$39,829	\$ 39,737

Other Long-Term Assets

Other long-term assets consist of the following (in thousands):

	March 31,	December 31,
	2014	2013
Deferred compensation plan assets	\$2,570	\$ 607
Prepaid expense	1,632	57
Other	957	980
Total other long-term assets	\$5,159	\$ 1,644

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	March 31,	December 31,
	2014	2013
Proceeds from litigation (see Note 6)	\$-	\$ 9,489
Deferred revenue and customer prepayments	2,940	2,523
Stock rotation reserve	1,779	1,459
Sales rebate	1,072	900
Commissions	786	931
Warranty	334	451
Other	1,648	1,623
Total accrued liabilities	\$8,559	\$ 17,376

A roll-forward of the warranty reserve is as follows (in thousands):

	Three Months Ended March 31,	
	2014	2013
Balance at beginning of period	\$451	\$331
Warranty provision for product sales	60	103
Settlements made	(74)	(93)
Unused warranty provision	(103)	(66)
Balance at end of period	\$334	\$275

Other Long-Term Liabilities

Other long-term liabilities consist of the following (in thousands):

	March 31,	December 31,
--	----------------------	-------------------------

	2014	2013
Deferred compensation plan liabilities	\$2,567	\$ 628
Other	1,107	850
Total other long-term liabilities	\$3,674	\$ 1,478

4. Net Income per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock, and calculated using the treasury stock method. The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2014	2013
Numerator:		
Net income	\$9,018	\$2,499
Denominator:		
Weighted average outstanding shares used to compute basic net income per share	38,470	36,259
Effect of dilutive securities	1,047	1,449
Weighted average outstanding shares used to compute diluted net income per share	39,517	37,708
Net income per share - basic	\$0.23	\$0.07
Net income per share - diluted	\$0.23	\$0.07

For the three months ended March 31, 2014, there were no anti-dilutive common stock equivalents. For the three months ended March 31, 2013, approximately 0.2 million common stock equivalents were excluded from the calculation of diluted net income per share because their inclusion would have been anti-dilutive.

5. Segment Information

As defined by the requirements of ASC 280-10-55, *Segment Reporting – Overall – Implementation*, the Company operates in one reportable segment that includes the design, development, marketing and sale of high-performance, mixed-signal analog semiconductors for the communications, storage and computing, consumer and industrial markets. The Company's chief operating decision maker is its chief executive officer. The Company derives a majority of its revenue from sales to customers located outside North America, with geographic revenue based on the customers' ship-to locations.

The following table summarizes those distributors with sales greater than 10% of the Company's total revenue:

Customer	Three Months Ended March 31,	
	2014	2013
A	26%	34%
B	10%	*

*Represents less than 10%.

The following table summarizes those distributors with accounts receivable balances greater than 10% of the Company's total accounts receivable:

Customer	March 31,		December 31,	
	2014	2013	2013	2014
A	24%	32%	32%	24%
B	16%	17%	17%	16%

The following is a summary of revenue by geographic regions (in thousands):

Country and Region	Three Months Ended March 31,	
	2014	2013
China	\$36,859	\$26,779
Taiwan	9,064	7,519
Europe	4,591	3,950
Korea	2,736	2,418
United States	2,603	1,901
Japan	2,141	1,521
Southeast Asia	2,013	7,329
Other	54	53
Total	\$60,061	\$51,470

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

Product Family	Three Months Ended March 31,	
	2014	2013
DC to DC products	\$53,935	\$46,442
Lighting control products	6,126	5,028
Total	\$60,061	\$51,470

The following is a summary of long-lived assets by geographic regions (in thousands):

Country	March	December
	31,	31,
	2014	2013
China	\$39,093	\$ 41,557
United States	31,753	24,719
Other	210	205
Total	\$71,056	\$ 66,481

6. *Litigation*

The Company and certain of its subsidiaries are parties to actions and proceedings in the ordinary course of business, including litigation regarding its shareholders and its intellectual property, challenges to the enforceability or validity of its intellectual property and claims that the Company's products infringe on the intellectual property rights of others. These proceedings often involve complex questions of fact and law and may require the expenditure of significant funds and the diversion of other resources to prosecute and defend. The Company defends itself vigorously against any such claims.

O2 Micro

In May 2012, the United States District Court for the Northern District of California (the "District Court") issued an order finding O2 Micro International, Ltd. ("O2 Micro") liable for approximately \$9.1 million in attorneys' fees and non-taxable costs, plus interest, in connection with the patent litigation that the Company won in 2010. This award was in addition to the approximately \$0.3 million in taxable costs that the District Court had earlier ordered O2 Micro to pay to the Company in connection with the same lawsuit. In October 2012, O2 Micro appealed the District Court's judgment to the United States Court of Appeals for the Federal Circuit (the "Federal Circuit"). In August 2013, the Federal Circuit affirmed O2 Micro's liability for the full amount of the award. In September 2013, O2 Micro filed a petition for rehearing of that ruling, but the Federal Circuit denied O2 Micro's petition for rehearing on October 16, 2013.

In November 2013, the Company received a cash payment of \$9.5 million from O2 Micro. In January 2014, O2 Micro filed an appeal with the United States Supreme Court. Had O2 Micro been successful in obtaining a favorable ruling against the Company, MPS could have been liable to return a portion or all of the \$9.5 million to O2 Micro. Accordingly, the Company recorded the \$9.5 million as a current liability as of December 31, 2013.

In March 2014, the Supreme Court declined to hear the case. As O2 Micro has no further legal avenues to appeal, the Company released the current liability of \$9.5 million and recorded the amount in litigation benefit, net, in the Condensed Consolidated Statement of Operations in the first quarter of 2014. In addition, the Company incurred additional legal fees of \$500,000 in connection with the final resolution of the lawsuit.

7. Cash, Cash Equivalents and Investments

The following is a summary of the Company's cash and cash equivalents, short-term and long-term investments (in thousands):

	Estimated Fair Market Value as of	
	March 31,	December 31,
	2014	2013
Cash, cash equivalents and investments:		
Cash	\$62,857	\$ 62,625
Money market funds	26,028	35,588
U.S. treasuries and government agency bonds	139,750	128,126
Auction-rate securities backed by student-loan notes	9,843	9,860
Total cash, cash equivalents and investments	\$238,478	\$ 236,199

Reported as:	March	December
	31,	31,
	2014	2013
Cash and cash equivalents	\$88,885	\$ 101,213
Short-term investments	139,750	125,126
Long-term investments	9,843	9,860
Total cash, cash equivalents and investments	\$238,478	\$ 236,199

For the three months ended March 31, 2014, the Company did not redeem any auction-rate securities. For the three months ended March 31, 2013, the Company redeemed \$25,000 of auction-rate securities at par.

The contractual maturities of the Company's short-term and long-term available-for-sale investments are as follows (in thousands):

	March	December
	31,	31,
	2014	2013
Due in less than 1 year	\$89,651	\$ 95,509
Due in 1 - 5 years	50,099	29,617
Due in greater than 5 years	9,843	9,860
	\$149,593	\$