POWER INTEGRATIONS INC
Form 10-K
February 10, 2015
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(Mark One)
x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2014
or
o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to

Commission File Number 0-23441

POWER INTEGRATIONS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of Incorporation or organization)	94-3065014 (I.R.S. Employer Identification No.)
5245 Hellyer Avenue, San Jose, California (Address of principal executive offices)	95138-1002 (Zip code)

(408) 414-9200
(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.001 Par Value	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

---

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES x NO o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

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 files). YES x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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:

Table of Contents

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x
The aggregate market value of registrant's voting and non-voting common stock held by non-affiliates of registrant on June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $1.6 billion, based upon the closing sale price of the common stock as reported on The NASDAQ Global Select Market. Shares of common stock held by each officer, director and holder of 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not a conclusive determination for other purposes.

Outstanding shares of registrant's common stock, $0.001 par value, as of January 30, 2015: 29,331,133.

DOCUMENTS INCORPORATED BY REFERENCE
The information required by Part III of this report, to the extent not set forth herein, is incorporated by reference from the Registrant's definitive proxy statement relating to the 2015 annual meeting of stockholders, which definitive proxy statement will be filed with the Securities and Exchange Commission within 120 days after the fiscal year to which this Report relates.

Table of Contents

POWER INTEGRATIONS, INC.
TABLE OF CONTENTS

Table of Contents

Cautionary Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K, including information incorporated by reference herein, includes a number of forward-looking statements that involve many risks and uncertainties. In some cases, forward-looking statements are indicated by the use of words such as “would”, “could”, “will”, “may”, “expect”, “believe”, “anticipate”, “if”, “future”, “intend “estimate”, “potential”, “seek” or “continue” and similar words and phrases, including the negatives of these terms, or other variations of these terms. These statements reflect our current views with respect to future events and our potential financial performance and are subject to risks and uncertainties that could cause our actual results and financial position to differ materially and adversely from what is projected or implied in any forward-looking statements included in this Form 10-K. These factors include, but are not limited to: we do not have long-term contracts with any of our customers and if they fail to place, or if they cancel or reschedule orders for our products, our operating results and our business may suffer; intense competition in the high-voltage power supply industry may lead to a decrease in our average selling price and reduced sales volume of our products; if demand for our products declines in our major end markets, our net revenues will decrease; we depend on third-party suppliers to provide us with wafers for our products and if they fail to provide us sufficient quantities of wafers, our business may suffer; if we are unable to adequately protect or enforce our intellectual property rights, we could lose market share, incur costly litigation expenses, suffer incremental price erosion or lose valuable assets, any of which could harm our operations and negatively impact our profitability; fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen, Swiss franc and Euro, may impact our gross margin or net income; audits of our tax returns and potential future changes in tax laws may increase the amount of taxes we are required to pay; we are engaged in intellectual property litigation, and if the outcome is unfavorable to us, it could result in significant losses and the right to use some of our technologies; and the other risks factors described in Item 1A of Part I -- “Risk Factors” of this Form 10-K. We make these forward looking statements based upon information available on the date of this Form 10-K, and we have no obligation (and expressly disclaim any obligation) to update or alter any forward-looking statements, whether as a result of new information or otherwise. In evaluating these statements, you should specifically consider the risks described under Item 1A of Part I -- “Risk Factors,” Item 7 of Part II -“Management's Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this Annual Report on Form 10-K.

Table of Contents

PART I.

Item 1. Business.

Overview

We design, develop and market analog and mixed-signal integrated circuits (ICs) and other electronic components and circuitry used in high-voltage power conversion. Our products are used in power converters that convert electricity from a high-voltage source (i.e., 48 volts or higher) to the type of power required for a specified downstream use. In most cases, this conversion entails, among other functions, converting alternating current (AC) to direct current (DC) or vice versa, reducing or increasing the voltage, and regulating the output voltage and/or current according to the customer's specifications.

A large percentage of our products are ICs used in AC-DC power supplies, which convert high-voltage AC from a wall outlet to the low-voltage DC required by most electronic devices. Power supplies incorporating our products are used with all manner of electronic products including mobile phones, computers, entertainment and networking equipment, appliances, utility meters, industrial controls and LED lights. Our highly integrated IC products incorporate high-voltage transistors (MOSFETs) and low-voltage control circuitry on either a monolithic die or in a hybrid configuration (i.e., separate MOSFETs and controllers side-by-side in a single package). We believe our patented TOPSwitch ICs, introduced in 1994, were the first highly integrated ICs to achieve widespread acceptance in the power-supply market. We have since introduced additional product families to broaden our addressable market and increase the functionality of our products; we currently offer IC products that can be used in power supplies with output wattages up to approximately 500 watts.

Since our May 2012 acquisition of CT-Concept Technologie AG (Concept), we also offer IGBT drivers - circuit boards containing multiple ICs, electrical isolation components and other circuitry - used to operate arrays of high-voltage, high-power transistors known as IGBT modules. These driver/module combinations are used for power conversion in high-power applications (i.e., power levels ranging from tens of kilowatts up to one gigawatt) such as industrial motors, solar- and wind-power systems, electric vehicles and high-voltage DC transmission systems.

Our products bring a number of important benefits to the power-conversion market compared with less advanced alternatives, including reduced component count and design complexity, smaller size, higher reliability and reduced time-to-market. Our products also improve the energy efficiency of power converters, helping our customers meet the increasingly stringent efficiency standards that have been adopted around the world for many electronic products, and improving the efficacy of renewable-energy systems, electric vehicles and other high-power applications.

Industry Background

Virtually every electronic device that plugs into a wall socket requires a power supply to convert the high-voltage alternating current provided by electric utilities into the low-voltage direct current required by most electronic devices. A power supply may be located inside a device, such as consumer appliances or desktop computer, or it may be outside the device as in the case of a mobile-phone charger or an adapter for a cordless phone.

Until approximately 1970, AC-DC power supplies were generally in the form of line-frequency, or linear, transformers. These devices, consisting primarily of copper wire wound around an iron core, tend to be bulky and heavy, and typically waste a substantial amount of electricity. In the 1970s, the invention of high-voltage discrete semiconductors enabled the development of a new generation of power supplies known as switched-mode power supplies, or switchers. These switchers generally came to be a cost-effective alternative to linear transformers in applications requiring more than about three watts of power; in recent years the use of linear transformers has declined even further as a result of energy-efficiency standards and higher raw-material prices.

Switchers are generally smaller, lighter-weight and more energy-efficient than linear transformers. However, switchers designed with discrete components are highly complex, containing numerous components and requiring a high level of analog design expertise. Further, the complexity and high component count of discrete switchers make them relatively costly, difficult to manufacture and prone to failures. Also, some discrete switchers lack inherent safety and energy-efficiency features; adding these features may further increase the component count, cost and complexity of the power supply.

In high-power systems such as industrial motor drives, electric locomotives and renewable-energy systems, power conversion is typically performed using arrays of high-power silicon transistors known as IGBT modules; these modules are operated by electronic circuitry known as IGBT drivers, whose function is to ensure accurate, safe and reliable operation of the IGBT modules. Much like discrete power supplies, discrete IGBT drivers tend to be highly complex, requiring a large number of components and a great deal of design expertise.

Our Highly Integrated Approach

In 1994 we introduced TOPSwitch, the industry's first cost-effective high-voltage IC for switched-mode AC-DC power supplies; we have since introduced a range of other product families such as TinySwitch, LinkSwitch and Hiper, which have expanded the range of power-supply applications we can address. In May 2012 we acquired Concept, further expanding our addressable market to include IGBT drivers.

Our ICs and IGBT drivers drastically reduce the complexity and component count of power converters compared to typical discrete designs by integrating many of the functions otherwise performed by numerous discrete electronic components, and by eliminating (or reducing the size and cost of) additional components through innovative system design. As a result, our products enable power converters to have superior features and functionality at a total cost equal to or lower than that of many competing alternatives. Our products offer the following key benefits:

•Fewer Components, Reduced Size and Higher Reliability

Our highly integrated ICs and IGBT drivers enable designs with up to 70% fewer components than comparable discrete designs. This reduction in component count enhances reliability and efficiency, reduces size, accelerates time-to-market and results in lower manufacturing costs for our customers. Power supplies that incorporate our ICs are also lighter and more portable than comparable power supplies built with copper-and-iron linear transformers, which are still used in some low-power applications.

•Reduced Time-to-Market, Enhanced Manufacturability

Because our products eliminate much of the complexity associated with the design of power converters, designs can typically be completed in much less time, resulting in more efficient use of our customers' design resources and shorter time-to-market for new designs. The lower component count and reduced complexity enabled by our products also makes designs more suitable for high-volume manufacturing. We also provide extensive hands-on design support as well as online design tools, such as our PI Expert design software, that further reduce time-to-market and product development risks.

•Energy Efficiency

Our patented EcoSmart technology, introduced in 1998, improves the energy efficiency of electronic devices during normal operation as well as standby and "no-load" conditions. This technology enables manufacturers to cost-effectively meet the growing demand for energy-efficient products, and to comply with increasingly stringent energy-efficiency requirements. Our Concept IGBT drivers also enable very high efficiency in high-power systems; in many such systems, such as renewable-energy installations, even small efficiency gains can dramatically shorten the payback period over which the cost of a system is recovered through energy savings.

•Wide Power Range and Scalability

Products in our current IC families can address AC-DC power supplies with output power up to approximately 500 watts as well as some high-voltage DC-DC applications; our Concept IGBT drivers are used in applications with power levels as high as one gigawatt. Within each of our product families, the designer can scale up or down in power to address a wide range of designs with minimal design effort.

Energy Efficiency

Power supplies often draw significantly more electricity than the amount needed by the devices they power. As a result, billions of dollars' worth of electricity is wasted each year, and millions of tons of greenhouse gases are unnecessarily produced by power plants. Energy waste occurs during the normal operation of a device and in standby mode, when the device is plugged in but idle. For example, computers and printers waste energy while in “sleep” mode. TVs that are turned off by remote control consume energy while awaiting a remote-control signal to turn them back on. A mobile-phone charger left plugged into a wall outlet continues to draw electricity even when not connected to the phone (a condition known as “no-load”). Many common household appliances, such as microwave ovens, dishwashers and washing machines, also consume power when not in use. One study has estimated that standby power alone amounts to as much as 10% of residential energy consumption in developed countries.

Lighting is another major source of energy waste. Less than 5% of the energy consumed by traditional incandescent light bulbs is converted to light, while the remainder is wasted as heat. The Alliance to Save Energy has estimated that a conversion to efficient lighting technologies such as compact fluorescent bulbs and light-emitting diodes, or LEDs, could save as much as $18 billion worth of electricity and 158 million tons of carbon dioxide emissions per year in the U.S. alone.

In response to concerns about the environmental impact of carbon emissions, policymakers are taking action to promote energy efficiency. For example, the ENERGY STAR® program and the European Union Code of Conduct encourage manufacturers of electronic devices to comply with voluntary energy-efficiency specifications. In 2007 the California Energy Commission, or CEC, implemented mandatory efficiency standards for external power supplies. The CEC standards were implemented nationwide in the U.S. in July 2008 as a result of the Energy Independence and Security Act of 2007, or EISA; these federal standards are scheduled to tighten in 2016. Similar standards for external power supplies took effect in the European Union in 2010 as part of the EU's EcoDesign Directive for Energy-Related Products.

In 2009 the CEC announced mandatory efficiency standards for televisions, which took effect in 2011, and in January 2012 the CEC announced mandatory efficiency standards for battery-charging systems, which took effect in 2013.

In 2010, the EU EcoDesign Directive implemented standards limiting standby power consumption on a wide range of electronic products; the limit was reduced by 50 percent beginning in 2013, with many products now limited to 500 milliwatts of standby usage. The EISA law also required substantial improvements in the efficiency of lighting technologies beginning in 2012; effective in 2014, traditional 100-, 75-, 60- and 40-watt bulbs may no longer be manufactured or sold in the U.S. Plans to eliminate conventional incandescent bulbs have also been announced or enacted in other geographies such as Canada, Australia and Europe.

We believe we offer products that enable manufacturers to meet or exceed these regulations, and all other such regulations of which we are aware. Our EcoSmart technology, introduced in 1998, dramatically reduces waste in both operating and standby modes; we estimate that this technology has saved billions of dollars' worth of standby power worldwide since 1998. In 2010 we introduced our CapZero and SenZero IC families, which eliminate additional sources of standby waste in some power supplies; we have also introduced a range of product families designed specifically for LED-lighting applications.

Products

Below is a brief description of our products:

•AC-DC power conversion products

TOPSwitch, our first commercially successful product family, was introduced in 1994. Since that time we have introduced a wide range of products (such as our TinySwitch, LinkSwitch, Hiper and InnoSwitch families) to increase the level of integration, improve upon the functionality of the original TOPSwitch and broaden the range of power levels we can address. In January 2015 we further expanded our product portfolio with the acquisition of Cambridge Semiconductor Ltd., a producer of controller ICs for low-power AC-DC applications. Since 2010 we have also introduced products designed specifically for LED-lighting applications, including our LYTSwitch family.

In 2010 we introduced our CapZero and SenZero families, which reduce standby-power consumption in certain applications by eliminating waste caused by so-called bleed resistors and sense resistors. Also, by virtue of our 2010 acquisition of Qspeed Semiconductor, we offer a range of high-performance, high-voltage diodes known as Qspeed diodes. Qspeed diodes utilize a proprietary silicon technology to provide a unique combination of high efficiency and low noise, as well as high-frequency operation, which reduces the cost and size of magnetic components in a power supply.

This portfolio of power-conversion products generally addresses power supplies ranging from less than one watt of output up to approximately 500 watts of output, a market we refer to as the “low-power” market. This market consists of an extremely broad range of applications including mobile-device chargers, consumer appliances, utility meters, LCD monitors, main and standby power supplies for desktop computers and TVs, LED lamps, and numerous other consumer and industrial applications.

•IGBT drivers

As a result of our May 2012 acquisition of Concept, we offer a range of IGBT-driver products sold primarily under the SCALE and SCALE-2 product-family names. These products are fully assembled circuit boards incorporating multiple ICs, electrical isolation components and other circuitry. We offer both ready to operate “plug-and-play” drivers designed specifically for use with particular IGBT modules, as well as “driver cores,” which provide more basic driver functionality that customers can customize to their own specifications after purchase. In addition, we offer custom made drivers based on our Scale technology.

•High-voltage DC-DC products

The DPA-Switch family of products, introduced in June 2002, was the first monolithic high-voltage DC-DC power conversion IC designed specifically for use in distributed power architectures. Applications include power-over-Ethernet powered devices such as voice-over-IP phones and security cameras, as well as network hubs, line cards, servers, digital PBX phones, DC-DC converter modules and industrial controls.

Other Product Information

TOPSwitch, TinySwitch, LinkSwitch, DPA-Switch, EcoSmart, Hiper, Qspeed, InnoSwitch, Scale-I, Scale-II, Scale-III, Peakswitch, Capzero, Chiphy, CONCEPT, Concept A Power Integrations Company and PI Expert are trademarks of Power Integrations, Inc.

End Markets and Applications

Our net revenues consist primarily of sales of the products described above. When evaluating our net revenues, we categorize our sales into the following four major end-market groupings: communications, computer, consumer, and industrial electronics. The table below provides the approximate mix of our net sales by end market:

	Year Ended December 31,					
End Market	2014		2013		2012	
Communications	18	%	21	%	24	%
Computer	10	%	10	%	12	%
Consumer	37	%	35	%	36	%
Industrial electronics	35	%	34	%	28	%

Our products are used in a vast range of power-conversion applications in the above-listed end-market categories. The following chart lists the most prominent applications for our products in each category.

Market Category	Primary Applications
Communications	Mobile phones, routers, cordless phones, broadband modems, voice-over-IP phones, other network and telecom gear
Computer	Desktop PCs, LCD monitors, servers, LCD projectors, adapters for notebook computers
Consumer	Major and small appliances, air conditioners, TV set-top boxes, digital cameras, TVs, video-game consoles

Industrial electronics	LED lighting, industrial controls, utility meters, motor controls, uninterruptible power supplies, tools, industrial motor drives, renewable energy systems, electric locomotives, high-voltage DC transmission systems

7

Sales, Distribution and Marketing

We sell our products to original equipment manufacturers, or OEMs, and merchant power supply manufacturers through our direct sales staff and a worldwide network of independent sales representatives and distributors. We have sales offices in the United States, Switzerland, United Kingdom, Germany, Italy, India, China, Japan, Korea, the Philippines, Singapore and Taiwan. Direct sales to OEMs and merchant power supply manufacturers represented approximately 25%, 25% and 26% of our net product revenues for 2014, 2013 and 2012, respectively, while sales to and through distributors accounted for approximately 75%, 75% and 74% for 2014, 2013 and 2012, respectively. Most of our distributors are entitled to return privileges based on sales revenue and are protected from price reductions affecting their inventories. Our distributors are not subject to minimum purchase requirements, and sales representatives and distributors can discontinue marketing our products at any time.

Our top ten customers, including distributors that resell to OEMs and merchant power supply manufacturers, accounted for 59%, 59% and 64% of our net revenues for 2014, 2013 and 2012, respectively.

The following distributors accounted for 10% or more of total net revenues in 2014, 2013 and 2012:

	Year Ended December 31,		
Customer	2014	2013	2012
Avnet	19%	19%	20%
ATM Electronic Corporation	*	*	12%

* Total customer revenue was less than 10% of net revenues

No other customers accounted for more than 10% of net revenues in these periods.

In 2014, 2013 and 2012 sales to customers in the United States accounted for approximately 5% of our net revenues in each of the respective years, and sales to customers outside of the United States accounted for approximately 95% of our net revenues in the same periods. See Note 6, "Significant Customers and International Sales," in our Notes to Consolidated Financial Statements regarding sales to customers located in foreign countries. See our consolidated financial statements regarding total revenues and profit for the last three fiscal years.

We are subject to risks stemming from the fact that most of our manufacturing and most of our customers are located in foreign jurisdictions. Risks related to our foreign operations are set forth in Item 1A of this Annual Report on Form 10-K, and include: potential weaker intellectual property rights under foreign laws, the burden of complying with foreign laws and foreign-currency exchange risk. See, in particular, the risk factor "Our international sales activities account for a substantial portion of our net revenues, which subjects us to substantial risks" in Item 1A of this Form 10-K.

Backlog

Our sales are primarily made pursuant to standard purchase orders. The quantity of products purchased by our customers as well as shipment schedules are subject to revisions that reflect changes in both the customers' requirements and in manufacturing availability. Historically, our business has been characterized by short-lead-time orders and quick delivery schedules; for this reason, and because orders in backlog are subject to cancellation or postponement, backlog is not necessarily a reliable indicator of future revenues. Furthermore, except in the case of our IGBT-driver products, we do not recognize revenue on distribution sales until our distributors report that they have sold our products to their customers. As a result, our revenues in a given period can differ significantly from the value of the products we ship in the same period. We believe this further reduces the reliability of order backlog as an indicator of future revenues.

Research and Development

Our research and development efforts are focused on improving our technologies, introducing new products to expand our addressable markets, reducing the costs of existing products, and improving the cost-effectiveness and functionality of our customers' power converters. We have assembled teams of highly skilled engineers to meet our research and development goals. These engineers have expertise in high-voltage device structure and process technology, analog IC design, system architecture and packaging.

In 2014, 2013 and 2012, we incurred costs of $55.0 million, $51.7 million and $45.7 million, respectively, for research and development. R&D expenses increased in 2014 compared to 2013, driven primarily by increased payroll and related expenses as a result of increased headcount, due mainly to the expansion of our product-development efforts. Research and development expenses increased in 2013 compared to the prior year due primarily to the May 2012 acquisition of Concept, which affected our results for the full year in 2013 but was only included in our results for eight months of 2012. (See Note 11, Acquisitions, in our Notes to Consolidated Financial Statements, for details).

Intellectual Property and Other Proprietary Rights

We use a combination of patents, trademarks, copyrights, trade secrets and confidentiality procedures to protect our intellectual-property rights. As of December 31, 2014, we held 724 U.S. patents and had received foreign patent protection on these patents resulting in 434 foreign patents. The U.S. patents have expiration dates ranging from 2016 to 2033. We also hold trademarks in the U.S. and various other geographies including Taiwan, Korea, Hong Kong, China, Europe and Japan.

We regard as proprietary some equipment, processes, information and knowledge that we have developed and used in the design and manufacture of our products. Our trade secrets include a high-volume production process that produces our patented high-voltage ICs. We attempt to protect our trade secrets and other proprietary-information through non-disclosure agreements, proprietary information agreements with employees and consultants, and other security measures.

Long-lived Assets

Our long-lived assets consist of property and equipment and intangible assets. Our intangible assets consist of developed and in-process technology, licenses, patents, customer relationships, trade name, domain name and goodwill. Our long-lived assets, including property and equipment and intangible assets, are located in the United States and in foreign countries; U.S. long-lived assets represented 40% in 2014, 2013 and 2012. Long-lived assets held outside of the United States represented 60% in 2014, 2013 and 2012. In 2014, 2013 and 2012 the majority of our long-lived assets were located in foreign countries, primarily Switzerland, which held approximately 31%, 33% and 33%, respectively, of our long-lived assets. See Note 2, Summary of Significant Accounting Policies, in our notes to consolidated financial statements regarding total property and equipment located in foreign countries.

Manufacturing

We contract with four foundries for the manufacture of the vast majority of our silicon wafers: (1) ROHM Lapis Semiconductor Co., Ltd., or Lapis, (formerly OKI Electric Industry), (2) Seiko Epson Corporation, or Epson, (3) X-FAB Semiconductor Foundries AG, or X-FAB, and (4) Renesas Electronics Corporation (RSMC), or Renesas (through its subsidiary Renesas Electronics America, Inc.). These contractors manufacture wafers using our proprietary high-voltage process technologies at fabrication facilities located in Japan, Germany and the United States. For a small number of our products, we also buy wafers manufactured in Singapore by Global Foundries using a standard, non-proprietary process to implement some integrated control circuits for use in combination with our proprietary high-voltage MOSFETs.

Our IC products are assembled and packaged by independent subcontractors in China, Malaysia, Thailand and the Philippines. Our ICs are tested predominantly at the facilities of our packaging subcontractors in Asia and, to a small extent, at our headquarters facility in San Jose, California. Our IGBT-driver boards are assembled by an independent subcontractor in Sri Lanka and tested at our facility in Switzerland.

Our fabless manufacturing model enables us to focus on our engineering and design strengths, minimize capital expenditures and still have access to high-volume manufacturing capacity. We utilize both proprietary and standard IC packages for assembly. Some of the materials used in our packages and aspects of assembly are specific to our products. We require our assembly manufacturers to use high-voltage molding compounds which are more difficult to process than industry standard molding compounds. We work closely with our contractors on a continuous basis to maintain and improve our manufacturing processes.

Our proprietary high-voltage processes do not require leading-edge geometries for them to be cost-effective, and can therefore use our foundries' older, low-cost facilities for wafer manufacturing. However, because of our highly sensitive high-voltage process, we must interact closely with our foundries to achieve satisfactory yields. Our wafer supply agreements with Lapis, Epson, X-FAB and Renesas expire in April 2018, December 2020, December 2020 and December 2014, respectively. (The contract with Renesas is currently being renegotiated and is expected to be finalized in the first quarter of 2015; until that time we are operating under the terms of the expired contract.) Under the terms of the Lapis agreement, Lapis has agreed to reserve a specified amount of production capacity and to sell wafers to us at fixed prices, which are subject to periodic review jointly by Lapis and us. In addition, Lapis requires us to supply them with a rolling six-month forecast on a monthly basis. Our agreement with Lapis provides for the purchase of wafers in U.S. dollars, with mutual sharing of the impact of the fluctuations in the exchange rate between the Japanese yen and the U.S. dollar. Under the terms of the Epson agreement, Epson has agreed to reserve a specified amount of production capacity and to sell wafers to us at fixed prices, which are subject to periodic review jointly by Epson and us. The agreement with Epson also requires us to supply rolling six-month forecasts on a monthly basis, to provide for the purchase of wafers in U.S. dollars and to share the impact of the exchange rate fluctuation between the Japanese yen and the U.S. dollar. Under the terms of the Renesas agreement and X-FAB agreement, both foundries have agreed to reserve a specified amount of production capacity and to sell wafers to us at fixed prices, which are subject to periodic review jointly by each of these foundries and us. The agreements with Renesas and X-FAB also require us to supply them with rolling six-month forecasts on a monthly basis. Our purchases of wafers from Renesas and X-FAB are denominated in U.S. dollars.

Although some aspects of our relationships with Lapis, Epson, X-FAB and Renesas are contractual, some important aspects of these relationships are not written in binding contracts and depend on the suppliers' continued cooperation. We cannot assure that we will continue to work successfully with Lapis, Epson, X-FAB or Renesas in the future, that they will continue to provide us with sufficient capacity at their foundries to meet our needs, or that any of them will not seek an early termination of their wafer supply agreement with us. Our operating results could suffer in the event of a supply disruption with Lapis, Epson, X-FAB or Renesas if we were unable to quickly qualify alternative manufacturing sources for existing or new products or if these sources were unable to produce wafers with acceptable manufacturing yields.

We typically receive shipments from our foundries approximately four to six weeks after placing orders, and lead times for new products can be substantially longer. To provide sufficient time for assembly, testing and finishing, we typically need to receive wafers four weeks before the desired ship date to our customers. As a result of these factors and the fact that customers' orders can be placed with little advance notice, we have only a limited ability to react to fluctuations in demand for our products. We try to carry a substantial amount of wafer and finished goods inventory to help offset these risks and to better serve our markets and meet customer demand.

Competition

Competing alternatives to our high-voltage ICs for the power-supply market include monolithic and hybrid ICs from companies such as Fairchild Semiconductor, STMicroelectronics, Infineon, ON Semiconductor and Sanken Electric Company, as well as PWM-controller chips paired with discrete high-voltage bipolar transistors and MOSFETs, which are produced by a large number of vendors, including those listed above as well as such companies as NXP Semiconductors, Diodes Inc., On-Bright Electronics and Dialog Semiconductor. Self-oscillating switchers, built with discrete components supplied by numerous vendors, are also commonly used. For some applications, line-frequency transformers are also a competing alternative to designs utilizing our products. Our IGBT-driver products compete with alternatives from such companies as Avago, Infineon and Semikron, as well as driver circuits made up of discrete devices.

Generally, our products enable customers to design power converters with total bill-of-materials (BOM) costs similar to those of competing alternatives. As a result, the value of our products is influenced by the prices of discrete components, which fluctuate in relation to market demand, raw-material prices and other factors, but have generally decreased over time.

While we vary the pricing of our ICs in response to fluctuations in prices of alternative solutions, we also compete based on a variety of other factors. Most importantly, the highly integrated nature of our products enables designs that utilize fewer total components than comparable discrete designs or designs using other integrated or hybrid products. This enables power converters to be designed more quickly and manufactured more efficiently and reliably than competing designs. We also compete on the basis of product functionality such as safety features and energy-efficiency features and on the basis of the technical support we provide to our customers. This support includes hands-on design assistance as well as a range of design tools and documentation such as software and reference designs. We also believe that our record of product quality and history of delivering products to our customers on a timely basis serve as additional competitive advantages.

Warranty

We generally warrant that our products will substantially conform to the published specifications for 12 months from the date of shipment. Under the terms of our purchase orders, our liability is limited generally to either a credit equal to the purchase price or replacement of the defective part.

Employees

As of December 31, 2014, we employed 590 full-time personnel, consisting of 95 in manufacturing, 189 in research and development, 252 in sales, marketing and applications support, and 54 in finance and administration.

Investor Information

We make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after filing this material electronically or otherwise furnishing it to the SEC. Investors may obtain free electronic copies or request paper copies of these reports via the "for investors" section of our website, http://investors.power.com. Our website address is provided solely for informational purposes. We do not intend, by this reference, that our website should be deemed to be part of this Annual Report. The reports filed with the SEC are also available at www.sec.gov.

Our corporate governance guidelines, the charters of our board committees, and our code of business conduct and ethics, including ethics provisions that apply to our principal executive officer, principal financial officer, controller and senior financial officers, are also available via the investor website listed above. These items are also available in print to any stockholder who requests them by calling (408) 414-9200.

Power Integrations, Inc. was incorporated in California on March 25, 1988, and reincorporated in Delaware in December 1997.

Executive Officers of the Registrant

As of January 30, 2015, our executive officers, who are appointed by and serve at the discretion of the board of directors, were as follows:

Name	Position With Power Integrations	Age
Balu Balakrishnan	President, Chief Executive Officer and Director	60
Wolfgang Ademmer	Vice President, High-Power Products	47
Douglas Bailey	Vice President, Marketing	48
Radu Barsan	Vice President, Technology	62
David "Mike" Matthews	Vice President, Product Development	50
Sandeep Nayyar	Vice President, Finance and Chief Financial Officer	55
Ben Sutherland	Vice President, Worldwide Sales	43
John Tomlin	Vice President, Operations	67
Clifford Walker	Vice President, Corporate Development	63

Balu Balakrishnan has served as president and chief executive officer and as a director of Power Integrations since January 2002. He served as president and chief operating officer from April 2001 to January 2002. From January 2000 to April 2001, he was vice president of engineering and strategic marketing. From September 1997 to January 2000, he was vice president of engineering and new business development. From September 1994 to September 1997, Mr. Balakrishnan served as vice president of engineering and marketing. Prior to joining Power Integrations in 1989, Mr. Balakrishnan was employed by National Semiconductor Corporation.

Wolfgang Ademmer serves as vice president of high-power products. Mr. Ademmer joined Power Integrations in 2012 in connection with our acquisition of Concept. Mr. Ademmer served as president and CEO of Concept since 2009, where he was responsible for overseeing the operations of Concept. Prior to joining Concept, he was with Infineon Technologies AG in Germany, leading that company's appliance and hybrid-vehicle business segment. He began his career in the power-electronics industry in 1993 at Eupec Gmbh, where he held a succession of roles, including vice president of sales and marketing, until the merger of Eupec and Infineon in 2005.

Douglas Bailey has served as our vice president of marketing since November 2004. From March 2001 to April 2004, he served as vice president of marketing at ChipX, a structured ASIC company. His earlier experience includes serving as business management and marketing consultant for Sapiential Prime, Inc., director of sales and business unit manager for 8x8, Inc., and serving in application engineering management for IIT, Inc. and design engineering roles with LSI Logic, Inmos, Ltd. and Marconi.

Radu Barsan has served as our vice president of technology since January 2013, leading our foundry engineering, technology development and quality organizations. Prior to joining Power Integrations, Mr. Barsan served as chairman and CEO at Redfern Integrated Optics, Inc., a supplier of single frequency narrow linewidth lasers, modules, and subsystems, from 2001 to 2013, where he was responsible for overseeing the operations of Redfern Integrated Optics. Previously, he served in a succession of engineering-management and technology-development roles at Phaethon Communications, Inc., a photonics technology company, Cirrus Logic, Inc., a high-precision analog and digital signal processing company, Advanced Micro Devices, a semiconductor design company, Cypress Semiconductor, Inc., a semiconductor company and Microelectronica a distributor of electronic components. Mr. Barsan has more than 30 years of commercial experience in semiconductor and optical components development, engineering and operations.

Mike Matthews has served as our vice president of product development since August 2012. Mr. Matthews joined Power Integrations in 1992, managing our European application-engineering group and then our European sales organization as managing director of Power Integrations (Europe). He has led our product-definition team since 2000, serving as director of strategic marketing prior to assuming his current role. Prior to joining Power Integrations, Mr. Matthews worked at several electric motor-drive companies and then at Siliconix, a semiconductor company, as a motor-control applications specialist.

Sandeep Nayyar has served as our vice president and chief financial officer since June 2010. Previously Mr. Nayyar served as vice president of finance at Applied Biosystems, Inc., a developer and manufacturer of life-sciences products, from 2002 to 2009. Mr. Nayyar was a member of the executive team with world-wide responsibilities for finance. From 1990 to 2001, Mr. Nayyar served in a succession of financial roles including vice president of finance at Quantum Corporation, a computer storage company. Mr. Nayyar also worked for five years in the public-accounting field at Ernst & Young LLP. Mr. Nayyar is a Certified Public Accountant, Chartered Accountant and has a Bachelor of Commerce from the University of Delhi, India.

Ben Sutherland has served as our vice president, worldwide sales since July 2011. Mr. Sutherland joined our company in May 2000 as a member of our sales organization in Europe. From May 2000 to July 2011, Mr. Sutherland served in various sales positions responsible primarily for our international sales, and more recently for domestic sales. From 1997 to 2000, Mr. Sutherland served in various product marketing and sales roles at Vishay Intertechnology, Inc., a manufacturer and supplier of discrete semiconductors and passive electronic components.

John Tomlin has served as our vice president, operations since October 2001. From 1981 to 2001, Mr. Tomlin served in a variety of senior management positions in operations, service, logistics and marketing, most recently as vice president of worldwide operations at Quantum Corporation, a computer storage company. In addition, Mr. Tomlin held positions in operations and supply chain management at Intel, a semiconductor chip manufacturer, and Diablo Systems, a disc drive and daisy wheel printer company.

Clifford Walker has served as our vice president, corporate development since June 1995. From September 1994 to June 1995, Mr. Walker served as vice president of Reach Software Corporation, a software company. From December 1993 to September 1994, Mr. Walker served as president of Morgan Walker International, a consulting company.

Item 1A. Risk Factors.

In addition to the other information in this report, the following factors should be considered carefully in evaluating our business before purchasing shares of our stock.

Our quarterly operating results are volatile and difficult to predict. If we fail to meet the expectations of public market analysts or investors, the market price of our common stock may decrease significantly. Our net revenues and operating results have varied significantly in the past, are difficult to forecast, are subject to numerous factors both within and outside of our control, and may fluctuate significantly in the future. As a result, our quarterly operating results could fall below the expectations of public market analysts or investors. If that occurs, the price of our stock may decline.

Some of the factors that could affect our operating results include the following:

- the demand for our products declining in the major end markets we serve, which may occur due to competitive factors, supply-chain fluctuations or changes in macroeconomic conditions;
- our products are sold through distributors, which limits our direct interaction with our end customers, which reduces our ability to forecast sales and increases the complexity of our business;
- competitive pressures on selling prices;
- the inability to adequately protect or enforce our intellectual property rights;
- expenses we are required to incur (or choose to incur) in connection with our intellectual property litigations;
- reliance on international sales activities for a substantial portion of our net revenues;

- fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen, the Euro and the Swiss franc;
- the volume and timing of delivery of orders placed by us with our wafer foundries and assembly subcontractors, and their ability to procure materials;

Table of Contents

- our ability to develop and bring to market new products and technologies on a timely basis;
- earthquakes, terrorists acts or other disasters;
- continued impact of changes in securities laws and regulations, including potential risks resulting from our evaluation of internal controls under the Sarbanes-Oxley Act of 2002;
- the lengthy timing of our sales cycle;
- undetected defects and failures in meeting the exact specifications required by our products;
- the ability of our products to penetrate additional markets;
- the volume and timing of orders received from customers;
- audits by the Internal Revenue Service, and potential future changes in tax laws may increase the amount of taxes we are required to pay;
- our ability to attract and retain qualified personnel;
- risks associated with acquisitions and strategic investments;
- our ability to successfully integrate, or realize the expected benefits from, our acquisitions;
- changes in environmental laws and regulations, including with respect to energy consumption and climate change; and
- interruptions in our information technology systems.

If demand for our products declines in our major end markets, our net revenues will decrease. A limited number of applications of our products, such as cellphone chargers, LED lights, desktop PCs and home appliances make up a significant percentage of our net revenues. We expect that a significant level of our net revenues and operating results will continue to be dependent upon these applications in the near term. The demand for these products has been highly cyclical and has been impacted by economic downturns in the past. Any economic slowdown in the end markets that we serve could cause a slowdown in demand for our ICs. When our customers are not successful in maintaining high levels of demand for their products, their demand for our ICs decreases, which adversely affects our operating results. Any significant downturn in demand in these markets would cause our net revenues to decline and could cause the price of our stock to fall.

Our products are sold through distributors, which limits our direct interaction with our end customers, therefore reducing our ability to forecast sales and increasing the complexity of our business. Sales to distributors accounted for 75% of net revenues in both the years ended December 31, 2014, and December 31, 2013. Selling through distributors reduces our ability to forecast sales and increases the complexity of our business, requiring us to:

- manage a more complex supply chain;
- monitor the level of inventory of our products at each distributor and
-

monitor the financial condition and credit-worthiness of our distributors, many of which are located outside of the United States and not publicly traded.

Since we have limited ability to forecast inventory levels at our end customers, it is possible that there may be significant build-up of inventories in the distributor channel, with the OEM or the OEM's contract manufacturer. Such a buildup could result in a slowdown in orders, requests for returns from customers, or requests to move out planned shipments. This could adversely impact our revenues and profits. Any failure to manage these complexities could disrupt or reduce sales of our products and unfavorably impact our financial results.

Intense competition in the high-voltage power supply industry may lead to a decrease in our average selling price and reduced sales volume of our products. The high-voltage power supply industry is intensely competitive and characterized by significant price sensitivity. Our products face competition from alternative technologies, such as linear transformers, discrete switcher power supplies, and other integrated and hybrid solutions. If the price of competing solutions decreases significantly, the cost effectiveness of our products will be adversely affected. If power requirements for applications in which our products are currently utilized go outside the cost-effective range of our products, some of these alternative technologies can be used more cost effectively. In addition, as our patents expire, our competitors could legally begin using the technology covered by the expired patents in their products, potentially increasing the performance of their products and/or decreasing the cost of their products, which may enable our competitors to compete more effectively. Our current patents may or may not inhibit our competitors from getting any benefit from an expired patent. Our U.S. patents have expiration dates ranging from 2016 to 2033. We cannot assure that our products will continue to compete favorably or that we will be successful in the face of increasing competition from new products and enhancements introduced by existing competitors or new companies entering this market. We believe our failure to compete successfully in the high-voltage power supply business, including our ability to introduce new products with higher average selling prices, would materially harm our operating results.

If we are unable to adequately protect or enforce our intellectual property rights, we could lose market share, incur costly litigation expenses, suffer incremental price erosion or lose valuable assets, any of which could harm our operations and negatively impact our profitability. Our success depends upon our ability to continue our technological innovation and protect our intellectual property, including patents, trade secrets, copyrights and know-how. We are currently engaged in litigation to enforce our intellectual property rights, and associated expenses have been, and are expected to remain, material and have adversely affected our operating results. We cannot assure that the steps we have taken to protect our intellectual property will be adequate to prevent misappropriation, or that others will not develop competitive technologies or products. From time to time, we have received, and we may receive in the future, communications alleging possible infringement of patents or other intellectual property rights of others. Costly litigation may be necessary to enforce our intellectual property rights or to defend us against claimed infringement. The failure to obtain necessary licenses and other rights, and/or litigation arising out of infringement claims could cause us to lose market share and harm our business.

As our patents expire, we will lose intellectual property protection previously afforded by those patents. Additionally, the laws of some foreign countries in which our technology is or may in the future be licensed may not protect our intellectual property rights to the same extent as the laws of the United States, thus limiting the protections applicable to our technology.

If we do not prevail in our litigation, we will have expended significant financial resources, potentially without any benefit, and may also suffer the loss of rights to use some technologies. We are currently involved in a number of patent litigation matters and the outcome of the litigation is uncertain. See Note 10, Legal Proceedings and Contingencies, in our Notes to Consolidated Financial Statements. For example, in one of our patent suits the infringing company has been found to infringe four of our patents. Despite the favorable court finding, the infringing party filed an appeal to the damages awarded. In another matter, we are being sued in an ongoing case for patent infringement. Should we ultimately be determined to be infringing another party's patents, or if an injunction is issued against us while litigation is pending on those claims, such result could have an adverse impact on our ability to sell products found to be infringing, either directly or indirectly. In the event of an adverse outcome, we may be required to pay substantial damages, stop our manufacture, use, sale, or importation of infringing products, or obtain licenses to the intellectual property we are found to have infringed. We have also incurred, and expect to continue to incur, significant legal costs in conducting these lawsuits, including the appeal of the case we won, and our involvement in this litigation and any future intellectual property litigation could adversely affect sales and divert the efforts and attention of our technical and management personnel, whether or not such litigation is resolved in our favor. Thus, even if we are successful in these lawsuits, the benefits of this success may fail to outweigh the significant legal costs we will have incurred.

Our international sales activities account for a substantial portion of our net revenues, which subjects us to substantial risks. Sales to customers outside of the United States of America account for, and have accounted for a large portion of our net revenues, including approximately 95% of our net revenues for both the years ended December 31, 2014, and December 31, 2013. If our international sales declined and we were unable to increase domestic sales, our revenues would decline and our operating results would be harmed. International sales involve a number of risks to us, including:

- potential insolvency of international distributors and representatives;

- reduced protection for intellectual property rights in some countries;

- the impact of recessionary environments in economies outside the United States;

- tariffs and other trade barriers and restrictions;

- the burdens of complying with a variety of foreign and applicable U.S. Federal and state laws; and

- foreign-currency exchange risk.

Our failure to adequately address these risks could reduce our international sales and materially and adversely affect our operating results. Furthermore, because substantially all of our foreign sales are denominated in U.S. dollars, increases in the value of the dollar cause the price of our products in foreign markets to rise, making our products more expensive relative to competing products priced in local currencies.

Fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen, Swiss franc and euro, may impact our gross margin and net income. Our exchange rate risk related to the Japanese yen includes two of our major suppliers, Epson and Lapis, with which we have wafer supply agreements based in U.S. dollars; however, these agreements also allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. Each year, our management and these suppliers review and negotiate pricing; the negotiated pricing is denominated in U.S. dollars but is subject to contractual exchange rate provisions. The fluctuation in the exchange rate is shared equally between Power Integrations and each of these suppliers. We completed the acquisition of Concept (located in Biel, Switzerland) in the second quarter of 2012. We maintain cash denominated in Swiss francs and euros to fund the operations of our Swiss subsidiary. The functional currency of our Swiss subsidiary is the U.S. dollar; gains and losses arising from the re-measurement of non-functional currency balances are recorded in other income in our consolidated statements of income, and material unfavorable exchange-rate fluctuations with the Swiss franc could negatively impact our net income.

We depend on third-party suppliers to provide us with wafers for our products and if they fail to provide us sufficient quantities of wafers, our business may suffer. We have supply arrangements for the production of wafers with Lapis, Renesas, X-FAB and Epson. Our contracts with these suppliers expire on varying dates, with the earliest having expired as of December 2014, which was Renesas (the contract with Renesas is currently being renegotiated and is expected to be finalized in the first quarter of 2015, until that time we are operating under the terms of the expired contract). Although some aspects of our relationships with Lapis, Renesas, X-FAB and Epson are contractual, many important aspects of these relationships depend on their continued cooperation. We cannot assure that we will continue to work successfully with Lapis, Renesas, X-FAB and Epson in the future, and that the wafer foundries' capacity will meet our needs. Additionally, one or more of these wafer foundries could seek an early termination of our wafer supply agreements. Any serious disruption in the supply of wafers from Lapis, Renesas, X-FAB or Epson could harm our business. We estimate that it would take 12 to 24 months from the time we identified an alternate manufacturing source to produce wafers with acceptable manufacturing yields in sufficient quantities to meet our needs.

Although we provide our foundries with rolling forecasts of our production requirements, their ability to provide wafers to us is ultimately limited by the available capacity of the wafer foundry. Any reduction in wafer foundry capacity available to us could require us to pay amounts in excess of contracted or anticipated amounts for wafer deliveries or require us to make other concessions to meet our customers' requirements, or may limit our ability to meet demand for our products. Further, to the extent demand for our products exceeds wafer foundry capacity, this could inhibit us from expanding our business and harm relationships with our customers. Any of these concessions or limitations could harm our business.

If our third-party suppliers and independent subcontractors do not produce our wafers and assemble our finished products at acceptable yields, our net revenues may decline. We depend on independent foundries to produce wafers, and independent subcontractors to assemble and test finished products, at acceptable yields and to deliver them to us in a timely manner. The failure of the foundries to supply us wafers at acceptable yields could prevent us from selling our products to our customers and would likely cause a decline in our net revenues and gross margin. In addition, our IC assembly process requires our manufacturers to use a high-voltage molding compound that has been available from only a few suppliers. These compounds and their specified processing conditions require a more exacting level of process control than normally required for standard IC packages. Unavailability of assembly materials or problems with the assembly process can materially and adversely affect yields, timely delivery and cost to manufacture. We may not be able to maintain acceptable yields in the future.

Table of Contents

In addition, if prices for commodities used in our products increase significantly, raw material costs would increase for our suppliers which could result in an increase in the prices our suppliers charge us. To the extent we are not able to pass these costs on to our customers; this would have an adverse effect on our gross margins.

If our efforts to enhance existing products and introduce new products are not successful, we may not be able to generate demand for our products. Our success depends in significant part upon our ability to develop new ICs for high-voltage power conversion for existing and new markets, to introduce these products in a timely manner and to have these products selected for design into products of leading manufacturers. New product introduction schedules are subject to the risks and uncertainties that typically accompany development and delivery of complex technologies to the market place, including product development delays and defects. If we fail to develop and sell new products in a timely manner then our net revenues could decline.

In addition, we cannot be sure that we will be able to adjust to changing market demands as quickly and cost-effectively as necessary to compete successfully. Furthermore, we cannot assure that we will be able to introduce new products in a timely and cost-effective manner or in sufficient quantities to meet customer demand or that these products will achieve market acceptance. Our failure, or our customers' failure, to develop and introduce new products successfully and in a timely manner would harm our business. In addition, customers may defer or return orders for existing products in response to the introduction of new products. When a potential liability exists we will maintain reserves for customer returns, however we cannot assure that these reserves will be adequate.

In the event of an earthquake, terrorist act or other disaster, our operations may be interrupted and our business would be harmed. Our principal executive offices and operating facilities are situated near San Francisco, California, and most of our major suppliers, which are wafer foundries and assembly houses, are located in areas that have been subject to severe earthquakes, such as Japan. Many of our suppliers are also susceptible to other disasters such as tropical storms, typhoons or tsunamis. In the event of a disaster, such as the earthquake and tsunami in Japan, we or one or more of our major suppliers may be temporarily unable to continue operations and may suffer significant property damage. Any interruption in our ability or that of our major suppliers to continue operations could delay the development and shipment of our products and have a substantial negative impact on our financial results.

Securities laws and regulations, including potential risk resulting from our evaluation of internal controls under the Sarbanes-Oxley Act of 2002, will continue to impact our results. Complying with the requirements of the Sarbanes-Oxley Act of 2002 and NASDAQ's conditions for continued listing have imposed significant legal and financial compliance costs, and are expected to continue to impose significant costs and management burden on us. These rules and regulations also may make it more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified executive officers and members of our board of directors, particularly qualified members to serve on our audit committee. Further, the rules and regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act, which became effective in 2011, may impose significant costs and management burden on us.

Additionally, because these laws, regulations and standards promulgated by the Sarbanes-Oxley Act and the Dodd-Frank Act are expected to be subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices.

Because the sales cycle for our products can be lengthy, we may incur substantial expenses before we generate significant revenues, if any. Our products are generally incorporated into a customer's products at the design stage. However, customer decisions to use our products, commonly referred to as design wins, can often require us to expend significant research and development and sales and marketing resources without any assurance of success. These significant research and development and sales and marketing resources often precede volume sales, if any, by a year or more. The value of any design win will largely depend upon the commercial success of the customer's product. We cannot assure that we will continue to achieve design wins or that any design win will result in future revenues. If a customer decides at the design stage not to incorporate our products into its product, we may not have another opportunity for a design win with respect to that product for many months or years.

Our products must meet exacting specifications, and undetected defects and failures may occur which may cause customers to return or stop buying our products. Our customers generally establish demanding specifications for quality, performance and reliability, and our products must meet these specifications. ICs as complex as those we sell often encounter development delays and may contain undetected defects or failures when first introduced or after commencement of commercial shipments. We have from time to time in the past experienced product quality, performance or reliability problems. If defects and failures occur in our products, we could experience lost revenue, increased costs, including warranty expense and costs associated with customer support and customer expenses, delays in or cancellations or rescheduling of orders or shipments and product returns or discounts, any of which would harm our operating results.

If our products do not penetrate additional markets, our business will not grow as we expect. We believe that our future success depends in part upon our ability to penetrate additional markets for our products. We cannot assure that we will be able to overcome the marketing or technological challenges necessary to penetrate additional markets. To the extent that a competitor penetrates additional markets before we do, or takes market share from us in our existing markets, our net revenues and financial condition could be materially adversely affected.

We do not have long-term contracts with any of our customers and if they fail to place, or if they cancel or reschedule orders for our products, our operating results and our business may suffer. Our business is characterized by short-term customer orders and shipment schedules, and the ordering patterns of some of our large customers have been unpredictable in the past and will likely remain unpredictable in the future. Not only does the volume of units ordered by particular customers vary substantially from period to period, but also purchase orders received from particular customers often vary substantially from early oral estimates provided by those customers for planning purposes. In addition, customer orders can be canceled or rescheduled without significant penalty to the customer. In the past, we have experienced customer cancellations of substantial orders for reasons beyond our control, and significant cancellations could occur again at any time. Also, a relatively small number of distributors, OEMs and merchant power supply manufacturers account for a significant portion of our revenues. Specifically, our top ten customers, including distributors, accounted for 59% of our net revenues in both the years ended December 31, 2014, and December 31, 2013. However, a significant portion of these revenues are attributable to sales of our products through distributors of electronic components. These distributors sell our products to a broad, diverse range of end users, including OEMs and merchant power supply manufacturers, which mitigates the risk of customer concentration to a large degree.

Audits of our tax returns and potential future changes in tax laws may increase the amount of taxes we are required to pay. Our operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions and to review or audit by the IRS and state, local and foreign tax authorities. In addition, the United States, countries in Asia and other countries where we do business have been considering changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to multinational companies. These potential changes could adversely affect our effective tax rates or result in other costs to us.

We must attract and retain qualified personnel to be successful and competition for qualified personnel is intense in our market. Our success depends to a significant extent upon the continued service of our executive officers and other key management and technical personnel, and on our ability to continue to attract, retain and motivate qualified personnel, such as experienced analog design engineers and systems applications engineers. The competition for these employees is intense, particularly in Silicon Valley. The loss of the services of one or more of our engineers, executive officers or other key personnel could harm our business. In addition, if one or more of these individuals leaves our employ, and we are unable to quickly and efficiently replace those individuals with qualified personnel who can smoothly transition into their new roles, our business may suffer. We do not have long-term employment contracts with, and we do not have in place key person life insurance policies on, any of our employees.

We are exposed to risks associated with acquisitions and strategic investments. We have made, and in the future intend to make, acquisitions of, and investments in, companies, technologies or products in existing, related or new markets such as Concept. Acquisitions involve numerous risks, including but not limited to:

- inability to realize anticipated benefits, which may occur due to any of the reasons described below, or for other unanticipated reasons;

- the risk of litigation or disputes with customers, suppliers, partners or stockholders of an acquisition target arising from a proposed or completed transaction;

Table of Contents

- impairment of acquired intangible assets and goodwill as a result of changing business conditions, technological advancements or worse-than-expected performance, which would adversely affect our financial results; and

- unknown, underestimated and/or undisclosed commitments, liabilities or issues not discovered in our due diligence of such transactions.

We also in the future may have strategic relationships with other companies, which may decline in value and/or not meet desired objectives. The success of these strategic relationships depends on various factors over which we may have limited or no control and requires ongoing and effective cooperation with strategic partners. Moreover, these relationships are often illiquid, such that it may be difficult or impossible for us to monetize such relationships.
Our inability to successfully integrate, or realize the expected benefits from, our acquisitions could adversely affect our results. We have made, and in the future intend to make, acquisitions of other businesses, such as Cambridge Semiconductor Limited and Concept, and with these acquisitions there is a risk that integration difficulties may cause us not to realize expected benefits. The success of the acquisitions could depend, in part, on our ability to realize the anticipated benefits and cost savings (if any) from combining the businesses of the acquired companies and our business, which may take longer to realize than expected.

Changes in environmental laws and regulations may increase our costs related to obsolete products in our existing inventory. Changing environmental regulations and the timetable to implement them continue to impact our customers' demand for our products. As a result there could be an increase in our inventory obsolescence costs for products manufactured prior to our customers' adoption of new regulations. Currently we have limited visibility into our customers' strategies to implement these changing environmental regulations into their business. The inability to accurately determine our customers' strategies could increase our inventory costs related to obsolescence.

Interruptions in our information technology systems could adversely affect our business. We rely on the efficient and uninterrupted operation of complex information technology systems and networks to operate our business. Any significant system or network disruption, including but not limited to new system implementations, computer viruses, security breaches, or energy blackouts could have a material adverse impact on our operations, sales and operating results. We have implemented measures to manage our risks related to such disruptions, but such disruptions could still occur and negatively impact our operations and financial results. In addition, we may incur additional costs to remedy any damages caused by these disruptions or security breaches.

Uncertainties arising out of economic consequences of current and potential military actions or terrorist activities and associated political instability could adversely affect our business. Like other U.S. companies, our business and operating results are subject to uncertainties arising out of economic consequences of current and potential military actions or terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. These uncertainties could also lead to delays or cancellations of customer orders, a general decrease in corporate spending or our inability to effectively market and sell our products. Any of these results could substantially harm our business and results of operations, causing a decrease in our revenues.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We own our principal executive, administrative, manufacturing and technical offices which are located in San Jose, California. We also own a research and development facility in New Jersey, which was purchased in 2010 in connection with our acquisition of an early-stage research and development company, and a test facility in Biel, Switzerland which was acquired in connection with our acquisition of Concept. We lease administrative office space in Singapore and Switzerland, a research and development facility in Canada and a design center in Germany, in addition to sales offices in various countries around the world to accommodate our sales force. We believe that our current facilities are sufficient for our company; however, if headcount increases above capacity we may need to lease additional space.

Table of Contents

Item 3. Legal Proceedings.

Information with respect to this item may be found in Note 10, Legal Proceedings and Contingencies, in our Notes to Consolidated Financial Statements included later in this Annual Report on Form 10-K, which information is incorporated herein by reference.

Item 4. Mine Safety Disclosures.

Not applicable.

Table of Contents

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock trades on the NASDAQ Global Select Market under the symbol “POWI”. The following table shows the high and low closing sales prices per share of our common stock as reported on the NASDAQ Global Select Market for the periods indicated during which our common stock traded on the NASDAQ Global Select Market.

	Price Range	
Year Ended December 31, 2014	High	Low
Fourth quarter	$54.96	$42.78
Third quarter	$60.25	$51.69
Second quarter	$66.60	$47.23
First quarter	$67.16	$54.94
Year Ended December 31, 2013	High	Low
Fourth quarter	$57.28	$51.40
Third quarter	$56.45	$41.16
Second quarter	$45.18	$38.28
First quarter	$44.65	$34.07

As of January 30, 2015, there were approximately 39 stockholders of record. Because brokers and other institutions hold many of our shares on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

In October 2013, our board of directors declared four quarterly cash dividends in the amount of $0.10 per share to be paid to stockholders of record at the end of each quarter in 2014; payouts of approximately $3.0 million each occurred on March 31, 2014, and June 30, 2014. In April 2014, our board of directors increased the dividend payments for the third and fourth quarters of 2014 to $0.12 per share; these quarterly payouts of approximately $3.6 million and $3.5 million were made on September 30, 2014, and December 31, 2014. In 2013 we paid quarterly dividends of $0.08 per share, which resulted in cash payouts of approximately $2.3 million to $2.4 million per quarter. In January 2015, our board of directors extended the $0.12 quarterly dividend through each quarter in 2015. The declaration of any future cash dividend is at the discretion of the board of directors and will depend on our financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination that cash dividends are in the best interest of our stockholders.

Table of Contents

ISSUER PURCHASES OF EQUITY SECURITIES

In October 2012, our board of directors authorized the use of $50.0 million for the repurchase of our common stock, subject to pre-defined price/volume guidelines. In 2012, we purchased approximately 0.7 million shares for $20.5 million under this stock repurchase program. No shares were purchased in the twelve months ended December 31, 2013, due to the stock price levels exceeding the pre-defined price guidelines mentioned above. In 2014 our board of directors authorized the use of an additional $75.0 million for this purpose. In the twelve months ended December 31, 2014, we purchased 1.6 million shares for $80.8 million. As of December 31, 2014, we had $23.7 million available for future stock repurchases. Authorization of future repurchase programs is at the discretion of the board of directors and will depend on our financial condition, results of operations, capital requirements, business conditions as well as other factors.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Repurchased Under the Plans or Programs (in millions)
October 1, 2014 to October 31, 2014	564,602	$48.09	564,602	$32.1
November 1, 2014 to November 30, 2014	153,831	$51.04	153,831	$24.3
December 1, 2014 to December 31, 2014	9,983	$49.81	9,983	$23.7
Total	728,416		728,416	

Table of Contents

Performance Graph(1)

The following graph shows the cumulative total stockholder return of an investment of $100 in cash on December 31, 2009 through December 31, 2014, for (a) our common stock, (b) The NASDAQ Composite Index and (c) The NASDAQ Electronic Components Index. Pursuant to applicable SEC rules, all values assume reinvestment of the full amount of all dividends. The stockholder return shown on the graph below is not necessarily indicative of future performance, and we do not make or endorse any predictions as to future stockholder returns.

	12/09	12/10	12/11	12/12	12/13	12/14
Power Integrations, Inc.	100.00	111.10	92	94	157	147
NASDAQ Composite	100.00	118	118.70	139.00	197	224
NASDAQ Electronic Components	100.00	116	105	104	144	191

(1) This Section is not “soliciting material,” is not deemed “filed” with the SEC and is not to be incorporated by reference in any filing of Power Integrations under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

Table of Contents

Item 6. Selected Financial Data.

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and the notes thereto included elsewhere in this Form 10-K to fully understand factors that may affect the comparability of the information presented below. We derived the selected consolidated balance sheet data as of December 31, 2014 and 2013, and the consolidated statements of income (loss) data for the years ended December 31, 2014, 2013 and 2012, from our audited consolidated financial statements, and accompanying notes, in this Annual Report on Form 10-K. In the year ended December 31, 2012, we incurred charges related to our investment in SemiSouth Laboratories (see Note 12, Transactions With Third Party, in our notes to consolidated financial statements), and from our settlement with the IRS related to the examination of our tax returns for the years 2003 through 2006 (refer to Note 8, Provision for Income Taxes, in our notes to consolidated financial statements). The consolidated statements of income (loss) data for each of the years ended December 31, 2011 and 2010, and the consolidated balance sheet data as of December 31, 2012, 2011 and 2010, are derived from our audited consolidated financial statements which are not included in this report. Our historical results are not necessarily indicative of results for any future period. Our selected financial data is presented below (in thousands, except per share data).

	Year Ended December 31,				
	2014	2013	2012	2011	2010
Consolidated Statements of Income (Loss):					
Net revenues	$348,797	$347,089	$305,370	$298,739	$299,803
Cost of revenues	159,227	163,853	154,868	158,093	147,262
Gross profit	189,570	183,236	150,502	140,646	152,541
Operating expenses:					
Research and development	54,981	51,654	45,709	40,295	35,886
Sales and marketing	47,796	45,466	37,998	32,624	31,167
General and administrative	30,997	32,050	30,243	24,508	25,562
Charge related to SemiSouth	—	—	25,200	—	—
Total operating expenses	133,774	129,170	139,150	97,427	92,615
Income from operations	55,796	54,066	11,352	43,219	59,926
Other income (expense):					
Other income, net	1,018	1,361	1,611	1,876	1,879
Charge related to SemiSouth	—	—	(33,745)	—	—
Total other income (expense)	1,018	1,361	(32,134)	1,876	1,879
Income (loss) before provision for (benefit from) income taxes	56,814	55,427	(20,782)	45,095	61,805
Provision for (benefit from) income taxes	(2,730)	(1,839)	13,622	10,804	12,341
Net income (loss)	$59,544	$57,266	$(34,404)	$34,291	$49,464
Earnings (loss) per share:					
Basic	$1.99	$1.95	$(1.20)	$1.20	$1.78
Diluted	$1.93	$1.88	$(1.20)	$1.14	$1.67
Shares used in per share calculation:					
Basic	29,976	29,421	28,636	28,609	27,837
Diluted	30,829	30,420	28,636	29,964	29,556
Dividend per share	$0.44	$0.32	$0.20	$0.20	$0.20

	Year Ended December 31,				
	2014	2013	2012	2011	2010

Consolidated Balance Sheet Data:					
Cash and cash equivalents	$60,708	$92,928	$63,394	$139,836	$155,667
Short-term marketable securities	114,575	109,179	31,766	40,899	27,355
Cash, cash equivalents and short-term marketable securities	$175,283	$202,107	$95,160	$180,735	$183,022
Working capital	$210,752	$227,004	$124,297	$216,079	$210,664
Total assets	$493,663	$501,421	$399,130	$432,919	$433,070
Long-term liabilities	$7,827	$14,317	$17,514	$34,368	$29,580
Stockholders' equity	$430,676	$436,686	$341,049	$364,529	$352,644

24

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of our operations should be read in conjunction with the consolidated financial statements and the notes to those statements included elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those contained in these forward-looking statements due to a number of factors, including those discussed in Part I, Item 1A “Risk Factors” and elsewhere in this report.

Business Overview

We design, develop and market analog and mixed-signal integrated circuits (ICs) and other electronic components and circuitry used in high-voltage power conversion. Our products are used in power converters that convert electricity from a high-voltage source (typically 48 volts or higher) to the type of power required for a specified downstream use. In most cases, this conversion entails, among other functions, converting alternating current (AC) to direct current (DC) or vice versa, reducing or increasing the voltage, and regulating the output voltage and/or current according to the customer's specifications.

A large percentage of our products are ICs used in AC-DC power supplies, which convert the high-voltage AC from a wall outlet to the low-voltage DC required by most electronic devices. Power supplies incorporating our products are used with all manner of electronic products including mobile phones, computers, entertainment and networking equipment, appliances, electronic utility meters, industrial controls and LED lights.

Since our May 2012 acquisition of CT-Concept Technologie AG (Concept), we also offer IGBT drivers - circuit boards containing multiple ICs, electrical isolation components and other circuitry - used to operate arrays of high-voltage, high-power transistors known as IGBT modules. These driver/module combinations are used for power conversion in high-power applications (i.e., power levels ranging from tens of kilowatts up to one gigawatt) such as industrial motors, solar- and wind-power systems, electric vehicles and high-voltage DC transmission systems.

Our net revenues were $348.8 million, $347.1 million and $305.4 million in 2014, 2013 and 2012, respectively. In 2014 revenue increased by $1.7 million, due primarily to growth in three of our primary end-market categories (consumer, industrial and computer), driven by higher unit sales for a range of applications including consumer appliances, industrial motor drives and desktop computers. The increase was partially offset by lower sales into the communications end market due primarily to lower unit sales for residential-networking applications and cellphone chargers. The increase in revenues from 2012 to 2013 was due in part to the inclusion of the former Concept business for the full year (compared to only eight months in 2012), and also reflected higher unit sales into the industrial, consumer and computing end markets, particularly for applications such as consumer appliances, industrial controls, LED lighting, industrial motor drives, renewable-energy systems and desktop PCs.

Our top ten customers, including distributors that resell to OEMs and merchant power supply manufacturers, accounted for 59%, 59% and 64% of our net revenues for 2014, 2013 and 2012, respectively. Our top two customers, both distributors of our products, collectively accounted for approximately 28% of our net revenues for 2014, 28% for 2013 and 32% in 2012. In 2014, 2013 and 2012, international sales made up 95% of net revenues.

Because our industry is intensely price-sensitive, our gross margin (gross profit divided by net revenues) is subject to change based on the relative pricing of solutions that compete with ours. Variations in product mix, end-market mix and customer mix can also cause our gross margin to fluctuate. Also, because we purchase a large percentage of our silicon wafers from foundries located in Japan, our gross margin is influenced by fluctuations in the exchange rate between the U.S. dollar and the Japanese yen. All else being equal, a 10% change in the value of the U.S. dollar compared to the Japanese yen would eventually result in a corresponding change in our gross margin of approximately 0.8% to 1.0%; this sensitivity may increase or decrease depending on the percentage of our wafer supply that we purchase from Japanese suppliers. Also, although our wafer fabrication and assembly operations are outsourced, as are most of our test operations, a portion of our production costs are fixed in nature. As a result, our unit costs and gross profit margin are impacted by the volume of units we produce.

Our gross profit, defined as net revenues less cost of revenues, was $189.6 million, or 54% of net revenues, in 2014, compared to $183.2 million, or 53% of net revenues in 2013, and $150.5 million, or 49% of net revenues, in 2012. The

Table of Contents

increase in 2014 was due primarily to: a favorable end-market mix, with a greater percentage of revenue coming from higher-margin end markets; a decline in the value of the Japanese yen versus the U.S. dollar, which decreased the cost of silicon wafers purchased from our Japanese wafer-fabrication foundries; and unit cost benefits resulting from higher production volumes. The increase in gross margin from 2012 to 2013 was due primarily to lower manufacturing costs stemming from a combination of internal cost-reduction initiatives, unit-cost benefits from higher production volumes, the decline in the value of the Japanese yen versus the U.S. dollar and a more favorable end-market mix.

Total operating expenses in 2014, 2013 and 2012 were $133.8 million, $129.2 million and $139.2 million, respectively. Operating expenses increased in 2014 compared to the prior year as a result of higher research and development expenses, including increased headcount as well as greater engineering-materials and equipment-depreciation expenses, all in support of our product-development efforts. Sales and marketing expenses also increased, due primarily to the expansion of our sales and application-support staffs, which resulted in higher salary and related expenses. Operating expenses decreased in 2013 from 2012 because in 2012 we recognized impairment charges associated with our investment in SemiSouth Laboratories, including the write-off of $10.0 million for a prepaid royalty and $15.2 million related to a payment under a loan guarantee for SemiSouth. (Refer to Note 12, Transactions With Third Party, in our Notes to Consolidated Financial Statements, for details on the impairment). The decrease in 2013 was partially offset by higher salary and intangible asset amortization expenses associated with the former Concept business, reflecting its inclusion for the full year of 2013 compared to only eight months in 2012. (Refer to Note 11, Acquisitions, in our Notes to Consolidated Financial Statements, for details).

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America, or U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those listed below. We base our estimates on historical facts and various other assumptions that we believe to be reasonable at the time the estimates are made. Actual results could differ from those estimates.

Our critical accounting policies are as follows:
- revenue recognition;
- stock-based compensation;
- estimating write-downs for excess and obsolete inventory;
- income taxes;
- business combinations; and
- goodwill and intangible assets.

Our critical accounting policies are important to the portrayal of our financial condition and results of operations, and require us to make judgments and estimates about matters that are inherently uncertain. A brief description of these critical accounting policies is set forth below. For more information regarding our accounting policies, see Note 2, Summary of Significant Accounting Policies, in our Notes to Consolidated Financial Statements.

Revenue recognition

Product revenues consist of sales to original equipment manufacturers, or OEMs, merchant power supply manufacturers and distributors. Approximately 75% of our net product sales were made to distributors in 2014. We apply the provisions of Accounting Standard Codification (“ASC”) 605-10 (“ASC 605-10”) and all related appropriate guidance. Revenue is recognized when all of the following criteria have been met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the price is fixed or determinable, and (4) collectability is reasonably assured. Customer purchase orders are generally used to determine the existence of an arrangement. Delivery is considered to have occurred when title and risk of loss have transferred to our customer. We evaluate whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. With respect to collectability, we perform credit checks for new customers and perform ongoing evaluations of our existing customers' financial condition and require letters of credit whenever deemed necessary.

Table of Contents

Sales to international OEMs and merchant power supply manufacturers for shipments from our facility outside of the United States are pursuant to EX Works, or EXW, shipping terms, meaning that title to the product transfers to the customer upon shipment from our foreign warehouse. Sales to international OEM customers and merchant power supply manufacturers that are shipped from our facility in California are pursuant to Delivered at Frontier, or DAF, shipping terms. As such, title to the product passes to the customer when the shipment reaches the destination country and revenue is recognized upon the arrival of the product in that country. Shipments to OEMs and merchant power supply manufacturers in the Americas are pursuant to Free on Board, or FOB, point of origin shipping terms meaning that title is passed to the customer upon shipment. Revenue is recognized upon title transfer for sales to OEMs and merchant power supply manufacturers, assuming all other criteria for revenue recognition are met.

Sales to most distributors are made under terms allowing certain price adjustments and rights of return on our products held by the distributors. As a result of these rights, we defer the recognition of revenue and the costs of revenues derived from sales to these distributors until our distributors report that they have sold our products to their customers. Our recognition of such distributor sell-through is based on point of sales reports received from the distributor, at which time the price is no longer subject to adjustment and is fixed, and the products are no longer subject to return to us except pursuant to warranty terms. The gross profit that is deferred upon shipment to the distributor is reflected as “deferred income on sales to distributors” in the accompanying consolidated balance sheets. The total deferred revenue as of December 31, 2014 and 2013, was approximately $25.0 million and $25.5 million, respectively. The total deferred cost as of December 31, 2014 and 2013, was approximately $9.8 million and $9.8 million, respectively.

Frequently, distributors need to sell at a price lower than the standard distribution price in order to win business. At the time the distributor invoices its customer or soon thereafter, the distributor submits a “ship and debit” price adjustment claim to us to adjust the distributor's cost from the standard price to the pre-approved lower price. After we verify that the claim was pre-approved, a credit memo is issued to the distributor for the ship and debit claim. We maintain a reserve for these unprocessed claims and for estimated future ship and debit price adjustments. The reserves appear as a reduction to accounts receivable and deferred income on sales to distributors in our accompanying consolidated balance sheets. To the extent future ship and debit claims significantly exceed amounts estimated, there could be a material impact on the deferred revenue and deferred margin ultimately recognized. To evaluate the adequacy of our reserves, we analyze historical ship and debit payments and levels of inventory in the distributor channels.

Sales to certain of our distributors are made under terms that do not include rights of return or price concessions after the product is shipped to the distributor. Accordingly, product revenue is recognized upon shipment and title transfer assuming all other revenue recognition criteria are met.

Stock-based compensation

We apply the provisions of ASC 718-10, Share-Based Payment. Under the provisions of ASC 718-10, we recognize the fair value of stock-based compensation in our financial statements over the requisite service period of the individual grants, which generally equals a four-year vesting period. We use estimates of volatility, expected term, risk-free interest rate, dividend yield and forfeitures in determining the fair value of these awards and the amount of compensation expense to recognize. Changes in the estimated forfeiture rate could result in changes to our current compensation charges for historical grants.

Estimating write-downs for excess and obsolete inventory

When evaluating the adequacy of our valuation adjustments for excess and obsolete inventory, we identify excess and obsolete products and also analyze historical usage, forecasted production based on demand forecasts, current economic trends and historical write-offs. This write-down is reflected as a reduction to inventory in the consolidated balance sheets and an increase in cost of revenues. If actual market conditions are less favorable than our assumptions, we may be required to take additional write-downs, which could adversely impact our cost of revenues and operating results.

Income taxes

Income tax expense is an estimate of current income taxes payable or refundable in the current fiscal year based on reported income before income taxes. Deferred income taxes reflect the effect of temporary differences and carry-forwards that are recognized for financial reporting and income tax purposes.

Table of Contents

We account for income taxes under the provisions of ASC 740. Under the provisions of ASC 740, deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, utilizing the tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We recognize valuation allowances to reduce any deferred tax assets to the amount that we estimate will more likely than not be realized based on available evidence and management's judgment. We limit the deferred tax assets recognized related to some of our officers' compensation to amounts that we estimate will be deductible in future periods based upon Internal Revenue Code Section 162(m). In the event that we determine, based on available evidence and management judgment, that all or part of the net deferred tax assets will not be realized in the future, we would record a valuation allowance in the period the determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our results of operations and financial position.

As of December 31, 2014, we continue to maintain a valuation allowance on our California deferred tax assets as we believe that it is not more likely than not that the deferred tax assets will be fully realized. We also maintain a valuation allowance with respect to some of our deferred tax assets relating primarily to tax credits in Canada and the state of New Jersey as well as Federal capital loss carryforwards.

On May 20, 2014, we signed an agreement to settle all positions and close out the examination of our income tax returns for the years 2007 through 2009. As a result, we adjusted our tax balances based on the facts, circumstances, and information available at the reporting date. The resolution of the audit resulted in a federal tax benefit to us of $2.8 million; we also recorded a state tax benefit of $0.5 million. The agreement with IRS also allowed us to repatriate up to $5.0 million from our foreign subsidiary without incurring additional U.S. income taxes.

We engage in qualifying activities for R&D credit purposes. The Tax Increase Prevention Act of 2014 was signed into law on December 19, 2014, to extend the federal research and development credit for 2014.

Business combinations

The purchase price of an acquisition is allocated to the underlying assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. To the extent the purchase price exceeds the fair value of the net identifiable tangible and intangible assets acquired and liabilities assumed, such excess is allocated to goodwill. We determine the estimated fair values after review and consideration of relevant information, including discounted cash flows, quoted market prices and estimates made by management. We adjust the preliminary purchase price allocation, as necessary, during the measurement period of up to one year after the acquisition closing date as we obtain more information as to facts and circumstances existing at the acquisition date impacting asset valuations and liabilities assumed. Acquisition-related costs are recognized separately from the acquisition and are expensed as incurred.

Goodwill and intangible assets

In accordance with ASC 350-10, Goodwill and Other Intangible Assets, we evaluate goodwill for impairment on an annual basis, or as other indicators of impairment emerge. The provisions of ASC 350-10 require that we perform a two-step impairment test. In the first step, we compare the implied fair value of our single reporting unit to its carrying value, including goodwill. If the fair value of our reporting unit exceeds the carrying amount no impairment adjustment is required. If the carrying amount of our reporting unit exceeds the fair value, step two will be completed to measure the amount of goodwill impairment loss, if any exists. If the carrying value of our single reporting unit's goodwill exceeds its implied fair value, then we record an impairment loss equal to the difference, but not in excess of the carrying amount of the goodwill. Under the amendments of ASC 350-10, ASU No. 2011-08, Testing Goodwill for

Impairment, beginning in the first quarter of 2012 we have the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, we elect this option and after assessing the totality of events or circumstances, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. We have not elected this option to date. We evaluated goodwill for impairment in the fourth quarters of 2014 and 2013, and concluded that no impairment existed as of December 31, 2014, and December 31, 2013.

ASC 350-10 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives, and reviewed for impairment in accordance with ASC 360-10, Accounting for the Impairment or

Table of Contents

Disposal of Long-Lived Assets. We review long-lived assets, such as acquired intangibles and property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We measure recoverability of assets to be held and used by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, we recognize an impairment charge by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Results of Operations

The following table sets forth some operating data in dollars, as a percentage of total net revenues and the increase (decrease) over prior periods for the periods indicated (dollar amounts in thousands).

	Year Ended December 31, Amount			Increase (Decrease)		Percent of Net Revenues		
	2014	2013	2012	2014 vs. 2013	2013 vs. 2012	2014	2013	2012
Total net revenues	$348,797	$347,089	$305,370	$1,708	$41,719	100.0 %	100.0 %	100.0 %
Cost of revenues	159,227	163,853	154,868	(4,626)	8,985	45.7	47.2	50.7
Gross profit	189,570	183,236	150,502	6,334	32,734	54.3	52.8	49.3
Operating expenses:								
Research and development	54,981	51,654	45,709	3,327	5,945	15.8	14.9	15.0
Sales and marketing	47,796	45,466	37,998	2,330	7,468	13.7	13.1	12.4
General and administrative	30,997	32,050	30,243	(1,053)	1,807	8.9	9.2	9.9
Charge related to SemiSouth	—	—	25,200	—	(25,200)	—	—	8.3
Total operating expenses	133,774	129,170	139,150	4,604	(9,980)	38.4	37.2	45.6
Income from operations	55,796	54,066	11,352	1,730	42,714	16.0	15.6	3.7
Other income (expense)								
Charge related to SemiSouth	—	—	(33,745)	—	33,745	—	—	(11.1)
Other income, net	1,018	1,361	1,611	(343)	(250)	0.3	0.4	0.6
Total other income (expense)	1,018	1,361	(32,134)	(343)	33,495	0.3	0.4	(10.5)
Income (loss) before provision for (benefit from) income tax	56,814	55,427	(20,782)	1,387	76,209	16.3	16.0	(6.8)
Provision for (benefit from) income taxes	(2,730)	(1,839)	13,622	(891)	(15,461)	(0.8)	(0.5)	4.5
Net income (loss)	$59,544	$57,266	$(34,404)	$2,278	$91,670	17.1 %	16.5 %	(11.3)%

Comparison of Years Ended December 31, 2014, 2013 and 2012

Net revenues. Net revenues consist of revenues from product sales, which are calculated net of returns and allowances. In 2014 revenue increased by $1.7 million, due primarily to growth in three of our primary end-market categories (consumer, industrial and computer), driven by higher unit sales for a range of applications including consumer appliances, industrial motor drives and desktop computers. The increase was partially offset by lower sales into the communications end market due primarily to lower unit sales for residential-networking applications and cellphone chargers.

The increase in revenues from 2012 to 2013 was due in part to the inclusion of the former Concept business for the full year (compared to only eight months in 2012), and also reflected higher unit sales into the industrial, consumer and computing end markets, particularly for such applications such as consumer appliances, industrial controls, LED lighting, industrial motor drives, renewable-energy systems and desktop PCs.

Table of Contents

Our net revenue mix by the end markets served in 2014, 2013 and 2012 were as follows:

	Year Ended December 31,		
End Market	2014	2013	2012
Communications	18 %	21 %	24 %
Computer	10 %	10 %	12 %
Consumer	37 %	35 %	36 %
Industrial electronics	35 %	34 %	28 %

Sales to customers outside of the United States were $332.8 million in 2014, compared to $328.5 million in 2013 and $289.5 million in 2012, representing approximately 95% of net revenues in each of 2014, 2013 and 2012. Although power supplies using our products are designed and distributed worldwide, most of these power supplies are manufactured by our customers in Asia. As a result, sales to this region accounted for approximately 80% of our net revenues in 2014, 81% in 2013 and 82% in 2012. We expect international sales to continue to account for a large portion of our net revenues.

Distributors accounted for 75% of our net product sales for the years ended December 31, 2014 and 2013, and 74% of our net product sales for the year ended December 31, 2012, with direct sales to OEMs and power supply manufacturers accounting for the remainder in each of the corresponding years. In 2014 and 2013, one distributor, Avnet, accounted for more than 10% of revenues. In 2012, two distributors, Avnet and ATM Electronic Corporation, each accounted for more than 10% of revenues. The table below includes net revenues from each of these customers for the three years ended December 31, 2014.

	Year Ended December 31,		
Customer	2014	2013	2012
Avnet	19 %	19 %	20 %
ATM Electronic Corporation	*	*	12 %

* Total customer revenue was less than 10% of net revenues

No other customers accounted for 10% or more of net revenues during these years.

Gross profit. Gross profit is net revenues less cost of revenues. Our cost of revenues consists primarily of the purchase of wafers from our contracted foundries, the assembly, packaging and testing of our products by sub-contractors, product testing performed in our own facility, overhead associated with the management of our supply chain and the amortization of acquired intangible assets. Gross margin is gross profit divided by net revenues. The table below compares gross profit and gross margin for the years ended December 31, 2014, 2013 and 2012 (dollars in millions):

	Year Ended December 31,		
	2014	2013	2012
Net revenues	$348.8	$347.1	$305.4
Gross profit	$189.6	$183.2	$150.5
Gross margin	54.3 %	52.8 %	49.3 %

The increase in gross margin from 2013 to 2014 was due primarily to: a favorable end-market mix, with a greater percentage of revenue coming from higher-margin end markets; a continued decline in the value of the Japanese yen versus the U.S. dollar, which decreased the cost of silicon wafers purchased from our Japanese wafer-fabrication foundries; and unit cost benefits from higher production volumes. The increase in gross margin from 2012 to 2013 was due primarily to lower manufacturing costs stemming from a combination of internal cost-reduction initiatives, unit-cost benefits from higher production volumes, the decline in the value of the Japanese yen versus the U.S. dollar and a more favorable end-market mix.

Research and development expenses. Research and development, or R&D, expenses consist primarily of employee-related expenses including stock-based compensation and expensed material and facility costs associated with the development of new processes and new products. We also record R&D expenses for prototype wafers related to new products

30

until the products are released to production. The table below compares R&D expenses for the years ended December 31, 2014, 2013 and 2012 (dollars in millions):

	Year Ended December 31,					
	2014		2013		2012	
Net revenues	$348.8		$347.1		$305.4	
R&D expenses	$55.0		$51.7		$45.7	
R&D expenses as a % of net revenues	15.8	%	14.9	%	15.0	%

R&D expenses increased in 2014 compared to 2013, driven primarily by increased payroll and related expenses as a result of increased headcount, due mainly to the expansion of our product-development efforts. We also increased outside-service expenses related to product design and development. The R&D increase was partially offset by lower stock-based compensation expense, reflecting the fact that our 2014 performance-based stock awards failed to vest due to our 2014 performance. R&D expenses increased in 2013 compared to 2012, driven primarily by increased payroll and related expenses as a result of increased headcount, due mainly to our acquisition of Concept in May 2012. In addition, we expanded our product-development efforts resulting in increased outside-service expenses related to product design and development.

Sales and marketing expenses. Sales and marketing expenses consist primarily of employee-related expenses, including stock-based compensation, commissions to sales representatives, amortization of acquired intangible assets and facilities expenses, including expenses associated with our regional sales and support offices. The table below compares sales and marketing expenses for the years ended December 31, 2014, 2013 and 2012 (dollars in millions):

	Year Ended December 31,					
	2014		2013		2012	
Net revenues	$348.8		$347.1		$305.4	
Sales and marketing expenses	$47.8		$45.5		$38.0	
Sales and marketing expenses as a % of net revenue	13.7	%	13.1	%	12.4	%

Sales and marketing expenses increased in 2014 compared to 2013, due primarily to increased salary and related expenses reflecting the expansion of our sales and application-support staffs. This increase was partially offset by lower amortization of acquisition-related intangible assets, as our Concept trade name was fully amortized in the second quarter of 2014. The increase in sales and marketing expenses in 2013 compared to 2012 was due primarily to the acquisition of Concept in May of 2012, which in turn resulted in higher payroll and related expenses including stock-based compensation expense, as well as increased amortization expenses related to acquired intangible assets. The expansion of our sales force also contributed to the year-over-year increase, as did higher marketing expenses, which increased due to the development of marketing materials for the Concept IGBT-driver product line as well as trade-show attendance.

General and administrative expenses. General and administrative, or G&A, expenses consist primarily of employee-related expenses, including stock-based compensation expenses for administration, finance, human resources and general management, as well as consulting, professional services, legal and auditing expenses. The table below compares G&A expenses for the years ended December 31, 2014, 2013 and 2012 (dollars in millions):

	Year Ended December 31,					
	2014		2013		2012	
Net revenues	$348.8		$347.1		$305.4	
G&A expenses	$31.0		$32.1		$30.2	
G&A expenses as a % of net revenue	8.9	%	9.2	%	9.9	%

G&A expenses decreased in 2014 compared to 2013 due primarily to lower stock-based compensation expense, reflecting the fact that our 2014 performance-based stock awards failed to vest due to our 2014 performance. In addition, we incurred lower legal expenses as a result of lower patent fees and general legal fees, partially offset by increased outside service fees related to our acquisition in January 2015 of Cambridge Semiconductor Ltd. ("CamSemi"), a UK company (refer to Note 11, Acquisitions, in our Notes to Consolidated Financial Statements for details). G&A expenses increased in 2013 compared to 2012 due primarily to increased headcount year-over-year, due primarily to our acquisition of Concept in May of 2012, which

Table of Contents

resulted in increased payroll and related expenses, including stock-based compensation expense. The increase was partially offset by decreased legal expenses related to patent litigation (refer to Note 10, Legal Proceedings and Contingencies, in our Notes to Consolidated Financial Statements for details), and a decrease in professional-service expenses following elevated expenses in 2012 in conjunction with the Concept acquisition and our audit settlement with the IRS.

Charge Related to SemiSouth. In October 2012, we determined that our assets related to SemiSouth Laboratories were impaired as of September 30, 2012. As a result we incurred a net charge to operating expenses of $25.2 million, comprising the write-offs of a prepaid royalty of $10.0 million and $15.2 million related to a loan guarantee for SemiSouth. Refer to Note 12, Transactions With Third Party, in our Notes to Consolidated Financial Statements for details on the SemiSouth charge.

Other income/expense, net. Other income (expense), net consists primarily of interest income earned on cash and cash equivalents, marketable securities and other investments, and the impact of foreign exchange gains or losses, in addition to an impairment charge related to SemiSouth. The table below compares other income, net for the years ended December 31, 2014, 2013 and 2012 (dollars in millions):

	Year Ended December 31,					
	2014		2013		2012	
Net revenues	$348.8		$347.1		$305.4	
Other income (expense)	$1.0		$1.4		$(32.1	)
Other income as a % of net revenue	0.3	%	0.4	%	(10.5	)%

Other income/expense decreased in 2014 compared to 2013 due to a 2013 gain realized for the sale of assets related to SemiSouth, partially offset by increased interest income in 2014. Other income/expense increased in 2013 compared to 2012, due primarily to a charge of $33.7 million in 2012 related to SemiSouth, comprising the write-off of $6.7 million of lease receivables, $7.0 million of preferred stock, a promissory note (net of imputed interest) in the amount of $13.2 million, $6.2 million for a purchase option, and other assets of $0.6 million. Refer to Note 12, Transactions With Third Party, in our Notes to Consolidated Financial Statements for details on the SemiSouth impairment. In addition, in 2013 we had the above-mentioned other income of $0.5 million gain for the sale of assets related to SemiSouth.

Provision for income taxes. Provision for income taxes represents federal, state and foreign taxes. The table below compares the provision for income taxes for the years ended December 31, 2014, 2013 and 2012 (dollars in millions):

	Year Ended December 31,					
	2014		2013		2012	
Income (loss) before provision for (benefit from) income taxes	$56.8		$55.4		$(20.8	)
Provision for (benefit from) income taxes	$(2.7	)	$(1.8	)	$13.6	
Effective tax rate	(4.8	)%	(3.3	)%	(65.5	)%

In 2014, our effective tax rate was impacted by an agreement reached with the Internal Revenue Service to conclude the examination of our income tax returns for the years 2007 through 2009. The resolution of the audit resulted in a federal tax benefit to us of $2.8 million; we also recorded a state tax benefit of $0.5 million. The one-time benefit included the reversal of $4.1 million of related unrecognized tax benefits that had been recorded as non-current liabilities in our consolidated balance sheets. Our effective tax rate for the year ended December 31, 2013, was favorably impacted by the geographic distribution of our world-wide earnings and earnings in lower-tax jurisdictions. Additionally, the rate was favorably impacted by federal research tax credits for 2014, 2013 and 2012.

The effective tax rate for the year ended December 31, 2012, was unfavorably impacted as a result of our audit agreement with the IRS, in connection with the IRS examination of our income tax returns for the years ended 2003 through 2006. The settlement included federal and state taxes plus interest charges totaling approximately $44.8 million, partially offset by the reversal of related unrecognized tax benefits of $29.1 million, for a net charge of $18.1 million. During the third quarter of 2012, we recorded an impairment charge and write-off of certain assets related to SemiSouth of approximately $58.9 million on which we recognized an $8.0 million tax benefit. The write-off resulted in a net loss for the year. For further income tax information refer to Note 8, Provision for Income Taxes, in our Notes to Consolidated Financial Statements.

Table of Contents

Liquidity and Capital Resources

We had approximately $175.3 million in cash, cash equivalents and short-term marketable securities at December 31, 2014, compared to $202.1 million at December 31, 2013, and $95.2 million at December 31, 2012. As of December 31, 2014, 2013 and 2012, we had working capital, defined as current assets less current liabilities, of approximately $210.8 million, $227.0 million and $124.3 million, respectively.

In March 2012, we loaned $18.0 million to SemiSouth in exchange for a promissory note. In October 2012, we determined that the loan to SemiSouth was other-than-temporarily impaired as of September 30, 2012; the loan was written off, resulting in a charge in our consolidated statements of income (loss) for the year ended December 31, 2012, under the caption “other income (expense), charge related to SemiSouth” (see Note 12, Transactions With Third Party, in our Notes to Consolidated Financial Statements for further details on the SemiSouth loan).
On July 5, 2012, we entered into a Credit Agreement (the "Credit Agreement") with two banks. The Credit Agreement provides us with a $100.0 million revolving line of credit to use for general corporate purposes with a $20.0 million sub-limit for the issuance of standby and trade letters of credit. The Credit Agreement was amended on April 1, 2014, to extend the Credit Agreement termination date from July 5, 2015, to April 1, 2017, with all other terms of the Credit Agreement remaining the same. Our ability to borrow under the revolving line of credit is conditioned upon our compliance with specified covenants, primarily a minimum cash requirement and a debt-to-earnings ratio, with which we are currently in compliance. The Credit Agreement terminates on April 1, 2017, and all advances under the revolving line of credit will become due on such date, or earlier in the event of a default. As of December 31, 2014, we had no amounts outstanding under our agreement.

Our operating activities generated cash of $85.6 million, $98.7 million, and $51.8 million in the years ended December 31, 2014, 2013 and 2012, respectively. In each of these years, cash was primarily generated from operating activities in the ordinary course of business.

Cash provided by operating activities totaled $85.6 million in the year ended December 31, 2014. Our net income was $59.5 million, which included non-cash depreciation, amortization and stock-based compensation expenses of $15.9 million, $6.1 million and $14.3 million, respectively. Sources of cash also included: (1) an $8.2 million decrease in prepaid expenses and other assets as a result of lower payments related to legal and R&D services, in addition to tax refunds received during the year; (2) a $2.1 million decrease in accounts receivable as a result of lower sales in the fourth quarter of 2014 compared to 2013 and improved collections; and (3) a $2.3 million increase in accounts payable due to the timing of payments. These sources of cash were partially offset by a $21.7 million increase in our inventories as a result of lower-than expected sales, and by a $3.2 million decrease in taxes payable.

Cash provided by operating activities totaled $98.7 million in the year ended December 31, 2013. Our net income was $57.3 million, which included non-cash depreciation, amortization and stock-based compensation expenses of $16.1 million, $7.4 million and $16.5 million, respectively. Sources of cash also included a $4.2 million increase in deferred income on sales to distributors, resulting from increased shipments to distributors in the fourth quarter of 2013 compared to the same period of 2012. These sources of cash were partially offset by a $4.9 million increase in accounts receivable resulting primarily from revenue growth in the fourth quarter of 2013 compared to the same period in 2012.

Cash provided by operating activities totaled $51.8 million in the year ended December 31, 2012. In 2012, our net loss was $34.4 million, which included non-cash depreciation, amortization and stock-based compensation expenses of $15.3 million, $5.2 million and $14.2 million, respectively. In addition we incurred a $58.9 million impairment charge related to our SemiSouth related assets (refer to Note 12, Transactions With Third Party, in our Notes to Consolidated Financial Statements, for details on our SemiSouth impairment and charges). Additional sources of cash included (1) a

$18.0 million decline in inventory due to reduced wafer purchases in 2012, and increased sales at the end of 2012 compared to 2011, and (2) a $5.3 million decrease in accounts receivable primarily due to the timing of ship-and-debit credit processing. These additional sources of cash and non-cash items were partially offset by (1) a $26.0 million decrease in taxes payable and other accrued liabilities primarily in connection with our IRS agreement (refer to Note 8, Provision for Income Taxes, in our Notes to Consolidated Financial Statements for details on our agreement) and (2) a $11.0 million increase in prepaid expenses and other assets primarily related to prepaid taxes (in connection with the tax benefit related to the SemiSouth impairment and the above-mentioned tax agreement).

Table of Contents

Our investing activities in the year ended December 31, 2014, resulted in a net $38.1 million use of cash, consisting primarily of: (1) $7.2 million, net, for purchases of marketable securities; (2) $23.1 million for purchases of property and equipment, primarily machinery and equipment for production and research and development; (3) $1.3 million for the purchase of power.com, our new domain name; and (4) a $6.6 million cash payment to CamSemi under a loan agreement (refer to Note 11, Acquisitions, in our Notes to Consolidated Financial Statements, for further details).

Our investing activities in the year ended December 31, 2013, resulted in a net $90.7 million use of cash, consisting primarily of $78.1 million, net, for purchases of marketable securities and $14.0 million for purchases of property and equipment. Our investment in property and equipment included purchases of manufacturing and research and development equipment, as well as an enterprise resource planning, or ERP, software upgrade and building improvements to our San Jose, California facility.

Our investing activities in the year ended December 31, 2012, resulted in a $124.7 million net use of cash, consisting of: (1) $115.7 million related to the acquisition of Concept; (2) $18.0 million for a loan to SemiSouth (refer to Note 12, Transactions With Third Party, in our Notes to Consolidated Financial Statements, for further details); (3) $15.2 million related to a payment under a loan guarantee for SemiSouth, refer to Note 12, Transactions With Third Party, in our Notes to Consolidated Financial Statements, for further details; and (4) $16.4 million for purchases of property and equipment, primarily building improvements in connection with our research and development facility in New Jersey and manufacturing equipment and software to support our growth. These uses of cash were partially offset by $40.5 million of proceeds from maturities of marketable securities.

Our financing activities in the year ended December 31, 2014, resulted in a net use of $79.6 million, consisting primarily of $80.8 million for the repurchase of our common stock, and $13.2 million for the payment of dividends to stockholders. The use of cash was partially offset by proceeds of $13.9 million from issuance of common stock, including the exercise of employee stock options and the issuance of shares through our employee stock purchase plan.

Our financing activities in the year ended December 31, 2013, resulted in net proceeds of $21.5 million, consisting primarily of $30.2 million from the issuance of common stock, including the exercise of employee stock options and the issuance of shares through our employee stock purchase plan, partially offset by $9.4 million for the payment of dividends to stockholders. Our financing activities in the year ended December 31, 2012, resulted in a net $3.6 million use of cash, consisting of $20.5 million used for the repurchase of our common stock and $5.8 million for the payment of dividends to stockholders, partially offset by proceeds of $22.0 million from the issuance of common stock, including the exercise of employee stock options and the issuance of shares through our employee stock purchase plan.

In October 2013, our board of directors declared four quarterly cash dividends in the amount of $0.10 per share to be paid to stockholders of record at the end of each quarter in 2014. Dividend payouts totaling approximately $3.0 million each were paid on March 31, 2014, and June 30, 2014. In April 2014, our board of directors increased the quarterly dividends for the third and fourth quarters of 2014 to $0.12 per share. Dividend payouts totaling approximately $3.6 million and $3.5 million were paid on September 30, 2014, and December 31, 2014, respectively. In January 2015, our board of directors extended the $0.12 quarterly dividend through each quarter in 2015.

In January 2013, our board of directors declared four quarterly cash dividends in the amount of $0.08 per share paid to stockholders of record at the end of each quarter in 2013. Payouts of approximately $2.3 million each were paid on March 29, 2013, and June 28, 2013, and approximately $2.4 million was paid on September 30, 2013, and December 31, 2013, respectively. In January 2012, our board of directors declared four quarterly cash dividends in the amount of $0.05 per share to be paid to stockholders of record at the end of each quarter in 2012. The quarterly dividend payments were each in the aggregate amount of approximately $1.4 million to stockholders of record. The declaration of any future cash dividend is at the discretion of the board of directors and will depend on the Company's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination that cash dividends are in the best interest of the Company's stockholders.

In October 2012, our board of directors authorized the use of $50.0 million for the repurchase of our common stock, with repurchases to be executed according to certain pre-defined price/volume guidelines set by the board of directors. In 2012, we purchased 0.7 million shares for approximately $20.5 million under this stock repurchase program. No shares were purchased during the twelve months ended December 31, 2013, due to the then current stock price levels which exceeded the pre-defined price guidelines mentioned above. In 2014 the our board of directors authorized the use of an additional $75.0

Table of Contents

million for this purpose. In the twelve months ended December 31, 2014, we purchased 1.6 million shares for $80.8 million. As of December 31, 2014, we had $23.7 million available for future stock repurchases. Authorization of future stock repurchase programs is at the discretion of the board of directors and will depend on our financial condition, results of operations, capital requirements, business conditions as well as other factors.

As of December 31, 2014, we had a contractual obligation related to income tax, consisting primarily of unrecognized tax benefits of approximately $11.2 million. The tax obligation was classified as long-term income taxes payable and a portion is recorded in deferred tax assets in our consolidated balance sheet.

In connection with our IRS settlements in 2014 and in 2012, we were entitled to repatriate $106.9 million from our foreign subsidiary without incurring additional U.S. income tax (See Note 8, Provision for Income Taxes, in our Notes to Condensed Consolidated Financial Statements).

Our cash, cash equivalents and investment balances may change in future periods due to changes in our planned cash outlays, including changes in incremental costs such as direct and integration costs related to future acquisitions. We expect continued sales growth in our foreign business and plan to use the earnings generated by our foreign subsidiaries to continue to fund both the working capital and growth needs of our foreign entities, along with providing funding for any future foreign acquisitions. We do not provide for U.S. taxes on our undistributed earnings of foreign subsidiaries that we intend to invest indefinitely outside the U.S., unless such taxes are otherwise required under U.S. tax law. Beginning in 2013, we determined that a portion of our foreign subsidiaries current and future earnings may be remitted prospectively to the U.S. for domestic cash flow purposes and, accordingly, provided for the related U.S. taxes in our consolidated financial statements. Currently the majority of our cash and marketable securities are held in the U.S. If we change our intent to invest our undistributed earnings outside the U.S. indefinitely or if a greater amount of undistributed earnings are needed for U.S. operations than previously anticipated and for which U.S. taxes have not been recorded, we would be required to accrue or pay U.S. taxes (subject to an adjustment for foreign tax credits, where applicable) and withholding taxes payable to various foreign countries on some or all of these undistributed earnings. As of December 31, 2014, we had undistributed earnings of foreign subsidiaries that are indefinitely invested outside of the U.S. of approximately $144.0 million.

If our operating results deteriorate in future periods, either as a result of a decrease in customer demand, or severe pricing pressures from our customers or our competitors, or for other reasons, our ability to generate positive cash flow from operations may be jeopardized. In that case, we may be forced to use our cash, cash equivalents and short-term investments, use our current financing or seek additional financing from third parties to fund our operations. We believe that cash generated from operations, together with existing sources of liquidity, will satisfy our projected working capital and other cash requirements for at least the next 12 months.

Off-Balance Sheet Arrangements

As of December 31, 2014 and 2013, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Contractual Obligations

As of December 31, 2014, we had the following contractual obligations and commitments required by SEC regulations to be disclosed in this table, consisting solely of non-cancelable operating lease agreements (in thousands):

Payments Due by Period

	Total	Less than 1 Year	1 - 3 Years	4 - 5 Years	Over 5 Years
Operating lease obligations	$4,832	$1,485	$1,969	$1,378	$—

In addition to our contractual obligations noted above we have a contractual obligation related to income tax as of December 31, 2014, which primarily comprises unrecognized tax benefits of approximately $11.2 million, and was classified as long-term income taxes payable and a portion is recorded in deferred tax assets in our consolidated balance sheet.

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We consider cash invested in highly liquid financial instruments with a remaining maturity of three months or less at the date of purchase to be cash equivalents. Investments in highly liquid financial instruments with maturities greater than three months are classified as short-term investments. We generally hold securities until maturity; however, they may be sold under certain circumstances, including, but not limited to, when necessary for the funding of acquisitions and other strategic investments. As a result of this policy, we classify our investment portfolio as available-for-sale. We invest in high-credit quality issuers and, by policy, limit the amount of credit exposure to any one issuer. As stated in our policy, we seek to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in safe and high-credit quality securities and by constantly positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer, guarantor or depository. The portfolio includes only marketable securities with active secondary or resale markets to facilitate portfolio liquidity. At December 31, 2014 and 2013, we held primarily cash equivalents and short-term investments with fixed interest rates. We do not hold any instruments for trading purposes.

Our investment securities are subject to market interest rate risk and will vary in value as market interest rates fluctuate. To minimize market risk, we invest in high-credit quality issuers and, by policy, limit the amount of credit exposure to any one issuer, and therefore if market interest rates were to increase or decrease by 10% from interest rates as of December 31, 2014, or December 31, 2013, the increase or decrease in the fair market value of our portfolio on these dates would not have been material. We monitor our investments for impairment on a periodic basis. Refer to Note 2, Summary of Significant Accounting Policies, for a tabular presentation of our available-for-sale investments and the expected maturity dates.

Foreign Currency Exchange Risk. As of December 31, 2014, our primary transactional currency was the U.S. dollar; in addition, we hold cash in Swiss francs and euro as a result of our acquisition of Concept in 2012. Cash balances held in foreign countries are subject to local banking laws and may bear higher or lower risk than cash deposited in the United States. The following represents the potential impact on our pretax income from a change in the value of the U.S. dollar compared to the Swiss franc and euro as of December 31, 2014. This sensitivity analysis applies a change in the U.S. dollar value of 5% and 10%.

	December 31, 2014	
	5%	10%
Swiss franc and euro foreign exchange impact (in thousands of USD)	$124	$248

The foreign exchange rate fluctuation between the U.S. dollar versus the Swiss franc and euro is recorded in other income in our consolidated statements of income (loss).

We have sales offices in various other foreign countries in which our expenses are denominated in the local currency, primary Asia and Western Europe. From time to time we may enter into foreign currency hedging contracts to hedge certain foreign currency transactions. As of December 31, 2014, and December 31, 2013, we did not have an open foreign currency hedge program utilizing foreign currency forward exchange contracts.

With two of our major suppliers, Seiko Epson Corporation, or Epson, and ROHM Lapis Semiconductor Co., Ltd., or Lapis, we have wafer supply agreements based in U.S. dollars; however, our agreements with Epson and Lapis also allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. Each year, our management and these suppliers review and negotiate pricing; the negotiated pricing is denominated in U.S. dollars but is subject to contractual exchange rate provisions. The fluctuation in the exchange rate is shared equally between us and each of these suppliers.

Nevertheless, as a result of our above-mentioned supplier agreements, our gross margin is influenced by fluctuations in the exchange rate between the U.S. dollar and the Japanese yen. All else being equal, a 10% change in the value of the U.S. dollar compared to the Japanese yen would result in a corresponding change in our gross margin of approximately 0.8% to 1.0%; this sensitivity may increase or decrease depending on the percentage of our wafer supply that we purchase from some of our Japanese suppliers and could subject our gross profit and operating results to the potential for material fluctuations.

Table of Contents

Item 8. Financial Statements and Supplementary Data.

The financial statements required by this item are set forth in the pages indicated in Item 15(a), and the supplementary data required by this item is included in Note 15, Selected Quarterly Information, in our notes to consolidated financial statements.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Management is required to evaluate our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Disclosure controls and procedures are controls and other procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Exchange Act, such as this Annual Report on Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include controls and procedures designed to provide reasonable assurance that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures include components of our internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the U.S. To the extent that components of our internal control over financial reporting are included within our disclosure controls and procedures, they are included in the scope of our periodic controls evaluation. Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective as of the end of the period covered by this report.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting.

Management conducted an assessment of Power Integrations' internal control over financial reporting as of December 31, 2014, based on the framework established by the Committee of Sponsoring Organization (COSO) of the Treadway Commission in Internal Control - Integrated Framework issued in 2013. Based on this assessment, management concluded that, as of December 31, 2014, our internal control over financial reporting was effective.

Table of Contents

The effectiveness of Power Integrations' internal control over financial reporting as of December 31, 2014, has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which appears below.

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the fourth quarter of 2014, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Power Integrations, Inc.
San Jose, California

We have audited the internal control over financial reporting of Power Integrations, Inc. and subsidiaries (the "Company") as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's Board of Directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and consolidated financial statement schedule as of and for the year ended December 31, 2014 of the Company and our report dated February 10, 2015 expressed an unqualified opinion on those consolidated financial statements and consolidated financial statement schedule.

/s/ DELOITTE & TOUCHE LLP
San Jose, California
February 10, 2015

Table of Contents

Item 9B. Other Information.

None

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The names of our executive officers and their ages, titles and biographies as of the date hereof are incorporated by reference from Part I, Item 1, above.

The following information is included in our Notice of Annual Meeting of Stockholders and Proxy Statement to be filed within 120 days after our fiscal year end of December 31, 2014, or the Proxy Statement, and is incorporated herein by reference:

- Information regarding our directors and any persons nominated to become a director, as well as with respect to some other required board matters, is set forth under Proposal 1 entitled “Election of Directors.”
- Information regarding our audit committee and our designated “audit committee financial expert” is set forth under the captions “Information Regarding the Board and its Committees” and “Audit Committee” under Proposal 1 entitled “Election of Directors.”
- Information on our code of business conduct and ethics for directors, officers and employees is set forth under the caption “Code of Business Conduct and Ethics” under Proposal 1 entitled “Election of Directors.”
- Information regarding Section 16(a) beneficial ownership reporting compliance is set forth under the caption “Section 16(a) Beneficial Ownership Reporting Compliance.”
- Information regarding procedures by which stockholders may recommend nominees to our board of directors is set forth under the caption “Nominating and Governance Committee” under Proposal 1 entitled “Election of Directors.”

Item 11. Executive Compensation.

Information regarding compensation of our named executive officers is set forth under the caption "Compensation of Executive Officers" in the Proxy Statement, which information is incorporated herein by reference.
Information regarding compensation of our directors is set forth under the caption "Compensation of Directors" in the Proxy Statement, which information is incorporated herein by reference.
Information relating to compensation policies and practices as they relate to risk management is set forth under the caption “Compensation Policies and Practices as They Relate to Risk Management” under Proposal 1 entitled “Election of Directors” in the Proxy Statement, which information is incorporated herein by reference.
Information regarding compensation committee interlocks is set forth under the caption "Compensation Committee Interlocks and Insider Participation" in the Proxy Statement, which information is incorporated herein by reference.
The Compensation Committee Report is set forth under the caption "Compensation Committee Report" in the Proxy Statement, which report is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information regarding security ownership of certain beneficial owners, directors and executive officers is set forth under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement, which information is incorporated herein by reference.

Information regarding our equity compensation plans, including both stockholder approved plans and non-stockholder approved plans, is set forth under the caption “Equity Compensation Plan Information" in the Proxy Statement, which information is incorporated herein by reference.

Table of Contents

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information regarding certain relationships and related transactions is set forth under the caption "Certain Relationships and Related Transactions" in the Proxy Statement, which information is incorporated herein by reference.

Information regarding director independence is set forth under the caption “Proposal 1 - Election of Directors” in the Proxy Statement, which information is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

Information regarding principal auditor fees and services is set forth under "Principal Accountant Fees and Services" in the Proposal entitled “Ratification of Selection of Independent Registered Public Accounting Firm” in the Proxy Statement, which information is incorporated herein by reference.

Table of Contents

PART IV

ITEM 15. FINANCIAL STATEMENTS AND EXHIBITS

(a) The following documents are filed as part of this Form:

1. Financial Statements

2. Financial Statement Schedules

Schedule II: Valuation and Qualifying Accounts.

All other schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

3. Exhibits

See Index to Exhibits at the end of this Report, which is incorporated herein by reference. The Exhibits listed in the accompanying Index to Exhibits are filed as part of this report.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Power Integrations, Inc.
San Jose, California

We have audited the accompanying consolidated balance sheets of Power Integrations, Inc. and subsidiaries (the "Company") as of December 31, 2014 and 2013, and the related consolidated statements of income (loss), comprehensive income (loss), stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included the consolidated financial statement schedule listed in the Index at Item 15 (a) 2. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and consolidated financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Power Integrations, Inc. and subsidiaries at December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on the criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 10, 2015, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP
San Jose, California
February 10, 2015

Table of Contents

POWER INTEGRATIONS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts and par value)

	December 31, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$60,708	$92,928
Short-term marketable securities	114,575	109,179
Accounts receivable, net of allowances of $191 and $120 in 2014 and 2013, respectively (Note 2)	10,186	12,389
Inventories	64,025	42,235
Deferred tax assets	39	2,059
Prepaid expenses and other current assets	16,379	18,632
Total current assets	265,912	277,422
PROPERTY AND EQUIPMENT, net	95,823	90,141
INTANGIBLE ASSETS, net	35,524	40,334
GOODWILL	80,599	80,599
DEFERRED TAX ASSETS (NOTE 8)	11,562	9,449
OTHER ASSETS	4,243	3,476
Total assets	$493,663	$501,421
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$21,980	$20,772
Accrued payroll and related expenses	9,071	8,900
Taxes payable	2,963	2,266
Deferred tax liabilities	2,193	943
Deferred income on sales to distributors	15,223	15,727
Other accrued liabilities	3,730	1,810
Total current liabilities	55,160	50,418
LONG-TERM INCOME TAXES PAYABLE (NOTE 8)	743	6,885
DEFERRED TAX LIABILITIES	4,272	5,273
OTHER LIABILITIES	2,812	2,159
Total liabilities	62,987	64,735
COMMITMENTS AND CONTINGENCIES (Notes 8, 9 and 10)		
STOCKHOLDERS' EQUITY:		
Common stock, $0.001 par value		
Authorized - 140,000,000 shares		
Outstanding - 29,208,468 and 30,021,943 shares in 2014 and 2013, respectively	29	30
Additional paid-in capital	171,938	223,660
Accumulated other comprehensive loss	(1,136)	(470)
Retained earnings	259,845	213,466
Total stockholders' equity	430,676	436,686
Total liabilities and stockholders' equity	$493,663	$501,421

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

POWER INTEGRATIONS, INC.
CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(In thousands, except per share amounts)

	Year Ended December 31,		
	2014	2013	2012
NET REVENUES	$348,797	$347,089	$305,370
COST OF REVENUES	159,227	163,853	154,868
GROSS PROFIT	189,570	183,236	150,502
OPERATING EXPENSES:			
Research and development	54,981	51,654	45,709
Sales and marketing	47,796	45,466	37,998
General and administrative	30,997	32,050	30,243
Charge related to SemiSouth (Note 12)	—	—	25,200
Total operating expenses	133,774	129,170	139,150
INCOME FROM OPERATIONS	55,796	54,066	11,352
OTHER INCOME (EXPENSE):			
Interest income	1,203	736	1,747
Interest expense	—	(23)	(2)
Charge related to SemiSouth (Note 12)	—	—	(33,745)
Other, net	(185)	648	(134)
Total other income (expense)	1,018	1,361	(32,134)
INCOME (LOSS) BEFORE INCOME TAXES	56,814	55,427	(20,782)
PROVISION FOR (BENEFIT FROM) INCOME TAXES	(2,730)	(1,839)	13,622
NET INCOME (LOSS)	$59,544	$57,266	$(34,404)
EARNINGS (LOSS) PER SHARE:			
Basic	$1.99	$1.95	$(1.20)
Diluted	$1.93	$1.88	$(1.20)
SHARES USED IN PER SHARE CALCULATION:			
Basic	29,976	29,421	28,636
Diluted	30,829	30,420	28,636

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

POWER INTEGRATIONS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Year Ended December 31,		
	2014	2013	2012
Net income (loss)	$ 59,544	$ 57,266	$ (34,404)
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments, net of $0 tax in 2014, 2013 and 2012	(79)	(29)	79
Unrealized gain (loss) on marketable securities, net of $0 tax in 2014, 2013 and 2012	(127)	72	138
Unrealized actuarial loss on pension benefits, net of tax of $128, $61 and $155 in 2014, 2013 and 2012, respectively (Note 13)	(460)	(220)	(560)
Total other comprehensive loss	(666)	(177)	(343)
Total comprehensive income (loss)	$ 58,878	$ 57,089	$ (34,747)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

POWER INTEGRATIONS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
BALANCE AT JANUARY 1, 2012	28,065	$28	$158,646	$50	$205,805	$364,529
Issuance of common stock under employee stock option and stock award plans	1,022	—	18,200	—	—	18,200
Repurchase of common stock	(676)	—	(20,467)	—	—	(20,467)
Issuance of common stock under employee stock purchase plan	125	—	3,752	—	—	3,752
Income tax benefits from employee stock plans	—	—	1,303	—	—	1,303
Stock-based compensation expense related to employee stock options and awards	—	—	13,092	—	—	13,092
Stock-based compensation expense related to employee stock purchases	—	—	1,142	—	—	1,142
Payment of dividends to stockholders	—	—	—	—	(5,755)	(5,755)
Unrealized actuarial loss on pension benefits (Note 13)	—	—	—	(560)	—	(560)
Unrealized gain on marketable securities	—	—	—	138	—	138
Foreign currency translation adjustment	—	—	—	79	—	79
Net loss	—	—	—	—	(34,404)	(34,404)
BALANCE AT DECEMBER 31, 2012	28,536	28	175,668	(293)	165,646	341,049
Issuance of common stock under employee stock option and stock award plans	1,358	2	26,267	—	—	26,269
Repurchase of common stock	—	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	128	—	3,971	—	—	3,971
Income tax benefits from employee stock plans	—	—	1,284	—	—	1,284
Stock-based compensation expense related to employee stock options and awards	—	—	15,275	—	—	15,275
Stock-based compensation expense related to employee stock purchases	—	—	1,195	—	—	1,195
Payment of dividends to stockholders	—	—	—	—	(9,446)	(9,446)
Unrealized actuarial loss on pension benefits (Note 13)	—	—	—	(220)	—	(220)
Unrealized gain on marketable securities	—	—	—	72	—	72
Foreign currency translation adjustment	—	—	—	(29)	—	(29)
Net income	—	—	—	—	57,266	57,266
BALANCE AT DECEMBER 31, 2013	30,022	30	223,660	(470)	213,466	436,686
Issuance of common stock under employee stock option and stock award plans	697	—	9,571	—	—	9,571

Repurchase of common stock	(1,603)	(1)	(80,760)	—	—	(80,761)
Issuance of common stock under employee stock purchase plan	92	—	4,284	—	—	4,284
Income tax benefits from employee stock plans	—	—	815	—	—	815
Stock-based compensation expense related to employee stock options and awards	—	—	12,983	—	—	12,983
Stock-based compensation expense related to employee stock purchases	—	—	1,385	—	—	1,385
Payment of dividends to stockholders	—	—	—	—	(13,165)	(13,165)
Unrealized actuarial loss on pension benefits (Note 13)	—	—	—	(460)	—	(460)
Unrealized loss on marketable securities	—	—	—	(127)	—	(127)
Foreign currency translation adjustment	—	—	—	(79)	—	(79)
Net income	—	—	—	—	59,544	59,544
BALANCE AT DECEMBER 31, 2014	29,208	$29	$171,938	$(1,136)	$259,845	$430,676

The accompanying notes are an integral part of these consolidated financial statements.

48

Table of Contents

POWER INTEGRATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31, 2014	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$59,544	$57,266	$(34,404)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	15,884	16,088	15,256
Amortization of intangibles	6,072	7,404	5,164
Charge related to SemiSouth (Note 12)	—	—	58,945
Loss (gain) on disposal of property and equipment	250	(131)	(1)
Gain on sale of asset held for sale	—	(497)	—
Stock-based compensation expense	14,282	16,485	14,224
Amortization of premium on marketable securities	1,694	789	850
Non-cash interest income from SemiSouth note	—	—	(1,445)
Deferred income taxes	157	(2,781)	2,017
Increase (reduction) in accounts receivable allowances	70	(127)	(24)
Excess tax benefit from employee stock plans	(437)	(734)	(704)
Tax benefit associated with employee stock plans	815	1,284	1,303
Change in operating assets and liabilities:			
Accounts receivable	2,133	(4,936)	5,313
Inventories	(21,703)	2,375	18,026
Prepaid expenses and other assets	8,211	(1,523)	(11,008)
Accounts payable	2,337	2,467	2,071
Taxes payable and accrued liabilities	(3,242)	1,065	(26,029)
Deferred income on sales to distributors	(505)	4,177	2,276
Net cash provided by operating activities	85,562	98,671	51,830
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(23,071)	(13,960)	(16,358)
Proceeds from sale of property and equipment	—	36	2
Proceeds from sale of assets held for sale	—	959	—
Other assets	(1,261)	—	—
Acquisition (Note 11)	—	—	(115,720)
Payment of guarantee of SemiSouth debt (Note 12)	—	—	(15,200)
Increase in financing lease receivables	—	—	(420)
Collections of financing lease receivables and other receivables	—	433	527
Loans to third parties (Notes 11 and 12)	(6,600)	—	(18,000)
Purchases of marketable securities	(45,269)	(109,482)	—
Proceeds from sales and maturities of marketable securities	38,052	31,350	40,463
Net cash used in investing activities	(38,149)	(90,664)	(124,706)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of common stock under employee stock plans	13,855	30,239	21,952

Table of Contents

	Year Ended December 31,		
Repurchase of common stock	(80,760)	—	(20,467)
Payments of dividends to stockholders	(13,165)	(9,446)	(5,755)
Excess tax benefit from employee stock plans	437	734	704
Net cash (used in) provided by financing activities	(79,633)	21,527	(3,566)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(32,220)	29,534	(76,442)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	92,928	63,394	139,836
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$60,708	$92,928	$63,394
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Unpaid property and equipment	$1,733	$2,862	$1,008
Fair value of SemiSouth purchase option (Note 12)	$—	$—	$6,216
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid (refund) for income taxes, net of refunds (Note 8)	$(3,121)	$(4,137)	$46,689

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE COMPANY:

Power Integrations, Inc. ("Power Integrations" or the "Company"), incorporated in California on March 25, 1988 and reincorporated in Delaware in December 1997, designs, develops, manufactures and markets analog and mixed-signal integrated circuits (ICs) and other electronic components and circuitry used in high-voltage power conversion. The Company's products are used in power converters that convert electricity from a high-voltage source (i.e., 48 volts or higher) to the type of power required for a specified downstream use. A large percentage of the Company's products are ICs used in AC-DC power supplies in a wide variety of end products, primarily in the consumer, communications, computer and industrial markets. The Company acquired CT-Concept Technologie AG ("Concept") in May 2012, and since then offers IGBT drivers used to operate arrays of high-voltage, high-power transistors known as IGBT modules, which are used for power conversion in high-power applications such as industrial motors, solar- and wind-power systems, electric vehicles and high-voltage DC transmission systems.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries after elimination of all intercompany transactions and balances.

Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition and allowances for receivables and inventories. These estimates are based on historical facts and various other factors, which the Company believes to be reasonable at the time the estimates are made. However, as the effects of future events cannot be determined with precision, actual results could differ significantly from management's estimates.

Cash and Cash Equivalents

The Company considers cash invested in highly liquid financial instruments with maturities of three months or less at the date of purchase to be cash equivalents.

Marketable Securities

The Company generally holds securities until maturity; however, they may be sold under certain circumstances including, but not limited to, when necessary for the funding of acquisitions and other strategic investments. As a result the Company classifies its investment portfolio as available-for-sale. The Company classifies all investments with an original maturity date greater than three months as short-term marketable securities in its Consolidated Balance Sheet. As of December 31, 2014, and December 31, 2013, the Company's marketable securities consisted primarily of corporate bonds and other high-quality commercial securities. The weighted average interest rate of investments at December 31, 2014 and 2013, was approximately 0.76% and 0.74%, respectively.

Amortized cost and estimated fair market value of investments classified as available-for-sale at December 31, 2014, were as follows (in thousands):

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Amortized Cost	Gross Unrealized Gains	Losses	Estimated Fair Market Value
Investments due in 4-12 months:				
Corporate securities	$30,233	$36	$—	$30,269
Total	30,233	36	—	30,269
Investments due between 12 months and 5-years:				
Corporate securities	84,259	92	(45)	84,306
Total	84,259	92	(45)	84,306
Total investment securities	$114,492	$128	$(45)	$114,575

Amortized cost and estimated fair market value of investments classified as available-for-sale at December 31, 2013, were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Losses	Estimated Fair Market Value
Investments due in less than 3 months:				
Commercial paper	$3,098	$1	$—	$3,099
Total	3,098	1	—	3,099
Investments due in 4-12 months:				
Corporate securities	6,007	33	—	6,040
Total	6,007	33	—	6,040
Investments due between 12 months and 5-years:				
Corporate securities	102,963	202	(26)	103,139
Total	102,963	202	(26)	103,139
Total investment securities	$112,068	$236	$(26)	$112,278

As of December 31, 2014, and 2013, there were no individual securities that had been in a continuous loss position for 12 months or longer.

Inventories

Inventories (which consist of costs associated with the purchases of wafers from domestic and offshore foundries and of packaged components from offshore assembly manufacturers, as well as internal labor and overhead associated with the testing of both wafers and packaged components) are stated at the lower of cost (first-in, first-out) or market. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values. Inventories consist of the following (in thousands):

	December 31, 2014	December 31, 2013
Raw materials	$21,127	$8,221
Work-in-process	14,643	13,216
Finished goods	28,255	20,798
Total	$64,025	$42,235

Additional Components of the Company's Consolidated Balance Sheet
Accounts Receivable (in thousands):

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2014	December 31, 2013
Accounts receivable trade	$38,344	$42,410
Accrued ship and debit and rebate claims	(27,967)	(29,901)
Allowance for doubtful accounts	(191)	(120)
Total	$10,186	$12,389

Prepaid Expenses and Other Current Assets (in thousands):

	December 31, 2014	December 31, 2013
Prepaid legal fees	$1,506	$6,267
Loan to Cambridge Semiconductor (Note 11)	6,600	—
Advance to suppliers	800	757
Prepaid income tax	3,208	7,521
Prepaid maintenance agreements	1,023	947
Interest receivable	664	519
Other	2,578	2,621
Total	$16,379	$18,632

Property and Equipment

Property and equipment consist of the following (in thousands):

	December 31, 2014	December 31, 2013
Land	$16,754	$16,754
Construction-in-progress	8,068	8,003
Building and improvements	44,794	43,641
Machinery and equipment	124,138	111,314
Computer software and hardware and office furniture and fixtures	37,867	34,327
	231,621	214,039
Accumulated depreciation	(135,798)	(123,898)
Total	$95,823	$90,141

Depreciation expense for property and equipment for fiscal years ended December 31, 2014, 2013 and 2012, was approximately $15.9 million, $16.1 million and $15.3 million, respectively, and was determined using the straight-line method over the following useful lives:

Building and improvements	4-40 years
Machinery and equipment	2-8 years
Computer software and hardware and office furniture and fixtures	4-5 years

Total property and equipment located in the United States at December 31, 2014, 2013 and 2012, was approximately $140 million, $134 million and $126 million, respectively. In 2014 13% of total property and equipment was held in Thailand

by one of the Company's sub-contractors. In 2013 and 2012, no more than 10% of total property and equipment was held in any foreign country.

Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income (loss) for three years ended December 31, 2014 (in thousands):

	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Foreign Currency Items	Total
Balance at January 1, 2012	$ —	$—	$50	$50
Other comprehensive income (loss) before reclassifications	138	(560)	79	(343)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	—	—
Other comprehensive income (loss)	138	(560)	79	(343)
Balance at December 31, 2012	138	(560)	129	(293)
Other comprehensive income (loss) before reclassifications	72	(277)	(29)	(234)
Amounts reclassified from accumulated other comprehensive income (loss)	—	57 (1)	—	57
Other comprehensive income (loss)	72	(220)	(29)	(177)
Balance at December 31, 2013	210	(780)	100	(470)
Other comprehensive income (loss) before reclassifications	(127)	(538)	(79)	(744)
Amounts reclassified from accumulated other comprehensive income (loss)	—	78 (1)	—	78
Other comprehensive income (loss)	(127)	(460)	(79)	(666)
Balance at December 31, 2014	$ 83	$(1,240)	$21	$(1,136)

(1) This component of accumulated other comprehensive income is included in the computation of net periodic pension cost for the years ended December 31, 2014 and December 31, 2013.

Business Combinations

The purchase price of an acquisition is allocated to the underlying assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. To the extent the purchase price exceeds the fair value of the net identifiable tangible and intangible assets acquired and liabilities assumed, such excess is allocated to goodwill. The Company determines the estimated fair values after review and consideration of relevant information, including discounted cash flows, quoted market prices and estimates made by management. The Company adjusts the preliminary purchase price allocation, as necessary, during the measurement period of up to one year after the acquisition closing date as it obtains more information as to facts and circumstances existing at the acquisition date impacting asset valuations and liabilities assumed. Acquisition-related costs are recognized separately from the acquisition and are expensed as incurred.

Goodwill and Intangible Assets

Goodwill and the Company's domain name are evaluated in accordance with Accounting Standards Codification, or ASC, 350-10, Goodwill and Other Intangible Assets, and an impairment analysis is conducted on an annual basis, or sooner if indicators exist for a potential impairment.

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In accordance with ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Assets, long-lived assets, such as property and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Employee Benefits Plan

The Company sponsors a 401(k) tax-deferred savings plan for all employees in the United States who meet certain eligibility requirements. Participants may contribute up to the amount allowable as a deduction for federal income tax purposes. The Company is not required to contribute; however, from time-to-time the Company will contribute a certain percentage of employee annual salaries on a discretionary basis, not to exceed an established threshold. In 2014 and 2013 the Company provided for a contribution of approximately $1.1 million and $1.1 million, respectively. No employee 401(k) contribution was provided for in 2012.

Retirement Benefit Obligations (Pension)

The Company recognizes the overfunded or underfunded status of a defined benefit pension or postretirement plan as an asset or liability in the accompanying consolidated balance sheets. Actuarial gains and losses are recorded in accumulated other comprehensive income (loss), a component of stockholders’ equity, and are amortized as a component of net periodic cost over the remaining estimated service period of participants.

Revenue Recognition

Product revenues consist of sales to original equipment manufacturers (“OEMs”), merchant power supply manufacturers and distributors. Approximately 75% of the Company's net product sales were made to distributors in 2014. The Company applies the provisions of Accounting Standard Codification (“ASC”) 605-10 (“ASC 605-10”) and all related appropriate guidance. Revenue is recognized when all of the following criteria have been met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the price is fixed or determinable, and (4) collectability is reasonably assured. Customer purchase orders are generally used to determine the existence of an arrangement. Delivery is considered to have occurred when title and risk of loss have transferred to the Company's customer. The Company evaluates whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. With respect to collectability, the Company performs credit checks for new customers and performs ongoing evaluations of its existing customers' financial condition and requires letters of credit whenever deemed necessary.

Sales to international OEMs and merchant power supply manufacturers for shipments from the Company's facility outside of the United States are pursuant to “EX Works” ("EXW") shipping terms, meaning that title to the product transfers to the customer upon shipment from the Company's foreign warehouse. Sales to international OEM customers and merchant power supply manufacturers that are shipped from the Company's facility in California are pursuant to “delivered at frontier” (“DAF”) shipping terms. As such, title to the product passes to the customer when the shipment reaches the destination country and revenue is recognized upon the arrival of the product in that country. Shipments to OEMs and merchant power supply manufacturers in the Americas are pursuant to “free on board” (“FOB”) point of origin shipping terms meaning that title is passed to the customer upon shipment. Revenue is recognized upon title transfer for sales to OEMs and merchant power supply manufacturers, assuming all other criteria for revenue recognition are met.

Sales to most of the Company's distributors are made under terms allowing certain price adjustments and rights of return on the Company's products held by its distributors. As a result of these rights, the Company defers the recognition of revenue and the costs of revenues derived from these sales until the Company's distributors report that they have sold the Company's products to their customers. The Company's recognition of such distributor revenue is based on point of sale reports received from the distributors, at which time the price is no longer subject to adjustment and is fixed, and the products are no longer subject to return to the Company except pursuant to warranty terms. The gross profit that is deferred as a result of this policy is reflected as “deferred income on sales to distributors” in the accompanying consolidated balance sheets. The total deferred revenue as of December 31, 2014, and December 31, 2013, was approximately $25.0 million and $25.5 million, respectively. The total deferred cost as of December 31, 2014, and December 31, 2013, was approximately $9.8 million and $9.8 million, respectively.

Frequently, distributors need to sell at a price lower than the standard distribution price in order to win business. At or soon after the distributor invoices its customer, the distributor submits a “ship and debit” price adjustment claim to the Company to adjust the distributor's cost from the standard price to the pre-approved lower price. After verification by the Company, a credit memo is issued to the distributor for the ship and debit claim. The Company maintains a reserve for unprocessed claims and future ship and debit price adjustments. The reserves appear as a reduction to accounts receivable and deferred income on sales to distributors in the Company's accompanying consolidated balance sheets. To the extent future ship and debit claims significantly exceed amounts estimated, there could be a material impact on the deferred revenue and deferred margin ultimately recognized. To evaluate the adequacy of its reserves, the Company analyzes historical ship and debit payments and levels of inventory in the distributor channels.

Sales to certain distributors of the Company are made under terms that do not include rights of return or price concessions after the product is shipped to the distributor. Accordingly, product revenue is recognized upon shipment and title transfer assuming all other revenue recognition criteria are met.

Foreign Currency Risk and Foreign Currency Translation

As of December 31, 2014, the Company's primary transactional currency was in U.S. dollars; in addition, the Company holds cash in Swiss francs and Euros as a result of its acquisition of Concept. The Company completed the acquisition of Concept, which is located in Biel, Switzerland, in the second quarter of 2012. Included in the assets acquired was cash denominated in Swiss francs and Euros, which will be used to fund operations of the Company's Swiss subsidiary. The functional currency of the Company's Swiss subsidiary is the U.S. dollar.

Gains and losses arising from the remeasurement of non-functional currency balances are recorded in "other income (expense)" in the accompanying consolidated statements of income (loss). For the years ended December 31, 2014, 2013 and 2012 the Company realized foreign exchange transaction gains (losses) of $0.1 million, $(0.1) million and $(0.6) million, respectively.

The functional currencies of the Company's other subsidiaries are the local currencies. Accordingly, all assets and liabilities are translated into U.S. dollars at the current exchange rates as of the applicable balance sheet date. Revenues and expenses are translated at the average exchange rate prevailing during the period. Cumulative gains and losses from the translation of the foreign subsidiaries' financial statements have been included in stockholders' equity.

Warranty

The Company generally warrants that its products will substantially conform to the published specifications for 12 months from the date of shipment. The Company's liability is limited to either a credit equal to the purchase price or replacement of the defective part. Returns under warranty have historically been immaterial, and as a result, the Company does not record a specific warranty reserve.

Advertising

Advertising costs are expensed as incurred. Advertising costs amounted to $1.5 million, $1.4 million, and $1.1 million, in 2014, 2013 and 2012, respectively.

Research and Development

Research and development costs are expensed as incurred.

Income Taxes

Income tax expense is an estimate of current income taxes payable or refundable in the current fiscal year based on reported income before income taxes. Deferred income taxes reflect the effect of temporary differences and carry-forwards that are recognized for financial reporting and income tax purposes.

The Company accounts for income taxes under the provisions of ASC 740. Under the provisions of ASC 740, deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, utilizing the tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company recognizes valuation allowances to reduce any deferred tax assets to the amount that it estimates will more likely than not be realized based on available evidence and management's judgment. The Company limits the deferred tax assets recognized related to certain officers' compensation to amounts that it estimates will be deductible in future periods based upon Internal Revenue Code Section 162(m). In the event that the Company determines, based on available evidence and management judgment, that all or part of the net deferred tax assets will not be realized in the future, it would record a valuation allowance in the period the determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with the Company's expectations could have a material impact on the Company's results of operations and financial position.

The Company engages in qualifying activities for R&D credit purposes. The Tax Increase Prevention Act of 2014 was signed into law on December 19, 2014, to extend the federal research and development credit for 2014.

During 2014, the Company settled with the IRS and closed out the examination of its income tax returns for the years 2007 through 2009. The resolution of the audit resulted in a federal tax benefit to the Company of $2.8 million; the Company also recorded a state tax benefit of approximately $0.5 million. The agreement with IRS also allowed the Company to repatriate $5.0 million from its foreign subsidiary without incurring additional U.S. income taxes.

Common Stock Repurchases and Common Stock Dividend

In October 2012, the Company's board of directors authorized the use of $50.0 million for the repurchase of its common stock, with repurchases to be executed according to certain pre-defined price/volume guidelines set by the board of directors. As of December 31, 2012, the Company purchased 0.7 million shares for approximately $20.5 million. No shares were purchased during the twelve months ended December 31, 2013, as the stock price levels exceeded the pre-defined price guidelines mentioned above. In 2014 the Company's board of directors authorized the use of an additional $75.0 million for this purpose. In the twelve months ended December 31, 2014, the Company purchased 1.6 million shares for $80.8 million. As of December 31, 2014, the Company had $23.7 million available for future stock repurchases. Authorization of future stock repurchase programs is at the discretion of the board of directors and will depend on the Company's financial condition, results of operations, capital requirements, business conditions as well as other factors.

In January 2012, the Company's board of directors declared four quarterly cash dividends in the amount of $0.05 per share to be paid to stockholders of record at the end of each quarter in 2012. The quarterly dividend payments were each in the aggregate amount of approximately $1.4 million to stockholders of record. In January 2013, the Company's board of directors declared four quarterly cash dividends in the amount of $0.08 per share paid to stockholders of record at the end of each quarter in 2013. Payouts of approximately $2.3 million each were paid on March 29, 2013, and June 28, 2013, and approximately $2.4 million was paid on September 30, 2013, and December

31, 2013, respectively.

In October 2013, the Company's board of directors declared four quarterly cash dividends in the amount of $0.10 per share to be paid to stockholders of record at the end of each quarter in 2014. Dividend payouts totaling approximately $3.0 million each were paid on March 31, 2014, and June 30, 2014. In April 2014, the Company's board of directors increased the quarterly dividends for the third and fourth quarters of 2014 to $0.12 per share. Dividend payouts totaling approximately $3.6 million and $3.5 million were paid on September 30, 2014, and December 31, 2014, respectively.

In January 2015, the Company's board of directors extended the $0.12 quarterly dividend through each quarter in 2015. The declaration of any future cash dividend is at the discretion of the board of directors and will depend on the

Company's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination that cash dividends are in the best interest of the Company's stockholders.

Indemnifications

The Company sells products to its distributors under contracts, collectively referred to as Distributor Sales Agreements (“DSA”). Each DSA contains the relevant terms of the contractual arrangement with the distributor, and generally includes certain provisions for indemnifying the distributor against losses, expenses, and liabilities from damages that may be awarded against the distributor in the event the Company's products are found to infringe upon a patent, copyright, trademark, or other proprietary right of a third party (“Customer Indemnification”). The DSA generally limits the scope of and remedies for the Customer Indemnification obligations in a variety of industry-standard respects, including, but not limited to, limitations based on time and geography, and a right to replace an infringing product. The Company also, from time to time, has granted a specific indemnification right to individual customers.

The Company believes its internal development processes and other policies and practices limit its exposure related to such indemnifications. In addition, the Company requires its employees to sign a proprietary information and inventions agreement, which assigns the rights to its employees' development work to the Company. To date, the Company has not had to reimburse any of its distributors or customers for any losses related to these indemnifications and no material claims were outstanding as of December 31, 2014. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases, the Company cannot determine the maximum amount of potential future payments, if any, related to such indemnifications.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") amended the existing accounting standards for revenue recognition, ASU 2014-09, Revenue from Contracts with Customers. The amendments are based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company is required to adopt the amendments in the first quarter of 2017. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently evaluating the impact of these amendments and the transition alternatives on its consolidated financial statements.

3. STOCK PLANS AND SHARE BASED COMPENSATION:

Stock Plans
As of December 31, 2014, the Company had two stock-based compensation plans (the “Plans”) which are described below.

2007 Equity Incentive Plan

The 2007 Equity Incentive Plan (the "2007 Plan") was adopted by the board of directors on September 10, 2007 and approved by the stockholders on November 7, 2007 as an amendment and restatement of the 1997 Stock Option Plan (the "1997 Plan"). The 2007 Plan provides for the grant of incentive stock options, nonstatutory stock options, restricted stock awards, restricted stock unit awards ("RSUs"), stock appreciation rights, performance stock unit awards ("PSU") and other stock awards to employees, directors and consultants. As of December 31, 2014, the maximum remaining number of shares that may be issued under the 2007 Plan was 6.5 million shares, which includes options issued but not exercised and awards granted but unvested and shares remaining available for issuance under the 1997 Plan, including shares subject to outstanding options and stock awards under the 1997 Plan. Pursuant to the 2007 Plan, the exercise price for incentive stock options and nonstatutory stock options is generally at least 100% of the fair market value of the underlying shares on the date of grant. Options generally vest over 48 months measured from the date of grant. Options generally expire no later than ten years after the date of grant, subject to earlier termination upon an optionee's cessation of employment or service.

Beginning January 27, 2009, grants pursuant to the Directors Equity Compensation Program (which was adopted by the board of directors on January 27, 2009) to non-employee directors have been made primarily under the 2007 Plan. The Directors Equity Compensation Program, provides for grants to outside directors as follows: effective annually, upon the first trading day of July, each outside director would receive a grant of an equity award with an aggregate value of $100,000. At each outside director's election, such award would consist entirely of RSUs or entirely of stock options. The quantity of options would be calculated by dividing $100,000 by the Black-Scholes value on the date of grant. The quantity of RSUs issued would be calculated by dividing $100,000 by the grant date fair value. Further, on the date of election of a new outside director, such new director would receive such grant as continuing outside directors receive on the first trading day of July; provided, however, that such grant is prorated for the portion of the year that such new outside director will serve until the next first trading day of July. The Directors Equity Compensation Program will remain in effect at the discretion of the board of directors or the compensation committee.

On July 28, 2009, the 2007 Plan was amended generally to prohibit outstanding options or stock appreciation rights from being canceled in exchange for cash without stockholder approval.

1997 Employee Stock Purchase Plan

Under the 1997 Employee Stock Purchase Plan (the “Purchase Plan”), eligible employees may apply accumulated payroll deductions, which may not exceed 15% of an employee's compensation, to the purchase of shares of the Company's common stock at periodic intervals. The purchase price of stock under the Purchase Plan is equal to 85% of the lower of (i) the fair market value of the Company's common stock on the first day of each offering period, or (ii) the fair market value of the Company's common stock on the purchase date (as defined in the Purchase Plan). Each offering period consists of one purchase period of approximately six months duration. An aggregate of 3.0 million shares of common stock were reserved for issuance to employees under the Purchase Plan. As of December 31, 2014, of the shares reserved for issuance, 2.7 million shares had been purchased and 0.3 million shares were reserved for future issuance under the Purchase Plan.

Stock-Based Compensation

The Company applies the provisions of ASC 718-10. Under the provisions of ASC 718-10, the Company recognizes the fair value of stock-based compensation in financial statements over the requisite service period of the individual grants, which generally equals a four-year vesting period. The Company uses estimates of volatility, expected term, risk-free interest rate, dividend yield and forfeitures in determining the fair value of these awards and the amount of compensation expense to recognize. The Company uses the straight-line method to amortize all stock awards granted over the requisite service period of the award.

Determining Fair Value of Stock Options

The Company uses the Black-Scholes valuation model for valuing stock option grants using the following assumptions and estimates:

Expected Volatility. The Company calculates expected volatility based on the historical price volatility of the Company's stock.

Expected Term. The Company utilizes a model which uses historical exercise, cancellation and outstanding option data to calculate the expected term of stock option grants.

Risk-Free Interest Rate. The Company bases the risk-free interest rate used in the Black-Scholes valuation model on the implied yield available on a U.S. Treasury note with a term approximately equal to the expected term of the underlying grants.

Dividend Yield. The dividend yield was calculated by dividing the annual dividend by the average closing price of the Company's common stock on a quarterly basis.

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Estimated Forfeitures. The Company uses historical data to estimate pre-vesting forfeitures, and records share-based compensation expense only for those awards that are expected to vest.

The following table summarizes the stock-based compensation expense recognized in accordance with ASC 718-10 for the twelve months ended December 31, 2014, 2013 and 2012 (in thousands).

	Year Ended December 31,		
	2014	2013	2012
Cost of revenues	$ 879	$ 1,074	$ 1,058
Research and development	4,784	5,746	5,503
Sales and marketing	3,540	3,642	3,317
General and administrative	5,079	6,023	4,346
Total stock-based compensation expense	$ 14,282	$ 16,485	$ 14,224

The following table summarizes total compensation expense related to unvested awards not yet recognized, net of expected forfeitures, and the weighted average period over which it is expected to be recognized as of December 31, 2014.

	December 31, 2014	
	Unrecognized Compensation Expense for Unvested Awards	Weighted Average Remaining Recognition Period
	(In thousands)	(In years)
Options	$ 786	1.1
Long-term performance-based awards	1,255	2.0
Restricted stock units	20,285	2.3
Purchase plan	144	0.5
Total unrecognized compensation expense	$ 22,470	

Stock compensation expense in the twelve months ended December 31, 2014, was approximately $14.3 million (comprising approximately $1.2 million related to stock options, $0.5 million related to long-term performance-based awards, $11.3 million related to restricted stock units and $1.3 million related to the Company's Purchase Plan).

Stock compensation expense in the twelve months ended December 31, 2013, was approximately $16.5 million (comprising approximately $2.3 million related to stock options, $3.2 million related to performance-based awards, $9.8 million related to restricted stock units and $1.2 million related to the Company's Purchase Plan).

Stock compensation expense in the twelve months ended December 31, 2012, was approximately $14.2 million (comprising approximately $4.0 million related to stock options, $2.1 million related to performance-based awards, $7.0 million related to restricted stock units and $1.1 million related to the Company's Purchase Plan).

The fair value of stock options granted is established on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used during the three years ended December 31, 2014, 2013 and 2012:

	2014*	2013*	2012
Risk-free interest rates	—%	—%	0.87% - 1.01%

Expected volatility rates	—%	—%	45%
Expected dividend yield	—%	—%	0.51% - 0.57%
Expected term of stock options (in years)	0.0	0.0	6.4
Weighted-average grant date fair value of options granted	$0.00	$0.00	$18.20

60

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

____
*The Company did not grant stock options in the years ended December 31, 2014 and 2013, and therefore no fair-value assumptions were reported for those periods.

The fair value of employees' stock purchase rights under the Purchase Plan was estimated using the Black-Scholes model with the following weighted-average assumptions used during the three years ended December 31, 2014, 2013 and 2012:

	2014	2013	2012
Risk-free interest rates	0.05% - 0.07%	0.08% - 0.11%	0.09% - 0.14%
Expected volatility rates	30% - 48%	33% - 37%	34% - 48%
Expected dividend yield	0.66% - 0.85%	0.62% - 0.80%	0.54% - 0.57%
Expected term of purchase right (years)	0.5	0.5	0.5
Weighted-average estimated fair value of purchase rights	$14.40	$11.01	$9.40

A summary of stock option activity under the Plans, excluding performance-based shares and restricted stock units, as of December 31, 2014, and changes during three years then ended, is presented below:

	Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2012	3,557	$24.01		
Granted	135	$42.66		
Exercised	(870)	$20.48		
Forfeited or expired	(5)	$21.10		
Outstanding at December 31, 2012	2,817	$26.00		
Granted	—	$—		
Exercised	(1,108)	$23.72		
Forfeited or expired	(18)	$39.70		
Outstanding at December 31, 2013	1,691	$27.34		
Granted	—	$—		
Exercised	(347)	$27.64		
Forfeited or expired	—	$—		
Outstanding at December 31, 2014	1,344	$27.27	3.56	$32,905
Exercisable at December 31, 2014	1,292	$26.69	3.42	$32,366
Vested and expected to vest at December 31, 2014	1,343	$27.25	3.56	$32,889

The total intrinsic value of options exercised during the twelve months ended December 31, 2014, 2013 and 2012, was $9.9 million, $26.5 million and $14.5 million, respectively.

The following table summarizes the stock options outstanding at December 31, 2014:

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Options Outstanding				Options Vested and Exercisable	
Exercise Price	Number Outstanding (in thousands)	Weighted Average Remaining Contractual Term (in years)	Weighted Average Exercise Price	Number Vested (in thousands)	Weighted Average Exercise Price
\$17.18 - \$21.00	124	3.08	\$19.08	124	\$19.08
\$21.14 - \$21.14	268	4.31	\$21.14	268	\$21.14
\$22.18 - \$24.21	93	2.45	\$23.68	93	\$23.68
\$25.25 - \$25.25	243	2.62	\$25.25	243	\$25.25
\$25.48 - \$26.49	40	2.02	\$25.73	40	\$25.73
\$26.75 - \$26.75	212	1.10	\$26.75	212	\$26.75
\$26.86 - \$36.95	150	4.85	\$33.10	140	\$32.89
\$37.96 - \$38.07	85	5.29	\$38.06	85	\$38.06
\$39.49 - \$39.49	48	6.50	\$39.49	48	\$39.49
\$42.88 - \$42.88	81	7.20	\$42.88	39	\$42.88
\$17.18 - \$42.88	1,344	3.56	\$27.27	1,292	\$26.69

Performance-based Awards

Under the performance-based awards program, the Company grants awards in the first half of the performance year in an amount equal to twice the target number of shares to be issued if the target performance metrics are met. The number of shares that are released at the end of the performance year can range from zero to 200% of the targeted number depending on the Company's performance. The performance metrics of this program are annual targets consisting of net revenue, non-GAAP operating earnings and strategic goals. Each performance-based award share granted from the 2007 Plan will reduce the number of shares available for issuance under the 2007 Plan by 2.0 shares.

During the twelve months ended December 31, 2014, the Company issued approximately 83,000 performance-based awards to employees and executives. As the net revenue and non-GAAP operating income are considered performance conditions, expense associated with these awards, net of estimated forfeitures is recognized over the service period based on an assessment of the achievement of the performance targets. The fair value of these performance-based awards is determined using the fair value of the Company's common stock on the date of the grant, reduced by the discounted present value of dividends expected to be declared before the awards vest. If the performance conditions are not achieved, no compensation cost is recognized and any previously recognized compensation is reversed. The Company's net revenue and non-GAAP operating income performance targets were not met in 2014, and therefore the 2014 performance-based awards were canceled, and no related expense was recognized in the twelve months ended December 31, 2014.

A portion of the 2013 performance-based awards issued to employees and executives vested in the first quarter of 2014. In January 2014, it was determined that approximately 83,000 shares of the approximately 102,000 performance-based awards granted in 2013 vested in aggregate under the revenue, non-GAAP operating income and strategic goals performance conditions for such awards. Accordingly, 83,000 performance-based awards were released to the Company's employees and executives in the first quarter of 2014.

A summary of performance-based awards outstanding as of December 31, 2014, and activity during the three years then ended, is presented below:

	Shares (in thousands)	Weighted-Average Grant Date Fair Value Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2012	—	$—		
Granted	102	$37.60		
Vested	—	$—		
Forfeited or canceled	—	$—		
Outstanding at December 31, 2012	102	$37.60		
Granted	102	$38.68		
Vested	(54)	$37.60		
Change in units due to performance achievement for PSUs not earned	(48)	$37.60		
Forfeited or canceled	(2)	$41.79		
Outstanding at December 31, 2013	100	$38.48		
Granted	83	$53.93		
Vested	(83)	$38.48		
Change in units due to performance achievement for PSUs not earned	(17)	$38.48		
Forfeited or canceled	(83)	$53.93		
Outstanding at December 31, 2014	—	$—	0	$—
Outstanding and expected to vest at December 31, 2014	—		0	$—

The weighted-average grant-date fair value per share of performance-based awards granted in the years ended December 31, 2014, 2013 and 2012, was approximately $53.93, $38.68 and $37.60, respectively. The grant date fair value of awards released, which were fully vested, in the years ended December 31, 2014 and 2013, was approximately $3.2 million and $2.0 million, respectively. There were no performance-based awards released in year ended December 31, 2012.

Long-Term Performance-based Units ("PRSUs")

In the first quarter of 2014 the Company began granting long-term performance-based awards. The Company's PRSU program provides for the issuance of PRSUs which will vest based on Company performance measured against the 2014 PRSU Plan's established 2016 revenue target. The PRSUs were granted in an amount equal to twice the target number of shares to be issued if the target performance metric is met. The actual number of shares the recipient receives is determined at the end of a three-year performance period based on results achieved versus the Company's performance goal, and may range from zero to 200% of the targeted number. The performance goal for PRSUs granted in fiscal 2014 was based on the Company's adjusted annual revenue growth. Each long-term performance-based award granted from the 2007 Plan will reduce the number of shares available for issuance under the 2007 Plan by 2 shares.

Recipients of a PRSU award generally must remain employed by the Company on a continuous basis through the end of the applicable three-year performance period in order to receive shares subject to that award. Expenses associated with these awards, net of estimated forfeitures, are recorded throughout the year depending on the number of shares expected to vest based on progress toward the performance target. The cost of long-term performance-based awards is determined using the fair value of the Company's common stock on the grant date, reduced by the discounted present value of dividends expected to be declared before the awards vest. If the performance conditions are not achieved, no compensation cost is recognized and any previously recognized compensation is reversed.

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of long-term performance-based awards outstanding as of December 31, 2014, and activity during the year then ended, is presented below:

	Shares (in thousands)	Weighted-Average Grant Date Fair Value Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2013	—	$—		
Granted	61	$55.51		
Vested	—	$—		
Forfeited or canceled	—	$—		
Outstanding at December 31, 2014	61	$55.51	2.0	$3,161
Outstanding and expected to vest at December 31, 2014	37		2.0	$1,928

Restricted Stock Units (RSUs)

The Company grants restricted stock units to employees under the 2007 Plan. RSUs granted to employees typically vest ratably over a four-year period, and are converted into shares of the Company's common stock upon vesting on a one-for-one basis subject to the employee's continued service to the Company over that period. The fair value of RSUs is determined using the fair value of the Company's common stock on the date of the grant, reduced by the discounted present value of dividends expected to be declared before the awards vest. Compensation expense is recognized on a straight-line basis over the requisite service period of each grant adjusted for estimated forfeitures. Each RSU award granted from the 2007 plan will reduce the number of shares available for issuance under the 2007 Plan by 2 shares.
A summary of RSUs outstanding as of December 31, 2014, and activity during the three years then ended, is as follows:

	Shares (in thousands)	Weighted-Average Grant Date Fair Value Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2012	458	$36.08		
Granted	293	$41.06		
Vested	(152)	$36.48		
Forfeited	(26)	$36.92		
Outstanding at December 31, 2012	573	$38.21		
Granted	386	$39.09		
Vested	(195)	$37.92		
Forfeited	(50)	$39.50		
Outstanding at December 31, 2013	714	$38.97		
Granted	281	$51.12		
Vested	(267)	$38.57		
Forfeited	(36)	$42.74		
Outstanding at December 31, 2014	692	$43.86	1.28	$35,821

Outstanding and expected to vest at December 31, 2014	645	1.22	$33,364

The weighted-average grant-date fair value per share of RSUs awarded in the years ended December 31, 2014, 2013 and 2012, was approximately $51.12, $39.09 and $41.06, respectively. The grant date fair value of awards vested in the years ended December 31, 2014, 2013 and 2012, was approximately $10.3 million, $7.4 million and $5.5 million, respectively.

Shares Reserved

As of December 31, 2014, the Company had approximately 3.3 million shares of common stock reserved for future issuance under stock option and stock purchase plans.

4. FAIR VALUE MEASUREMENTS:

ASC 820-10, Fair Value Measurements, clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. 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. As a basis for considering such assumptions, ASC 820-10 establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices for identical assets in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

The Company's cash and investment instruments are classified within Level 1 or Level 2 of the fair-value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The type of instrument valued based on quoted market prices in active markets primarily includes money market securities. This type of instrument is generally classified within Level 1 of the fair-value hierarchy. The types of instruments valued based on other observable inputs (Level 2 of the fair-value hierarchy) include investment-grade corporate bonds and government, state, municipal and provincial obligations. Such types of investments are valued by using a multi-dimensional relational model, the inputs are primarily benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications.

The Company principally holds securities until maturity; however, they may be sold under certain circumstances, including, but not limited to, the funding of acquisitions and other strategic investments. Accordingly, the Company classified its investment portfolio as available-for-sale as of December 31, 2014 and December 31, 2013.

The fair value hierarchy of the Company's short-term marketable securities at December 31, 2014, and December 31, 2013, was as follows (in thousands):

	Fair Value Measurement at December 31, 2014		
Description	December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Money market funds	$3,370	$3,370	$—
Corporate securities	114,575	—	114,575
Total	$117,945	$3,370	$114,575

	Fair Value Measurement at December 31, 2013		
Description	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level	Significant Other Observable Inputs (Level 2)

		1)	
Commercial paper	$3,099	$—	$3,099
Money market funds	17,492	17,492	—
Corporate securities	109,179	—	109,179
Total	$129,770	$17,492	$112,278

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company did not transfer any investments between level 1 and level 2 of the fair value hierarchy in the twelve months ended December 31, 2014, and December 31, 2013.

5. GOODWILL AND INTANGIBLE ASSETS:

There were no changes in the carrying amount of goodwill during the twelve months ended December 31, 2014, and December 31, 2013.

Intangible assets consist primarily of developed technology, acquired licenses, customer relationships, trade name, domain name, in-process research and development and patent rights, and are reported net of accumulated amortization. The Company amortizes the cost of all intangible assets over the shorter of the estimated useful life or the term of the developed technology, acquired licenses, customer relationships, trade name and patent rights, which range from two to 12 years, with the exception of $4.7 million of in-process research and development and $1.3 million to acquire an internet domain name. In-process research and development is assessed for impairment until the development is completed and products are available for sale, at which time the Company will begin to amortize the in-process research and development. The Company does not expect the amortization of in-process research and development to begin in 2015. The Company acquired the rights to the internet domain name www.power.com, which is now the Company's primary domain name; the cost to acquire the domain name has been recorded as an intangible asset and will not be amortized as it has an indefinite useful life. Amortization for acquired intangible assets was approximately $6.1 million, $7.4 million and $5.2 million in the years ended December 31, 2014, 2013 and 2012, respectively. The Company does not believe there is any significant residual value associated with the following intangible assets:

	December 31, 2014			December 31, 2013		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
	(in thousands)					
Domain name	$1,261	$—	$1,261	$—	$—	$—
In-process research and development	4,690	—	4,690	4,690	—	4,690
Technology licenses	3,000	(2,625)	375	3,000	(2,325)	675
Patent rights	1,949	(1,949)	—	1,949	(1,949)	—
Developed technology	26,670	(7,828)	18,842	26,670	(5,247)	21,423
Customer relationships	17,610	(7,254)	10,356	17,610	(4,664)	12,946
Trade name	3,600	(3,600)	—	3,600	(3,000)	600
Total intangible assets	$58,780	$(23,256)	$35,524	$57,519	$(17,185)	$40,334

The estimated future amortization expense related to definite-lived intangible assets at December 31, 2014, is as follows:

Fiscal Year	Estimated Amortization (in thousands)
2015	$5,009
2016	4,394
2017	3,994
2018	3,746
2019	3,424

Thereafter	9,006
Total (1)	$29,573

(1) The total above excludes $4.7 million of in-process research and development which will be amortized upon completion of development over the estimated useful life of the technology.

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. SIGNIFICANT CUSTOMERS AND INTERNATIONAL SALES:

Segment Reporting

The Company is organized and operates as one reportable segment, the design, development, manufacture and marketing of analog and mixed-signal ICs and other electronic components and circuitry used in high-voltage power conversion. The Company's chief operating decision maker, the chief executive officer, reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance.

Product Sales

Net revenues consist primarily of sales of the Company's high-voltage integrated-circuit products, IGBT drivers and high-voltage silicon diodes. When evaluating the Company's net revenues, the Company categorizes its sales into the following four major end markets served; communications, computer, consumer and industrial electronics. The table below provides the percentage of net sales activity by end markets served on a comparative basis for all periods:

	Year Ended December 31,					
End Market	2014		2013		2012	
Communications	18	%	21	%	24	%
Computer	10	%	10	%	12	%
Consumer	37	%	35	%	36	%
Industrial electronics	35	%	34	%	28	%

Customer Concentration
Ten customers accounted for approximately 59%, 59% and 64% of net revenues for the years ended December 31, 2014, 2013 and 2012, respectively. A significant portion of these revenues are attributable to sales of the Company’s products to distributors of electronic components. These distributors sell the Company’s products to a broad, diverse range of end users, including OEMs and merchant power supply manufacturers.

The following customers each accounted for 10% or more of total net revenues:

	Year Ended December 31,					
Customer	2014		2013		2012	
Avnet	19	%	19	%	20	%
ATM Electronic Corporation	*		*		12	%

* Total customer revenue was less than 10% of net revenues

Avnet and ATM Electronic Corporation are distributors of the Company's products. No other customers accounted for 10% or more of the Company's net revenues in those periods.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consisted principally of cash investments and trade receivables. The Company has cash investment policies that limit cash investments to low-risk investments. With respect to trade receivables, the Company performs ongoing evaluations of its customers' financial conditions and requires letters of credit whenever deemed necessary. Additionally, the Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends related to past write-offs and other relevant information. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its customers. Financial instruments that potentially subject the Company to concentrations of credit risk

consist principally of cash investments and trade receivables. As of December 31, 2014, and December 31, 2013, 66% and 71%, respectively, of accounts receivable were concentrated with the Company's top 10 customers.
The following customers each represented 10% or more of accounts receivable:

Customer	December 31, 2014		December 31, 2013	
Avnet	22	%	21	%
ATM Electronic Corporation	*		17	%
Burnon International Ltd.	11	%	*	

* Total customer accounts receivable was less than 10%
Avnet, ATM Electronic Corporation and Burnon International Ltd. are distributors of the Company’s products. No other customers accounted for 10% or more of the Company’s accounts receivable in these periods.

International Sales

The Company markets its products globally through its sales personnel and a worldwide network of independent sales representatives and distributors. As a percentage of total net revenues, international sales, which consist of sales to distributors and direct customers outside of the United States of America, comprise the following:

	Year Ended December 31,					
	2014		2013		2012	
Hong Kong/China	47	%	47	%	45	%
Taiwan	15	%	15	%	17	%
Korea	11	%	11	%	12	%
Western Europe (excluding Germany)	11	%	11	%	10	%
Japan	5	%	5	%	6	%
Singapore	1	%	2	%	2	%
Germany	2	%	2	%	1	%
Other	3	%	2	%	2	%
Total foreign revenue	95	%	95	%	95	%

The remainder of the Company’s sales is to customers within the United States of America.

7. EARNINGS PER SHARE:

Basic earnings (loss) per share are calculated by dividing net income (loss) by the weighted-average shares of common stock outstanding during the period. Diluted earnings (loss) per share are calculated by dividing net income (loss) by the weighted-average shares of common stock and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares included in this calculation consist of dilutive shares issuable upon the assumed exercise of outstanding common stock options, the assumed vesting of outstanding restricted stock units and performance based awards, and the assumed issuance of awards under the stock purchase plan, as computed using the treasury stock method.

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of the earnings (loss) per share calculation is as follows (in thousands, except per share amounts):

	Year Ended December 31,		
	2014	2013	2012
Basic earnings (loss) per share:			
Net income (loss)	$59,544	$57,266	$(34,404)
Weighted-average common shares	29,976	29,421	28,636
Basic earnings (loss) per share	$1.99	$1.95	$(1.20)
Diluted earnings (loss) per share (1):			
Net income (loss)	$59,544	$57,266	$(34,404)
Weighted-average common shares	29,976	29,421	28,636
Effect of dilutive securities:			
Employee stock plans	853	999	—
Diluted weighted-average common shares	30,829	30,420	28,636
Diluted earnings (loss) per share	$1.93	$1.88	$(1.20)

(1) The Company includes the shares underlying performance-based awards in the calculation of diluted earnings per share if the performance conditions have been satisfied as of the end of the reporting period and excludes such shares when the necessary conditions have not been met. The Company has excluded all performance-based awards underlying the 2014 awards in the 2014 calculation as the performance conditions for those awards were not met as of the end of the period. The Company has included the shares underlying the 2013 and 2012 awards in the respective year calculations, as those shares were contingently issuable upon the satisfaction of the annual targets consisting of net revenue, non-GAAP operating earnings and achievement of strategic goals as of the end of the periods.

In the years ended December 31, 2014 and 2013, options to purchase 36,501 shares and 122,263 shares outstanding, respectively, were not included in the computation of diluted earnings per share for the periods then ended because they were determined to be anti-dilutive. In the year ended December 31, 2012, all shares attributable to stock-based awards were excluded in the computation of diluted earnings per share, as the Company was in a net loss position.

8. PROVISION FOR INCOME TAXES:

Income Taxes

The Company accounts for income taxes under the provisions of ASC 740. Under the provisions of ASC 740, deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, utilizing the tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

U.S. and foreign components of income before income taxes were (in thousands):

	Year Ended December 31,		
	2014	2013	2012
U.S. operations	$(5,064)	$1,936	$(36,178)
Foreign operations	61,878	53,491	15,396
Total pretax income (loss)	$56,814	$55,427	$(20,782)

The components of the provision for (benefit from) income taxes are as follows (in thousands):

	Year Ended December 31,		
	2014	2013	2012
Current provision (benefit):			
Federal	$(1,234)	$(558)	$9,813
State	(137)	2	(2,083)
Foreign	3,094	3,049	1,892
	1,723	2,493	9,622
Deferred provision (benefit):			
Federal	(3,279)	(3,633)	2,647
State	(284)	—	3,109
Foreign	(890)	(699)	(1,756)
	(4,453)	(4,332)	4,000
Total	$(2,730)	$(1,839)	$13,622

The Company is entitled to a deduction for federal and state tax purposes with respect to employees' stock option activity. The net reduction in taxes otherwise payable in excess of any amount credited to income tax expense has been reflected as an adjustment to additional paid-in capital. For 2014, 2013 and 2012, the benefit arising from employee stock option activity that resulted in an adjustment to additional paid in capital was approximately $0.8 million, $1.3 million and $1.3 million, respectively.

The provision for (benefit from) income taxes differs from the amount, which would result by applying the applicable federal income-tax rate to income before provision for (benefit from) income taxes, as follows:

	2014	2013	2012
Provision computed at Federal statutory rate	35.0%	35.0%	35.0%
State tax provision, net of Federal benefit	—	—	8.9
Business tax credits	(5.5)	(8.1)	4.9
Stock-based compensation	(2.9)	(2.8)	2.5
Foreign income taxed at different rate	(28.6)	(29.5)	25.9
IRS audit settlement	(5.8)	—	(87.2)
Valuation allowance	2.0	(0.1)	(48.4)
Other	1.0	2.2	(7.2)
Total	(4.8)%	(3.3)%	(65.6)%

The Company reached a settlement with the IRS in the quarter ended June 30, 2014, to close out the examination of its federal income-tax returns for the years 2007 through 2009. As a result, the Company adjusted its tax balances and the provision for income tax for the year ended December 31, 2014, includes a one-time benefit of $3.3 million comprising $2.8 million in federal income taxes and interest, and state income taxes of approximately $0.5 million. The one-time benefit includes the reversal of $4.1 million of related unrecognized tax benefits that had been recorded as non-current liabilities in the Company's consolidated balance sheets. The Company has now concluded all U.S. federal income-tax matters for the years through 2009. The Company engages in qualifying activities for R&D credit purposes. The Tax Increase Prevention Act of 2014 was signed into law on December 19, 2014, to extend the federal research and development credit for 2014. The related tax benefit was taken in the fourth quarter of 2014.

The effective tax rate for the year ended December 31, 2013, was favorably impacted by the geographic distribution of the Company's world-wide earnings and earnings in lower-tax jurisdictions. Additionally, the rate was favorably impacted by federal research tax credits both for 2013 and 2012.

Table of Contents
POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the third quarter of 2012, the Company recorded an impairment charge and write-off of certain assets related to SemiSouth of approximately $58.9 million, on which the Company recognized a $8.0 million tax benefit. The write-off resulted in a net loss for 2012.

During the third quarter of 2012 the Company made a one-time payment of taxes and interest totaling $42.6 million in connection with settling the U.S. Internal Revenue Service ("IRS") examination of the Company's income tax returns for the years 2003 through 2006. Related to this, the provision for income tax in the second quarter of 2012 included a one-time charge of $44.8 million, comprising $35.0 million in federal income taxes, net interest of $5.7 million, and state income taxes (including interest) of approximately $4.1 million. The impact of the charge was partially offset by the reversal of $26.9 million of related unrecognized tax benefits that had been recorded as non-current liabilities in the Company's consolidated balance sheet resulting in a net charge of $18.1 million. Additionally, there was a $2.2 million reduction of the valuation allowance on the Company's California deferred tax assets.

The components of the net deferred income tax asset (liabilities) were as follows (in thousands):

	December 31, 2014	2013
Deferred tax assets:		
Other reserves and accruals	$3,928	$6,893
Tax credit carry-forwards	19,602	12,453
Stock compensation	5,429	5,964
Capital losses	11,401	10,307
Net operating loss	3,680	1,014
Valuation allowance	(25,828)	(19,271)
	18,212	17,360
Deferred tax liabilities:		
Depreciation	(3,320)	(4,226)
Acquired intangibles	(3,502)	(4,303)
Unremitted earnings	(5,182)	(2,432)
Other	(1,072)	(1,107)
	(13,076)	(12,068)
Net deferred tax asset	$5,136	$5,292

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities and projected future taxable income. In the event that the Company determines, based on available evidence and management judgment, that all or part of the net deferred tax assets will not be realized in the future, the Company would record a valuation allowance in the period the determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with the Company’s expectations could have a material impact on its results of operations and financial position.

As of December 31, 2014, the Company continues to maintain a valuation allowance primarily as a result of SemiSouth capital losses for federal purposes, and on its California deferred tax assets as the Company believes that it is not more likely than not that the deferred tax assets will be fully realized. In addition, the Company maintains a valuation allowance with respect to certain of its deferred tax assets relating to tax credits in Canada and the state of

New Jersey.

As of December 31, 2014, the Company had federal research and development tax credit carry-forwards of approximately $10.8 million, which will begin to expire in 2030 if unutilized, California research and development tax credit carry-forwards of approximately $14.9 million (there is no expiration of research and development tax credit carry-forwards for the state of California) and California net operating losses of $31.5 million which will begin to expire in 2032. As of December 31, 2014, the Company had Canadian scientific research and experimental development tax credit carry-forwards of approximately $2.3 million and New Jersey research and experimental development tax credit carry-forwards of approximately $0.4 million, which will start to expire in 2026 and 2027, respectively.

The Company does not provide for U.S. taxes on its undistributed earnings of foreign subsidiaries that it intends to invest indefinitely outside the U.S., unless such taxes are otherwise required under U.S. tax law. Beginning in 2013, the Company determined that a portion of its foreign subsidiaries current and future earnings may be remitted prospectively to the U.S. for domestic cash flow purposes and, accordingly, provided for the related U.S. taxes in its consolidated financial statements. If the Company changes its intent to invest its undistributed foreign earnings indefinitely or if a greater amount of undistributed earnings are needed for U.S. operations than previously anticipated and for which U.S. taxes have not been recorded, the Company would be required to accrue or pay U.S. taxes (subject to an adjustment for foreign tax credits, where applicable) and withholding taxes payable to various foreign countries on some or all of these undistributed earnings. As of December 31, 2014, the Company had undistributed earnings of foreign subsidiaries that are indefinitely invested outside of the U.S. of approximately $144.0 million. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Unrecognized Tax Benefits

The Company applies the provisions of ASC 740-10, relating to accounting for uncertain income taxes.

Reconciliation of the Beginning and Ending Amount of Unrecognized Tax Benefits (in thousands):

Unrecognized Tax Benefits Balance at January 1, 2012	$34,855